ACCOUNTING REFORM AND INVESTOR PROTECTION
VOLUME IV

S. HRG. 107–948

ACCOUNTING REFORM AND INVESTOR PROTECTION

DOCUMENTS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

VOLUME IV

ON

THE LEGISLATIVE HISTORY OF THE SARBANES-OXLEY ACT OF 2002: ACCOUNTING REFORM AND INVESTOR PROTECTION ISSUES RAISED BY ENRON AND OTHER PUBLIC COMPANIES

REPORTS, BILLS, AND THE SARBANES-OXLEY ACT OF 2002

APRIL 16, 22, 24, 25, MAY 6, JUNE 18, 26, JULY 15, 16, AND 25, 2002

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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THE WHITE HOUSE
OFFICE OF THE PRESS SECRETARY,
July 30, 2002.

The PRESIDENT. Thank you very much. Welcome to the White House, and welcome to this historic occasion.

During the past year the American economy has faced several sudden challenges, and proven its great resiliency. Terrorists attacked the center and symbol of our prosperity. A recession cost many American workers their jobs. And now corporate corruption has struck at investor confidence, offending the conscience of our Nation. Yet, in the aftermath of September 11, we refuse to allow fear to undermine our economy. And we will not allow fraud to undermine it either.

With well-timed tax cuts we fought our way out of recession and back to economic growth. And now with a tough new law we will act against those who have shaken confidence in our markets, using the full authority of Government to expose corruption, punish wrongdoers, and defend the rights and interests of American workers and investors.

My Administration pressed for greater corporate integrity. A united Congress has written it into law. And today I sign the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt. This new law sends very clear messages that all concerned must heed. This law says to every dishonest corporate leader: you will be exposed and punished; the era of low standards and false profits is over; no boardroom in America is above or beyond the law.

This law says to honest corporate leaders: your integrity will be recognized and rewarded, because the shadow of suspicion will be lifted from good companies that respect the rules.

This law says to corporate accountants: the high standards of your profession will be enforced without exception; the auditors will be audited; the accountants will be held to account.

This law says to shareholders that the financial information you receive from a company will be true and reliable, for those who deliberately sign their names to deception will be punished.

This law says to workers: we will not tolerate reckless practices that artificially drive up stock prices and eventually destroy the companies, and the pensions, and your jobs.

And this law says to every American: there will not be a different ethical standard for corporate America than the standard that applies to everyone else. The honesty you expect in your small businesses, or in your workplaces, in your community or in your

home, will be expected and enforced in every corporate suite in this country.

I commend the Congress for passing a strong set of reforms. I particularly thank Senator Paul Sarbanes and Congressman Mike Oxley. Both are very thoughtful, and were persistent voices for reform. They are true advocates of corporate integrity. I appreciate their working together to send a signal to the rest of the country that it is possible in Washington, DC, to set aside partisan differences and to do what is right for the American people. I also appreciate the bipartisan leadership in the Congress, and I particularly thank Senator Daschle and Senator Lott who are with us here today.

I want to thank members of my Cabinet who worked on this bill: Secretary of Treasury O'Neill and Attorney General Ashcroft, Secretary Evans, Secretary Chao. I appreciate the FBI (Federal Bureau of Investigations) Director being here, along with the Chairman of Securities and Exchange Commission, Harvey Pitt. I appreciate the Corporate Fraud Task Force members who are here. I want to assure the American people, they are just getting started.

America's system of free enterprise, with all its risk and all its rewards is a strength of our country, and a model for the world. Yet free markets are not a jungle in which only the unscrupulous survive, or a financial free-for-all guided only by greed. The fundamentals of a free market—buying and selling, saving and investing—require clear rules and confidence in basic fairness.

The only risks, the only fair risks are based on honest information. Tricking an investor into taking a risk is theft by another name. Corporate executives must set an ethical tone for their companies. They must understand the skepticism Americans feel and take action to set clear standards of right and wrong. Those who break the rules tarnish a great economic system that provides opportunity for all.

Their actions hurt workers who committed their lives to building the company that hired them. Their actions hurt investors and retirees who placed their faith in the promise of growth and integrity. For the sake of our free economy, those who break the law—break the rules of fairness, those who are dishonest, however wealthy or successful they may be, must pay a price.

Today, we are taking practical steps to encourage honest enterprise in our Nation. Under this law, CEO's and chief financial officers must personally vouch for the truth and fairness of their companies' disclosures. Those financial disclosures will be broader and better for the sake of shareholders and investors.

Corporate officials will play by the same rules as their employees. In the periods when workers are prevented from buying and selling stock in their pensions or 401(k)'s, corporate officials will also be barred from any buying or selling.

Corporate misdeeds will be found and will be punished. This law authorizes new funding for investigators and technology at the Securities and Exchange Commission (SEC) to uncover wrongdoing. The SEC will now have the administrative authority to bar dishonest directors and officers from ever again serving in positions of corporate responsibility. The penalties for obstructing justice and shredding documents are greatly increased. Corporate crime will no

longer pay. CEO's who profit by betraying the public trust will be forced to return those gains to investors. And the maximum prison term for common types of fraud has quadrupled from 5 to 20 years.

For the first time, the accounting profession will be regulated by an independent board. This board will set clear standards to uphold the integrity of public audits, and have the authority to investigate abuses and discipline offenders. And auditing firms will no longer be permitted to provide consulting services that create conflicts of interest.

This law gives my Administration new tools for enforcement. We will use them to the fullest. We will continue to investigate, arrest, and prosecute corporate officials who break the law. The Corporate Fraud Task Force I established is now hard at work, overseeing investigations of alleged fraud and insider trading. More than 200 Federal prosecutors are at work detecting and punishing corporate crimes. Every corporate official who has chosen to commit a crime can expect to face the consequences. No more easy money for corporate criminals, just hard time.

As the work of enforcement proceeds, I hope Congress will join me in other important efforts to protect the savings and investments of Americans preparing for retirement. We have seen how workers can lose a lifetime of savings overnight, locked into pension plans without adequate choices and information.

Workers should be able to sell company stock and diversify into other investments after 3 years in their own company's plan. They should receive updates on their retirement accounts, not once a year, but every 3 months. They should have access to sound investment advice. I have proposed pension protection reforms; the House has passed them. I hope the Senate takes them up soon.

We must also work together to promote more growth in the economy and jobs for the American people. The fundamentals of our economy are sound. After all, sales of automobiles and new houses are on the rise. New unemployment claims have been falling since April. Inflation is low, productivity is increasing, and growth continues. Those are signs of strength in our economy, and with the right policies we can build on it.

We must continue to work to control Federal spending, and make the tax cuts permanent, so Americans can save and plan for their own future. We must tear down trade barriers, so people everywhere can buy American. We must make terrorism insurance available to spur more construction.

And on energy, we must encourage conservation through new technology and produce more energy at home, to give our economy safe and steady sources of power, and make our country less reliant upon foreign sources of power.

The attacks against our economy in the last year have caused deep hardship, and highlighted the economy's fundamental strength. The American economy is more diverse and more innovative than ever before. And its greatest strength, the people who make it work, are better trained and more productive and more highly skilled than ever before.

Whenever we face challenges, from the fear that threatened our economy after September 11 to the fraud that threatens investor confidence today, we have tackled them head on. The American

economy depends on fairness and honesty. The vast majority of businesses uphold those values. With this law, we have new tools to enforce those values, and we will use those tools aggressively to defend our free enterprise system against corruption and crime.

It is now my honor to sign the Sarbanes-Oxley Act of 2002.

[Applause.]

[The bill is signed.]

Public Law 107–204
107th Congress

An Act

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

July 30, 2002
[H.R. 3763]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sarbanes-Oxley Act of 2002. Corporate responsibility. 15 USC 7201 note.

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

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(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

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Sec. 403. Disclosures of transactions involving management and principal stockholders.

Sec. 404. Management assessment of internal controls.
Sec. 405. Exemption.
Sec. 406. Code of ethics for senior financial officers.
Sec. 407. Disclosure of audit committee financial expert.
Sec. 408. Enhanced review of periodic disclosures by issuers.
Sec. 409. Real time issuer disclosures.

TITLE V—ANALYST CONFLICTS OF INTEREST

Sec. 501. Treatment of securities analysts by registered securities associations and national securities exchanges.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

Sec. 601. Authorization of appropriations.
Sec. 602. Appearance and practice before the Commission.
Sec. 603. Federal court authority to impose penny stock bars.
Sec. 604. Qualifications of associated persons of brokers and dealers.

TITLE VII—STUDIES AND REPORTS

Sec. 701. GAO study and report regarding consolidation of public accounting firms.
Sec. 702. Commission study and report regarding credit rating agencies.
Sec. 703. Study and report on violators and violations
Sec. 704. Study of enforcement actions.
Sec. 705. Study of investment banks.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

Sec. 801. Short title.
Sec. 802. Criminal penalties for altering documents.
Sec. 803. Debts nondischargeable if incurred in violation of securities fraud laws.
Sec. 804. Statute of limitations for securities fraud.
Sec. 805. Review of Federal Sentencing Guidelines for obstruction of justice and extensive criminal fraud.
Sec. 806. Protection for employees of publicly traded companies who provide evidence of fraud.
Sec. 807. Criminal penalties for defrauding shareholders of publicly traded companies.

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

Sec. 901. Short title.
Sec. 902. Attempts and conspiracies to commit criminal fraud offenses.
Sec. 903. Criminal penalties for mail and wire fraud.
Sec. 904. Criminal penalties for violations of the Employee Retirement Income Security Act of 1974.
Sec. 905. Amendment to sentencing guidelines relating to certain white-collar offenses.
Sec. 906. Corporate responsibility for financial reports.

TITLE X—CORPORATE TAX RETURNS

Sec. 1001. Sense of the Senate regarding the signing of corporate tax returns by chief executive officers.

TITLE XI—CORPORATE FRAUD AND ACCOUNTABILITY

Sec. 1101. Short title.
Sec. 1102. Tampering with a record or otherwise impeding an official proceeding.
Sec. 1103. Temporary freeze authority for the Securities and Exchange Commission.
Sec. 1104. Amendment to the Federal Sentencing Guidelines.
Sec. 1105. Authority of the Commission to prohibit persons from serving as officers or directors.
Sec. 1106. Increased criminal penalties under Securities Exchange Act of 1934.

15 USC 7201.

SEC. 2. DEFINITIONS.

(a) IN GENERAL.—In this Act, the following definitions shall apply:

(1) APPROPRIATE STATE REGULATORY AUTHORITY.—The term "appropriate State regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States

having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) AUDIT.—The term "audit" means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) AUDIT COMMITTEE.—The term "audit committee" means—

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) AUDIT REPORT.—The term "audit report" means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or

(ii) asserts that no such opinion can be expressed.

(5) BOARD.—The term "Board" means the Public Company Accounting Oversight Board established under section 101.

(6) COMMISSION.—The term "Commission" means the Securities and Exchange Commission.

(7) ISSUER.—The term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

(8) NON-AUDIT SERVICES.—The term "non-audit services" means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.—

(A) IN GENERAL.—The terms "person associated with a public accounting firm" (or with a "registered public accounting firm") and "associated person of a public accounting firm" (or of a "registered public accounting firm") mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) EXEMPTION AUTHORITY.—The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) PROFESSIONAL STANDARDS.—The term "professional standards" means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

(11) PUBLIC ACCOUNTING FIRM.—The term "public accounting firm" means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) REGISTERED PUBLIC ACCOUNTING FIRM.—The term "registered public accounting firm" means a public accounting firm registered with the Board in accordance with this Act.

(13) RULES OF THE BOARD.—The term "rules of the Board" means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) SECURITY.—The term "security" has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(15) SECURITIES LAWS.—The term "securities laws" means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder.

(16) STATE.—The term "State" means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

(b) CONFORMING AMENDMENT.—Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) is amended by inserting "the Sarbanes-Oxley Act of 2002," before "the Public".

SEC. 3. COMMISSION RULES AND ENFORCEMENT. 15 USC 7202.

(a) REGULATORY ACTION.—The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) ENFORCEMENT.—

(1) IN GENERAL.—A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2) INVESTIGATIONS, INJUNCTIONS, AND PROSECUTION OF OFFENSES.—Section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u) is amended—

(A) in subsection (a)(1), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,";

(B) in subsection (d)(1), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,";

(C) in subsection (e), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,"; and

(D) in subsection (f), by inserting "or the Public Company Accounting Oversight Board" after "self-regulatory organization" each place that term appears.

(3) CEASE-AND-DESIST PROCEEDINGS.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by inserting "registered public accounting firm (as defined in section 2 of the Sarbanes-Oxley Act of 2002)," after "government securities dealer,".

(4) ENFORCEMENT BY FEDERAL BANKING AGENCIES.—Section 12(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(i)) is amended by—

(A) striking "sections 12," each place it appears and inserting "sections 10A(m), 12,"; and

(B) striking "and 16," each place it appears and inserting "and 16 of this Act, and sections 302, 303, 304, 306, 401(b), 404, 406, and 407 of the Sarbanes-Oxley Act of 2002,".

(c) EFFECT ON COMMISSION AUTHORITY.—Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

15 USC 7211.

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;

(3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon,

registered public accounting firms and associated persons of such firms, in accordance with section 105;

(5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof. The Commission shall be responsible, prior to the appointment of the Board, for the planning for the establishment and administrative transition to the Board's operation.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors Deadline.

of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and

Contracts.

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

(g) RULES OF THE BOARD.—The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) ANNUAL REPORT TO THE COMMISSION.—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission. Deadline.

SEC. 102. REGISTRATION WITH THE BOARD. 15 USC 7212.

(a) MANDATORY REGISTRATION.—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) APPLICATIONS FOR REGISTRATION.—

(1) FORM OF APPLICATION.—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) CONTENTS OF APPLICATIONS.—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) CONSENTS.—Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

Deadline.

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required

to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) PUBLIC AVAILABILITY.—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) REGISTRATION AND ANNUAL FEES.—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES. 15 USC 7213.

(a) AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.—

(1) IN GENERAL.—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) RULE REQUIREMENTS.—In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such internal control structure and procedures—

(aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

(III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.

(B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, and advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(3) AUTHORITY TO ADOPT OTHER STANDARDS.—

(A) IN GENERAL.—In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the

Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) INDEPENDENCE STANDARDS AND RULES.—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.—

(1) IN GENERAL.—The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) BOARD RESPONSES.—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) EVALUATION OF STANDARD SETTING PROCESS.—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7214.

(a) IN GENERAL.—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) INSPECTION FREQUENCY.—

(1) IN GENERAL.—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) ADJUSTMENTS TO SCHEDULES.—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be "final agency action" for purposes of section 704 of title 5, United States Code.

(3) TIMING.—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS. 15 USC 7215.

(a) IN GENERAL.—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms. Establishment.

(b) INVESTIGATIONS.—

(1) AUTHORITY.—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) TESTIMONY AND DOCUMENT PRODUCTION.—In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) NONCOOPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) COORDINATION AND REFERRAL OF INVESTIGATIONS.—

Notification.

(A) COORDINATION.—The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) REFERRAL.—The Board may refer an investigation under this section—

(i) to the Commission;

(ii) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(iii) at the direction of the Commission, to—

(I) the Attorney General of the United States;

(II) the attorney general of 1 or more States; and

(III) the appropriate State regulatory authority.

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may—

(i) be made available to the Commission; and

(ii) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

(I) the Attorney General of the United States;

(II) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;

(III) State attorneys general in connection with any criminal investigation; and

(IV) any appropriate State regulatory authority,

each of which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine

whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title;

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than $100,000 for a natural person or $2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than $750,000 for a natural person or $15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(6) FAILURE TO SUPERVISE.—

(A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION.—

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable

care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.—

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

15 USC 7216.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.—

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm

(or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.—

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term "foreign public accounting firm" means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD. 15 USC 7217.

(a) GENERAL OVERSIGHT RESPONSIBILITY.—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)), and of section 17(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)(1)) shall apply to the Board as fully as if the Board were a "registered securities association" for purposes of those sections 17(a)(1) and 17(b)(1).

(b) RULES OF THE BOARD.—

(1) DEFINITION.—In this section, the term "proposed rule" means any proposed rule of the Board, and any modification of any such rule.

(2) PRIOR APPROVAL REQUIRED.—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) APPROVAL CRITERIA.—The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) PROPOSED RULE PROCEDURES.—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a "registered securities association" for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase "consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization" in section 19(b)(2) of that Act shall be deemed to read "consistent with the requirements of title I of the Sarbanes-Oxley Act of 2002, and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors"; and

(B) the phrase "otherwise in furtherance of the purposes of this title" in section 19(b)(3)(C) of that Act shall be deemed to read "otherwise in furtherance of the purposes of title I of the Sarbanes-Oxley Act of 2002".

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a "registered securities association" for purposes of that section 19(c), except that the phrase "to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this title" in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read "to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Sarbanes-Oxley Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board".

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to "members" of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase "consistent with the purposes of this title" in that section 19(e)(1) shall be deemed to read "consistent with the purposes of this title and title I of the Sarbanes-Oxley Act of 2002";

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove

from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

15 USC 7218.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

"(b) RECOGNITION OF ACCOUNTING STANDARDS.—

"(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as 'generally accepted' for purposes of the securities laws, any accounting principles established by a standard setting body—

"(A) that—

"(i) is organized as a private entity;

"(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

"(iii) is funded as provided in section 109 of the Sarbanes-Oxley Act of 2002;

"(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and

"(v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

"(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

"(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.".

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors. Regulations.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—

(1) STUDY.—

(A) IN GENERAL.—The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) STUDY TOPICS.—The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING. 15 USC 7219.

(a) IN GENERAL.—The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) ANNUAL BUDGETS.—The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains (or at the beginning of the Board's first fiscal year, which may be a short fiscal year). The budget of the Board shall be subject to approval by the Commission. The budget for the first fiscal year of the Board shall be prepared and approved promptly following the appointment of the initial five Board members, to permit action by the Board of the organizational tasks contemplated by section 101(d).

(c) SOURCES AND USES OF FUNDS.—

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e). Accounting support fees and other receipts of the Board and of such standard-setting body shall not be considered public monies of the United States.

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (i), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board. Such fee may also cover costs incurred in the Board's first fiscal year (which may be a short fiscal year), or may be levied separately with respect to such short fiscal year.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (g), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.—The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (g), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) LIMITATION ON FEE.—The amount of fees collected under this section for a fiscal year on behalf of the Board or the standards setting body, as the case may be, shall not exceed the recoverable budget expenses of the Board or body, respectively (which may include operating, capital, and accrued items), referred to in subsection (c)(1).

(g) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in

a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(h) CONFORMING AMENDMENTS.—Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)) is amended—

(1) in subparagraph (A), by striking "and" at the end; and

(2) in subparagraph (B), by striking the period at the end and inserting the following: "; and

"(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 109 of the Sarbanes-Oxley Act of 2002.".

(i) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

(j) START-UP EXPENSES OF THE BOARD.—From the unexpended balances of the appropriations to the Commission for fiscal year 2003, the Secretary of the Treasury is authorized to advance to the Board not to exceed the amount necessary to cover the expenses of the Board during its first fiscal year (which may be a short fiscal year).

TITLE II—AUDITOR INDEPENDENCE

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended by adding at the end the following:

"(g) PROHIBITED ACTIVITIES.—Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the 'Board'), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

"(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

"(2) financial information systems design and implementation;

"(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

"(4) actuarial services;

"(5) internal audit outsourcing services;

"(6) management functions or human resources;

"(7) broker or dealer, investment adviser, or investment banking services;

"(8) legal services and expert services unrelated to the audit; and

"(9) any other service that the Board determines, by regulation, is impermissible.

"(h) PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.—A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).".

15 USC 7231.

(b) EXEMPTION AUTHORITY.—The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(i) PREAPPROVAL REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) AUDIT COMMITTEE ACTION.—All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

"(B) DE MINIMUS EXCEPTION.—The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

"(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

"(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

"(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

"(2) DISCLOSURE TO INVESTORS.—Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

"(3) DELEGATION AUTHORITY.—The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

"(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES.—In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.".

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(j) AUDIT PARTNER ROTATION.—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.".

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(k) REPORTS TO AUDIT COMMITTEES.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

"(1) all critical accounting policies and practices to be used;

"(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

"(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.".

SEC. 205. CONFORMING AMENDMENTS.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

"(58) AUDIT COMMITTEE.—The term 'audit committee' means—

"(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the

purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

"(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

"(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term 'registered public accounting firm' has the same meaning as in section 2 of the Sarbanes-Oxley Act of 2002.".

(b) AUDITOR REQUIREMENTS.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended—

(1) by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm";

(2) by striking "the independent public accountant" each place that term appears and inserting "the registered public accounting firm";

(3) in subsection (c), by striking "No independent public accountant" and inserting "No registered public accounting firm"; and

(4) in subsection (b)—

(A) by striking "the accountant" each place that term appears and inserting "the firm";

(B) by striking "such accountant" each place that term appears and inserting "such firm"; and

(C) in paragraph (4), by striking "the accountant's report" and inserting "the report of the firm".

(c) OTHER REFERENCES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 12(b)(1) (15 U.S.C. 78l(b)(1)), by striking "independent public accountants" each place that term appears and inserting "a registered public accounting firm"; and

(2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm".

(d) CONFORMING AMENDMENT.—Section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(f)) is amended—

15 USC 78j–1.

(1) by striking "DEFINITION" and inserting "DEFINITIONS"; and

(2) by adding at the end the following: "As used in this section, the term 'issuer' means an issuer (as defined in section 3), the securities of which are registered under section 12, or that is required to file reports pursuant to section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.".

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(l) CONFLICTS OF INTEREST.—It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in

any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.".

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7232.

(a) STUDY AND REVIEW REQUIRED.—The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section. Deadline.

(c) DEFINITION.—For purposes of this section, the term "mandatory rotation" refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY. 15 USC 7233.

(a) COMMISSION REGULATIONS.—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title. Deadline.

(b) AUDITOR INDEPENDENCE.—It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES. 15 USC 7234.

In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

SEC. 301. PUBLIC COMPANY AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following: 15 USC 78j–1.

"(m) STANDARDS RELATING TO AUDIT COMMITTEES.—

"(1) COMMISSION RULES.—

Deadline.

"(A) IN GENERAL.—Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

"(B) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

"(2) RESPONSIBILITIES RELATING TO REGISTERED PUBLIC ACCOUNTING FIRMS.—The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

"(3) INDEPENDENCE.—

"(A) IN GENERAL.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

"(B) CRITERIA.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

"(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

"(ii) be an affiliated person of the issuer or any subsidiary thereof.

"(C) EXEMPTION AUTHORITY.—The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Commission determines appropriate in light of the circumstances.

"(4) COMPLAINTS.—Each audit committee shall establish procedures for—

"(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

"(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

"(5) AUTHORITY TO ENGAGE ADVISERS.—Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

"(6) FUNDING.—Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

"(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

"(B) to any advisers employed by the audit committee under paragraph (5).".

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS. 15 USC 7241.

(a) REGULATIONS REQUIRED.—The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that—

(1) the signing officer has reviewed the report;

(2) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;

(3) based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;

(4) the signing officers—

(A) are responsible for establishing and maintaining internal controls;

(B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;

(C) have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and

(D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

(5) the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—

(A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and

(B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

(6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

(b) FOREIGN REINCORPORATIONS HAVE NO EFFECT.—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

(c) DEADLINE.—The rules required by subsection (a) shall be effective not later than 30 days after the date of enactment of this Act.

15 USC 7242.

SEC. 303. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) ENFORCEMENT.—In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment.

15 USC 7243.

SEC. 304. FORFEITURE OF CERTAIN BONUSES AND PROFITS.

(a) ADDITIONAL COMPENSATION PRIOR TO NONCOMPLIANCE WITH COMMISSION FINANCIAL REPORTING REQUIREMENTS.—If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) COMMISSION EXEMPTION AUTHORITY.—The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

SEC. 305. OFFICER AND DIRECTOR BARS AND PENALTIES.

(a) UNFITNESS STANDARD.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(2)) is amended by striking "substantial unfitness" and inserting "unfitness".

(2) SECURITIES ACT OF 1933.—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking "substantial unfitness" and inserting "unfitness".

(b) EQUITABLE RELIEF.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end the following:

"(5) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.".

SEC. 306. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS. 15 USC 7244.

(a) PROHIBITION OF INSIDER TRADING DURING PENSION FUND BLACKOUT PERIODS.—

(1) IN GENERAL.—Except to the extent otherwise provided by rule of the Commission pursuant to paragraph (3), it shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer.

(2) REMEDY.—

(A) IN GENERAL.—Any profit realized by a director or executive officer referred to in paragraph (1) from any purchase, sale, or other acquisition or transfer in violation of this subsection shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(B) ACTIONS TO RECOVER PROFITS.—An action to recover profits in accordance with this subsection may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(3) RULEMAKING AUTHORIZED.—The Commission shall, in consultation with the Secretary of Labor, issue rules to clarify the application of this subsection and to prevent evasion thereof. Such rules shall provide for the application of the requirements of paragraph (1) with respect to entities treated as a single employer with respect to an issuer under section 414(b), (c), (m), or (o) of the Internal Revenue Code of 1986 to the extent necessary to clarify the application of such requirements and to prevent evasion thereof. Such rules may also provide for

appropriate exceptions from the requirements of this subsection, including exceptions for purchases pursuant to an automatic dividend reinvestment program or purchases or sales made pursuant to an advance election.

(4) BLACKOUT PERIOD.—For purposes of this subsection, the term "blackout period", with respect to the equity securities of any issuer—

(A) means any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan; and

(B) does not include, under regulations which shall be prescribed by the Commission—

(i) a regularly scheduled period in which the participants and beneficiaries may not purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer, if such period is—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before becoming participants under the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor.

(5) INDIVIDUAL ACCOUNT PLAN.—For purposes of this subsection, the term "individual account plan" has the meaning provided in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34), except that such term shall not include a one-participant retirement plan (within the meaning of section 101(i)(8)(B) of such Act (29 U.S.C. 1021(i)(8)(B))).

(6) NOTICE TO DIRECTORS, EXECUTIVE OFFICERS, AND THE COMMISSION.—In any case in which a director or executive officer is subject to the requirements of this subsection in connection with a blackout period (as defined in paragraph (4)) with respect to any equity securities, the issuer of such equity securities shall timely notify such director or officer and the Securities and Exchange Commission of such blackout period.

(b) NOTICE REQUIREMENTS TO PARTICIPANTS AND BENEFICIARIES UNDER ERISA.—

(1) IN GENERAL.—Section 101 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021) is amended by redesignating the second subsection (h) as subsection (j), and by inserting after the first subsection (h) the following new subsection:

"(i) NOTICE OF BLACKOUT PERIODS TO PARTICIPANT OR BENEFICIARY UNDER INDIVIDUAL ACCOUNT PLAN.—

"(1) DUTIES OF PLAN ADMINISTRATOR.—In advance of the commencement of any blackout period with respect to an individual account plan, the plan administrator shall notify the plan participants and beneficiaries who are affected by such action in accordance with this subsection.

"(2) NOTICE REQUIREMENTS.—

"(A) IN GENERAL.—The notices described in paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall include—

"(i) the reasons for the blackout period,

"(ii) an identification of the investments and other rights affected,

"(iii) the expected beginning date and length of the blackout period,

"(iv) in the case of investments affected, a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period, and

"(v) such other matters as the Secretary may require by regulation.

"(B) NOTICE TO PARTICIPANTS AND BENEFICIARIES.—Except as otherwise provided in this subsection, notices described in paragraph (1) shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies at least 30 days in advance of the blackout period.

"(C) EXCEPTION TO 30-DAY NOTICE REQUIREMENT.—In any case in which—

"(i) a deferral of the blackout period would violate the requirements of subparagraph (A) or (B) of section 404(a)(1), and a fiduciary of the plan reasonably so determines in writing, or

"(ii) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator, and a fiduciary of the plan reasonably so determines in writing,

subparagraph (B) shall not apply, and the notice shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies as soon as reasonably possible under the circumstances unless such a notice in advance of the termination of the blackout period is impracticable.

"(D) WRITTEN NOTICE.—The notice required to be provided under this subsection shall be in writing, except that such notice may be in electronic or other form to the extent that such form is reasonably accessible to the recipient.

"(E) NOTICE TO ISSUERS OF EMPLOYER SECURITIES SUBJECT TO BLACKOUT PERIOD.—In the case of any blackout period in connection with an individual account plan, the plan administrator shall provide timely notice of such

blackout period to the issuer of any employer securities subject to such blackout period.

"(3) EXCEPTION FOR BLACKOUT PERIODS WITH LIMITED APPLICABILITY.—In any case in which the blackout period applies only to 1 or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor and occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of such merger, acquisition, divestiture, or transaction, the requirement of this subsection that the notice be provided to all participants and beneficiaries shall be treated as met if the notice required under paragraph (1) is provided to such participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

"(4) CHANGES IN LENGTH OF BLACKOUT PERIOD.—If, following the furnishing of the notice pursuant to this subsection, there is a change in the beginning date or length of the blackout period (specified in such notice pursuant to paragraph (2)(A)(iii)), the administrator shall provide affected participants and beneficiaries notice of the change as soon as reasonably practicable. In relation to the extended blackout period, such notice shall meet the requirements of paragraph (2)(D) and shall specify any material change in the matters referred to in clauses (i) through (v) of paragraph (2)(A).

"(5) REGULATORY EXCEPTIONS.—The Secretary may provide by regulation for additional exceptions to the requirements of this subsection which the Secretary determines are in the interests of participants and beneficiaries.

"(6) GUIDANCE AND MODEL NOTICES.—The Secretary shall issue guidance and model notices which meet the requirements of this subsection.

"(7) BLACKOUT PERIOD.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'blackout period' means, in connection with an individual account plan, any period for which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted, if such suspension, limitation, or restriction is for any period of more than 3 consecutive business days.

"(B) EXCLUSIONS.—The term 'blackout period' does not include a suspension, limitation, or restriction—

"(i) which occurs by reason of the application of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934),

"(ii) which is a change to the plan which provides for a regularly scheduled suspension, limitation, or restriction which is disclosed to participants or beneficiaries through any summary of material modifications, any materials describing specific investment alternatives under the plan, or any changes thereto, or

"(iii) which applies only to 1 or more individuals, each of whom is the participant, an alternate payee

(as defined in section 206(d)(3)(K)), or any other beneficiary pursuant to a qualified domestic relations order (as defined in section 206(d)(3)(B)(i)).

"(8) INDIVIDUAL ACCOUNT PLAN.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'individual account plan' shall have the meaning provided such term in section 3(34), except that such term shall not include a one-participant retirement plan.

"(B) ONE-PARTICIPANT RETIREMENT PLAN.—For purposes of subparagraph (A), the term 'one-participant retirement plan' means a retirement plan that—

"(i) on the first day of the plan year—

"(I) covered only the employer (and the employer's spouse) and the employer owned the entire business (whether or not incorporated), or

"(II) covered only one or more partners (and their spouses) in a business partnership (including partners in an S or C corporation (as defined in section 1361(a) of the Internal Revenue Code of 1986)),

"(ii) meets the minimum coverage requirements of section 410(b) of the Internal Revenue Code of 1986 (as in effect on the date of the enactment of this paragraph) without being combined with any other plan of the business that covers the employees of the business,

"(iii) does not provide benefits to anyone except the employer (and the employer's spouse) or the partners (and their spouses),

"(iv) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control, and

"(v) does not cover a business that leases employees.".

(2) ISSUANCE OF INITIAL GUIDANCE AND MODEL NOTICE.— The Secretary of Labor shall issue initial guidance and a model notice pursuant to section 101(i)(6) of the Employee Retirement Income Security Act of 1974 (as added by this subsection) not later than January 1, 2003. Not later than 75 days after the date of the enactment of this Act, the Secretary shall promulgate interim final rules necessary to carry out the amendments made by this subsection.

Deadlines.

Regulations.

(3) CIVIL PENALTIES FOR FAILURE TO PROVIDE NOTICE.— Section 502 of such Act (29 U.S.C. 1132) is amended—

(A) in subsection (a)(6), by striking "(5), or (6)" and inserting "(5), (6), or (7)";

(B) by redesignating paragraph (7) of subsection (c) as paragraph (8); and

(C) by inserting after paragraph (6) of subsection (c) the following new paragraph:

"(7) The Secretary may assess a civil penalty against a plan administrator of up to $100 a day from the date of the plan administrator's failure or refusal to provide notice to participants and beneficiaries in accordance with section 101(i). For purposes of this paragraph, each violation with respect to any single participant or beneficiary shall be treated as a separate violation.".

(3) PLAN AMENDMENTS.—If any amendment made by this subsection requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after the effective date of this section, if—

(A) during the period after such amendment made by this subsection takes effect and before such first plan year, the plan is operated in good faith compliance with the requirements of such amendment made by this subsection, and

(B) such plan amendment applies retroactively to the period after such amendment made by this subsection takes effect and before such first plan year.

(c) EFFECTIVE DATE.—The provisions of this section (including the amendments made thereby) shall take effect 180 days after the date of the enactment of this Act. Good faith compliance with the requirements of such provisions in advance of the issuance of applicable regulations thereunder shall be treated as compliance with such provisions.

15 USC 7245.

SEC. 307. RULES OF PROFESSIONAL RESPONSIBILITY FOR ATTORNEYS.

Deadline.

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

15 USC 7246.

SEC. 308. FAIR FUNDS FOR INVESTORS.

(a) CIVIL PENALTIES ADDED TO DISGORGEMENT FUNDS FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

(b) ACCEPTANCE OF ADDITIONAL DONATIONS.—The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United

States for a disgorgement fund described in subsection (a). Such gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (a).

(c) STUDY REQUIRED.—

(1) SUBJECT OF STUDY.—The Commission shall review and analyze—

(A) enforcement actions by the Commission over the five years preceding the date of the enactment of this Act that have included proceedings to obtain civil penalties or disgorgements to identify areas where such proceedings may be utilized to efficiently, effectively, and fairly provide restitution for injured investors; and

(B) other methods to more efficiently, effectively, and fairly provide restitution to injured investors, including methods to improve the collection rates for civil penalties and disgorgements.

(2) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after of the date of the enactment of this Act, and shall use such findings to revise its rules and regulations as necessary. The report shall include a discussion of regulatory or legislative actions that are recommended or that may be necessary to address concerns identified in the study. Deadline.

(d) CONFORMING AMENDMENTS.—Each of the following provisions is amended by inserting ", except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002" after "Treasury of the United States":

(1) Section 21(d)(3)(C)(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(C)(i)).

(2) Section 21A(d)(1) of such Act (15 U.S.C. 78u-1(d)(1)).

(3) Section 20(d)(3)(A) of the Securities Act of 1933 (15 U.S.C. 77t(d)(3)(A)).

(4) Section 42(e)(3)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a–41(e)(3)(A)).

(5) Section 209(e)(3)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9(e)(3)(A)).

(e) DEFINITION.—As used in this section, the term "disgorgement fund" means a fund established in any administrative or judicial proceeding described in subsection (a).

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

SEC. 401. DISCLOSURES IN PERIODIC REPORTS. 15 USC 7261.

(a) DISCLOSURES REQUIRED.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(i) ACCURACY OF FINANCIAL REPORTS.—Each financial report that contains financial statements, and that is required to be prepared in accordance with (or reconciled to) generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been

identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

Deadline. Regulations.

"(j) OFF-BALANCE SHEET TRANSACTIONS.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.".

Deadline.

(b) COMMISSION RULES ON PRO FORMA FIGURES.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act fo 2002, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

(c) STUDY AND REPORT ON SPECIAL PURPOSE ENTITIES.—

Deadline.

(1) STUDY REQUIRED.—The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934, as added by this section, complete a study of filings by issuers and their disclosures to determine—

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

Deadline.

(2) REPORT AND RECOMMENDATIONS.—Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth—

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934;

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose entities sponsored by an issuer in cases in which the issuer has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

SEC. 402. ENHANCED CONFLICT OF INTEREST PROVISIONS.

(a) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(k) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—

"(1) IN GENERAL.—It shall be unlawful for any issuer (as defined in section 2 of the Sarbanes-Oxley Act of 2002), directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. An extension of credit maintained by the issuer on the date of enactment of this subsection shall not be subject to the provisions of this subsection, provided that there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after that date of enactment.

"(2) LIMITATION.—Paragraph (1) does not preclude any home improvement and manufactured home loans (as that term is defined in section 5 of the Home Owners' Loan Act (12 U.S.C. 1464)), consumer credit (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or any extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or a charge card (as defined in section 127(c)(4)(e) of the Truth in Lending Act (15 U.S.C. 1637(c)(4)(e)), or any extension of credit by a broker or dealer registered under section 15 of this title to an employee of that broker or dealer to buy, trade, or carry securities, that is permitted under rules or regulations of the Board of Governors of the Federal Reserve System pursuant to section 7 of this title (other than an extension of credit that would be used to purchase the stock of that issuer), that is—

"(A) made or provided in the ordinary course of the consumer credit business of such issuer;

"(B) of a type that is generally made available by such issuer to the public; and

"(C) made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such extensions of credit.

"(3) RULE OF CONSTRUCTION FOR CERTAIN LOANS.—Paragraph (1) does not apply to any loan made or maintained

by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b).".

SEC. 403. DISCLOSURES OF TRANSACTIONS INVOLVING MANAGEMENT AND PRINCIPAL STOCKHOLDERS.

(a) AMENDMENT.—Section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) is amended by striking the heading of such section and subsection (a) and inserting the following:

"SEC. 16. DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS.

"(a) DISCLOSURES REQUIRED.—

"(1) DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS REQUIRED TO FILE.—Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 12, or who is a director or an officer of the issuer of such security, shall file the statements required by this subsection with the Commission (and, if such security is registered on a national securities exchange, also with the exchange).

"(2) TIME OF FILING.—The statements required by this subsection shall be filed—

"(A) at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g);

"(B) within 10 days after he or she becomes such beneficial owner, director, or officer;

"(C) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206(b) of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note)) involving such equity security, before the end of the second business day following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible.

"(3) CONTENTS OF STATEMENTS.—A statement filed—

"(A) under subparagraph (A) or (B) of paragraph (2) shall contain a statement of the amount of all equity securities of such issuer of which the filing person is the beneficial owner; and

"(B) under subparagraph (C) of such paragraph shall indicate ownership by the filing person at the date of filing, any such changes in such ownership, and such purchases and sales of the security-based swap agreements as have occurred since the most recent such filing under such subparagraph.

Deadline.

"(4) ELECTRONIC FILING AND AVAILABILITY.—Beginning not later than 1 year after the date of enactment of the Sarbanes-Oxley Act of 2002—

"(A) a statement filed under subparagraph (C) of paragraph (2) shall be filed electronically;

Deadline.

"(B) the Commission shall provide each such statement on a publicly accessible Internet site not later than the end of the business day following that filing; and

"(C) the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website, not later than the end of the business day following that filing.". Deadline.

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective 30 days after the date of the enactment of this Act. 15 USC 78p note.

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS. 15 USC 7262.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

SEC. 405. EXEMPTION. 15 USC 7263.

Nothing in section 401, 402, or 404, the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS. 15 USC 7264.

(a) CODE OF ETHICS DISCLOSURE.—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions. Regulations.

(b) CHANGES IN CODES OF ETHICS.—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8–K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers. Regulations.

(c) DEFINITION.—In this section, the term "code of ethics" means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7265.

SEC. 407. DISCLOSURE OF AUDIT COMMITTEE FINANCIAL EXPERT.

(a) RULES DEFINING "FINANCIAL EXPERT".—The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) CONSIDERATIONS.—In defining the term "financial expert" for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7266.

SEC. 408. ENHANCED REVIEW OF PERIODIC DISCLOSURES BY ISSUERS.

(a) REGULAR AND SYSTEMATIC REVIEW.—The Commission shall review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 (including reports filed on Form 10–K), and which have a class of securities listed on a national securities exchange or traded on an automated quotation facility of a national securities association, on a regular and systematic basis for the protection of investors. Such review shall include a review of an issuer's financial statement.

(b) REVIEW CRITERIA.—For purposes of scheduling the reviews required by subsection (a), the Commission shall consider, among other factors—

(1) issuers that have issued material restatements of financial results;

(2) issuers that experience significant volatility in their stock price as compared to other issuers;

(3) issuers with the largest market capitalization;

(4) emerging companies with disparities in price to earning ratios;

(5) issuers whose operations significantly affect any material sector of the economy; and

(6) any other factors that the Commission may consider relevant.

(c) MINIMUM REVIEW PERIOD.—In no event shall an issuer required to file reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 be reviewed under this section less frequently than once every 3 years.

SEC. 409. REAL TIME ISSUER DISCLOSURES.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(l) REAL TIME ISSUER DISCLOSURES.—Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.".

TITLE V—ANALYST CONFLICTS OF INTEREST

SEC. 501. TREATMENT OF SECURITIES ANALYSTS BY REGISTERED SECURITIES ASSOCIATIONS AND NATIONAL SECURITIES EXCHANGES.

(a) RULES REGARDING SECURITIES ANALYSTS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15C the following new section:

"SEC. 15D. SECURITIES ANALYSTS AND RESEARCH REPORTS. 15 USC 78o–6.

"(a) ANALYST PROTECTIONS.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed— Deadline.

"(1) to foster greater public confidence in securities research, and to protect the objectivity and independence of securities analysts, by—

"(A) restricting the prepublication clearance or approval of research reports by persons employed by the broker or dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

"(B) limiting the supervision and compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities; and

"(C) requiring that a broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report, except that such rules may not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such research report in accordance with the policies and procedures of the firm;

"(2) to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities;

"(3) to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision; and

"(4) to address such other issues as the Commission, or such association or exchange, determines appropriate.

"(b) DISCLOSURE.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report, as applicable, conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report, including—

"(1) the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report;

"(2) whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the securities analyst, from the issuer that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure by virtue of this paragraph of material non-public information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors;

"(3) whether an issuer, the securities of which are recommended in the appearance or research report, currently is, or during the 1-year period preceding the date of the appearance or date of distribution of the report has been, a client of the registered broker or dealer, and if so, stating the types of services provided to the issuer;

"(4) whether the securities analyst received compensation with respect to a research report, based upon (among any other factors) the investment banking revenues (either generally or specifically earned from the issuer being analyzed) of the registered broker or dealer; and

"(5) such other disclosures of conflicts of interest that are material to investors, research analysts, or the broker or dealer as the Commission, or such association or exchange, determines appropriate.

"(c) DEFINITIONS.—In this section—

"(1) the term 'securities analyst' means any associated person of a registered broker or dealer that is principally responsible for, and any associated person who reports directly or indirectly to a securities analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of 'securities analyst'; and

"(2) the term 'research report' means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.".

(b) ENFORCEMENT.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended by inserting "15D," before "15B".

(c) COMMISSION AUTHORITY.—The Commission may promulgate and amend its regulations, or direct a registered securities association or national securities exchange to promulgate and amend its rules, to carry out section 15D of the Securities Exchange Act of 1934, as added by this section, as is necessary for the protection of investors and in the public interest. 15 USC 78o–6 note.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

SEC. 601. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $776,000,000 for fiscal year 2003, of which—

"(1) $102,700,000 shall be available to fund additional compensation, including salaries and benefits, as authorized in the Investor and Capital Markets Fee Relief Act (Public Law 107–123; 115 Stat. 2390 et seq.);

"(2) $108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and

"(3) $98,000,000 shall be available to add not fewer than an additional 200 qualified professionals to provide enhanced oversight of auditors and audit services required by the Federal securities laws, and to improve Commission investigative and

disciplinary efforts with respect to such auditors and services, as well as for additional professional support staff necessary to strengthen the programs of the Commission involving Full Disclosure and Prevention and Suppression of Fraud, risk management, industry technology review, compliance, inspections, examinations, market regulation, and investment management.".

SEC. 602. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4B the following:

15 USC 78d–3.

"SEC. 4C. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

"(a) AUTHORITY TO CENSURE.—The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—

"(1) not to possess the requisite qualifications to represent others;

"(2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or

"(3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

"(b) DEFINITION.—With respect to any registered public accounting firm or associated person, for purposes of this section, the term 'improper professional conduct' means—

"(1) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and

"(2) negligent conduct in the form of—

"(A) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted; or

"(B) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.".

SEC. 603. FEDERAL COURT AUTHORITY TO IMPOSE PENNY STOCK BARS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)), as amended by this Act, is amended by adding at the end the following:

"(6) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(A) IN GENERAL.—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(B) DEFINITION.—For purposes of this paragraph, the term 'person participating in an offering of penny stock' includes

any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

(b) SECURITIES ACT OF 1933.—Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following:

"(g) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(1) IN GENERAL.—In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(2) DEFINITION.—For purposes of this subsection, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

SEC. 604. QUALIFICATIONS OF ASSOCIATED PERSONS OF BROKERS AND DEALERS.

(a) BROKERS AND DEALERS.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by striking subparagraph (F) and inserting the following:

"(F) is subject to any order of the Commission barring or suspending the right of the person to be associated with a broker or dealer;"; and

(2) in subparagraph (G), by striking the period at the end and inserting the following: "; or

"(H) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(b) INVESTMENT ADVISERS.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended—

(1) by striking paragraph (7) and inserting the following:

"(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser;";

(2) in paragraph (8), by striking the period at the end and inserting "; or"; and

(3) by adding at the end the following:

"(9) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(c) CONFORMING AMENDMENTS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(A) in section 3(a)(39)(F) (15 U.S.C. 78c(a)(39)(F))—

(i) by striking "or (G)" and inserting "(H), or (G)"; and

(ii) by inserting ", or is subject to an order or finding," before "enumerated";

(B) in each of section 15(b)(6)(A)(i) (15 U.S.C. 78o(b)(6)(A)(i)), paragraphs (2) and (4) of section 15B(c) (15 U.S.C. 78o–4(c)), and subparagraphs (A) and (C) of section 15C(c)(1) (15 U.S.C. 78o–5(c)(1))—

(i) by striking "or (G)" each place that term appears and inserting "(H), or (G)"; and

(ii) by striking "or omission" each place that term appears, and inserting ", or is subject to an order or finding,"; and

(C) in each of paragraphs (3)(A) and (4)(C) of section 17A(c) (15 U.S.C. 78q–1(c))—

(i) by striking "or (G)" each place that term appears and inserting "(H), or (G)"; and

(ii) by inserting ", or is subject to an order or finding," before "enumerated" each place that term appears.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(f)) is amended—

(A) by striking "or (8)" and inserting "(8), or (9)"; and

(B) by inserting "or (3)" after "paragraph (2)".

TITLE VII—STUDIES AND REPORTS

SEC. 701. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF PUBLIC ACCOUNTING FIRMS.

15 USC 7201 note.

(a) STUDY REQUIRED.—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms capable of providing audit services to large national and multi-national business organizations that are subject to the securities laws;

(B) the present and future impact of the condition described in subparagraph (A) on capital formation and securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing audit services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among public accounting firms, including—

(A) higher costs;

(B) lower quality of services;

(C) impairment of auditor independence; or

(D) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among public accounting firms.

(b) CONSULTATION.—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Commission;

(2) the regulatory agencies that perform functions similar to the Commission within the other member countries of the Group of Seven Industrialized Nations;

(3) the Department of Justice; and

(4) any other public or private sector organization that the Comptroller General considers appropriate.

(c) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

Deadline.

SEC. 702. COMMISSION STUDY AND REPORT REGARDING CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the role of credit rating agencies in the evaluation of issuers of securities;

(B) the importance of that role to investors and the functioning of the securities markets;

(C) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(D) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(E) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and

(F) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

Deadline.

(b) REPORT REQUIRED.—The Commission shall submit a report on the study required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 180 days after the date of enactment of this Act.

SEC. 703. STUDY AND REPORT ON VIOLATORS AND VIOLATIONS.

(a) STUDY.—The Commission shall conduct a study to determine, based upon information for the period from January 1, 1998, to December 31, 2001—

(1) the number of securities professionals, defined as public accountants, public accounting firms, investment bankers, investment advisers, brokers, dealers, attorneys, and other securities professionals practicing before the Commission—

(A) who have been found to have aided and abetted a violation of the Federal securities laws, including rules or regulations promulgated thereunder (collectively referred to in this section as "Federal securities laws"), but who have not been sanctioned, disciplined, or otherwise penalized as a primary violator in any administrative action or civil proceeding, including in any settlement of such an action or proceeding (referred to in this section as "aiders and abettors"); and

(B) who have been found to have been primary violators of the Federal securities laws;

(2) a description of the Federal securities laws violations committed by aiders and abettors and by primary violators, including—

(A) the specific provision of the Federal securities laws violated;

(B) the specific sanctions and penalties imposed upon such aiders and abettors and primary violators, including the amount of any monetary penalties assessed upon and collected from such persons;

(C) the occurrence of multiple violations by the same person or persons, either as an aider or abettor or as a primary violator; and

(D) whether, as to each such violator, disciplinary sanctions have been imposed, including any censure, suspension, temporary bar, or permanent bar to practice before the Commission; and

(3) the amount of disgorgement, restitution, or any other fines or payments that the Commission has assessed upon and collected from, aiders and abettors and from primary violators.

(b) REPORT.—A report based upon the study conducted pursuant to subsection (a) shall be submitted to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives not later than 6 months after the date of enactment of this Act.

SEC. 704. STUDY OF ENFORCEMENT ACTIONS.

(a) STUDY REQUIRED.—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws, and restatements of financial statements, over the 5-year period preceding the date of enactment of this Act, to identify areas of reporting that are 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.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, not later than 180 days after the date of enactment of this Act, and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study. Deadline.

SEC. 705. STUDY OF INVESTMENT BANKS.

(a) GAO STUDY.—The Comptroller General of the United States shall conduct a study on whether investment banks and financial advisers assisted public companies in manipulating their earnings and obfuscating their true financial condition. The study should address the rule of investment banks and financial advisers—

(1) in the collapse of the Enron Corporation, including with respect to the design and implementation of derivatives transactions, transactions involving special purpose vehicles, and other financial arrangements that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company;

(2) in the failure of Global Crossing, including with respect to transactions involving swaps of fiberoptic cable capacity, in the designing transactions that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company; and

(3) generally, in creating and marketing transactions which may have been designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks faced by the companies or any other mechanism to obscure a company's financial picture.

(b) REPORT.—The Comptroller General shall report to Congress not later than 180 days after the date of enactment of this Act on the results of the study required by this section. The report shall include a discussion of regulatory or legislative steps that Deadline.

are recommended or that may be necessary to address concerns identified in the study.

Corporate and Criminal Fraud Accountability Act of 2002.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

18 USC 1501 note.

SEC. 801. SHORT TITLE.

This title may be cited as the "Corporate and Criminal Fraud Accountability Act of 2002".

SEC. 802. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

"§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

"Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

"§ 1520. Destruction of corporate audit records

"(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

Regulations.

"(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies. The Commission may, from time to time, amend or supplement the rules and regulations that it is required to promulgate under this section, after adequate notice and an opportunity for comment, in order to ensure that such rules and regulations adequately comport with the purposes of this section.

"(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 10 years, or both.

"(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation imposed by Federal or State law or regulation to maintain, or refrain from destroying, any document.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

"1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.

"1520. Destruction of corporate audit records.".

SEC. 803. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking "or" after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting "; or"; and

(3) by adding at the end, the following:

"(19) that—

"(A) is for—

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results from—

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".

SEC. 804. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—

(1) by inserting "(a)" before "Except"; and

(2) by adding at the end the following:

"(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

"(1) 2 years after the discovery of the facts constituting the violation; or

"(2) 5 years after such violation.".

(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act. 28 USC 1658 note.

(c) NO CREATION OF ACTIONS.—Nothing in this section shall create a new, private right of action. 28 USC 1658 note.

28 USC 994 note.

SEC. 805. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.

(a) ENHANCEMENT OF FRAUD AND OBSTRUCTION OF JUSTICE SENTENCES.—Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—

(1) the base offense level and existing enhancements contained in United States Sentencing Guideline 2J1.2 relating to obstruction of justice are sufficient to deter and punish that activity;

(2) the enhancements and specific offense characteristics relating to obstruction of justice are adequate in cases where—

(A) the destruction, alteration, or fabrication of evidence involves—

(i) a large amount of evidence, a large number of participants, or is otherwise extensive;

(ii) the selection of evidence that is particularly probative or essential to the investigation; or

(iii) more than minimal planning; or

(B) the offense involved abuse of a special skill or a position of trust;

(3) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this title, are sufficient to deter and punish that activity;

(4) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of a substantial number of victims; and

(5) the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct.

Deadline.

(b) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the prcedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 806. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

"§ 1514A. Civil action to protect against retaliation in fraud cases

"(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)),

or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

"(A) a Federal regulatory or law enforcement agency;

"(B) any Member of Congress or any committee of Congress; or

"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

"(b) ENFORCEMENT ACTION.—

"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

"(A) filing a complaint with the Secretary of Labor; or

"(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

"(2) PROCEDURE.—

"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs. Deadline.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

"(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

"1514A. Civil action to protect against retaliation in fraud cases.".

SEC. 807. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Securities fraud

"Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

"(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 25 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1348. Securities fraud.".

White-Collar Crime Penalty Enhancement Act of 2002.

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

18 USC 1341 note.

SEC. 901. SHORT TITLE.

This title may be cited as the "White-Collar Crime Penalty Enhancement Act of 2002".

SEC. 902. ATTEMPTS AND CONSPIRACIES TO COMMIT CRIMINAL FRAUD OFFENSES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1348 as added by this Act the following:

"§ 1349. Attempt and conspiracy

"Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1349. Attempt and conspiracy.".

SEC. 903. CRIMINAL PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking "five" and inserting "20".

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking "five" and inserting "20".

SEC. 904. CRIMINAL PENALTIES FOR VIOLATIONS OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

Section 501 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1131) is amended—

(1) by striking "$5,000" and inserting "$100,000";

(2) by striking "one year" and inserting "10 years"; and

(3) by striking "$100,000" and inserting "$500,000".

SEC. 905. AMENDMENT TO SENTENCING GUIDELINES RELATING TO CERTAIN WHITE-COLLAR OFFENSES. 28 USC 994 note.

(a) DIRECTIVE TO THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 18, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and, as appropriate, amend the Federal Sentencing Guidelines and related policy statements to implement the provisions of this Act.

(b) REQUIREMENTS.—In carrying out this section, the Sentencing Commission shall—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of the offenses and the penalties set forth in this Act, the growing incidence of serious fraud offenses which are identified above, and the need to modify the sentencing guidelines and policy statements to deter, prevent, and punish such offenses;

(2) consider the extent to which the guidelines and policy statements adequately address whether the guideline offense levels and enhancements for violations of the sections amended by this Act are sufficient to deter and punish such offenses, and specifically, are adequate in view of the statutory increases in penalties contained in this Act;

(3) assure reasonable consistency with other relevant directives and sentencing guidelines;

(4) account for any additional aggravating or mitigating circumstances that might justify exceptions to the generally applicable sentencing ranges;

(5) make any necessary conforming changes to the sentencing guidelines; and

(6) assure that the guidelines adequately meet the purposes of sentencing, as set forth in section 3553(a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the procedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1349, as created by this Act, the following:

"§ 1350. Failure of corporate officers to certify financial reports

(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

"(b) CONTENT.—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act pf 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

"(c) CRIMINAL PENALTIES.—Whoever—

"(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $1,000,000 or imprisoned not more than 10 years, or both; or

"(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"1350. Failure of corporate officers to certify financial reports.".

TITLE X—CORPORATE TAX RETURNS

SEC. 1001. SENSE OF THE SENATE REGARDING THE SIGNING OF CORPORATE TAX RETURNS BY CHIEF EXECUTIVE OFFICERS.

It is the sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

TITLE XI—CORPORATE FRAUD ACCOUNTABILITY

Corporate Fraud Accountability Act of 2002.

SEC. 1101. SHORT TITLE.

15 USC 78a note.

This title may be cited as the "Corporate Fraud Accountability Act of 2002".

SEC. 1102. TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN OFFICIAL PROCEEDING.

Section 1512 of title 18, United States Code, is amended—

(1) by redesignating subsections (c) through (i) as subsections (d) through (j), respectively; and

(2) by inserting after subsection (b) the following new subsection:

"(c) Whoever corruptly—

"(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or

"(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years, or both.".

SEC. 1103. TEMPORARY FREEZE AUTHORITY FOR THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—Section 21C(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)) is amended by adding at the end the following:

"(3) TEMPORARY FREEZE.—

"(A) IN GENERAL.—

"(i) ISSUANCE OF TEMPORARY ORDER.—Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

"(ii) STANDARD.—A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that

notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

"(iii) EFFECTIVE PERIOD.—A temporary order issued under clause (i) shall—

"(I) become effective immediately;

"(II) be served upon the parties subject to it; and

"(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

"(iv) EXTENSIONS AUTHORIZED.—The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

"(B) PROCESS ON DETERMINATION OF VIOLATIONS.—

"(i) VIOLATIONS CHARGED.—If the issuer or other person described in subparagraph (A) is charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

"(ii) VIOLATIONS NOT CHARGED.—If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.".

(b) TECHNICAL AMENDMENT.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by striking "This" and inserting "paragraph (1)".

28 USC 994 note.

SEC. 1104. AMENDMENT TO THE FEDERAL SENTENCING GUIDELINES.

(a) REQUEST FOR IMMEDIATE CONSIDERATION BY THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission is requested to—

(1) promptly review the sentencing guidelines applicable to securities and accounting fraud and related offenses;

(2) expeditiously consider the promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses; and

(3) submit to Congress an explanation of actions taken by the Sentencing Commission pursuant to paragraph (2) and

any additional policy recommendations the Sentencing Commission may have for combating offenses described in paragraph (1).

(b) CONSIDERATIONS IN REVIEW.—In carrying out this section, the Sentencing Commission is requested to—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of securities, pension, and accounting fraud and the need for aggressive and appropriate law enforcement action to prevent such offenses;

(2) assure reasonable consistency with other relevant directives and with other guidelines;

(3) account for any aggravating or mitigating circumstances that might justify exceptions, including circumstances for which the sentencing guidelines currently provide sentencing enhancements;

(4) ensure that guideline offense levels and enhancements for an obstruction of justice offense are adequate in cases where documents or other physical evidence are actually destroyed or fabricated;

(5) ensure that the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(6) make any necessary conforming changes to the sentencing guidelines; and

(7) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553 (a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than the 180 days after the date of enactment of this Act, in accordance with the procedures sent forth in section 21(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired. Deadline.

SEC. 1105. AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21C of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3) is amended by adding at the end the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.".

(b) SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end of the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or that is required to file reports pursuant to section 15(d) of that Act, if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.".

SEC. 1106. INCREASED CRIMINAL PENALTIES UNDER SECURITIES EXCHANGE ACT OF 1934.

Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended—

(1) by striking "$1,000,000, or imprisoned not more than 10 years" and inserting "$5,000,000, or imprisoned not more than 20 years"; and

(2) by striking "$2,500,000" and inserting "$25,000,000".

SEC. 1107. RETALIATION AGAINST INFORMANTS.

(a) IN GENERAL.—Section 1513 of title 18, United States Code, is amended by adding at the end the following:

Penalties.

"(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.".

Approved July 30, 2002.

LEGISLATIVE HISTORY—H.R. 3763 (S. 2673):

HOUSE REPORTS: Nos. 107–414 (Comm. on Financial Services) and 107–610 (Comm. of Conference).

SENATE REPORTS: No. 107–205 accompanying S. 2673 (Comm. on Banking, Housing, and Urban Affairs).

CONGRESSIONAL RECORD, Vol. 148 (2002):

Apr. 24, considered and passed House.

July 15, considered and passed Senate, amended, in lieu of S. 2673.

July 25, House and Senate agreed to conference report.

WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 38 (2002):

July 30, Presidential remarks and statement.

○

107TH CONGRESS
2D SESSION

H. R. 5118

AN ACT

To provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Corporate Fraud Accountability Act of 2002''.

SEC. 2. HIGHER MAXIMUM PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking ''five'' and inserting ''20''.

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking ''five'' and inserting ''20''.

(c) SECURITIES FRAUD.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

''§ 1348. Securities fraud

''Whoever knowingly executes a scheme or artifice—

''(1) to defraud any person in connection with any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l, 78o(d)) or section 6 of the Securities Act of 1933 (15 U.S.C. 77f); or

''(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C.

78l, 78o(d)) or section 6 of the Securities Act of 1933 (15 U.S.C. 77f),

shall be fined under this title, or imprisoned not more than 25 years, or both.''.

(d) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

''1348. Securities fraud.''.

SEC. 3. TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN OFFICIAL PROCEEDING.

Section 1512 of title 18, United States Code, is amended—

(1) by redesignating subsections (c) through (i) as subsections (d) through (j), respectively; and

(2) by inserting after subsection (b) the following new subsection:

''(c) Whoever corruptly—

''(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or

''(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years, or both.''.

SEC. 4. AMENDMENT TO THE FEDERAL SENTENCING GUIDELINES.

(a) REQUEST FOR IMMEDIATE CONSIDERATION BY THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission is requested to—

(1) promptly review the sentencing guidelines applicable to securities and accounting fraud and related offenses;

(2) expeditiously consider the promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses; and

(3) submit to Congress an explanation of actions taken by the Sentencing Commission pursuant to paragraph (2) and any additional policy recommendations the Sentencing Commission may have for combating offenses described in paragraph (1).

(b) CONSIDERATIONS IN REVIEW.—In carrying out this section, the Sentencing Commission is requested to—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of securities, pension, and accounting fraud and the need for

aggressive and appropriate law enforcement action to prevent such offenses;

(2) assure reasonable consistency with other relevant directives and with other guidelines;

(3) account for any aggravating of mitigating circumstances that might justify exceptions, including circumstances for which the sentencing guidelines currently provide sentencing enhancements;

(4) ensure that guideline offense levels and enhancements for an obstruction of justice offense are adequate in cases where documents or other physical evidence are actually destroyed or fabricated;

(5) ensure that the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(6) make any necessary conforming changes to the sentencing guidelines; and

(7) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553 (a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing

Commission is requested to promulgate the guidelines or amendments provided for under this sections as soon as practicable, and in any event not later than the 120 days after the date of enactment of this Act, in accordance with the procedures sent forth in section 21(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 5. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking ''or'' after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting ''; or''; and

(3) by adding at the end, the following:

''(19) that—

''(A) is a claim for—

''(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results, in relation to any claim described in subparagraph (A), from—

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".

SEC. 6. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1349. Failure of corporate officers to certify financial reports

"(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange

Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chairman of the board, chief executive officer, and chief financial officer (or equivalent thereof) of the issuer.

"(b) CONTENT.—The statement required under subsection (a) shall certify that those financial statements fairly and accurately represent, in all material respects, the operations and financial condition of the issuer.

"(c) CRIMINAL PENALTIES.—Whoever—

"(1) knowingly violates this section shall be fined not more than $1,000,000, or imprisoned not more than 10 years, or both; or

"(2) willfully violates this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"1349. Failure of corporate officers to certify financial reports.".

SEC. 7. ATTEMPTS AND CONSPIRACIES TO COMMIT CRIMINAL OFFENSES.

(a) IN GENERAL.—Chapter 1 of title 18, United States Code, is amended by inserting before section 2 the following:

"§ 1. Attempt and conspiracy

"Any person who attempts or conspires to commit any offense against the United States shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of title 18, United States Code, is amended so that the item relating to section 1 reads as follows: "1. Attempt and conspiracy.".

SEC. 8. INCREASED CRIMINAL PENALTIES UNDER SECURITIES EXCHANGE ACT OF 1934.

Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended—

(1) by striking "$1,000,000, or imprisoned not more than 10 years" and inserting "$5,000,000, or imprisoned not more than 20 years"; and

(2) by striking "$2,500,000" and inserting "$25,000,000".

SEC. 9. TEMPORARY FREEZE AUTHORITY FOR THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—Section 21C(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)) is amended by adding at the end the following:

"(3) TEMPORARY FREEZE.—

"(A) IN GENERAL.—

"(i) ISSUANCE OF TEMPORARY ORDER.—Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation of otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

"(ii) STANDARD.—A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

"(iii) EFFECTIVE PERIOD.—A temporary order issued under clause (i) shall—

"(I) become effective immediately;

"(II) be served upon the parties subject to it; and

"(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

"(iv) EXTENSIONS AUTHORIZED.—The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

"(B) PROCESS ON DETERMINATION OF VIOLATIONS.—

"(i) VIOLATIONS CHARGED.—If the issuer or other person described in subparagraph (A) is charged with any violation of the Federal securities laws before the expiration of the effective period of a

temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

"(ii) VIOLATIONS NOT CHARGED.—If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.".

(b) TECHNICAL AMENDMENT.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by striking "This" and inserting "paragraph (1)".

SEC. 10. AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21C of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3) is amended by adding at the end the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section, or that is required to file reports pursuant to section (d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.".

(b) SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end of the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such

In the Senate of the United States,

July 15, 2002.

Resolved, That the bill from the House of Representatives (H.R. 3763) entitled ''An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.'', do pass with the following

AMENDMENT:

Strike out all after the enacting clause and insert:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ''Public Company Accounting Reform and Investor Protection Act of 2002''.

1 *(b) TABLE OF CONTENTS.—The table of contents for*
2 *this Act is as follows:*

Sec. 1. Short title; table of contents.
Sec. 2. Definitions.
Sec. 3. Commission rules and enforcement.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Sec. 101. Establishment; administrative provisions.
Sec. 102. Registration with the Board.
Sec. 103. Auditing, quality control, and independence standards and rules.
Sec. 104. Inspections of registered public accounting firms.
Sec. 105. Investigations and disciplinary proceedings.
Sec. 106. Foreign public accounting firms.
Sec. 107. Commission oversight of the Board.
Sec. 108. Accounting standards.
Sec. 109. Funding.

TITLE II—AUDITOR INDEPENDENCE

Sec. 201. Services outside the scope of practice of auditors.
Sec. 202. Preapproval requirements.
Sec. 203. Audit partner rotation.
Sec. 204. Auditor reports to audit committees.
Sec. 205. Conforming amendments.
Sec. 206. Conflicts of interest.
Sec. 207. Study of mandatory rotation of registered public accounting firms.
Sec. 208. Commission authority.
Sec. 209. Considerations by appropriate State regulatory authorities.

TITLE III—CORPORATE RESPONSIBILITY

Sec. 301. Public company audit committees.
Sec. 302. Corporate responsibility for financial reports.
Sec. 303. Improper influence on conduct of audits.
Sec. 304. Forfeiture of certain bonuses and profits.
Sec. 305. Officer and director bars and penalties.
Sec. 306. Insider trades during pension fund blackout periods prohibited.

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

Sec. 401. Disclosures in periodic reports.
Sec. 402. Enhanced conflict of interest provisions.
Sec. 403. Disclosures of transactions involving management and principal stockholders.
Sec. 404. Management assessment of internal controls.
Sec. 405. Exemption.
Sec. 406. Code of ethics for senior financial officers.
Sec. 407. Disclosure of audit committee financial expert.

TITLE V—ANALYST CONFLICTS OF INTEREST

Sec. 501. Treatment of securities analysts by registered securities associations.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

Sec. 601. Authorization of appropriations.
Sec. 602. Appearance and practice before the Commission.
Sec. 603. Federal court authority to impose penny stock bars.
Sec. 604. Qualifications of associated persons of brokers and dealers.

TITLE VII—STUDIES AND REPORTS

Sec. 701. GAO study and report regarding consolidation of public accounting firms.
Sec. 702. Commission study and report regarding credit rating agencies.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

Sec. 801. Short title.
Sec. 802. Criminal penalties for altering documents.
Sec. 803. Debts nondischargeable if incurred in violation of securities fraud laws.
Sec. 804. Statute of limitations for securities fraud.
Sec. 805. Review of Federal sentencing guidelines for obstruction of justice and extensive criminal fraud.
Sec. 806. Protection for employees of publicly traded companies who provide evidence of fraud.
Sec. 807. Criminal penalties for defrauding shareholders of publicly traded companies.

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

Sec. 901. Short title.
Sec. 902. Criminal penalties for conspiracy to commit offense or to defraud the United States.
Sec. 903. Criminal penalties for mail and wire fraud.
Sec. 904. Criminal penalties for violations of the Employee Retirement Income Security Act of 1974.
Sec. 905. Amendment to sentencing guidelines relating to certain white-collar offenses.
Sec. 906. Corporate responsibility for financial reports.
Sec. 907. Higher maximum penalties for mail and wire fraud.
Sec. 908. Tampering with a record or otherwise impeding an official proceeding.
Sec. 909. Temporary freeze authority for the Securities and Exchange Commission.
Sec. 910. Amendment to the Federal sentencing guidelines.
Sec. 911. Authority of the Commission to prohibit persons from serving as officers or directors.

TITLE X—CORPORATE TAX RETURNS

Sec. 1001. Sense of the Senate regarding the signing of corporate tax returns by chief executive officers.

1 ***SEC. 2. DEFINITIONS.***

2 *(a) IN GENERAL.—In this Act, the following defini-*
3 *tions shall apply:*

(1) APPROPRIATE STATE REGULATORY AUTHORITY.—The term "appropriate State regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) AUDIT.—The term "audit" means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) AUDIT COMMITTEE.—The term "audit committee" means—

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) AUDIT REPORT.—The term "audit report" means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or

(ii) asserts that no such opinion can be expressed.

(5) BOARD.—The term "Board" means the Public Company Accounting Oversight Board established under section 101.

(6) COMMISSION.—The term "Commission" means the Securities and Exchange Commission.

(7) ISSUER.—The term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports pursuant to

section 15(d) of that Act (15 U.S.C. 78o(d)), or that will be required to file such reports at the end of a fiscal year of the issuer in which a registration statement filed by such issuer has become effective pursuant to the Securities Act of 1933 (15 U.S.C. 77a et. seq.), unless its securities are registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) on or before the end of such fiscal year.

(8) NON-AUDIT SERVICES.—The term "non-audit services" means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.—

(A) IN GENERAL.—The terms "person associated with a public accounting firm" (or with a "registered public accounting firm") and "associated person of a public accounting firm" (or of a "registered public accounting firm") mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connec-

tion with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) EXEMPTION AUTHORITY.—The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) PROFESSIONAL STANDARDS.—The term "professional standards" means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

(11) PUBLIC ACCOUNTING FIRM.—The term "public accounting firm" means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) REGISTERED PUBLIC ACCOUNTING FIRM.—The term "registered public accounting firm" means a public accounting firm registered with the Board in accordance with this Act.

(13) RULES OF THE BOARD.—The term "rules of the Board" means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) SECURITY.—The term "security" has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(15) SECURITIES LAWS.—The term "securities laws" means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder.

(16) STATE.—The term "State" means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

(b) CONFORMING AMENDMENT.—Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) is amended by inserting "the Public Company Accounting Reform and Investor Protection Act of 2002," before "the Public".

SEC. 3. COMMISSION RULES AND ENFORCEMENT.

(a) REGULATORY ACTION.—The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) ENFORCEMENT.—

(1) IN GENERAL.—A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2) INVESTIGATIONS, INJUNCTIONS, AND PROSECUTION OF OFFENSES.—Section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u) is amended

(A) in subsection (a)(1), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,";

(B) in subsection (d)(1), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,";

(C) in subsection (e), by inserting "the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm," after "is a participant,"; and

(D) in subsection (f), by inserting "or the Public Company Accounting Oversight Board" after "self-regulatory organization" each place that term appears.

(3) CEASE-AND-DESIST PROCEEDINGS.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by inserting "reg-

istered public accounting firm (as defined in section 2 of the Public Company Accounting Reform and Investor Protection Act of 2002)," after "government securities dealer,".

(c) EFFECT ON COMMISSION AUTHORITY.—Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once

a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;

(3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms, in accordance with section 105;

(5) perform such other duties or functions as the Board determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures re-

quired of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor

was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

(g) RULES OF THE BOARD.—The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all pur-

poses, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) ANNUAL REPORT TO THE COMMISSION.—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

SEC. 102. REGISTRATION WITH THE BOARD.

(a) MANDATORY REGISTRATION.—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) APPLICATIONS FOR REGISTRATION.—

(1) FORM OF APPLICATION.—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) CONTENTS OF APPLICATIONS.—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the

preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) CONSENTS.—Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production

of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph

(1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) PUBLIC AVAILABILITY.—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) REGISTRATION AND ANNUAL FEES.—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES.

(a) AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.—

"(1) IN GENERAL.—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) RULE REQUIREMENTS.—In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit

report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe the scope of the auditor's testing of the system of internal accounting controls of the issuer required by section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)), and present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such system of internal accounting controls—

(aa) complies with the requirements of that section 13(b)(2); and

(bb) provides reasonable assurance that receipts and expenditures of the issuer comply with applicable law, and are being made in accordance with proper authorizations of the management and directors of the issuer; and

(III) a description of significant defects in such internal controls, and of any material noncompliance, of which the auditor should know on the basis of such testing; and

(B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, and advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(3) AUTHORITY TO ADOPT OTHER STANDARDS.—

(A) IN GENERAL.—In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) INDEPENDENCE STANDARDS AND RULES.—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of in-

vestors, to implement, or as authorized under, title II of this Act.

(c) COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.—

(1) IN GENERAL.—The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) BOARD RESPONSES.—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) EVALUATION OF STANDARD SETTING PROCESS.—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated

professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) IN GENERAL.—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) INSPECTION FREQUENCY.—

(1) IN GENERAL.—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) ADJUSTMENTS TO SCHEDULES.—The Board may, by rule, adjust the inspection schedules set

under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take appropriate disciplinary action, if any, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take

such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm,

to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y),

or deemed to be "final agency action" for purposes of section 704 of title 5, United States Code.

(3) TIMING.—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS.

(a) IN GENERAL.—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

(b) INVESTIGATIONS.—

(1) AUTHORITY.—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act,

practice, or omission is brought to the attention of the Board.

(2) TESTIMONY AND DOCUMENT PRODUCTION.—In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this

section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) NONCOOPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) REFERRAL.—The Board may refer an investigation under this section—

(A) to the Commission;

(B) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(C) at the direction of the Commission, to—

(i) the Attorney General of the United States;

(ii) the attorney general of 1 or more States; and

(iii) the appropriate State regulatory authority.

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and infor-

mation prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—All information referred to in subparagraph (A) may, in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, and without the loss of its status as confidential and privileged in the hands of the Board, be made available to the Commission, the Attorney General of the United States, to the ap-

propriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator, to State attorneys general in connection with any criminal investigation, and to any appropriate State regulatory authority, which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has

engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title;

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than $100,000 for a natural person or $2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than $750,000 for a natural person or $15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(6) FAILURE TO SUPERVISE.—

(A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and

detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION.—

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an ac-

countancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.—

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.—

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or

any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm (or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.—

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an

audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or

Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term "foreign public accounting firm" means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD.

(a) GENERAL OVERSIGHT RESPONSIBILITY.—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act.

(b) RULES OF THE BOARD.—

(1) DEFINITION.—In this section, the term "proposed rule" means any proposed rule of the Board, and any modification of any such rule.

(2) PRIOR APPROVAL REQUIRED.—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) APPROVAL CRITERIA.—The Commission shall approve a proposed rule, if it finds that the rule is

consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) PROPOSED RULE PROCEDURES.—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a "registered securities association" for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase "consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization" in section 19(b)(2) of that Act shall be deemed to read "consistent with the requirements of title I of the Public Company Accounting Reform and Investor Protection Act of 2002, and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors"; and

(B) the phrase "otherwise in furtherance of the purposes of this title" in section 19(b)(3)(C) of that Act shall be deemed to read "otherwise in furtherance of the purposes of title I of the Public

Company Accounting Reform and Investor Protection Act of 2002".

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a "registered securities association" for purposes of that section 19(c), except that the phrase "to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this title" in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read "to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Public Company Accounting Reform and Investor Protection Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board".

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to "members" of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase "consistent with the purposes of this title" in that section 19(e)(1) shall be deemed to read "consistent with the purposes of this title and title I of the Public Company Accounting Reform and Investor Protection Act of 2002";

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

"(b) RECOGNITION OF ACCOUNTING STANDARDS.—

"(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as 'generally accepted' for purposes of the securities laws, any accounting principles established by a standard setting body—

"(A) that—

"(i) is organized as a private entity;

"(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

"(iii) is funded as provided in section 109 of the Public Company Accounting Reform and Investor Protection Act of 2002;

"(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices;

"(v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

"(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

"(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.".

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—

(1) STUDY.—

(A) IN GENERAL.—The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) STUDY TOPICS.—The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING.

(a) IN GENERAL.—The Board, and the standard setting body designated pursuant to section 19(b) of the Secu-

rities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) ANNUAL BUDGETS.—The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains. The budget of the Board shall be subject to approval by the Commission.

(c) SOURCES AND USES OF FUNDS.—

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e).

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (h), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship

program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (f), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.—The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (f), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may

be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(g) CONFORMING AMENDMENTS.—Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)) is amended—

(1) in subparagraph (A), by striking "and" at the end;

(2) in subparagraph (B), by striking the period at the end and inserting the following: "; and

"(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 109 of the Public Company Accounting Reform and Investor Protection Act of 2002.".

(h) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

TITLE II—AUDITOR INDEPENDENCE

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended by adding at the end the following:

"(g) PROHIBITED ACTIVITIES.—It shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Public Company Accounting Reform and Investor Protection Act of 2002 (in this section referred to as the 'Board'), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

"(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

"(2) financial information systems design and implementation;

"(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

"(4) actuarial services;

"(5) internal audit outsourcing services;

"(6) management functions or human resources;

"(7) broker or dealer, investment adviser, or investment banking services;

"(8) legal services and expert services unrelated to the audit; and

"(9) any other service that the Board determines, by regulation, is impermissible.

"(h) PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.—A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).".

(b) EXEMPTION AUTHORITY.—The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of in-

vestors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(i) PREAPPROVAL REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) AUDIT COMMITTEE ACTION.—All auditing services (which may entail providing comfort letters in connection with securities underwritings) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

"(B) DE MINIMUS EXCEPTION.—The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

"(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor;

"(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

"(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved by the audit committee prior to the completion of the audit, by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

"(2) DISCLOSURE TO INVESTORS.—Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

"(3) DELEGATION AUTHORITY.—The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to

the full audit committee at each of its scheduled meetings.

"(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES.—In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.".

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(j) AUDIT PARTNER ROTATION.—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead audit partner (having primary responsibility for the audit) or the audit partner responsible for reviewing the audit that is assigned to perform those audit services has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.".

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(k) REPORTS TO AUDIT COMMITTEES.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

"(1) all critical accounting policies and practices to be used;

"(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

"(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.".

SEC. 205. CONFORMING AMENDMENTS.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

"(58) AUDIT COMMITTEE.—The term 'audit committee' means—

"(A) a committee (or equivalent body) established by and amongst the board of directors

of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

"(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

"(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term 'registered public accounting firm' has the same meaning as in section 3 of the Public Company Accounting Reform and Investor Protection Act of 2002.".

(b) AUDITOR REQUIREMENTS.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended—

(1) by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm";

(2) by striking "the independent public accountant" each place that term appears and inserting "the registered public accounting firm";

(3) in subsection (c), by striking "No independent public accountant" and inserting "No registered public accounting firm"; and

(4) in subsection (b)—

(A) by striking "the accountant" each place that term appears and inserting "the firm";

(B) by striking "such accountant" each place that term appears and inserting "such firm"; and

(C) in paragraph (4), by striking "the accountant's report" and inserting "the report of the firm".

(c) OTHER REFERENCES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 12(b)(1) (15 U.S.C. 78l(b)(1)), by striking "independent public accountants" each place that term appears and inserting "a registered public accounting firm"; and

(2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm".

(d) CONFORMING AMENDMENT.—Section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(f)) is amended—

(1) by striking "DEFINITION" and inserting "DEFINITIONS"; and

(2) by adding at the end the following: "As used in this section, the term 'issuer' means an issuer (as

defined in section 3), the securities of which are registered under section 12, or that is required to file reports pursuant to section 15(d), or that will be required to file such reports at the end of a fiscal year of the issuer in which a registration statement filed by such issuer has become effective pursuant to the Securities Act of 1933 (15 U.S.C. 77a et. seq.), unless its securities are registered under section 12 of this title on or before the end of such fiscal year.".

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(l) CONFLICTS OF INTEREST.—It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer or any person serving in an equivalent position for the issuer was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.".

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) STUDY AND REVIEW REQUIRED.—The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section.

(c) DEFINITION.—For purposes of this section, the term "mandatory rotation" refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY.

(a) COMMISSION REGULATIONS.—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title.

(b) AUDITOR INDEPENDENCE.—It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit

report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES.

In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

SEC. 301. PUBLIC COMPANY AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following:

"(m) STANDARDS RELATING TO AUDIT COMMITTEES.—

"(1) COMMISSION RULES.—

"(A) IN GENERAL.—Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

"(B) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

"(2) RESPONSIBILITIES RELATING TO REGISTERED PUBLIC ACCOUNTING FIRMS.—The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolu-

tion of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

"(3) INDEPENDENCE.—

"(A) IN GENERAL.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

"(B) CRITERIA.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

"(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

"(ii) be an affiliated person of the issuer or any subsidiary thereof.

"(C) EXEMPTION AUTHORITY.—The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Com-

mission determines appropriate in light of the circumstances.

"(4) COMPLAINTS.—Each audit committee shall establish procedures for—

"(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

"(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

"(5) AUTHORITY TO ENGAGE ADVISERS.—Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

"(6) FUNDING.—Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

"(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

"(B) to any advisers employed by the audit committee under paragraph (5).".

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) CERTIFICATION OF PERIODIC REPORTS.—Each periodic report containing financial statements filed by an issuer with the Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, shall be accompanied by a written statement by the chief executive officer and chief financial officer (or the equivalent thereof) of the issuer.

(b) CONTENT.—The statement required by subsection (a) shall certify the appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer.

(c) FOREIGN REINCORPORATIONS HAVE NO EFFECT.—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

SEC. 303. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful, in contravention of such rules or regulations as the Commis-

sion shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) ENFORCEMENT.—In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment.

SEC. 304. FORFEITURE OF CERTAIN BONUSES AND PROFITS.

(a) ADDITIONAL COMPENSATION PRIOR TO NONCOMPLIANCE WITH COMMISSION FINANCIAL REPORTING REQUIREMENTS.—If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) COMMISSION EXEMPTION AUTHORITY.—The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

SEC. 305. OFFICER AND DIRECTOR BARS AND PENALTIES.

(a) UNFITNESS STANDARD.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d)(2) of the Securities Exchange Act of 1934

(15 U.S.C. 78u(d)(2)) is amended by striking "substantial unfitness" and inserting "unfitness".

(2) SECURITIES ACT OF 1933.—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking "substantial unfitness" and insert "unfitness".

(b) EQUITABLE RELIEF.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended—

(1) by redesignating paragraphs (2) through (4) as paragraphs (3) through (5), respectively; and

(2) by inserting after paragraph (1) the following:

"(2) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.".

SEC. 306. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS PROHIBITED.

(a) PROHIBITION.—It shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security),

during any blackout period with respect to such equity security, in accordance with any exception provided by rule of the Commission pursuant to subsection (d).

(b) EFFECTIVENESS.—

(1) NOTICE REQUIREMENTS.—Except as provided in paragraph (2), no blackout period may take effect earlier than 30 days after the date on which written notice of such blackout period is provided by the plan administrator to the participants or beneficiaries.

(2) EXCEPTION.—The 30-day notice requirement in paragraph (1) shall not apply, and notice under paragraph (1) shall be furnished as soon as is reasonably possible, in any case in which—

(A) a deferral of the blackout period would violate the requirements of subparagraph (A) or (B) of section 404(a)(1) of the Employment Retirement Income Security Act of 1974, and a fiduciary of the plan so reasonably determines in writing; or

(B) the inability to provide the 30-day notice is due to events that were unforeseeable, or circumstances beyond the reasonable control of the plan administrator, and a fiduciary of the plan so reasonably determines in writing.

(3) WRITTEN NOTICE.—The notice required to be provided under paragraph (1) shall be in writing, except that such notice may be in electronic form to the extent that such form is reasonably accessible to the recipient.

(c) REMEDY.—

(1) IN GENERAL.—Any profit realized by a director or executive officer referred to in subsection (a) from any purchase, sale, or other acquisition or transfer in violation of this section shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(2) ACTIONS TO RECOVER PROFITS.—An action to recover profits in accordance with this section may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(d) RULEMAKING AUTHORIZED.—The Commission may issue rules to clarify the application of this subsection,

to ensure adequate notice to all persons affected by this subsection, and to prevent evasion thereof.

(e) DEFINITIONS.—For purposes of this section—

(1) the term "blackout period", with respect to the equity securities of any issuer—

(A) means any period during which the ability of not fewer than 50 percent of the participants or beneficiaries under all applicable individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan, is suspended by the issuer or a fiduciary of the plan; and

(B) does not include—

(i) a period in which the employees of an issuer may not allocate their interests in the individual account plan due to an express investment restriction—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before joining the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an applicable individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction; and

(2) the term "individual account plan" has the same meaning as in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)).

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

SEC. 401. DISCLOSURES IN PERIODIC REPORTS.

(a) DISCLOSURES REQUIRED.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(i) ACCURACY OF FINANCIAL REPORTS.—Each financial report that is required to be prepared in accordance with generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally

accepted accounting principles and the rules and regulations of the Commission.

"(j) OFF-BALANCE SHEET TRANSACTIONS.—Not later than 180 days after the date of enactment of the Public Company Accounting Reform and Investor Protection Act of 2002, the Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.".

(b) COMMISSION RULES ON PRO FORMA FIGURES.—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial infor-

mation, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

(c) STUDY AND REPORT ON SPECIAL PURPOSE ENTITIES.—

(1) STUDY REQUIRED.—The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934, as added by this section, complete a study of filings by issuers and their disclosures to determine—

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

(2) REPORT AND RECOMMENDATIONS.—Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee

on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth—

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934;

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose entities sponsored by an issuer in cases in which the issuer has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality

of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

SEC. 402. ENHANCED CONFLICT OF INTEREST PROVISIONS.

(a) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(k) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—

"(1) IN GENERAL.—It shall be unlawful for any issuer, directly or indirectly, to extend or maintain credit, or arrange for the extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer.

"(2) LIMITATION.—Paragraph (1) does not preclude any home improvement and manufactured home loans (as that term is defined in section 5 of the Home Owners Loan Act), consumer credit (as defined in section 103 of the Truth in Lending Act), or any extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), that is—

"(A) made in the ordinary course of the consumer credit business of such issuer;

"(B) of a type that is generally made available by such issuer to the public; and

"(C) made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such loans.".

SEC. 403. DISCLOSURES OF TRANSACTIONS INVOLVING MANAGEMENT AND PRINCIPAL STOCKHOLDERS.

Section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78p(a)) is amended—

(1) by striking "security, shall file," and inserting the following:

"(1) shall file"; and

(2) by striking "beneficial owner, and" and all that follows through the end of the subsection and inserting the following: "beneficial owner; and

"(2) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving such equity security, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement before the end of the second business day

following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible, indicating ownership by that person at the date of filing, any such changes in such ownership, and such purchases and sales of the security-based swap agreements as have occurred since the most recent such filing under this paragraph.".

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment re-

quired by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

SEC. 405. EXEMPTION.

Nothing in section 401, 402, or 404, the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS.

(a) CODE OF ETHICS DISCLOSURE.—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer, comptroller or principal accounting officer, or persons performing similar functions.

(b) CHANGES IN CODES OF ETHICS.—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8–K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics of the issuer.

(c) DEFINITION.—In this section, the term "code of ethics" means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

SEC. 407. DISCLOSURE OF AUDIT COMMITTEE FINANCIAL EXPERT.

(a) RULES DEFINING "FINANCIAL EXPERT".—The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) CONSIDERATIONS.—In defining the term "financial expert" for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

TITLE V—ANALYST CONFLICTS OF INTEREST

SEC. 501. TREATMENT OF SECURITIES ANALYSTS BY REGISTERED SECURITIES ASSOCIATIONS.

(a) RULES REGARDING SECURITIES ANALYSTS.—Section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3) is amended by adding at the end the following:

"(n) RULES REGARDING SECURITIES ANALYSTS.—

"(1) ANALYST PROTECTIONS.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this subsection, rules reasonably designed to address conflicts of inter-

est that can arise when research analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed—

"(A) to foster greater public confidence in securities research, and to protect the objectivity and independence of securities analysts, by—

"(i) restricting the prepublication clearance or approval of research reports by persons employed by the broker or dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

"(ii) limiting the supervision and compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities; and

"(iii) requiring that a broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate

against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report, except that such rules may not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such research report in accordance with the policies and procedures of the firm;

"(B) to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities;

"(C) to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in invest-

ment banking activities might potentially bias their judgment or supervision; and

"(D) to address such other issues as the Commission, or such association or exchange, determines appropriate.

"(2) DISCLOSURE.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this subsection, rules reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report, as applicable, conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report, including—

"(A) the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report;

"(B) whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the securities analyst,

from the issuer that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure by virtue of this subparagraph of material non-public information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors;

"(C) whether an issuer, the securities of which are recommended in the appearance or research report, currently is, or during the 1-year period preceding the date of the appearance or date of distribution of the report has been, a client of the registered broker or dealer, and if so, stating the types of services provided to the issuer;

"(D) whether the securities analyst received compensation with respect to a research report, based upon (among any other factors) the investment banking revenues (either generally or specifically earned from the issuer being analyzed) of the registered broker or dealer; and

"(E) such other disclosures of conflicts of interest that are material to investors, research an-

alysts, or the broker or dealer as the Commission, or such association or exchange, determines appropriate.

"(3) DEFINITIONS.—In this subsection—

"(A) the term 'securities analyst' means any associated person of a registered broker or dealer that is principally responsible for, and any associated person who reports directly or indirectly to a securities analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of 'securities analyst'; and

"(B) the term 'research report' means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.".

(b) ENFORCEMENT.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended by inserting "15A(n)," before "15B".

(c) COMMISSION AUTHORITY.—The Commission may promulgate and amend its regulations, or direct a registered securities association or national securities exchange to promulgate and amend its rules, to carry out section

15A(n) of the Securities Exchange Act of 1934, as added by this section, as is necessary for the protection of investors and in the public interest.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

SEC. 601. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $776,000,000 for fiscal year 2003, of which—

"(1) $102,700,000 shall be available to fund additional compensation, including salaries and benefits, as authorized in the Investor and Capital Markets Fee Relief Act (Public Law 107–123; 115 Stat. 2390 et seq.);

"(2) $108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and

"(3) $98,000,000 shall be available to add not fewer than an additional 200 qualified professionals

to provide enhanced oversight of auditors and audit services required by the Federal securities laws, and to improve Commission investigative and disciplinary efforts with respect to such auditors and services, as well as for additional professional support staff necessary to strengthen the programs of the Commission involving Full Disclosure and Prevention and Suppression of Fraud, risk management, industry technology review, compliance, inspections, examinations, market regulation, and investment management.".

SEC. 602. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4B the following:

"SEC. 4C. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

"(a) AUTHORITY TO CENSURE.—The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—

"(1) not to possess the requisite qualifications to represent others;

"(2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or

"(3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

"(b) DEFINITION.—With respect to any registered public accounting firm, for purposes of this section, the term 'improper professional conduct' means—

"(1) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and

"(2) negligent conduct in the form of—

"(A) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm knows, or should know, that heightened scrutiny is warranted; or

"(B) repeated instances of unreasonable conduct, each resulting in a violation of applica-

ble professional standards, that indicate a lack of competence to practice before the Commission.

"(c) STUDY AND REPORT.—(1) The Commission shall conduct a study to determine based upon information for the period from January 1, 1998 to December 31, 2001—

"(A) the number of 'securities professionals', which term shall mean public accountants, public accounting firms, investment bankers, investment advisers, brokers, dealers, attorneys, and other securities professionals practicing before the Commission—

"(i) who have been found to have aided and abetted a violation of the Federal securities laws, including rules or regulations promulgated thereunder (hereinafter collectively referred to as 'Federal securities laws'), but who have not been sanctioned, disciplined, or otherwise penalized as a primary violator in any administrative action or civil proceeding, including in any settlement of such actions or proceedings (referred to hereinafter as 'aiders and abettors'); and

"(ii) who have been found to have been primary violators of the Federal securities laws;

"(B) a description of the Federal securities laws violations committed by aiders and abettors and by primary violators, including—

"(i) the specific provisions of the Federal securities laws violated;

"(ii) the specific sanctions and penalties imposed upon, such aiders and abettors and primary violators, including the amount of any monetary penalties assessed upon and collected from such persons;

"(iii) the occurrence of multiple violations by the same person or persons either as an aider or abettor or as a primary violator; and

"(iv) whether as to each such violator disciplinary sanctions have been imposed, including any censure, suspension, temporary bar, or permanent bar to practice before the Commission; and

"(C) the amount of disgorgement, restitution or any other fines or payments the Commission has (i) assessed upon and (ii) collected from, aiders and abettors and from primary violators.

"(2) A report based upon the study conducted pursuant to subsection (c)(1) shall be submitted to the Senate Committee on Banking, Housing, and Urban Affairs no later than 6 months after the date of enactment of the 'Public Company Accounting Reform and Investor Protection Act of 2002'.

"(d) RULES OF PROFESSIONAL RESPONSIBILITY FOR ATTORNEYS.—Not later than 180 days after the date of enactment of this section, the Commission shall establish rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of public companies, including a rule requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof) and, if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the company, or to the board of directors.".

(b) ELECTRONIC FILING.—Notwithstanding the provisions of section 403 of this Act, section 16(a)(2) of the Securities and Exchange Act of 1934, as added by section 403, is amended to read as follows:

"(2) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving such equity security, shall file electronically with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement before the end of the second business day following the day on which the subject transaction has been executed, or at such other times as the Commission shall establish, by rule, in any case in which the Commission determines that such 2 day period is not feasible, and the Commission shall provide that statement on a publicly accessible Internet site not later than the end of the business day following that filing, and the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website not later than the end of the business day following that filing (the requirements of this paragraph with respect to electronic filing and providing the statement on a corporate website shall take effect 1 year after the date of enactment of this paragraph), indicating ownership by that person at the date of filing, any such changes in such ownership, and such purchases and sales of the

security-based swap agreements as have occurred since the most recent such filing under this paragraph.''.

SEC. 603. FEDERAL COURT AUTHORITY TO IMPOSE PENNY STOCK BARS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)), as amended by this Act, is amended by adding at the end the following:

''(7) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

''(A) IN GENERAL.—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

''(B) DEFINITION.—For purposes of this paragraph, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The

Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.

(b) SECURITIES ACT OF 1933.—Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following:

"(g) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(1) IN GENERAL.—In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(2) DEFINITION.—For purposes of this subsection, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The

Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

SEC. 604. QUALIFICATIONS OF ASSOCIATED PERSONS OF BROKERS AND DEALERS.

(a) BROKERS AND DEALERS.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by striking subparagraph (F) and inserting the following:

"(F) is subject to any order of the Commission barring or suspending the right of the person to be associated with a broker or dealer;"; and

(2) in subparagraph (G), by striking the period at the end and inserting the following: "; or

"(H) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the

Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(b) INVESTMENT ADVISERS.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended by striking paragraphs (7) and (8) and inserting the following:

"(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser; or

"(8) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the

Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(c) CONFORMING AMENDMENTS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(A) in section 3(a)(39)(F) (15 U.S.C. 78c(a)(39)(F)), by inserting ", or is subject to an order or finding," before "enumerated";

(B) in each of sections 15(b)(6)(A)(i) (15 U.S.C. 78o(b)(6)(A)(i)), paragraphs (2) and (4) of section 15B(c) (15 U.S.C. 78o–4(c)), and subparagraphs (A) and (C) of section 15C(c)(1) (15 U.S.C. 78o–5(c)(1)) by striking "or omission" each place that term appears, and inserting ", or is subject to an order or finding,"; and

(C) in each of paragraphs (3)(A) and (4)(C) of section 17A(c) (15 U.S.C. 78q–1(c)), by inserting ", or is subject to an order or finding," before "enumerated" each place that term appears.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(f)) is amended, by inserting "or (3)" after "paragraph (2)".

TITLE VII—STUDIES AND REPORTS

SEC. 701. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF PUBLIC ACCOUNTING FIRMS.

(a) STUDY REQUIRED.—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms capable of providing audit services to large national and multi-national business organizations that are subject to the securities laws;

(B) the present and future impact of the condition described in subparagraph (A) on cap-

ital formation and securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing audit services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among public accounting firms, including—

(A) higher costs;

(B) lower quality of services;

(C) impairment of auditor independence; or

(D) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among public accounting firms.

(b) CONSULTATION.—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Commission;

(2) the regulatory agencies that perform functions similar to the Commission within the other

member countries of the Group of Seven Industrialized Nations;

(3) the Department of Justice; and

(4) any other public or private sector organization that the Comptroller General considers appropriate.

(c) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 702. COMMISSION STUDY AND REPORT REGARDING CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the role of credit rating agencies in the evaluation of issuers of securities;

(B) the importance of that role to investors and the functioning of the securities markets;

(C) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(D) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(E) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and

(F) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

(b) REPORT REQUIRED.—The Commission shall submit a report on the study required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 180 days after the date of enactment of this Act.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

SEC. 801. SHORT TITLE.

This title may be cited as the "Corporate and Criminal Fraud Accountability Act of 2002".

SEC. 802. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

"§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

"Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 10 years, or both.

"§ 1520. Destruction of corporate audit records

"(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities

Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

"(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies.

"(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 5 years, or both.

"(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation,

imposed by Federal or State law or regulation, to maintain, or refrain from destroying, any document.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

"1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.
"1520. Destruction of corporate audit records.".

SEC. 803. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking "or" after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting "; or"; and

(3) by adding at the end, the following:

"(19) that—

"(A) arises under a claim relating to—

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulations or orders issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results, in relation to any claim described in subparagraph (A), from—

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".

SEC. 804. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—

(1) by inserting "(a)" before "Except"; and

(2) by adding at the end the following:

"(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in sec-

tion 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

"(1) two years after the discovery of the facts constituting the violation; or

"(2) five years after such violation.".

(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

(c) NO CREATION OF ACTIONS.—Nothing in this section shall create a new, private right of action.

SEC. 805. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.

Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—

(1) the base offense level and existing enhancements contained in United States Sentencing Guideline 2J1.2 relating to obstruction of justice are sufficient to deter and punish that activity;

(2) the enhancements and specific offense characteristics relating to obstruction of justice are adequate in cases where—

(A) documents and other physical evidence are actually destroyed, altered, or fabricated;

(B) the destruction, alteration, or fabrication of evidence involves—

(i) a large amount of evidence, a large number of participants, or is otherwise extensive;

(ii) the selection of evidence that is particularly probative or essential to the investigation; or

(iii) more than minimal planning; or

(C) the offense involved abuse of a special skill or a position of trust;

(3) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this title, are sufficient to deter and punish that activity;

(4) the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(5) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of a substantial number of victims; and

(6) the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct.

SEC. 806. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

"§ 1514A. Civil action to protect against retaliation in fraud cases

"(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such com-

pany, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

"(A) a Federal regulatory or law enforcement agency;

"(B) any Member of Congress or any committee of Congress; or

"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343,

1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

"(b) ENFORCEMENT ACTION.—

"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

"(A) filing a complaint with the Secretary of Labor; or

"(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

"(2) PROCEDURE.—

"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, in-

cluding litigation costs, expert witness fees, and reasonable attorney fees.

"(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

"1514A. Civil action to protect against retaliation in fraud cases.".

SEC. 807. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Securities fraud

"Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

"(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or

property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 10 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1348. Securities fraud.".

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

SEC. 901. SHORT TITLE.

This title may be cited as the "White-Collar Crime Penalty Enhancement Act of 2002".

SEC. 902. CRIMINAL PENALTIES FOR CONSPIRACY TO COMMIT OFFENSE OR TO DEFRAUD THE UNITED STATES.

Section 371 of title 18, United States Code, is amended by striking "If two or more" and all that follows through "If, however," and inserting the following:

"(a) IN GENERAL.—If 2 or more persons—

"(1) conspire to commit any offense against the United States, in any manner or for any purpose,

and 1 or more of such persons do any act to effect the object of the conspiracy, each person shall be fined or imprisoned, or both, as set forth in the specific substantive offense which was the object of the conspiracy; or

"(2) conspire to defraud the United States, or any agency thereof in any manner or for any purpose, and 1 or more of such persons do any act to effect the object of the conspiracy, each person shall be fined under this title, or imprisoned not more than 10 years, or both.

"(b) MISDEMEANOR OFFENSE.—If, however,".

SEC. 903. CRIMINAL PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking "five years" and inserting "10 years".

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking "five years" and inserting "10 years".

SEC. 904. CRIMINAL PENALTIES FOR VIOLATIONS OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

Section 501 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1131) is amended—

(1) by striking "$5,000" and inserting "$100,000";

(1) by striking "one year" and inserting "10 years"; and

(3) by striking "$100,000" and inserting "$500,000".

SEC. 905. AMENDMENT TO SENTENCING GUIDELINES RELATING TO CERTAIN WHITE-COLLAR OFFENSES.

(a) DIRECTIVE TO THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 18, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and, as appropriate, amend the Federal Sentencing Guidelines and related policy statements to implement the provisions of this title.

(b) REQUIREMENTS.—In carrying out this section, the Sentencing Commission shall—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of the offenses and the penalties set forth in this title, the growing incidence of serious fraud offenses which are identified above, and the need to modify the sentencing guidelines and policy statements to deter, prevent, and punish such offenses;

(2) consider the extent to which the guidelines and policy statements adequately address—

(A) whether the guideline offense levels and enhancements for violations of the sections amended by this title are sufficient to deter and punish such offenses, and specifically, are adequate in view of the statutory increases in penalties contained in this title; and

(B) whether a specific offense characteristic should be added in United States Sentencing Guideline section 2B1.1 in order to provide for stronger penalties for fraud when the crime is committed by a corporate officer or director;

(3) assure reasonable consistency with other relevant directives and sentencing guidelines;

(4) account for any additional aggravating or mitigating circumstances that might justify exceptions to the generally applicable sentencing ranges;

(5) make any necessary conforming changes to the sentencing guidelines; and

(6) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553(a)(2) of title 18, United States Code.

SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Failure of corporate officers to certify financial reports

"(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chairman of the board, chief executive officer, and chief financial officer (or equivalent thereof) of the issuer.

"(b) CONTENT.—The statement required under subsection (a) shall certify the appropriateness of the financial statements and disclosures contained in the periodic report or financial report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer.

"(c) CRIMINAL PENALTIES.—Notwithstanding any other provision of law—

"(1) any person who recklessly and knowingly violates any provision of this section shall upon conviction be fined not more than $500,000, or imprisoned not more than 5 years, or both; or

"(2) any person who willfully violates any provision of this section shall upon conviction be fined not more than $1,000,000, or imprisoned not more than 10 years, or both.".

(b) TECHNICAL AND CONFORMING AMENDMENT.—The section analysis for chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"1348. Failure of corporate officers to certify financial reports.".

SEC. 907. HIGHER MAXIMUM PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking "five" and inserting "ten".

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking "five" and inserting "ten".

SEC. 908. TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN OFFICIAL PROCEEDING.

Section 1512 of title 18, United States Code, is amended—

(1) by re-designating subsections (c), (d), (e), (f), (g), (h), and (i) as subsections (d), (e), (f), (g), (h), (i) and (j);

(2) by inserting after subsection (b) the following new subsection:

"(c) Whoever corruptly—

"(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or

"(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so;

shall be fined under this title or imprisoned not more than 10 years, or both.".

SEC. 909. TEMPORARY FREEZE AUTHORITY FOR THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—The Securities Exchange Act of 1934 is amended by inserting after section 21C(c)(2) (15 U.S.C. 78u–3(c)(2)) the following:

"(3) TEMPORARY FREEZE.—(A) Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

Such an order shall be entered, if the court finds that the issuer is likely to make such extraordinary payments, only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest. A temporary order shall become effective immediately and shall be served upon the parties subject to it and, unless set aside, limited or suspended by court of competent jurisdiction, shall remain effective and enforceable for 45 days. The period of the order may be extended by the court upon good cause shown for not longer than 45 days, provided that the combined period of the order not exceed 90 days.

"(B) If the individual affected by such order is charged with violations of the Federal securities laws by the expiration of the 45 days (or the expiration of any extended period), the escrow would continue, subject to court approval, until the conclusion of any legal proceedings. The issuer and the affected director, officer, partner, controlling person, agent or employee would have the right to petition the court for review of the order. If the individual affected by such order is not charged, the escrow will terminate at the expiration of the 45 days (or the expiration of any ex-

tended period), and the payments (with accrued interest) returned to the issuer.".

(b) TECHNICAL AMENDMENT.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by striking "This" and inserting "Paragraph (1) of this".

SEC. 910. AMENDMENT TO THE FEDERAL SENTENCING GUIDELINES.

(a) REQUEST FOR IMMEDIATE CONSIDERATION BY THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission is requested to—

(1) promptly review the sentencing guidelines applicable to securities and accounting fraud and related offenses;

(2) expeditiously consider promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses; and

(3) submit to Congress an explanation of actions taken by the Commission pursuant to paragraph (2) and any additional policy recommendations the Com-

mission may have for combating offenses described in paragraph (1).

(b) OTHER.—In carrying out this section, the Sentencing Commission is requested to—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of securities, pension, and accounting fraud and the need for aggressive and appropriate law enforcement action to prevent such offenses;

(2) assure reasonable consistency with other relevant directives and with other guidelines;

(3) account for any aggravating or mitigating circumstances that might justify exceptions, including circumstances for which the sentencing guidelines currently provide sentencing enhancements;

(4) make any necessary conforming changes to the sentencing guidelines; and

(5) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553(a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than the 120 days after the date of the enactment of this

Act, in accordance with the procedures set forth in section 21(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 911. AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) In section 21C of the Securities Exchange Act of 1934, add at the end a new subsection as follows:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) of this title or the rules or regulations thereunder from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of this title or that is required to file reports pursuant to section 15(d) of this title if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer.".

(b) In section 8A of the Securities Act of 1933 add at the end a new subsection as follows:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—

In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) of this title from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934 or that is required to file reports pursuant to section 15(d) of that Act if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer.".

TITLE X—CORPORATE TAX RETURNS

SEC. 1001. SENSE OF THE SENATE REGARDING THE SIGNING OF CORPORATE TAX RETURNS BY CHIEF EXECUTIVE OFFICERS.

It is the sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

Attest:

Secretary.

Calendar No. 442

107TH CONGRESS, 2d Session | SENATE | REPORT 107–205

PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2673

TOGETHER WITH

ADDITIONAL VIEWS

JULY 3, 2002.—Ordered to be printed

Filed, under the authority of the Senate of June 26, 2002

U.S. GOVERNMENT PRINTING OFFICE

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107TH CONGRESS, 2d Session | SENATE | REPORT 107–205

PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002

JULY 3, 2002.—Ordered to be printed

Filed, under the authority of the order of the Senate of June 26, 2002

Mr. SARBANES, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 2673]

The Committee on Banking, Housing and Urban Affairs reported an original bill to improve quality and transparency in financial reporting and independent audits and accounting services for public companies, to create a Public Company Accounting Oversight Board, to enhance the standard setting process for accounting practices, to strengthen the independence of firms that audit public companies, to increase corporate responsibility and the usefulness of corporate financial disclosure, to protect the objectivity and independence of securities analysts, to improve Securities and Exchange Commission resources and oversight, and for other purposes, and reports favorably thereon and recommends that the bill do pass.

INTRODUCTION

On June 18, 2002, the Senate Committee on Banking, Housing, and Urban Affairs considered the "Public Company Accounting Reform and Investor Protection Act of 2002," a bill to improve quality and transparency in financial reporting and independent audits and accounting services for public companies, to create a Public Company Accounting Oversight Board, to enhance the standard-setting process for accounting practices, to strengthen the independence of firms that audit public companies, to increase cor-

porate responsibility and the usefulness of corporate financial disclosure, to protect the objectivity and independence of securities analysts, to improve Securities and Exchange Commission resources and oversight, and for other purposes. The Committee voted 17–4 to report the bill to the Senate for consideration as promptly as circumstances permit. Senators voting in favor of the motion to report the bill were: Sarbanes, Dodd, Johnson, Reed, Schumer, Bayh, Miller, Carper, Stabenow, Corzine, Akaka, Shelby, Bennett, Allard, Enzi, Hagel, and Bunning; Senators voting against the motion were: Gramm, Santorum, Crapo, and Ensign.

PURPOSE OF THE LEGISLATION

The purpose of the bill is to address the systemic and structural weaknesses affecting our capital markets which were revealed by repeated failures of audit effectiveness and corporate financial and broker-dealer responsibility in recent months and years. The bill creates a strong independent board to oversee the conduct of the auditors of public companies, and it strengthens auditor independence from corporate management by limiting the scope of non-audit services that auditors can offer their public company audit clients. However, the bill applies only to the auditing of public companies. The statutory intent is that state regulatory authorities should make independent determinations of the proper standards for small- and medium-sized accounting firms that do not audit public companies; state authorities should not presume that the standards applied under the bill should apply to those companies under state regulatory schemes.

The bill also requires steps to enhance the direct responsibility of senior corporate management for financial reporting and for the quality of financial disclosures made by public companies. The bill establishes clear statutory rules to limit, and expose to public view, possible conflicts of interest affecting securities analysts. Finally, the bill authorizes substantially higher funding for the Securities and Exchange Commission.

HEARINGS

The Banking Committee's action followed ten hearings on the accounting and investor protection issues raised by the financial revelations involving Enron and other public companies. These issues include: the integrity of certified financial audits; appropriate accounting principles and auditing standards; the effectiveness of the accounting regulatory oversight system; the importance of auditor independence for the quality of audits; conflicts of interest, and the compromise to auditor independence, raised by accounting firms' increased offering of consulting services to audit clients; the completeness of corporate disclosure in SEC filings and shareholder communications; conflicts of interest among securities underwriters and affiliated stock analysts; insider abuses; corporate responsibility; and the adequacy of resources available to the Securities and Exchange Commission to meet its responsibilities.

On February 12, 2002, the Committee heard from a panel of five former Chairmen of the Securities and Exchange Commission: Roderick M. Hills, Chairman, 1975–77; Harold M. Williams, Chairman,

1977–81; David Ruder, Chairman, 1987–89; Richard C. Breeden, Chairman, 1989–93; and Arthur Levitt, Jr., Chairman, 1993–2000.[1]

On February 14, 2002, Paul Volcker, Chairman of the Trustees of the International Accounting Standards Committee, and former Chairman of the Board of Governors of the Federal Reserve System, and Sir David Tweedie, Chairman of the International Accounting Standards Board, and former Chairman of the United Kingdom's Accounting Standards Board, appeared before the Committee to discuss "International Accounting Standards and Necessary Reforms to Improve Financial Reporting."

On February 26, 2002, a panel of three former Chief Accountants of the Securities and Exchange Commission and a former Chairman of the Financial Accounting Standards Board testified on "Oversight of the Accounting Profession, Audit Quality and Independence, and Formulation of Accounting Principles." The witnesses were Walter P. Schuetze, Chief Accountant, 1992–95; Michael H. Sutton, Chief Accountant, 1995–98; Lynn E. Turner, Chief Accountant, 1998–2001; and Dennis R. Beresford, Chairman, Financial Accounting Standards Board, 1987–97.

On February 27, 2002, the Committee heard testimony on "Corporate Governance" from John H. Biggs, Chairman, President, and Chief Executive Officer, Teachers' Insurance and Annuity Association—College Retirement Equities Fund (TIAA–CREF), and former member of the Public Oversight Board; and Ira M. Millstein, Senior Partner, Weil, Gotshal & Manges LLP, and Co-Chair of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees.

On March 5, 2002, the Committee heard from David M. Walker, Comptroller General of the United States; as well as Robert Glauber, Chairman and Chief Executive Officer, National Association of Securities Dealers, Inc., and former Under Secretary for Finance, Department of Treasury, under President Bush (1989–1992); Joel Seligman, Dean and Ethan A. H. Shepley University Professor, Washington University School of Law; and John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School.

On March 6, 2002, the Committee heard testimony on "Oversight of the Accounting Profession, Audit Quality and Independence, and Formulation of Accounting Principles" from Shaun O'Malley, Chairman, 2000 Public Oversight Board Panel on Audit Effectiveness, and former Chairman, Price Waterhouse LLP; Lee Seidler, Deputy Chairman, 1978 American Institute of Certified Public Accountants ("AICPA") Commission on Auditors' Responsibilities, and Managing Director Emeritus, Bear Stearns & Co.; Arthur R. Wyatt, former President, American Accounting Association, and Professor of Accountancy Emeritus, University of Illinois; Abraham Briloff, Emanuel Saxe Distinguished Professor Emeritus, Baruch College, City University of New York; and Bevis Longstreth, Member, 2000 Public Oversight Board Panel on Audit Effectiveness, and former Commissioner, Securities and Exchange Commission (1981–84).

On March 14, 2002, the Committee heard from representatives of the accounting industry, the American Enterprise Institute, and The Brookings Institution. The witnesses were James G. Castellano, Chairman, AICPA, and Managing Partner, Rubin,

[1] John Shad, the SEC's Chairman from 1981–87, is deceased.

Brown, Gornstein & Co. LLP; James S. Gerson, Chairman, Auditing Standards Board, AICPA, and Partner, PricewaterhouseCoopers LLP; William Balhoff, Chairman, AICPA Private Company Practice Section; Olivia F. Kirtley, former Chair, AICPA; James E. Copeland, Jr., Chief Executive Officer, Deloitte & Touche LLP; Peter J. Wallison, Resident Fellow and Co-Director, Financial Deregulation Project, American Enterprise Institute; and Robert E. Litan, Director, Economic Studies Program, The Brookings Institution.

On March 19, 2002, the Committee heard from two members of the recently-disbanded Public Oversight Board ("P.O.B."): Charles A. Bowsher, former Comptroller General of the United States, who was the P.O.B.'s Chairman; and Aulana L. Peters, former Commissioner, Securities and Exchange Commission (1984–88), who was a member of the P.O.B.; as well as from L. William Seidman, former Chairman, Federal Deposit Insurance Corporation and Resolution Trust Corporation, and former Partner, Seidman & Seidman; John C. Whitehead, former Co-Chairman, Goldman Sachs & Co., Co-Chair of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, and former Deputy Secretary of State (1985–89); and Michael Mayo, Managing Director, Prudential Securities, Inc.

On March 20, 2002, the Committee heard from a variety of interested parties including Thomas A. Bowman, President and Chief Executive Officer, Association for Investment Management and Research; Howard M. Metzenbaum, Chairman, Consumer Federation of America, and former U.S. Senator; Damon Silvers, Associate General Counsel, AFL–CIO; and Sarah Teslik, Executive Director, Council of Institutional Investors.

On March 21, 2002, the Committee heard testimony from Harvey L. Pitt, Chairman, Securities and Exchange Commission.

TITLE-BY-TITLE SUMMARY OF MAJOR PROVISIONS

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Title I of the bill creates a Public Company Accounting Oversight Board (the "Board"), to provide for more effective oversight of the part of the nation's accounting industry that audits public companies. Title I reflects significant portions of S. 2004, authored by Senators Dodd and Corzine, as well as the terms of an amendment offered at the Committee's June 18 mark-up by Senator Enzi, which was adopted by voice vote.

The new Board may, subject to review by the Securities and Exchange Commission (the "SEC" or the "Commission"), establish, adopt, or modify auditing, quality control, ethics, and independence standards for public company audits, inspect accounting firms, investigate potential violations of applicable rules relating to audits, and impose sanctions if those violations are established. The Board will have authority only with respect to audits of public companies. It has no jurisdiction over the work of accountants in auditing other companies.

The Board will bring together various issues and responsibilities that have in the past been subject to what one Committee witness

characterized as "a bewildering array of monitoring groups"[2] under the auspices of the accounting profession. As Shaun O'Malley, Chairman of the 2000 Panel on Audit Effectiveness (and former Chairman of Price Waterhouse LLP), explained to the Committee in greater detail:

> The profession's combination of public oversight and voluntary self-regulation is extensive, Byzantine, and insufficient. The Panel found that the current system of governance lacks sufficient public representation, suffers from divergent views among its members as to the profession's priorities, implements a disciplinary system that is slow and ineffective, lacks efficient communication among its various entities and with the SEC, and lacks unified leadership and oversight.[3]

Twenty witnesses who appeared before the Committee in its ten days of hearings on accounting reform and investor protection stressed the need for a strong Board to oversee the auditors of public companies. Paul Volcker, the former Chairman of the Federal Reserve Board, told the Committee that:

> [o]ver the years, there have also [i.e., in addition to the SEC] been repeated efforts to provide oversight by industry or industry/public member boards. By and large, I think we have to conclude that those efforts at self-regulation have been unsatisfactory. Thus, experience strongly suggests that governmental oversight, with investigation and enforcement powers, is necessary to assure discipline.[4]

Charles W. Bowsher, the Comptroller General of the United States from 1981–1996 and the last Chairman of the Public Oversight Board (P.O.B.),[5] as well as former SEC Commissioner Aulana Peters and John Biggs, who were also members of the P.O.B., made the same recommendation when they testified before the Committee.[6] They were also among the number of witnesses who emphasized that any Board must be *created by statute* to establish its authority properly and firmly.

The concerns of the Committee extend beyond immediate allegations of wrongdoing, to the fundamental principles on which the functioning of free markets and the protection of investors are based. Each of the country's federal securities laws—the 1933,

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[2] Testimony of John H. Biggs, Chairman, President and CEO, Teachers' Insurance and Annuity Association—College Retirement Equities Fund (TIAA–CREF), and former member of the Public Oversight Board, before the Committee on February 27, 2002.

[3] Testimony of Shaun O'Malley, Chairman, 2000 Public Oversight Board Panel on Audit Effectiveness, and former Chairman, Price Waterhouse LLP, before the Committee on March 6, 2002.

[4] Testimony of Paul Volcker, Chairman of the Trustees of the International Accounting Standards Committee, and former Chairman of the Board of Governors of the Federal Reserve System, before the Committee on February 14, 2002.

[5] The Public Oversight Board was created in 1977 as part of self-regulatory efforts by the accounting industry. In January 2002, the P.O.B. voted unanimously to disband, in "recognition of the obstacles to achieving this goal [i.e., effective self-regulation] which have been encountered in recent years, and given the proposal of the SEC in consultation with the AICPA and the SEC Practice Section Executive Committee, without input from the Public Oversight Board, to reorganize the self-regulatory structure. * * *" Resolution of the Public Oversight Board, January 20, 2002. Available at http://www.publicoversightboard.org/about.htm.

[6] Testimony of Charles A. Bowsher, Chairman, Public Oversight Board, and former Comptroller General of the United States, before the Committee on March 29, 2002; testimony of Aulana L. Peters, Member, Public Oversight Board and former Commissioner, Securities and Exchange Commission (1984–88), before the Committee on March 19, 2002; Biggs Testimony, February 27, 2002.

1934, 1935, and 1940 Acts—requires comprehensive financial statements that must be prepared, in the words of the Securities Act of 1933, by "an *independent* public or certified accountant."[7] Professor Benjamin Graham's seminal textbook for securities analysts explains why:

> Prior to the SEC legislation * * * it was by no means unusual to encounter semi-fraudulent distortions of corporate accounts * * * almost always for the purpose of making the results look better than they were, and it was generally associated with some scheme of stock-market manipulation in which the management was participating.[8]

However, the franchise given to public accountants by the securities laws is *conditional;* it comes in return for the CPA's faithful assumption of a public trust. (The Supreme Court's now-classic statement of that trust, in *United States* v. *Arthur Young,* 465 U.S.C. 805 (1984) is discussed below.) The testimony heard by the Committee repeatedly indicated that a number of forces have undermined the fulfillment of this public trust over the years. Lee Seidler, Deputy Chairman of a 1978 commission organized to review "auditors' responsibilities," told the Committee that, twenty-five years ago, that commission had found a gap between the reasonable expectations of users of financial statements and the performance of auditors that has not improved since. He continued:

> in 1978 [the commission] also said: the public accounting profession has failed to react and evolve rapidly enough to keep pace with the speed of change in the American business environment. And unfortunately, a quarter of a century later, I have to repeat that. It's identical.[9]

A. Appointment and operation of board

The successful operation of the Board depends upon its independence and professionalism. The Board will have five members, each of whom must have a demonstrated commitment to the interests of investors, as well as an understanding of the financial disclosures required of public companies, and the responsibilities for those disclosures, under the federal securities laws. Three members of the Board will have a general background, and two members will have an accountancy background.[10] (The Board's Chairperson may have an accountancy background, but if so, he or she may not have been a practicing accountant for at least five years prior to appointment to the Board.)

Board members are to be appointed by the SEC after consultation with the Federal Reserve Board and the Department of the Treasury. They will serve full-time, for five-year (staggered) terms, with a two-term limit. To further assure their independence, Board members may engage in no other business activities of any nature,

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[7] Schedule A(25) of the Securities Act of 1933, 15 U.S.C. § 77(aa)(25) (emphasis added); see also section 13(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(a)(2), section 14 of the Public Utility Holding Company Act of 1935, at U.S.C. § 79n, and section 30(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a–29(g).

[8] Graham, Dodd, and Cottle, Security Analysis, 108 (4th ed., 1962).

[9] Testimony of Lee Seidler, former partner, Bear Stearns & Co. and Deputy Chair of the 1978 Commission on Auditors' Responsibilities, before the Committee on March 6, 2002.

[10] Senator Enzi suggested that the bill *require,* not merely permit, that two Board members have an accountancy background.

or receive any payments from any accounting firms (except for standard retirement payments) or other persons. In addition, former Board members will be subject to a one-year "cooling off" period at the end of their Board service, during which time they may not work for an accounting firm registered with the Board.

It is essential that the Board have a strong, well-trained, and experienced staff, of sufficient size to carry out its responsibilities. A number of witnesses emphasized, for example, that inspections must no longer be left to "peer reviews" of one accounting firm by another.[11] The bill makes it plain, as the Committee intends, that the Board is to provide for staff salaries that are fully competitive with those for comparable private-sector self-regulatory, accounting, technical, supervisory, or related staff or management positions.[12]

Prompt Action is Essential. The Committee believes that the new oversight arrangements must come into effect quickly. The SEC is to appoint the initial Board within three months of the bill's enactment, so that the Board can take the steps necessary to begin its operation within six months of its appointment, and the registration of accounting firms (below) can be completed within six months after the Board begins operation.

B. Registration of accounting firms

Accounting firms that audit public companies must register with the Board, no later than six months after the SEC determines that the Board is ready to begin operation. It is unlawful for a firm that has not registered to continue to audit public companies.

Conditioning eligibility to audit public companies on registration with the Board is the linchpin of the Board's authority. Suspension or revocation of registration renders a firm unable to continue its public company audit practice.

As part of its registration process, each accounting firm must execute a consent to comply with any requests, within the Board's authority, for documents or testimony made in the course of the Board's operation. The firm must also agree to obtain (and ultimately, if necessary, to enforce) similar consents from the firm's partners and employees, who are subject to the Board's investigative and disciplinary jurisdiction.

Certain necessary information is to accompany the registration materials (including a list of the firm's accountants who perform public company audits), and the Board will determine within 45 days of receipt whether an application is complete and the applicant can be registered. Basic registration information is to be public, but each accounting firm may protect from public disclosure information that it reasonably identifies as proprietary or that is oth-

[11] Testimony of Harold M. Williams, former SEC Chairman (1977–81), before the Committee on February 12, 2002; Biggs Testimony, February 27, 2002; testimony of Joel Seligman, Dean and Ethan A.H. Shepley University Professor, Washington University School of Law, before the Committee on March 5, 2002; testimony of Bevis Longstreth, Member, 2000 Public Oversight Board Panel on Audit Effectiveness, and former Commissioner, Securities and Exchange Commission (1981–84), before the Committee on March 6, 2002; cf. testimony of Robert Glauber, Chairman and Chief Executive Officer, National Association of Securities Dealers, Inc., and former Under Secretary for Finance, Department of Treasury, under President Bush (1989–1992), before the Committee on March 5, 2002.

[12] The Board itself will be a corporation created under the D.C. Nonprofit Corporation Act. It will be neither an agency nor establishment of the federal government, and its members and employees are not to be deemed to be federal officers or employees by reason of their Board service.

erwise protected by law. Each registrant is to file a report annually to update the required information.

The Board is to assess a registration fee, and an annual fee, to recover the costs of processing and reviewing applications and annual reports.

C. Auditing, quality control, ethics, and independence standards and rules

The bill requires the Board to establish or adopt auditing, quality control, and ethics standards for the audit of public companies. The Committee has concluded that the Board's plenary authority in this area is essential for the Board's effective operation, a position taken during the hearings by a number of witnesses, including former SEC Chairman Levitt, former Comptroller General Bowsher, and former FDIC Chairman Seidman (himself once a principal of a substantial accounting firm).[13]

The Board's standard-setting authority, however, is neither intended nor structured to exclude practicing accountants from participation in the standard-setting process. The Board may adopt as part of its rules (and modify as appropriate for that purpose, at the time of adoption or thereafter), any portion of a statement of auditing, quality control, or ethics standards that meets the bill's statutory tests and that is proposed (i) by a professional group of accountants (designated by a rule of the Board for that purpose), or (ii) by one or more advisory groups of practicing accountants or other interested parties convened by the Board. (Pre-existing standards of designated professional groups of accountants may be adopted during the Board's transitional period.) The Board is to cooperate on an ongoing basis with the designated professional groups of accountants noted above, with its own advisory groups, and with other interested groups (and the accounting profession and the investing public at large), in examining the need for changes in any standards subject to Board authority. It is to recommend issues for inclusion on the agendas of these groups, take other steps to facilitate the standard-setting process, and respond in a timely fashion to requests for changes in the standards. Finally, rules are open to comment by accountants and any other interested persons in a public process before they are approved either by the Board or, ultimately, by the SEC. Many of these provisions were suggested by Senator Enzi.

Particular Standards Required by the Bill. Although the Board's power to establish or adopt auditing and related standards extends to the full range of those standards, the bill specifies certain provisions that must be part of the standards. These include (i) preparation, and maintenance for at least seven years, by public company auditors of audit work papers and related information in sufficient detail to support each audit's conclusions, (ii) "second partner" review and approval of each public company audit report and its issuance, and (iii) inclusion in each audit report of a description of the auditor's testing of the public company's systems for compliance with the requirements of section 13(b)(2) of the Securities Ex-

[13] Testimony of Arthur Levitt, former SEC Chairman (1993–2000), before the Committee on February 12, 2002; Bowsher Testimony, March 19, 2002; testimony of L. William Seidman, former Chairman, Federal Deposit Insurance Corporation and Resolution Trust Corporation, and former partner, Seidman & Seidman, before the Committee on March 19, 2002.

change Act and of the company's controls over its receipts and expenditures, together with specific notation of any significant defects or material noncompliance of which the auditor should know on the basis of such testing. In addition, the quality control standards adopted by the Board must address an accounting firm's monitoring of ethics and independence; internal and external consulting on audit issues; audit supervision; hiring, development, and advancement of audit personnel; acceptance and continuance of engagements; and internal inspection.

Auditor Independence. The Board is also authorized to issue rules to implement the provisions of title II of the bill relating to auditor independence. That authority is discussed in greater detail in connection with title II, below.

D. Inspections of registered accounting firms

Virtually every witness who addressed the details of auditor oversight agreed on the critical need for a regular and comprehensive review, by an independent body of inspectors, of each audit firm's compliance with audit standards and procedures. A program of inspections is essential to identify problems in firm procedures, training, and "culture" before those problems can produce audit failures that trigger large investor losses and threaten confidence in the capital markets.[14]

The Board is to inspect the operations of each registered accounting firm, in order to assess compliance of that firm, and of its partners and employees, with the new statute, the Board's rules, and professional accounting standards. Initially, firms that audit more than 100 public companies are to be inspected each year, and firms that audit 100 or fewer public companies are to be inspected at least every three years. The Board is given the power to adjust these inspection schedules if it finds different schedules to be consistent with the bill's purposes, the protection of investors, and the public interest.

During an inspection, the Board is to review particular audit engagements (that it selects) of a firm and the firm's general quality control systems and policies, as well as to perform such other testing of the firm's audit, supervisory, and quality control procedures as is necessary or appropriate. The Board is specifically given authority to require firms to retain their records for inspection purposes regardless of whether retention of those records is otherwise required.

After each inspection, the Board will prepare an inspection report, which will be available for comment in draft form by the firm under inspection. Quality control defects found by the Board may be disposed of simply by corrective action, but specific violations identified during inspections may form the basis for a more formal investigation or disciplinary action by the Board and are to be reported, if appropriate, to the SEC and relevant state accountancy boards; final inspection reports are to be sent to the SEC and relevant state accountancy boards in any event. The reports will also be made public, subject to appropriate protection of confidential or proprietary information. However, firms will be given 12 months to

[14] See, *e.g.*, Ruder Testimony, February 12, 2002; Seligman Testimony, March 5, 2002; Seidler Testimony, March 6, 2002.

correct defects in their quality control systems, to the satisfaction of the Board, before portions of the reports dealing with those defects are added to the public record.[15]

E. Investigations and disciplinary proceedings

Committee witnesses stressed that the Board must possess investigative and disciplinary authority. Arthur Levitt, who served as Chairman of the SEC during most of the 1990s, told the Committee that:

> We need a truly independent oversight body that has the power not only to set the standards by which audits are performed, but also to conduct timely investigations that cannot be deferred for any reason and to discipline accountants.[16]

Robert Glauber, the Chairman and CEO of the National Association of Securities Dealers, explained that:

> Any form of private-sector regulation must be empowered to effectively enforce the rules: [it must possess] the ability to levy meaningful fines, place conditions on continued participation in the industry, suspend, and where appropriate, banish those who misbehave from the industry. This "ultimate sanction" is both a powerful deterrent for would-be violators and an important investor protection.[17]

In response, the bill grants the Board broad authority to investigate any act or practice, or omission, by a registered accounting firm, or its associated persons, that may violate the new statute, the Board's rules, professional accounting standards, or the portions of the Federal securities laws (and SEC rules) relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect to those reports.

The Board's rules are to prescribe fair investigative and disciplinary procedures. It may, under those rules, require testimony or the production of audit work papers and other documents from (and may inspect the records of) registered firms or their associated persons, and it may suspend or revoke the registration of a firm, or suspend or bar from further association with a firm an "associated person," for non-cooperation with a Board investigation, subject to review of that action by the SEC.[18]

Committee witnesses also emphasized that information gathered by Board investigators should be "privileged from outsiders" during the investigative process. Under the bill, any information gathered in the course of an investigation is to be confidential and privileged for all purposes (including civil discovery), unless and until particular information is presented in connection with a public proceeding. However, the Board may disclose investigative information, if it determines that such disclosure is "necessary to accomplish the purposes of the Act or to protect investors," to the SEC,

[15] The bill creates a right to interim SEC review of certain inspection-related disputes.

[16] Levitt Testimony, February 12, 2002.

[17] Glauber Testimony, March 5, 2002. John Biggs said simply: "Accounting firms must know that they cannot refuse to open their books or prevent their staff from cooperating with this new agency." Biggs Testimony, February 27, 2002.

[18] The Board may request, but not require, the testimony of, or production of documents, in the possession of any other person (for example, an audit firm's client). Its rules may provide for procedures to seek issuance of a subpoena from the SEC to any person.

any federal financial supervisor (if the investigation pertains to an institution under the latter's supervision), the Attorney General, and, with the SEC's permission, to state attorneys general, in connection with criminal investigations, or state accountancy boards. (The Board may also refer an investigation to the SEC or other agencies to which disclosure of information is permitted.)

A full range of sanctions is available if the Board finds that a registered firm (or its partners or employees) has violated one or more of the rules within the Board's investigative jurisdiction. Potential sanctions include revocation or suspension of an accounting firm's registration, or of the ability of particular individuals to remain associated with that firm or become associated with any other registered accounting firm (effectively barring the subject of the sanction from participating in audits of public companies), substantial civil money penalties,[19] required professional education or training, and censure; the breadth of these sanctions is intended to encourage flexible and appropriate action, designed to correct if possible. The Board's ability to suspend or bar an associated person from the auditing of public companies, and its ability to impose civil money penalties above a certain amount, is limited to situations involving intentional, knowing, or reckless conduct, or repeated negligent conduct.

An important provision of the bill permits the Board to impose sanctions upon a registered accounting firm for failure reasonably to supervise a partner or employee who is found to have violated applicable rules. The terms for liability for failure to supervise are similar to those that apply to broker-dealers under section 15(b)(4) of the Securities Exchange Act of 1934; they permit an accounting firm to defend itself from supervisory liability by showing that its internal control procedures were reasonable and were operating fully in the situation at issue.

The Board's determination that a violation has occurred and that a sanction should be imposed may be appealed to the Commission (as described below). Disciplinary sanctions must be reported to the Commission, appropriate state or foreign boards of accountancy, and the public (once any stay of enforcement pending appeal has been lifted).

F. Foreign public accounting firms

Companies that sell shares to U.S. investors, and are subject to the federal securities laws, can be organized and operate in any part of the world. Their financial statements are not necessarily audited by U.S. accounting firms, and the Committee believes that there should be no difference in treatment of a public company's auditors under the bill simply because of a particular auditor's place of operation. Otherwise, a significant loophole in the protection offered U.S. investors would be built into the statutory system.

Thus, accounting firms organized under the laws of countries other than the United States that issue audit reports for public companies subject to the U.S. securities laws are covered by the bill in the same manner as domestic accounting firms, subject to the exemptive authority of both the Board and the SEC. (Registration

[19] Fines imposed by the Board are to be used to fund a scholarship program for students in undergraduate or graduate programs in accounting.

under the bill will not in itself provide a basis for subjecting a foreign accounting firm to U.S. jurisdiction other than with respect to controversies between such a firm and the Board.) The Board is also authorized to determine that other foreign accounting firms play a sufficiently substantial role in the preparation and furnishing of such reports for particular issuers that their coverage under the bill is necessary or appropriate to protect investors and the public interest.

Finally, the bill sets terms for the production in the United States by a foreign public accounting firm of its audit work papers, for any audit in which the foreign accounting firm issues an opinion or otherwise performs material services upon which an accounting firm registered under the bill relies in issuing all or part of a public company audit report. The foreign firm is deemed, by performing such work, to have consented to production, and the domestic accounting firm that relies on the foreign accounting firm's work must have secured, as a condition of its reliance, the foreign firm's agreement to the production.

G. SEC oversight of the Board

The Board is subject to SEC oversight and review to assure that the Board's policies are consistent with the administration of the federal securities laws, and to protect the rights of accounting firms and individuals subject to the Board's jurisdiction. Oversight also allows the public an important forum for commenting on Board rules relating to auditing, quality control, and related standards.

The rules for SEC oversight of the Board are generally the same as those that apply to SEC oversight of the National Association of Securities Dealers, under section 19 of the Securities Exchange Act. Thus, the Board's proposed rules will be filed with the SEC and published by the SEC for public comment; SEC approval is necessary in most cases before rules of the Board take effect, and the SEC may itself abrogate or amend Board rules (as well as disapprove proposed Board rules). (Transitional rules are to be separately approved by the SEC at the time of the SEC's determination that the Board is ready to begin operation.) Disciplinary sanctions imposed by the Board are subject to SEC review and may be canceled or modified (or in some cases enhanced) by the SEC. The SEC can relieve the Board of any responsibility to enforce any provision of the bill, or censure or limit operations of the Board, or remove a Board member, for cause. Finally, the bill makes clear that any violations of its terms will constitute a violation of the Securities Exchange Act itself for purposes of the SEC's enforcement (including injunctive and cease-and-desist) authority under that Act, so that the SEC may proceed under the bill's provisions directly if appropriate.

H. Accounting principles

Since 1973, the SEC has generally required public companies operating in the United States to prepare their financial statements in accordance with "principles, standards, and practices" promulgated by the Financial Accounting Standards Board (the "FASB") in the absence of specific SEC pronouncements on particular ac-

counting questions.[20] The bill seeks to formalize the SEC's reliance on the FASB and, as discussed below, to strengthen the independence of the FASB by assuring its funding and eliminating any need for it to seek contributions from accounting firms or companies whose financial statements must conform to FASB's rules. Thus, the bill amends the Securities Act of 1933 specifically to allow the SEC to recognize as "generally accepted" (for securities law purposes) accounting principles established by a private entity that is funded as outlined in the bill (described below) and that has adopted procedures (including acting by majority vote) to ensure prompt consideration of necessary changes to the body of accounting principles.

An important issue presented to the Committee was the potential difference between an accounting regime that contains detailed rules for the treatment of particular items, and a regime that simply outlines general concepts (or "principles") to be applied to particular items. Witnesses noted the possibility that the overly-detailed approach of U.S. standard-setters may have delayed updating of necessary guidance and at the same time drawn the focus of auditors away from the overriding principle that a set of financial statements, taken as a whole, must fairly and completely reflect the economic results and operations of the company being audited. To allow more careful consideration of the differences between various formulations of accounting standards, the bill requires the Commission to conduct a study, within 12 months, of the adoption by the U.S. financial reporting system of a principles-based accounting system.

I. Funding

The Committee's witnesses overwhelmingly agreed that both the Board and the FASB required guaranteed sources of funding, in order to protect their independence. Several witnesses testified to the problems various attempts at oversight of auditors had encountered when voluntary funding was withheld. With respect to the FASB, Michael Sutton, a former SEC Chief Accountant, testified to the Committee that "[t]o restore confidence in our standards setters, we should take immediate steps to secure independent funding for the FASB—funding that does not depend on contributions from constituents that have a stake in the outcome of the process."[21]

Under the bill, public companies are required to pay "accounting support fees" to support the annual budgets of the Board and the FASB. (The Board's budget will be subject to approval by the SEC.) Amounts payable by public companies to either body will generally be allocated among those companies based on relative average annual monthly market capitalization for the 12 months prior to the year to which the support fee relates; both the Board and the FASB are permitted to differentiate among various classes of public companies in allocating fees.

[20] Accounting Series Release No. 150, 3 SEC Dock. 275 (1973).

[21] Testimony of Michael Sutton, former SEC Chief Accountant (1995–98), before the Committee on February 26, 2002.

TITLE II—AUDITOR INDEPENDENCE

The issue of auditor independence is at the center of this legislation. Public confidence in the integrity of financial statements of publicly-traded companies is based on belief in the independence of the auditor from the audit client. As noted above, each of the country's federal securities laws requires comprehensive financial statements that must be prepared, in the words of the Securities Act of 1933, by "an *independent* public or certified accountant."

The statutory independent audit requirement has two sides. It grants a franchise to the nation's public accountants—their services, and only their services, and certification, must be secured before an issuer of securities can go to market, have the securities listed on the nation's stock exchanges, or comply with the reporting requirements of the securities laws. This is a source of significant private benefit to the public accountants.

But the franchise is conditional. It comes in return for the CPA's assumption of a public duty and obligation. As a unanimous Supreme Court noted nearly 20 years ago: "In certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility. * * * [That auditor] owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust." *United States* v. *Arthur Young,* 465 U.S. 805, 817–18 (1984) (emphasis added).

Richard Breeden, Chairman of the SEC from 1989–93, put it succinctly in testimony before the Committee:

> While companies in the U.S. do not have to employ a law firm, an underwriter, or other types of professionals, federal law requires a publicly-traded company to hire an independent accounting firm to perform an annual audit. In addition to this shared federal monopoly, more than a hundred million investors in the U.S. depend on audited financial statements to make investment decisions. This imbues accounting firms with a high level of public trust, and also explains why there is a strong federal interest in how well the accounting system functions.[22]

There is arguably an inherent conflict in the fact that an auditor is paid by the company for which the audit is being performed. That conflict is implicit in the relationship between the auditor and the audit client. In the last 15 years, however, the rapid growth in management consulting services offered by the major accounting firms has created a second, more substantial conflict that has eroded the independence that the auditor must bring to the audit function.

According to the SEC, 55 percent of the average revenue of the big five accounting firms came from accounting and auditing services in 1988. Twenty-two percent of the average revenue came from management consulting services. By 1999, those figures had fallen to 31 percent for accounting and auditing services, and risen to 50

[22] Testimony of Richard Breeden, former SEC Chairman (1989–93), before the Committee on February 12, 2002.

percent for management consulting services. Recent data reported to the SEC showed on average public accounting firms' non-audit fees comprised 73 percent of their total fees, or $2.69 in non-audit fees for every $1.00 in audit fees. At the same time, the frequency of financial restatements by public companies has dramatically increased. From 1990–97, the number of public company financial restatements averaged 49 per year, but jumped to an average of 150 per year in 1999 and 2000.

For these reasons, the bill includes a number of provisions directed to the issue of auditor independence.

A. Services outside the scope of practice of auditors

A number of the witnesses who testified before the Committee during the course of the hearings, as well as other informed observers, argued that the growth in the non-audit consulting business done by the large accounting firms for their audit clients has so compromised the independence of the audits that a complete prohibition is required on the provision of consulting services by accounting firms to their audit clients.

Perhaps the strongest advocates of this view have been the managers of large pension funds who are entrusted with people's retirement savings. James E. Burton, Chief Executive Officer of the California Public Employees' Retirement System (CalPERS), which manages pension and health benefits for more than 1.3 million members with aggregate holdings totaling almost $150 billion, has stated: "We believe that the inherent conflicts created when an external auditor is simultaneously receiving fees from a company for non-audit work cannot be remedied by anything less than a bright-line ban. An accounting firm should be an auditor or a consultant, but not both to the same client."[23]

John Biggs is Chairman of Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA–CREF), the largest private pension system in the world providing pensions and other financial products to the education and research community. TIAA–CREF manages approximately $275 billion in pension assets for over 2 million participants. Mr. Biggs has stated:

> Another critical element in reforming audit practices is a bright line division between audit and consulting functions. We believe such separation will help restore public trust in corporate financial statements. For example, TIAA–CREF does not allow our public audit firm to provide any consulting services to us, and our policy even bars our auditor from providing tax services. * * *
>
> Our long-term policy has served us well in assuring the independence of our auditors. Because auditors owe their primary duty to the shareholders, questions about the primacy of that duty are raised if the audit firm provides other, potentially more lucrative, consulting services to the company. The board and the public auditor should both see to it that, in fact as well as in appearance, the auditor reports to the independent board audit committee and acts on behalf of shareholders. The key reason why awarding

[23] Letter from James E. Burton, Chief Executive Officer, California Public Employees' Retirement System (CalPERS), to Chairman Paul S. Sarbanes, June 26, 2002.

> consulting contracts and other non-audit work to the audit firm is troubling is because it results in conflicting loyalties. While the board's audit committee is formally responsible for hiring and firing the outside auditor, management controls virtually all the other types of non-audit work the audit firm may do for the company. Those contracts with management blur the reporting relationship—it is difficult to believe that auditors do not feel pressure for the overall success of their firm with the client. Even their own compensation packages may be tied to consulting and non-audit services being provided by their firm to the company. * * *
>
> Congress has a clear mandate from the shareholders and the general public to act strongly and swiftly. By requiring public companies to use different accounting firms for their audit and consulting services and by establishing an independent board with real authority to oversee the accounting profession you will be taking important steps toward reversing the crisis of confidence in financial markets that exists today.[24]

In addition, respected former corporate leaders and former public officials endorsed this approach. For example, John Whitehead, former Co-Chairman of Goldman Sachs and former Co-Chairman of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, told the Committee:

> I have reached the conclusion that the accounting firm that does the audit should not do other advisory work for the company. Without that, the independence of the auditor's work will always be suspect. I reach that decision reluctantly but I don't see that it is possible to restore public confidence in the independence of the auditors without it.[25]

Walter Schuetze, a former SEC Chief Accountant (who is also a former Big 8 accounting firm partner and an original member of the FASB), stated, "I would support a complete separation and allow the audit firm to provide only audit services to the audit client. No other services whatsoever."[26] Former SEC Chairman Harold Williams also suggested that a complete ban on consulting services be considered for audit clients of accounting firms.[27]

The Committee considered adopting a complete prohibition on non-audit services by accounting firms for their audit clients, but instead decided on a somewhat more flexible approach. The approach adopted by the Committee is supported by former Comptroller General Bowsher, former SEC Chairman Arthur Levitt, and former Federal Reserve Board Chairman Paul Volcker.[28]

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[24] Letter from John H. Biggs, Chairman, President and CEO, Teachers' Insurance and Annuity Association—College Retirement Equities Fund (TIAA–CREF), to Chairman Paul S. Sarbanes, June 28, 2002.

[25] Testimony of John C. Whitehead, former Co-Chairman, Goldman Sachs & Co., and former Deputy Secretary of State, before the Committee on March 19, 2002.

[26] Testimony of Walter P. Schuetze, former SEC Chief Accountant (1992–95), before the Committee on February 26, 2002.

[27] Williams Testimony, February 12, 2002.

[28] Bowsher Testimony, March 19, 2002; Levitt Testimony, February 12, 2002; Volcker Testimony, February 14, 2002.

The bill provides that it shall be unlawful for a public accounting firm registered with the Board which performs an audit for a public company to provide, contemporaneously with the audit, the following non-audit services:

(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

(2) financial information systems design and implementation;

(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(4) actuarial services;

(5) internal audit outsourcing services;

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services unrelated to the audit; and

(9) any other services that the Board determines, by regulation, is impermissible.

The Board may, on a case-by-case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of non-audit services to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. A registered public accounting firm may engage in any non-audit service, including tax services, that is not on the list for an audit client only if the activity is approved in advance by the audit committee of the issuer. No limitations are placed on accounting firms in providing non-audit services to public companies which they do not audit or to any non-public companies.

The need for this provision was clearly stated by David M. Walker, Comptroller General of the United States, in a statement he released on June 18, in which he said:

> I believe that legislation that will provide a framework and guidance for the SEC to use in setting independence standards for public company audits is needed. History has shown that the AICPA [American Institute of Certified Public Accountants] and the SEC have failed to update their independence standards in a timely fashion and that past updates have not adequately protected the public's interests. In addition, the accounting profession has placed too much emphasis on growing non-audit fees and not enough emphasis on modernizing the auditing profession for the 21st century environment. Congress is the proper body to promulgate a framework for the SEC to use in connection with independence related regulatory and enforcement actions in order to help ensure confidence in financial reporting and safeguard investors and the public's interests.
>
> The independence provision [of the bill] * * * strikes a reasoned and reasonable balance that will enable auditors to perform a range of non-audit services for their audit clients and an unlimited range of non-audit services for their non-audit clients. Most importantly, the proposed legislation adopts a "principle based" and "substance over form" approach that can stand the test of time and, if adopted,

will better protect the public's interests. In my opinion, the time to act on independence legislation is now.[29]

Some argue that standards for auditor independence should be left to the SEC and the new Board. The approach adopted by the bill reflects the Committee's belief that the issue of auditor independence is so fundamental to the problems currently being experienced in our financial markets that statutory standards are needed to assure the independence of the auditor from the audit client.

The intention of this provision is to draw a clear line around a limited list of non-audit services that accounting firms may not provide to public company audit clients because their doing so creates a fundamental conflict of interest for the accounting firms. The list is based on simple principles. An accounting firm, in order to be independent of its audit client, should not audit its own work, which would be involved in providing bookkeeping services, financial information systems design, appraisal or valuation services, actuarial services, and internal audit outsourcing services to an audit client. The accounting firm should not function as part of management or as an employee of the audit client, which would be required if the accounting firm provides human resources services such as recruiting, hiring, and designing compensation packages for the officers, directors, and managers of an audit client. The accounting firm should not act as an advocate of the audit client, which would be involved in providing legal and expert services to an audit client in legal, administrative, or regulatory proceedings, or serving as a broker-dealer, investment adviser, or investment banker to an audit client, which places the auditor in the role of promoting a client's stock or other interests.

The accounting industry itself has announced voluntarily that it will not provide two of these non-audit services—internal audit services and financial information systems design and implementation—to public company audit clients because of the conflicts they present. The other prohibited non-audit services also pose clear conflicts of interest for accounting firms when provided for audit clients. For example, in its oversight hearing earlier this year on the failure of Superior Bank, FSB, in Hinsdale, Illinois, the Committee learned first-hand the risks associated with allowing accounting firms to audit their own work.[30] In that case, the accounting firm audited and certified a valuation of risky residual assets calculated according to a methodology it had provided as a consultant. The valuation was excessive and led to the failure of the institution.

The Board is given authority to make case-by-case exemptions in instances where the Board believes an exemption is in the public interest and consistent with the protection of investors. Further, no limitations are placed on accounting firms in providing non-audit services to public companies that they do not audit or to any private companies. The purpose is to assure the independence of the audit, not to put an end to the provision of non-audit services by accounting firms.

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[29] Statement of David Walker, Comptroller General of the United States, June 18, 2002.

[30] "Analysis of the Failure of Superior Bank, FSB, Hinsdale, Illinois," Hearing before the Senate Committee on Banking, Housing, and Urban Affairs, February 7, 2002.

In summary, the bill adopts a strong, balanced approach to assure that in return for the significant private benefits conferred on accounting firms by our securities laws, they maintain their independence from the companies they audit and fulfill their "public trust."

B. Audit committee pre-approval of audit and non-audit services

The legislation requires that audit services, as well as non-audit services other than those proscribed by the bill, must be pre-approved by the audit committee of the public company's board of directors. The Committee heard testimony on the role that the audit committee of a public company should play in connection with the engagement of an auditor to provide audit and non-audit services contemporaneously. Michael Sutton, former Chief Accountant of the SEC, said, "Whatever non-audit services might be permitted, I think they should be permitted only with the approval of the audit committee."[31] Former SEC Commissioner Bevis Longstreth told the Committee:

> I suggest a simple exclusionary rule covering virtually all non-audit services, in place of the deeply complex, existing rule that I hope, by now, to have convinced you is ineffective. This rule would redefine the category of services to be barred as including everything other than the work involved in performing an audit and other work that is integral to the function of the audit. Use of such an exception should require at least the following: (a) Before any such service is rendered, a finding by the client's audit committee that special circumstances make it obvious that the best interests of the company and its shareholders will be served by retaining its audit firm to render such service and that no other vendor of such service can serve those interests as well; (b) Forthwith upon the making of such a finding, submission of a written copy thereof to the SEC and the SRO having jurisdiction over the profession; and (c) In the company's next proxy statement for election of directors, disclosure of such finding by the audit committee and the amount paid and expected to be paid to the auditor for such service.[32]

After studying this issue, the Committee believes the protection of investors warrants a requirement that a public company's audit committee approve in advance the services that the auditor will provide to such company (if those services are not explicitly prohibited under the bill). Accordingly, the bill requires the audit committee of a public company to pre-approve all of the services, both audit and non-audit, provided to that company by a registered public accounting firm. The bill does not require an issuer's audit committee to pre-approve non-audit services provided by an accounting firm that is not auditing the issuer.

The bill does not require the audit committee to make a particular finding in order to pre-approve an activity. The members of the audit committee shall vote consistent with the standards they

[31] Sutton Testimony, February 26, 2002.
[32] Longstreth Testimony, March 6, 2002.

determine to be appropriate in light of their fiduciary responsibilities and such other considerations they deem to be relevant.

The audit committee must pre-approve a non-audit service before it commences. The audit committee may pre-approve at any time in advance of the activity. For example, an audit committee may grant pre-approval at its March meeting for a non-audit service that would begin in August. However, the Commission or the Board under its general authority may specify a maximum period of time in advance of which the approval may not be granted, such as, for example, requiring the pre-approval to be granted no earlier than one year prior to the commencement of the service.

The bill does not limit the number of non-audit services that the audit committee may pre-approve at one meeting or occasion. The Committee intends, however, that each non-audit service be specifically identified in order to be approved by the audit committee. The Committee does not intend for the statutory requirement to be satisfied by an audit committee voting, for example, to permit "any service that management determines appropriate for the auditor to perform" or "all non-audit services permissible under law."

The Committee has chosen to offer audit committees a delegation option in their administration of the pre-approval requirement. The bill permits the audit committee to delegate to one or more of its members (who are members of the board of directors) the authority to pre-approve non-audit services. After a delegated member has granted a pre-approval, he or she is required to report the decision at the next meeting of the full audit committee. This delegation of authority may be useful where, for example, the audit committee is asked to determine whether or not to permit the issuer's auditor to perform a new non-audit service within a short period of time.

The Committee has taken into account the atypical circumstance where an auditor is providing to the issuer a service that was anticipated to be an audit service within the scope of the engagement, but is later discovered to be a non-audit service. The bill provides that the pre-approval requirement is waived with respect to a non-audit service if: (1) the service was not recognized by the issuer at the time of the audit engagement to be a non-audit service, (2) the aggregate amount paid for all services described in (1) is not more than 5 percent of the total amount of revenues paid by the issuer to the auditor, and (3) the service is promptly brought to the attention of the audit committee, and (4) the audit committee approves the activity prior to the conclusion of the audit. This post-approval may be granted by the entire audit committee or by one or more audit committee members (who are members of the board of directors) to whom authority to grant such approvals has been delegated by the audit committee. This flexibility was suggested by Senator Enzi.

The bill requires that the audit committee approvals be disclosed to investors in periodic reports filed with the Commission.

The bill specifically notes that audit services "may entail providing comfort letters in connection with securities underwriting" in order to make clear that providing such a comfort letter is an audit service.

C. Audit partner rotation

The Committee heard testimony from numerous witnesses on whether, in order to maintain the objectivity of its audits, an issuer should be required to rotate its audit firm after a number of consecutive years. For example, former SEC Chairman Arthur Levitt proposed "that serious consideration be given to requiring companies to change their audit firm—not just the partners—every 5–7 years to ensure that fresh and skeptical eyes are always looking at the numbers."[33] Former SEC Chairman Harold Williams recommended a requirement that issuers "[h]ire auditors with a fixed term with no right to terminate for five or seven years."[34] John Whitehead, former Co-Chairman, Goldman Sachs & Co., recommended requiring "[t]erm limits of 8 to 10 years."[35] Lynn Turner, former SEC Chief Accountant, recommended requiring "mandatory rotation (5 to 7 years)."[36]

Other witnesses felt that accounting firm rotation could be disruptive to the issuer and that the costs of mandatory rotation might outweigh the benefits. Former SEC Chairman Rod Hills said that "[f]orcing a change of auditors can only lower the quality of audits and increase their costs."[37] Shaun O'Malley, Chairman, 2000 Public Oversight Board Panel on Audit Effectiveness, said that "forcing issuers to change auditors every few years * * * would undermine audit effectiveness."[38]

The Committee determined that the possibility of requiring audit firm rotation merits further study. The bill directs the U.S. General Accounting Office ("GAO") to analyze the merits and potential effects of requiring mandatory rotation of auditors, and to report its analysis to Congress within one year.

While the bill does not require issuers to rotate their accounting firms, the Committee recognizes the strong benefits that accrue for the issuer and its shareholders when a new accountant "with fresh and skeptical eyes" evaluates the issuer periodically. Accordingly, the bill requires a registered public accounting firm to rotate its lead partner and its review partner on audits so that neither role is performed by the same accountant for the same issuer for more than five consecutive years.[39]

D. Disclosures of accounting issues.

The Committee believes that it is important for the audit committee to be aware of key assumptions underlying a company's financial statements and of disagreements that the auditor has with management. The audit committee should be informed in a timely manner of such disagreements, so that it can independently review them and intervene if it chooses to do so in order to assure the integrity of the audit.

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[33] Levitt Testimony, on February 12, 2002.
[34] Williams Testimony, February 12, 2002.
[35] Whitehead Testimony, March 19, 2002.
[36] Testimony of Lynn Turner, former SEC Chief Accountant (1998–2001), before the Committee on February 26, 2002.
[37] Testimony of Roderick M. Hills, former SEC Chairman (1975–77), before the Committee on February 12, 2002.
[38] O'Malley Testimony, March 6, 2002.
[39] The "lead" partner is the partner who is in charge of the audit engagement. The "review" partner refers to the outside partner brought in to review the work done by the lead partner and the audit team.

Accordingly, the bill requires a registered independent public accounting firm performing an audit for a public company to report in a timely manner to that company's audit committee (1) the critical accounting policies and practices to be used; (2) all alternative treatments of financial information within GAAP (generally accepted accounting principles) that have been discussed with management; (3) any accounting disagreements between the auditor and management; and (4) other material written communications between the auditor and management.

E. Cooling off period

The Committee received extensive testimony on whether to impose a cooling off period between an accountant's employment by an auditor and his or her employment by an issuer. Several witnesses advocated this requirement, in order to enhance the integrity of an audit. Former Comptroller General Bowsher recommended to the Committee that "[e]ngagement and other partners who are associated with an audit should be prohibited from taking employment with the affected firm until a two-year 'cooling off' period has expired."[40] Lynn Turner, former SEC Chief Accountant, said, "Cooling off periods should last two years. Close the door between the audit firm, its partners and employees, and the company being audited."[41] Other witnesses also gave testimony that "the revolving door between audit firms and their audit clients" should be closed by enacting a cooling off period. James E. Copeland, Jr., Chief Executive Officer, Deloitte & Touche LLP, opposed a cooling off period because of concerns that it would "impose unwarranted costs on the public, the client and the profession."[42]

The Committee considered various options, including imposing a cooling off period of one, two, or three years, and applying a cooling off period to all employees who worked for the auditor, regardless of whether they worked on the audit of a particular issuer and regardless of the position they would take with that issuer, or applying a cooling off period only to certain groups of employees.

The Committee decided to impose a one-year cooling off period that would apply to an employee of the accounting firm who worked on the issuer's audit and subsequently seeks to be employed by that issuer in a senior management capacity. Thus, the bill provides that an accounting firm may not provide audit services for a public company if that company's chief executive officer, controller, chief financial officer, chief accounting officer, or other individual serving in an equivalent position, was employed by the accounting firm during the one year before the start of the audit services. The cooling off period does not take effect if the CEO or other senior official worked for the auditor but did not work on the issuer's audit or if a member of the audit team is hired by the issuer for a position other than CEO, CFO, controller, chief accounting officer, or an equivalent position. However, if an issuer hires an accountant from the audit team as its CEO, for example, it would be required to change auditors.

[40] Bowsher Testimony, March 19, 2002.
[41] Turner Testimony, February 26, 2002.
[42] Testimony of James E. Copeland, Jr., Chief Executive Officer, Deloitte & Touche LLP, before the Committee on March 14, 2002.

F. The bill does not create state regulatory standards

Titles I and II are designed to apply only to accounting firms that audit public companies. They are not designed to apply to audits of private companies. Nonetheless, some have raised the concern that the bill could lead state regulatory authorities to impose similar requirements for audits of private companies.

The bill indicates clearly that Congress does not intend that state regulatory authorities should find this Act controlling in their regulation of non-registered accountants. The bill states that it is the intention of the Act that, in supervising non-registered accounting firms, state regulatory authorities should make an independent determination of the proper standards, and should not presume the standards applied by the Board under this bill to be applicable to small- and medium-sized non-registered accounting firms. Senators Hagel and Enzi proposed this provision.

TITLE III—B CORPORATE RESPONSIBILITY

In further response to recent corporate failures, title III of the bill makes a number of changes to improve the responsibility of public companies for their financial disclosures. To that end, the bill incorporates a number of reform proposals made by the President on March 7, 2002. These reforms are supplemented with additional provisions that the Committee believes will improve investor protection in connection with the operation of public companies.

Recent events have highlighted the failure of companies' internal audit committees to properly police their auditors and have raised awareness of the need for strong, competent audit committees with real authority. Several witnesses suggested that the Committee make changes in the role of audit committees in order to enhance the audit process. In response, under the bill, the SEC must draft rules directing national securities exchanges and associations to require listed companies to comply with a number of enumerated provisions regarding audit committees. The Committee believes that the bill's approach to strengthening audit committees will help avoid future auditing breakdowns.

The bill also contains a number of provisions aimed at corporate management. Defects in procedures for monitoring financial results and controls have been blamed for recent corporate failures. The bill therefore requires CEOs and CFOs to certify their companies' financial reports, outlaws fraud and deception by managers in the auditing process, prevents CEOs and CFOs from benefitting from profits they receive as a result of misstatements of their company's financials, and facilitates the imposition of judicial bars against officers and directors who have violated the securities laws. Finally, title III includes a provision intended to prevent employees from being required to hold company stock in their retirement accounts while officers and directors are free to sell their shares.

A. Issuer audit committees

Oversight of Auditors. Witnesses at the Committee's hearings suggested that the auditing process may be compromised when auditors view their main responsibility as serving the company's management rather than its full board of directors or its audit committee. For this reason, the bill requires audit committees to be di-

rectly responsible for the appointment, compensation, and oversight of the work of auditors, and requires auditors to report directly to the audit committee.

Many witnesses testified as to the importance of these provisions. In particular, witnesses believed that the hiring and firing of the auditor should be the exclusive province of the audit committee. A number of witnesses emphasized that "audit committees [should] be solely responsible for the retention of accounting firms and be responsible for the fees paid to them."[43] Sarah Teslik, Executive Director of the Council of Institutional Investors, told the Committee that "perhaps [the] single first step [Congress] should take to increase auditor independence is to require a listing standard [of the national securities exchanges and associations] that the audit committee of the board hire and fire the auditors," the approach taken by the bill.[44] Additional witnesses who supported making the audit committee responsible for hiring and firing the auditors included: Robert E. Litan, Director of the Economic Studies Program of The Brookings Institution; Damon Silvers, Associate General Counsel of the AFL–CIO; and former U.S. Comptroller General Bowsher.[45]

Audit Committee Member Independence. Many recent failures have been attributed to close ties between audit committee members and management. In 1998–99, the NYSE and Nasdaq sponsored the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The Blue Ribbon Committee, chaired by Committee witnesses Ira Millstein and John Whitehead, made a number of recommendations to enhance audit procedures and effectiveness, including recommendations to increase the independence of audit committee members. Mr. Millstein and Mr. Whitehead, as well as Blue Ribbon Committee member John Biggs, testified at the hearings in support of adoption of the Blue Ribbon Committee's recommendations.[46] Consistent with their recommendations, the bill enhances audit committee independence by barring audit committee members from accepting consulting fees or being affiliated persons of the issuer or the issuer's subsidiaries other than in the member's capacity as a member of the board of directors or any board committee.

The audit committee independence provisions were supported by a number of witnesses in addition to Messrs. Millstein, Whitehead, and Biggs. Former SEC Chairman Arthur Levitt testified that "as a listing condition, stock exchanges should require at least a majority of company boards to meet a strict definition of independence," including barring audit committee members from accepting consulting fees from the company.[47] Former SEC Chairman Roderick M. Hills and Washington University School of Law Dean Seligman also recommended that Congress require that companies have inde-

[43] *See, e.g.*, Seligman Testimony, March 5, 2002.

[44] Testimony of Sarah Teslik, Executive Director, Council of Institutional Investors, before the Committee on March 20, 2002.

[45] Testimony of Robert E. Litan, Director, Economic Studies Program, The Brookings Institution, before the Committee on March 14, 2002; testimony of Damon Silvers, Associate General Counsel, AFL–CIO, before the Committee on March 20, 2002; Bowsher Testimony, March 19, 2002.

[46] Testimony of Ira Millstein, Senior Partner, Weil, Gotshal & Manges LLP, before the Committee on February 27, 2002; Whitehead Testimony, March 19, 2002; Biggs Testimony, February 27, 2002.

[47] Levitt Testimony, February 12, 2002.

pendent audit committees.[48] Former Senator Howard Metzenbaum, the Chairman of Consumer Federation of America, testified that lack of independence frequently leads audit committees to have a "fealty to the management that an audit committee shouldn't have."[49]

Additional Audit Committee Responsibilities. The bill contains several additional provisions regarding audit committees. The bill requires audit committees to have in place procedures to receive and address complaints regarding accounting, internal control, or auditing issues. Further, the bill includes an amendment by Senator Stabenow providing protection for corporate "whistleblowers" by specifying that audit committees must establish procedures for employees' anonymous submission of concerns regarding accounting or auditing matters.

The bill also requires public companies to provide their audit committees with authority and funding to engage independent counsel and other advisers as they determine necessary in order to carry out their duties. Comptroller General Walker agreed that audit committee members must be "adequately resourced," suggesting that audit committee members "may need their own staff."[50]

In light of recent events, the Committee believes that these audit committee provisions should be codified in the securities laws in order to help rectify auditing misconduct and to enhance the effectiveness of audit committee oversight of public company audits.

B. Corporate responsibility for financial reports

The Committee believes that management should be held responsible for the financial representations of their companies. The bill therefore clearly establishes that CEOs and CFOs are responsible for the presentation of material in their company's financial reports. Under one of the recommendations put forward by the President on March 7, "CEOs would personally attest each quarter that the financial statements and company disclosures accurately and fairly disclose the information of which the CEO is aware that a reasonable investor should have to make an informed investment decision." In effect the bill adopts this proposal, in an approach developed with Senator Miller, by requiring CEOs and CFOs to certify, in periodic reports containing financial statements filed with the Commission pursuant to section 13(a) or 15(d) of the Exchange Act, the appropriateness of financial statements and disclosures contained therein, and that those financials and disclosures fairly present the company's operations and financial condition.

These provisions reflect the Committee's concern regarding the reliability of companies' audited financial statements. In his testimony before the Committee, former SEC Chairman Breeden recognized that there is "growing doubt about whether audited financial statements are believable."[51] Council of Institutional Investors Executive Director Sarah Teslik echoed this concern in testifying that

[48] Hills Testimony, February 12, 2002; Seligman Testimony, March 5, 2002.

[49] Testimony of Howard M. Metzenbaum, Chairman, Consumer Federation of America, and former U.S. Senator, before the Committee on March 20, 2002.

[50] Testimony of David Walker, Comptroller General of the United States, before the Committee on March 5, 2002.

[51] Breeden Testimony, on February 12, 2002.

"CEOs, audit committee members and outside auditors" should be required to "sign the financials as true and accurate."[52]

C. Prohibited influence

Numerous witnesses testifying before the Committee, including Shaun O'Malley, Chair of the 2000 Public Oversight Board Panel on Audit Effectiveness, and Sarah Teslik, Council of Institutional Investors Executive Director, were concerned with addressing fraud and misconduct in the audit process.[53] In response, title III of the bill makes it unlawful for any officer or director of an issuer, or person acting under the direction thereof, to fraudulently influence, coerce, manipulate, or mislead any accountant engaged in preparing an audit of that issuer, for the purpose of rendering the audit report misleading. The Commission is provided with exclusive authority to enforce this section. The bill establishes a 90-day deadline for proposed rules or regulations by the Commission under this section, and a 270-day deadline for final rules or regulations.

D. Forfeiture of bonuses and profits

Recent events have raised concern about management benefitting from unsound financial statements, many of which ultimately result in corporate restatements. The President has recommended that "CEOs or other officers should not be allowed to profit from erroneous financial statements," and that "CEO bonuses and other incentive-based forms of compensation [sh]ould be disgorged in cases of accounting restatement and misconduct."

Title III includes provisions designed to prevent CEOs or CFOs from making large profits by selling company stock, or receiving company bonuses, while management is misleading the public and regulators about the poor health of the company. The bill requires that in the case of accounting restatements that result from material non-compliance with SEC financial reporting requirements, CEOs and CFOs must disgorge bonuses and other incentive-based compensation and profits on stock sales, if the non-compliance results from misconduct. The required disgorgement applies to amounts received for the 12 months after the first public issuance or filing of a financial document embodying such financial reporting requirement. Under this section, the SEC may exempt any person from this requirement as it deems necessary and appropriate.

E. Officer and director bars and penalties

Title III also includes several measures affecting officers and directors who have violated the securities laws. The staff of the Commission indicated to the Committee staff that when enforcement proceedings are brought under the securities laws, courts in some cases have been reluctant to impose prospective bars against violators serving as officers or directors of companies. The bill would facilitate not only the SEC's prevention of individuals who have violated the securities laws from serving as officers and directors, but also the imposition of penalties on violators of securities laws.

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[52] Teslik Testimony, March 20, 2002.
[53] O'Malley Testimony, March 6, 2002; Teslik Testimony, March 20, 2002.

Currently, it must be proved that an officer or director has both violated the securities laws, and has shown "substantial unfitness" to serve before a bar can be imposed. The Commission has argued that the "substantial unfitness" standard for imposing bars is inordinately high, causing courts to refrain from imposing bars even in cases of egregious misconduct. The proposed bill rectifies this deficiency by modifying the standard governing imposition of officer and director bars from "substantial unfitness" to "unfitness."

These provisions also reflect the President's recommendation that "CEOs or other officers who clearly abuse their power should lose their right to serve in any corporate leadership positions."

The Commission has also suggested that it should be allowed to obtain additional relief in enforcement cases. For a securities law violation, currently an individual may be ordered to disgorge funds that he or she received "as a result of the violation." Rather than limiting disgorgement to these gains, the bill will permit courts to impose any equitable relief necessary or appropriate to protect, and mitigate harm to, investors.

F. Prohibition on insider trades during pension fund blackout periods

As former SEC Chairman Breeden observed, "The spectacle of corporate insiders plundering their own companies or selling their stock quietly in advance of a looming collapse has awakened a sense of revulsion among investors who were left with worthless stock."[54] In some cases, officers and directors have profited by selling off large portions of company stock during a time when employees were prevented from selling company stock in their section 401(k) retirement plans. To address this problem, the bill prohibits key individuals from engaging in transactions involving any equity security of the issuer during a "blackout" period when at least half of the issuer's individual account plan participants are not permitted to purchase, sell, or otherwise transfer their interest in that equity security. Upon Senator Miller's recommendation, this section applies to directors and executive officers in order to ensure that the prohibition is limited to individuals in policy-making positions.

The bill provides added protection for participants in retirement plans by requiring that they be provided with written notice at least 30 days before a blackout period. Two exceptions to the 30-day notice are provided in response to Senator Enzi's recommendations. First, an exception is allowed in cases where a deferral of the blackout period to comply with the 30-day notice requirement would violate ERISA provisions that require fiduciaries to act exclusively on behalf of participants, and those that require trustees to act prudently, in their decisions regarding plan assets. Second, an exception may be provided where the inability to provide the notice is due to unforeseeable events or circumstances beyond the reasonable control of the plan administrator.

The Committee is concerned that without the provisions of title III, our financial markets will witness numerous corporate restatements in the future. The Committee believes that title III incor-

[54] Breeden Testimony, on February 12, 2002.

porates needed reforms that will enhance corporate responsibility among public companies.

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

The Committee heard testimony about the imperative necessity for investors to have accurate and full financial information available on a timely basis in order to make appropriate investment decisions. The Committee has identified certain key disclosures that require legislative action.

A. Accounting adjustments

The bill requires that financial statements filed with the Commission reflect the material adjustments under GAAP that have been identified by the auditor.

B. Off-balance sheet transactions

Former SEC Chairman Richard Breeden testified, after the problems of Enron Corp. and its special purpose entities, on the need for "enhance[d] disclosure of 'off-balance sheet' transactions and debt."[55] To address this need, the bill requires annual and quarterly reports filed with the SEC to disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.

C. Pro-forma financial disclosures

Thomas A. Bowman, President and CEO of the Association for Investment Management and Research (AIMR), testified before the Committee on his concerns about the use of pro forma disclosures:

> Another creative way in which managements mislead investors and manipulate investor expectations is by communication of "pro forma earnings," company-specific variations of earnings, or "earnings before the bad stuff." With all its deficiencies, we believe that earnings data based on Generally Accepted Accounting Principles (GAAP) are still the most useful starting point for analysis of a company's performance. Analysts and other investors at least know how GAAP earnings are computed and, hence, there is some comparability across companies. We believe that GAAP earnings should always be displayed more prominently than non-GAAP earnings data.
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> Unfortunately, just the opposite seems to be the norm, particularly in press releases where pro forma earnings get the most emphasis and GAAP earnings may not be mentioned at all. GAAP earnings and associated balance sheet may only become available to investors in SEC filings one to two weeks after pro forma earnings are announced.
>
> While pro forma earnings can be helpful supplemental information for analysts, the practice of providing pro forma earnings is widely abused. Companies selectively ex-

[55] Breeden Testimony, February 12, 2002.

> clude all sorts of financial reporting items, including depreciation, amortization, payroll taxes on exercises of options, investment gains and losses, stock compensation expenses, acquisition-related and restructuring costs. John Bogle, the respected investment professional, recently noted in a speech to the New York Society of Securities Analysts, "In 2001, 1,500 companies reported pro forma earnings, what their earnings would have been if bad things hadn't happened." We recommend that either the FASB or SEC curtail this practice or ensure that pro forma earnings data never have more prominence than GAAP earnings in company communications.[56]

Former Federal Reserve Board Chairman Paul Volcker also testified about concerns with pro forma earnings: "Those problems, building over a period of years, have now exploded in a sense of crisis, a crisis as exemplified by the Enron collapse. But Enron is not the only symptom. We've had * * * too many doubts about pro forma earnings."[57] Dean Joel Seligman testified that, after taking into account current regulatory efforts on disclosure of pro forma figures, "[m]ore needs to be done."[58]

The Committee seeks to address problems attendant to pro forma financial disclosures by requiring the SEC to promulgate rules requiring that issuers publish pro forma data with a reconciliation to comparable financial data calculated according to GAAP and in a way that is not misleading and does not contain untrue statements. The reconciliation presumes, and would require, the issuer to publish financial data calculated according to GAAP at the same time as it publishes pro forma data. This should enable investors to, at the least, simultaneously compare the pro forma financial data with the same types of financial disclosures (e.g., earnings) calculated according to GAAP for the comparable reporting period.

The Committee recognizes from the recent experience of Enron Corp. and other public companies the need for additional types of disclosures. The Committee supports public and private efforts that result in greater quality, clarity, and completeness in the disclosures made by public companies.

D. Enhanced disclosures of loans

Enron Corp. and other corporations have made loans to directors and executive officers totaling many millions of dollars.[59] Many of

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[56] Testimony of Thomas A. Bowman, President and Chief Executive Officer, Association for Investment Management and Research, before the Committee on March 20, 2002.

[57] Volcker Testimony, February 14, 2002.

[58] Seligman Testimony, March 5, 2002.

[59] For example:

Two of Enron's top officials who were also board members—Kenneth Lay and Jeffery Skilling—received personal loans from Enron. Mr. Lay received more than $70 million in cash during one 12-month period and repaid the loan with his own Enron stock. Wall Street Journal (May 3, 2002).

WorldCom's board extended its former chief executive, Bernard Ebbers, a personal loan of $366.5 million. Richard Waters, Pressure Forces Ebbers to Leave WorldCom, Financial Times (May 1, 2002).

Adelphia Communications made $3.1 billion in off-balance sheet loans to its founder, John Rigas, reportedly without the knowledge of its shareholders or board. Richard Waters, Rigas Agrees to Give Up Adelphia, Financial Times (May 24, 2002).

In April, Qwest revealed in its proxy statement that it lent $4 million to President and COO Afshin Mohebbi. It was reported that a portion of the loan will be used to pay the premium

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these insider loans are disclosed to investors in the annual proxy materials months after they occur.

In his testimony, former SEC Chairman Richard Breeden recommended that "immediate 8–K disclosure" of insider loans be required.[60]

The Committee is aware that investors are concerned about loans to insiders and want to know this information promptly after the loans are made in order to better inform their investment decisions. The bill requires an issuer in its current reports to disclose within seven days, or such other time period determined to be appropriate by the SEC, all loans, except credit card loans, made by the issuer and its affiliates to any director or executive officer, specifying amounts paid and balances owed on such obligations and any conflicts of interest, as defined by the SEC. The Committee created an exemption from reporting for credit card loans made by the issuer to a director or executive officer in the ordinary course of the issuer's consumer credit business, of a type generally made available by the issuer to the public on market terms. The bill gives the SEC the flexibility to shorten the period to less than seven days or extend it to more than seven days if it deems appropriate.

These provisions will result in information about insider loans and other conflicts of interest being disclosed in a timely manner so investors can consider such data in making their investment decisions.

E. Disclosures of transactions involving management

The Committee received testimony that insiders should be required to report their transactions in the stock of their companies more promptly. Ira Millstein, Senior Partner, Weil, Gotshal & Manges LLP and Co-Chair of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, testified that, "SEC rules should be amended to mandate prompt disclosure of transactions between the corporation (or its affiliates) and members of senior management, directors or controlling shareholders."[61] Former Comptroller General Bowsher echoed this objective when he testified: "To discourage conflicts of interest involving public corporations, Congress should amend the Securities Exchange Act of 1934 to require more meaningful and timely disclosure of related party transactions among officers, directors, or other affiliated persons and the public corporation."[62]

At present, Section 16(a) of the Exchange Act requires insiders to report trades by the tenth day of the month following the month in which the transaction was executed. The Committee recognizes

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on his life insurance policy. Jim Seymour, Nacchio Dip: Qwest CEO Delays His Pay Raise, TheStreet.com (April 9, 2002).

Global Crossing Ltd. eliminated or substantially reduced the terms of $18 million worth of personal loans the company made to two of its top executives in the months before the telecommunications company filed for bankruptcy protection, regulatory filings show. Elizabeth Douglass, Global Eased Loan Terms Compensation: The firm forgave or reduced advances to executives in the months before its Chapter 11 filing, L.A. Times (February 7, 2002).

AES Corp., a power producer, granted $1.5 million personal loans to both its chief financial officer and an executive vice president in October to prevent them from being forced to immediately sell company shares due to margin calls. AES Makes Loans To Two Executives To Cover Margin Calls, Wall Street Journal (March 26, 2002).

[60] Breeden Testimony, February 12, 2002.

[61] Millstein Testimony, February 27, 2002.

[62] Bowsher Testimony, March 19, 2002.

that some investors find trades by insiders to be probative of whether investing in a company is desirable and feel that, in today's markets, the current deadline imposed by Section 16(a) allows too long a delay in reporting.

The bill would amend Section 16(a) to require directors, officers and 10 percent equity holders to report their purchases and sales of securities more promptly, that is, by the end of the second day following the transaction or such other time established by the SEC where the two-day period is not feasible. The purpose is to make available to investors information about insider transactions more promptly so they can make better informed investment decisions.

F. Management assessment of internal controls

The Committee heard testimony from former Comptroller General Bowsher, who recommended:

> Management of public companies should be required to prepare an annual statement of compliance with internal controls to be filed with the SEC. The corporation's chief financial officer and chief executive officer should sign this attestation and the auditor should review it. An auditor's review and report on the effectiveness of internal controls would—as the General Accounting Office (GAO) found in a 1996 report—improve "the auditor's ability to provide more relevant and timely assurances on the quality of data beyond that contained in traditional financial statements and disclosures." Both the POB and the AICPA supported the recommendation when the GAO made it, but the SEC did not adopt it.[63]

In order to enhance the quality of reporting and increase investor confidence, the bill requires that annual reports filed with the SEC must be accompanied by a statement by the management of the issuer that management is responsible for creating and maintaining adequate internal controls. Management must also present its assessment of the effectiveness of those controls. A similar requirement was enacted in 1991 and has been imposed on depository institutions through Section 36 of the Federal Deposit Insurance Act.

In addition, the company's auditor must report on and attest to management's assessment of the company's internal controls. In requiring the registered public accounting firm preparing the audit report to attest to and report on management's assessment of internal controls, the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges or fees. High quality audits typically incorporate extensive internal control testing. The Committee intends that the auditor's assessment of the issuer's system of internal controls should be considered to be a core responsibility of the auditor and an integral part of the audit report.

G. Exemptions for investment companies

The bill exempts investment companies from certain disclosure requirements. The Committee feels that the objectives of those disclosure sections are adequately addressed by existing Federal secu-

[63] Bowsher Testimony, March 19, 2002.

rities laws and the rules thereunder affecting investment companies.

For example, Section 17(a) of the Investment Company Act of 1940 and Rule 17j–1 thereunder prohibit affiliated persons of an investment company from borrowing money or other property from, or selling or buying securities or other property to or from the investment company, or any company that the investment company controls. Investment company officials therefore would not have any insider loans to report, as would be required under the bill.

H. Code of ethics for senior financial officers

The problems surrounding Enron Corp. and other public companies raise concerns about the ethical standards of corporations and their senior financial managers. The Committee believes that investors have a legitimate interest in knowing whether a public company holds its financial officers to certain ethical standards in their financial dealings. The bill requires issuers to disclose whether or not they have adopted a code of ethics for senior financial officers and, if not, why not. This section was recommended by Senator Corzine.

I. Disclosure of audit committee financial expert

As discussed above, the Committee received testimony about the important role played by the audit committee in corporate governance. The Committee believes the effectiveness of the audit committee depends in part on its members' knowledge of and experience in auditing and financial matters. Investors may find it relevant in making their investment decisions whether an issuer's audit committee has at least one member who has relevant, sophisticated financial expertise with which to discharge his or her duties.

The bill requires the SEC to adopt rules requiring issuers to disclose whether their audit committees include among their members at least one "financial expert." In defining "financial expert," the SEC shall consider whether a person understands GAAP and financial statements, has experience preparing or auditing financial statements, has experience with internal accounting controls, and understands audit committee functions.

TITLE V—ANALYST CONFLICTS OF INTEREST

The Committee heard persuasive testimony that a serious problem exists regarding conflicts of interest between Wall Street stock analysts and their employing brokerage firms, on the one hand, and the public companies that the stock analysts cover, on the other hand. Growing knowledge of these conflicts is harming the integrity and credibility to the public of stock analyst recommendations.

The Committee heard testimony from Thomas A. Bowman, President and CEO of the Association for Investment Management and Research, who said, "Clearly, the erosion of investor confidence in the independence and objectivity of 'Wall Street' research reports and recommendations * * * could seriously harm the reputation of the entire investment profession."[64] He added, "Only if the invest-

[64] Bowman Testimony, March 20, 2002.

ing public believes that the information available to them is fair, accurate, and transparent can they have confidence in the integrity of the financial markets and the investment professionals who serve them."[65] He explained how "some Wall Street firms may pressure their analysts to issue favorable research on current or prospective investment-banking clients" and that investors who receive recommendations "may not be aware of the pressures on Wall Street analysts."[66] Former SEC Chairman Richard Breeden suggested as a goal that Congress "[i]mprove independence of stock analyst recommendations," explaining that "[a]nalyst recommendations should be driven by analysis and fundamentals, not the pursuit of investment banking business for their firms."[67]

The Attorney General of the State of New York, Eliot Spitzer, in a letter to Chairman Sarbanes, stated, "Problems in this area have existed for several years and recently appear to have grown worse."[68] In his office's extensive investigation of analyst recommendations, he said he has found that "research reports and stock ratings of companies that were potential banking clients of [a major broker-dealer] were often distorted to assist the firm in obtaining and retaining investment banking business. One management document we obtained actually acknowledged the conflict and its results, stating: 'We are off base on how we rate stocks and how much we bend over backwards to accommodate banking, etc.' We believe that the lack of research independence from investment banking likely extends to other firms as well."[69]

The Committee feels that it is critical to restore investor confidence in this area. The bill is intended to prevent certain pressures on analysts which could compromise their objectivity and to provide disclosure to investors of certain conflicts of interest that can also influence the objectivity of the analyst in preparing a research report.

The Committee received testimony specifically demonstrating that conflicts of interest distort securities analysts' recommendations. Professor John Coffee of Columbia Law School told the Committee of a number of studies that sought to assess the impact of conflicts of interest on the objectivity of securities analysts' recommendations:

> Several studies find that 'independent' analysts (i.e., analysts not associated with the underwriter for a particular issuer) behave differently than analysts who are so associated with the issuer's underwriter. For example, Roni Michaely and Kent Womack find that the long-run performance of firms recommended by analysts who are associated with an underwriter was significantly worse than the performance of firms recommended by independent securities analysts.* * *
>
> Still another study by CFO Magazine reports that analysts who work for full-service investment banking firms have 6% higher earnings forecasts and close to 25% more

[65] Bowman Testimony, March 20, 2002.
[66] Bowman Testimony, March 20, 2002.
[67] Breeden Testimony, February 12, 2002.
[68] Letter from Eliot Spitzer, Attorney General of the State of New York, to Chairman Paul S. Sarbanes, June 5, 2002.
[69] Spitzer Letter, June 5, 2002.

> buy recommendations than do analysts at firms without such ties. Similarly, using a sample of 2,400 seasoned equity offerings between 1989 and 1994, Lin and McNichols find that lead and co-underwriter analysts' growth forecasts and particularly their recommendations are significantly more favorable than those made by unaffiliated analysts.[70]

The Committee also heard testimony on a variety of specific analyst conflicts and the manner in which they might be addressed. These conflicts included the firm's manner of compensating the analyst, revenues to the firm from the subject company, pressure and coercion from the investment banking staff and others on the analyst, retaliation against the analyst, and the analyst's or the analyst's firm's ability to profit from stock ownership and trading.

Chinese Walls. Dean Joel Seligman recommended addressing "whether investment banks have adequately maintained 'Chinese walls' between retail brokerage and underwriting and whether, more fundamentally, securities firms that underwrite should be separated from retail brokerage."[71] The bill creates new Section 15A(n)(1)(C) of the Securities Exchange Act of 1934, which mandates rules "to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision."

Blackout Periods. Professor Coffee cited abuses involving the so-called "Booster Shot" and recommended that research reports not be issued during certain periods. He testified:

> Firms contemplating an IPO increasingly seek to hire as lead underwriter the firm that employs the star analyst in their field. The issuer's motivation is fueled in large part by the fact that the issuer's management almost invariably is restricted from selling its own stock (by contractual agreement with the underwriters) until the expiration of a lock-up period that typically extends six months from the date of the offering. The purpose of the lock-up agreement is to assure investors that management and the controlling shareholders are not "bailing out" of the firm by means of the IPO. But as a result, the critical date (and market price) for the firm's insiders is not the date of the IPO (or the market value at the conclusion of the IPO), but rather the expiration date of the lock-up agreement six months later (and the market value of the stock on that date). From the perspective of the issuer's management, the role of the analyst is to "maintain a buzz" about the stock and create a price momentum that peaks just before the lock-up's expiration. To do this, the analyst may issue a favorable research report just before the lock-up's expiration (a so-called "booster shot" in the vernacular). To the extent that favorable ratings issued at this point seem particu-

[70] Testimony of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, before the Committee on March 5, 2002 (internal citations omitted).
[71] Seligman Testimony, March 5, 2002.

> larly conflicted and suspect, an NASD rule might forbid analysts associated with underwriters from issuing research reports for a reasonable period (say, thirty days) both before and after the lock-up expiration date. Proposed Rule 2711 [of the NASD] stops well short of this and only extends the "quiet period" so that it now would preclude research reports for this first 40 days after an IPO. Such a limited rule in no way interferes with the dubious tactic of "booster shots."[72]

The bill directs that rules be adopted "to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities." The "booster shot" is a type of situation that the SEC and the self-regulatory organizations should consider in framing such rules.

Services Provided. Mr. Bowman recommended disclosure of "the nature of the relationship or services provided" by an analyst's firm to the subject company.[73] The bill requires disclosure of the types of services provided.

Supervision by Investment Bankers and Disclosure of Investment Banking Relationships. Michael Mayo, Managing Director of Prudential Securities, recommended that Congress "[t]ake actions to minimize the interference of investment bankers with the job of research analysts" and "[d]isclose investment banking relationships to investors."[74] The bill prohibits the pre-publication clearance of research or recommendations by investment banking or other staff not directly responsible for investment research and requires disclosure of whether the issuer is or has recently been a client of the analyst's firm, and if so, the services provided.

Lynn Turner, former SEC Chief Accountant, testified: "As long as the investment-banking arm of Wall Street has influence over the work of the research analysts or their compensation, analysts will not be able to provide independent research."[75] The bill requires the creation of rules that limit the supervision and compensatory evaluation of research personnel to officials who are not engaged in investment banking activities.

Compensation from the Subject Firm to the Broker and Deal-Based Analyst Pay. Mr. Mayo raised the concern, "Does the retail investor know that the brokerage firm pitching shares is also earning investment banking fees from the company?" and also recommended that the Congress "eliminate deal-based incentive pay" for research analysts.[76] The bill requires disclosure of whether any compensation has been received by the broker-dealer from the issuer, subject to such exemptions as the Commission may determine necessary and appropriate to prevent disclosure of material non-public information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors. The

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[72] Coffee Testimony, March 5, 2002 (internal citations omitted).
[73] Bowman Testimony, March 20, 2002.
[74] Testimony of Michael Mayo, Managing Director, Prudential Securities, Inc., before the Committee on March 19, 2002.
[75] Turner Testimony, February 26, 2002.
[76] Mayo Testimony, March 19, 2002.

bill, while not eliminating deal-based pay, requires disclosure of whether the analyst received compensation based on an affiliate's investment banking revenues from the subject of any research report.

Retaliation. The Committee heard testimony about the serious problem of retaliation against analysts who wrote negative research reports. Professor Coffee testified, "In self-reporting studies, securities analysts report that they are frequently pressured to make positive buy recommendations or at least to temper negative opinions."[77] He added, "According to one survey, 61% of all analysts have experienced retaliation—threats of dismissal, salary reduction, etc.—as the result of negative research reports. Clearly, negative research reports (and ratings reductions) are hazardous to an analyst's career. Congress could either adopt, or instruct the NASD to adopt, an anti-retaliation rule: no analyst should be fired, demoted, or economically penalized for issuing a negative report, downgrading a rating, or reducing an earnings, price, or similar target."[78]

Eliot Spitzer, Attorney General of the State of New York, concluded that the analyst conflict regulations put forth by the self-regulatory organizations "fall short of what should be legislated in this area [because], [f]or example, the regulations fail to address the problem of intimidation or retaliation against analysts who publish unfavorable research about a company."[79]

The bill requires rules to be promulgated to protect securities analysts from retaliation or intimidation because of negative, or otherwise unfavorable, research reports, subject to the proviso that such rules may not limit a broker-dealer from disciplining a securities analyst in accordance with firm policies and procedures for causes other than writing such a research report.

Professor Coffee recommended that a no-retaliation rule should:

> not bar staff reductions or reduced bonuses based on economic downturns or individualized performance assessments. Thus, given the obvious possibility that the firm could reduce an analyst's compensation in retaliation for a negative report, but describe its action as based on an adverse performance review of the individual, how can this rule be made enforceable? The best answer may be NASD arbitration. That is, an employee who felt that he or she had been wrongfully terminated or that his or her salary had been reduced in retaliation for a negative research report could use the already existing system of NASD employee arbitration to attempt to reverse the decision. Congress could also establish the burden of proof in such litigation and place it on the firm, rather than the employee/analyst. Further, Congress could entitle the employee to some form of treble damages or other punitive award to make this form of litigation viable. Finally, Congress could mandate an NASD penalty if retaliation were found, either by an NASD arbitration panel or in an NASD disciplinary proceeding.[80]

[77] Coffee Testimony, March 5, 2002.
[78] Coffee Testimony, March 5, 2002 (internal citations omitted).
[79] Spitzer Letter, June 5, 2002.
[80] Coffee Testimony, March 5, 2002.

The exception is intended to make certain that writing a negative research report does not protect an analyst who is, for example, incompetent or otherwise deficient. However, it is not intended to be used to permit a broker-dealer to discipline a good analyst for writing a negative report using a false pretext. In adopting a proposed rule, the SEC or a self-regulatory organization should consider Professor Coffee's recommendations.

Additional Analyst Issues. The Committee heard testimony about various additional concerns and recommendations to prevent analyst conflicts of interest and otherwise enhance investor protection, some of which are discussed below.

Professor Coffee recommended "A No-Selling Rule." He testified:

> If we wish the analyst to be a more neutral and objective umpire, one logical step might be to preclude the analyst from direct involvement in selling activities. For example, it is today standard for the "star" analyst to participate in "road shows" managed by the lead underwriters, presenting its highly favorable evaluation of the issuer and even meeting on a one-to-one basis with important institutional investors. Such sales activity seems inconsistent with the much-cited "Chinese Wall" between investment banking and investment research * * *.
>
> Although a "no-selling" rule would do much to restore the objectivity of the analyst's role, one counter-consideration is that the audience at the road show is today limited to institutions and high net worth individuals. Hence, there is less danger that the analyst will overreach unsophisticated retail investors. For all these reasons, this is an area where a more nuanced rule could be drafted by the NASD at the direction of Congress that would be preferable to a legislative command.[81]

Dean Joel Seligman also recommended considering "a new form of adviser liability for recommendations without a reasonable basis."[82]

Mr. Bowman recommended disclosure of "[i]nvestment holdings of Wall Street analysts, their immediate families, the Wall Street firm's management and the firms themselves" as well as disclosure of "[m]aterial gifts received by the analyst from either the subject company or the Wall Street firm's investment-banking or corporate finance department."[83]

Mr. Bowman explained the need for greater explanatory information about analysts' rating systems. He said that "rating systems need to be overhauled so that investors can better understand how ratings are determined and compare ratings across firms. Ratings must be concise, clear, and easily understood by the average investor" and he recommended disclosures of "where and how to obtain information about the firm's rating system."[84] He also said that "Wall Street analysts and their firms should also be required to update or re-confirm their recommendations on a timely and regular basis, and more frequently in periods of high market volatility.

[81] Coffee Testimony, March 5, 2002.
[82] Seligman Testimony, March 5, 2002.
[83] Bowman Testimony, March 20, 2002.
[84] Bowman Testimony, March 20, 2002.

They should be required to issue a "final" report when coverage is being discontinued and provide a reason for discontinuance. Quietly and unobtrusively discontinuing coverage or moving to a "not rated" category, i.e., a "closet" sell, does not serve investors' interests."[85]

The Committee also heard testimony about the intimidation of analysts by issuers. Mr. Bowman testified that:

> strong pressure to prepare "positive" reports and make "buy" recommendations comes directly from corporate issuers, who retaliate in both subtle, and not so subtle, ways against analysts they perceive as "negative" or not "understanding" their company. Issuers complain to Wall Street firms" management about "negative" or uncooperative analysts. They bring lawsuits against firms and analysts personally for negative coverage. But more insidiously, they "blackball" analysts by not taking their questions on conference calls or not returning their individual calls to investor relations or other company management. This puts the "negative" analyst at a distinct competitive disadvantage, increases the amount of uncertainty an analyst must deal with in doing valuation and making a recommendation, and disadvantages the firm's clients, who pay for that research. Such actions create a climate of fear and intimidation that fosters neither independence nor objectivity. Analysts walk a tightrope when dealing with company managements. A false step may cost them an important source of information and ultimately their jobs.[86]

Mr. Mayo, a victim of issuer retaliation, gave testimony from first-hand experience of the problem. He said, "It is still hard for an analyst to be objective and critical. When an analyst says "Sell," there can be backlash from investors who own the stock, from the company being scrutinized, and even from individuals inside the analyst's firm. While much attention in Washington is being paid to the pressures related to a firm's investment banking operations, other pressures can be as great or more. The main point: Some companies may intimidate analysts into being bullish. Those who stand up may face less access to company information and perhaps backlashes, too."[87]

While the bill does not specifically identify remedies to these situations, it authorizes the Commission, or a registered securities association or exchange at the Commission's direction, to create rules to address such other issues as it determines appropriate and to require such other disclosures of conflicts of interest that are material to investors, research analysts, or the broker or dealer as it deems appropriate. The Commission, and the association and exchanges, should consider the issues noted above as they adopt other rules necessary and appropriate to protect investors in the area of analyst recommendations. The prohibition of specific activities identified in title V is not an exhaustive solution to the analyst conflicts problem, and the Committee expects the Commission and

[85] Bowman Testimony, March 20, 2002.
[86] Bowman Testimony, March 20, 2002.
[87] Mayo Testimony, March 19, 2002.

the self-regulatory organizations to use their authority to apply such additional rules as they deem appropriate.

The bill requires that rules be adopted within one year. Existing rules that satisfy the requirements of the bill do not have to be reproposed or readopted. Existing rules that do not contradict the bill or that impose requirements that are not imposed by the bill do not have to be withdrawn or reproposed. For example, self-regulatory organization rules that require disclosure of statistics regarding analyst ratings or of the securities holdings of an analyst's family members in a subject company are not adversely affected by this bill.

It should be noted that title V of the bill creates a new Section 15A(n)(B), (C) and (D) of the Exchange Act, which requires disclosure of simply "affirmative" or "negative" in response to "whether" an event has occurred. Further, Section 15A(n)(C) requires a description of the types of services provided, rather than a list of all specific services. This requirement is to enable the investor to assess whether the relationship is likely to influence the objectivity of the subjective portions of the research report.

The new Section 15A(n)(B) of the Exchange Act created by the bill authorizes the Commission to grant exemptions to prevent disclosure of material non-public information about specific future investment banking revenues. In determining whether to grant an exemption, the Commission should take into account the importance that Congress places on providing investors with this information for making investment decisions and the likelihood that stating an affirmative response would divulge material non-public information that would be understood by investors, particularly in light of the size and complexity of the brokerage firm. For example, a complex brokerage firm which has received money from an issuer may be far less likely to disclose material nonpublic information simply by responding "yes," and therefore not merit an exception, than a small firm that only is engaged to find buyers for an issuer and has received compensation.

The Committee heard testimony from authorities which stated that the rules set forth by self-regulatory organizations are inadequate to address the analyst conflicts of interest issue. Former SEC Chairman Arthur Levitt testified, "we must better expose Wall Street analysts' conflicts of interest * * * the New York Stock Exchange and the National Association of Securities Dealers [rulemaking] * * * is not enough."[88] Also, Attorney General Spitzer stated "the proposed regulations by the National Association of Securities Dealers and the New York Stock Exchange fall short of what should be legislated in this area."[89] The Committee feels that while the NYSE and NASD rules will improve the quality of analysts' stock recommendations, title V is needed to address analyst conflicts and to strengthen investor protection.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

The Committee determined that it is necessary to increase the resources available to the SEC and to increase the authority of the

[88] Levitt Testimony, on February 12, 2002.
[89] Spitzer Letter, June 5, 2002.

SEC to enable it more effectively to accomplish its mission of assuring the integrity of the markets and protecting investors.

SEC Authorization. Witnesses before the Committee testified consistently and strongly that the SEC needs additional resources in order to effectively carry out its mission and protect investors. John Whitehead, former Co-Chairman, Goldman Sachs & Co., testified: "I think the SEC is under-funded and has been for some years. When you consider the seriousness [to] the system of just one Enron, it's dangerous to fool around with relatively small increases in budgets that the SEC asks for."[90] David Walker, U.S. Comptroller General, testified, "[T]he SEC's ability to fulfill its mission has become increasingly strained due in part to imbalances between the SEC's workload (such as filings, complaints, inquiries, investigations, examinations and inspections) and staff resources * * *. Over the last decade, securities markets have experienced unprecedented growth and change * * *. At the same time, the SEC has been faced with an ever-increasing workload and ongoing human capital challenges, most notably high staff turnover and numerous vacancies."[91]

Former SEC Chairmen Roderick Hills, Harold Williams, Richard Breeden, and Arthur Levitt all supported increasing the SEC's resources.[92] Chairman Breeden recommended that Congress "[s]trengthen the SEC's resources through expanded budget authority (offset by increased user fees), immediate and continuing funding of pay parity provisions, and addition of 200 new accounting positions."[93]

Professor John Coffee testified, "I think you're hearing from all of us that the SEC is resource-constrained and I think the less visible casualty of that are the offices such as the office of the chief accountant, where you can't really measure the output until a scandal like Enron comes along."[94]

The Committee also received and considered the General Accounting Office report, "SEC OPERATIONS: Increased Workload Creates Challenges," March 5, 2002 (GAO–02–302). GAO found that industry officials said "the SEC's limited staff resources have resulted in substantial delays in SEC regulatory and oversight processes, which hampers competition and reduces market efficiencies. In addition, they said information technology issues need additional funding, and SEC needs more expertise to keep pace with rapidly changing financial markets. Finally, the officials said that SEC's reliance on a small number of seasoned staff to do the majority of the routine work does not allow those staff to adequately deal with emerging issues."

The bill authorizes an appropriation of $776,000,000 for the SEC for fiscal year 2003. This includes:

- $102,700,000 to fund pay on a par with the federal bank regulators for SEC employees' salaries as well as their fringe benefits, as authorized by the Investor and Capital Markets Fee Relief Act (P.L. 107–123);

[90] Whitehead Testimony, March 19, 2002.
[91] Walker Testimony, March 5, 2002.
[92] Hills Testimony, February 12, 2002; Williams Testimony, February 12, 2002; Breeden Testimony, February 12, 2002; Levitt Testimony, February 12, 2002.
[93] Breeden Testimony, February 12, 2002.
[94] Coffee Testimony, March 5, 2002.

- $108,400,000 to fund enhanced information technology, security enhancements, and recovery and mitigation activities; and
- $98,000,000 to fund at least 200 more professionals to oversee auditors and auditing services, and additional staff to improve SEC investigative and disciplinary efforts and strengthen the SEC's oversight and regulation of market participants and of issuer disclosure, securities markets, and investment companies.

Codifying Rule of Procedure. In its Rules of Procedure, the SEC has a procedure to discipline professionals, including accountants, who lack the requisite qualifications to practice before the Commission. Professor Coffee testified before the Committee that "[t]he SEC's authority under Rule 102(e) was clouded by the D.C. Circuit's decision in *Checkosky* v. *SEC,* 139 F.3d 221 (D.C. Cir. 1998) (dismissing Rule 102(e) proceeding against two accountants of a "Big Five" firm). The SEC revised Rule 102 in late 1998 in response to this decision (see Securities Act Rel. No. 7593 (Oct. 18, 1998)), but its authority in this area is still subject to some doubt that Congress may wish to remove or clarify."[95] Lynn E. Turner, former SEC Chief Accountant, said, "[t]he statutory authority of the SEC also needs to be examined and beefed up as it relates to Rule 102(e) proceedings."[96]

The bill codifies the authority of the SEC in 17 CFR 210.102(e) to censure or deny, temporarily or permanently, the privilege of appearing or practicing before it to any person found by the SEC after notice and opportunity for hearing: (i) not to possess the requisite qualifications to represent others, (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of, any provision of the federal securities laws or the rules and regulations thereunder.

Penny Stock Bar. Under current law, the penny stock bar is available only in administrative proceedings. However, the Commission frequently brings cases involving serious microcap or penny stock fraud in federal district court in order to obtain injunctive relief. In such a case, if the Commission also wishes to obtain a penny stock bar, it must bring a separate administrative proceeding, typically after the district court case is concluded. The Commission would be able to obtain all necessary relief more efficiently if the district courts had the authority to order penny stock bars.

The bill authorizes federal courts to impose penny stock bars, or conditionally or unconditionally and temporarily or permanently prohibit a person from participating in a penny stock offering. The Commission has requested this authority in order to deal more swiftly with penny stock fraud.

Qualifications of Associated Persons of Brokers and Dealers. The SEC staff has advised the Committee that in recent years, there has been a growing perception that fraud artists are able to exploit gaps in federal and state regulatory systems and to move from one sector of the financial services industry to another without suffi-

[95] Coffee Testimony, March 5, 2002.
[96] Turner Testimony, February 26, 2002.

cient impediment. The SEC lacks the enforcement authority to bar individuals from coming into the securities industry who have been found by other financial regulators to have engaged in fraudulent, deceptive, or dishonest conduct in other financial industries. The bill gives the SEC this power. In order to reduce the migration of fraud perpetrators into the securities industry, the bill authorizes the Commission to bar from the securities industry persons who have been suspended or barred by a state securities, banking, or insurance regulator because of fraudulent, manipulative, or deceptive conduct. The Commission requested this authority.

TITLE VII—STUDIES AND REPORTS

The Committee identified two subjects of concern for additional study: the ongoing consolidation of the accounting industry and the performance of credit rating agencies.

Historically, the accounting industry has been consolidating into fewer large accounting firms. James E. Copeland, CPA and Chief Executive Officer, Deloitte & Touche, testified, "I've been on record since the last spate of proposed mergers saying that I thought the further consolidation of our industry would not be in the public's interest." [97]

The bill, in a section authored by Senator Akaka, directs the Comptroller General, in consultation with the SEC, similar regulatory agencies of the other G–7 nations, and the Department of Justice, to conduct a study identifying the factors that have led to the consolidation of public accounting firms since 1989, the impact of such consolidation, and solutions to any problems caused by such consolidation. The study shall also examine the problems faced by businesses as a result of limited competition among public accounting firms, and consider whether federal or state regulations impede competition among public accounting firms. A report is to be submitted to the Senate Banking Committee and the House Financial Services Committee within one year of enactment of this legislation.

The Federal regulation of credit-rating bureaus was raised at the hearing of March 21, 2002. The bill, in a section authored by Senator Bunning, directs the SEC to conduct a study of the role of credit rating agencies in the operation of the securities market, including an examination of the role of credit rating agencies in the evaluation of issuers, the importance of that role to investors, any impediments to the rating agencies' accurate appraisal of issuers, any barriers to entry into the business of acting as a credit rating agency, measures to improve the dissemination of information about issuers when credit rating agencies announce credit ratings, and any conflicts of interest in the operation of credit rating agencies. A report is to be submitted to the President, the Senate Banking Committee, and the House Financial Services Committee within 180 days of enactment.

[97] Copeland Testimony, March 14, 2002.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title and table of contents

Section 2. Definitions

Section 2 contains a set of definitions of terms that are used in the bill.

1. An "appropriate state regulatory authority" is a state authority responsible for licensing or other regulation of the practice of accounting in a state that has jurisdiction over an accounting firm or its personnel in connection with a particular matter.

2. An "audit" is an examination of the financial statements of an issuer by an independent public accounting firm, in accordance with rules of the new accounting oversight board or the SEC, for the purpose of expressing an opinion on those statements. This definition should be read in connection with the definitions of "issuer" and "audit report," below.

3. An "audit committee" is a committee of an issuer's board of directors created to oversee the accounting and financial reporting processes and audits of the financial statements of the issuer.

4. An "audit report" is a document, prepared following an audit performed for purposes of an issuer's compliance with the federal securities laws, in which a public accounting firm sets forth its opinion regarding a financial statement, report, or other document, or asserts that no such opinion can be expressed.

5. The "Board" is the Public Company Accounting Oversight Board established by section 101 of the bill.

6. The "Commission" is the U.S. Securities and Exchange Commission.

7. An "issuer" is a company that issues or proposes to issue securities, if the securities are registered under section 12 of the Securities Exchange Act of 1934, or if the company is required to file reports with the SEC under section 15(d) of the Securities Exchange Act (or will be required to file those reports at the end of the fiscal year in which a registration statement for the issuer's securities has become effective under the Securities Act of 1933).

8. "Non-audit services" are professional services provided to an issuer by an accounting firm registered with the Board, other than those required to be provided in connection with an audit or other review of the issuer's financial statements.

9. A "person associated with a public accounting firm" is a proprietor, partner, shareholder, principal, or an accountant or other professional employee of a public accounting firm, or any independent contractor or entity that shares in compensation or profits, or that participates on behalf of the firm in an activity, in connection with preparation or issuance of an audit report.

10. "Professional standards" include (i) accounting principles established by the standard-setting body recognized under the bill or prescribed or recognized by the SEC that are relevant to particular audit reports or accounting firm quality control systems, and (ii) auditing standards, standards for attestation engagements, quality control policy, ethical and competency standards, and independence standards that relate to the preparation of audit reports and are established or adopted by the Board or SEC.

11. A "public accounting firm" includes a proprietorship or entity engaged in the practice of public accounting or preparing or issuing audit reports. To the extent the new oversight board designates in its rules, the term can also include an associated person of an accounting firm.

12. A "registered public accounting firm" is a firm that registers with the new oversight board, as required by section 102 of the bill.

13. The "rules of the Board" include both the formal bylaws and rules adopted by the new oversight board (subject to action of the SEC under section 107 of the bill) and stated policies, practices, and interpretations of the board that the SEC deems to be rules of the board.

14. The term "security" has the same meaning as in section 3(a) of the Securities Exchange Act.

15. The term "securities laws" has the meaning given that term in section 3(a)(47) of the Securities Exchange Act, and includes the SEC's rules, regulations and orders. (Section 2(b), in a conforming amendment, makes the bill a part of the section 3(a)(47) definition.)

16. A "State" includes any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, and any other U.S. territory or possession.

Section 3. Commission rules and enforcement

Section 3 generally gives the Securities and Exchange Commission (the "Commission" or the "SEC") authority to promulgate rules consistent with the Act and provides that a violation of the Act, or of any rule of the Commission or of the new Public Company Accounting Oversight Board created by title I of the Act, will be treated for all purposes as a violation of the Securities Exchange Act of 1934 and the rules thereunder; similarly, the new Board will be treated as if it were a self-regulatory organization under the 1934 Act for purposes of the Commission's investigative and enforcement authority. It should be emphasized that the new Board's own authority is limited to the work of accountants in auditing public companies; the Board has no jurisdiction with respect to the work of accountants in performing audits of other companies.

Section 3 thus confirms that the Commission will have the authority to enforce the Act directly. Section 3 also makes clear that nothing in the Act or the rules of the new Board limits the Commission's own authority over accounting firms and their personnel, or accounting, auditing, independence, or other standards relating to auditors' reports.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Section 101. Establishment

Section 101 creates a new Public Company Accounting Oversight Board (the "Board"). The Board will oversee the auditing of companies that are subject to the federal securities laws (*i.e.,* companies ("public companies" or "issuers") that have chosen to sell stock or debt instruments to public investors). Accounting firms that perform audits of public companies must register with the Board, and the Board will possess authority, subject to action by the Commission, to (i) set auditing, quality control, ethics, and independence standards (the latter supplementing statutory provisions on that

subject), with respect to audits of the financial statements of public companies, (ii) inspect accounting firms' audit operations with respect to public companies, (iii) investigate potential violations by the firms or their partners or employees of the Act, the Board's rules, related provisions of the securities laws (and the Commission's rules), and professional accounting and conduct standards, and (iv) impose sanctions for violations. Again, the Board's authority in these areas is focused on, and limited to, the audit of public companies; it has no jurisdiction over accountants performing other audits. The Board is to submit an annual report of its activities to the Commission, which in turn is to send a copy to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs within 30 days of receipt.

Legally, the Board will be a private nonprofit corporation subject to the District of Columbia Nonprofit Corporation Act. The Board will not be an agency or establishment of the United States. It is explicitly given authority to set compensation for its employees at levels comparable to similar positions in the private sector.

Membership. Section 101(e) provides that the Board will have five members. The initial Board will be appointed by the Commission, after consultation with the Federal Reserve Board and the Department of the Treasury, within 90 days of the date of enactment; vacancies will be filled by the Commission after similar consultations. Board members will serve full-time, for five-year (staggered) terms, with a two-term limit. All Board members must have an understanding of the responsibilities for and the nature of the financial disclosures and accountants' responsibilities required by the securities laws. Three members of the Board will have a general background, and two members will have an accountancy background; the Board's Chairperson may be one of the two Board members with an accountancy background, but if so, he or she may not have been a practicing accountant for at least five years prior to appointment to the Board. Internal Board standard of conduct rules must include a one-year ban on practice before the Board (or before the Commission, with respect to Board-related matters) for former Board members and appropriate "cooling off" periods (not to exceed one year) for former Board staff.

The initial Board's first task will be to hire staff, propose or adopt its first sets of rules and generally bring the organization into operational existence, so that the Commission can make a determination, required under section 101(d) within 270 days of enactment, that the Board possesses the capacity to carry out its responsibilities and enforce compliance with title I of the Act.

Section 102. Registration with the Board

The Commission's determination that the Board can begin to exercise its authority starts the running of a 180-day period within which each public accounting firm that prepares or issues audit reports for public companies must register with the Board. At the end of the 180–day period it will become unlawful for an unregistered accounting firm to audit a public company. (Again, lack of registration will have no effect on an accounting firm's ability to perform any other sort of work.) An application for registration must include information about the identity of the public companies for which an accounting firm currently or during the previous

year performs or has performed audit work, certain current financial information about the accounting firm itself, a statement of the firm's quality control policies for its accounting and auditing practice, a list of the firm's accountants who participate in public company audits, and information about pending civil, criminal, or disciplinary actions, and client-auditor disputes, relating to the firm's audits of public companies. The application must also include a consent to compliance with any requests for documents or testimony, within the Board's authority, made to the registrant in the course of the Board's operation and an agreement to obtain and if necessary to enforce similar consents from the firm's partners and employees who participate in public company audits. Registered accounting firms will be required to report changes in this information to the Board annually (or more frequently if the Board so requires).

Information submitted to the Board as part of each application will be made available to the public, subject to limitations to protect the confidentiality of proprietary, personal, and other information for which such protection is necessary or required by law. In particular, information "reasonably identified by [the registrant] as proprietary information" will be withheld from disclosure.

The Board is authorized by section 102(f) to impose a registration fee and an annual fee on each registrant, to cover the cost of processing and reviewing applications and annual reports.

Section 103. Auditing, quality control, and independence standards and rules

Section 103 requires the Board to establish auditing, quality control, and ethical standards, as required by the Act or the rules of the Commission or necessary or appropriate in the public interest or for the protection of investors, to be used by registered accounting firms in the preparation of audit reports for public companies. The Board is also to adopt rules to implement the provisions on the independence of public company auditors contained in title II of the Act.

The Board's rules specifically must require (i) preparation and maintenance for 7 years by public company auditors of audit work papers and related information in sufficient detail to support each audit's conclusions, (ii) "second partner" review and approval of each public company audit report and its issuance, and (iii) inclusion in each audit report of a description of the auditor's testing of the public company's systems for compliance with the requirements of section 13(b)(2) of the Securities Exchange Act and of the company's controls over its receipts and expenditures, together with specific notation of any significant defects or material noncompliance of which the auditor should know on the basis of such testing.

Section 103 also specifies the subjects that the quality control standards adopted by the Board must address. These are: monitoring of ethics and independence; internal and external consulting on audit issues; audit supervision; hiring, development, and advancement of audit personnel; acceptance and continuance of engagements; and internal inspection.

The Board may adopt as part of its rules (and modify as appropriate for that purpose, at the time of adoption or thereafter), any portion of a statement of auditing, quality control, or ethics stand-

ards that meet the statutory test prepared (i) by a professional group of accountants designated by a rule of the Board for that purpose, or (ii) by one or more advisory groups convened by the Board. (Pre-existing standards of designated professional groups of accountants that may be adopted during the Board's nine-month transitional period are to be separately approved by the Commission at the time of the Commission's determination (pursuant to section 101(d), noted above) that the Board is ready to begin operation.)

The Board will convene advisory groups of practicing accountants and other experts, as well as representatives of other interested groups (subject to appropriate conflict of interest rules), to make recommendations concerning, or propose drafts of, the content of any required standards for public company auditors.

The Board is to cooperate on an ongoing basis with both the designated professional groups of accountants noted above, and with its own advisory groups, in examining the need for changes in any standards subject to Board authority. The Board is to recommend issues for inclusion on the agendas of these groups, and take other steps to facilitate the standard-setting process, and it is to respond in a timely fashion to requests for changes in the standards over which the Board has authority.

Finally, the Board is to include a summary of the results of its standard-setting responsibilities in each of its annual reports. Each summary must include a discussion of the Board's work with any designated professional group of accountants or advisory group, as well as the Board's pending agenda for future standard-setting projects.

Section 104. Inspections of registered public accounting firms

Section 104 outlines the duty of the staff of the Board to undertake annual inspections of registered public accounting firms that prepare audit reports for more than 100 public companies, and triennial inspections of firms that prepare audit reports for 100 or fewer public companies, to assess the degree of compliance by those firms with the Act, the rules of the Board, and professional standards relating to audits of public companies. (The inspection cycles for different-sized accounting firms may be subsequently changed by the Board.) The Board is to (i) identify in the course of each inspection any act, practice, or omission by the firm or its partners or employees revealed by the inspection that may violate the Act, the Board's or related Commission rules, the firm's own quality control policies, or professional standards, (ii) report any such finding, if appropriate, to the Commission and each state accountancy board with jurisdiction over the matter, and (iii) commence a formal investigation or take any appropriate disciplinary action with respect to the violation.

The scope of each inspection will include both particular audit and review engagements (which may include engagements that are otherwise the subject of ongoing controversy between the accounting firm under inspection and third parties), selected solely by the Board, as well as a review of each firm's quality control system and its compliance with professional standards relating to audit reports for public companies. The term "professional standards" means, for purposes of title I and the Board's authorization, (i) generally ac-

cepted accounting principles, (ii) auditing standards, standards for attestation engagements and quality control policies, and ethical and competency standards that the Board adopts, and (iii) independence standards that the Board adopts to implement title II of the Act.

The rules of the Board are to provide a procedure for review and comment on a draft inspection report by the firm inspected; the text of any comment by the firm on a draft inspection report is to be attached, with appropriate redactions to protect confidential information, to the final report. That report is to be sent to the Commission and the appropriate state board of accountancy and made available to the public (subject, again, to protection of confidential and proprietary information). Portions of an inspection report which deal with criticisms of or potential defects in the quality control systems of a firm will not be made public if the defects are addressed to the satisfaction of the Board within 12 months of the date of the report. In certain cases interim Commission review of certain inspection-related disputes is available.

Section 105. Investigations and disciplinary proceedings

Section 105 outlines the investigative and disciplinary authority of the Board over firms that audit public companies and partners and employees of these firms.

Investigations. Section 105(a) authorizes the Board to investigate any act or practice by a registered accounting firm, or its partners or employees, that may violate the Act, the Board's rules, professional standards, and the portion of the securities laws and SEC rules that relate to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto. The Board may require testimony or production of documents or information, or inspect documents or information, in the possession of any registered public accounting firm or its partners or employees. The Board's investigative activities and any information gathered in the course of an investigation are to be confidential and privileged for all purposes (including civil discovery), unless and until particular information is presented in connection with a public proceeding. The Board may refer investigations to the Commission, any other federal functional regulator (in the case of an investigation relating to the audit of an institution subject to the jurisdiction of such functional regulator), and, at the direction of the Commission, to the Attorney General, state attorneys general in connection with any criminal investigation, or appropriate state boards of accountancy, and may share information derived from investigations with the same parties, but only if the Board determines that such disclosure is "necessary to accomplish the purposes of the Act or to protect investors." The Board's investigators are granted civil immunity for their activities during an investigation to the same extent that a federal investigator would enjoy such immunity.

Disciplinary proceedings. Section 105(b) authorizes the Board to impose a full range of sanctions if it finds that a registered firm, or its partners or employees, have engaged in any act or practice that violates the Act, the Board's rules, professional standards, or the portion of the securities laws (and SEC rules) relating to audits of public companies. Potential sanctions include revocation or sus-

pension of the registration of an accounting firm, or of the ability of particular individuals to remain associated with that firm or become associated with any other registered accounting firm (effectively barring the subject of the sanction from participating in audits of public companies), substantial civil money penalties, required professional education or training, or censure; the Board's ability to suspend or bar an associated person from the auditing of public companies, and the Board's ability to impose civil money penalties above a certain amount, is limited to situations involving intentional, knowing, or reckless conduct, or repeated negligent conduct. The Board may also impose sanctions upon a registered accounting firm for failure reasonably to supervise a partner or employee (in terms similar to those that apply to broker-dealers under section 15(b)(4) of the Securities Exchange Act of 1934, which permit the firm to defend by showing that its internal control procedures were reasonable and were operating fully in the case at issue).

The Board's rules must set out fully the procedural requirements for disciplinary proceedings. Disciplinary sanctions finally imposed must be reported to the Commission, appropriate state or foreign boards of accountancy, and the public (once any stay of enforcement pending appeal has been lifted). Any sanction may be appealed to the Commission under the provisions of section 107(c) (described below).

Fines imposed by the Board are to be used to fund a scholarship program for students in undergraduate or graduate programs in accounting.

Section 106. Foreign public accounting firms

Section 106 provides that accounting firms organized under the laws of countries other than the United States that issue audit reports for public companies subject to the U.S. securities laws are covered by the Act in the same manner as domestic accounting firms, subject to the exemptive authority of both the Board and the Commission. (Registration under the Act will not in itself provide a basis for subjecting a foreign accounting firm to U.S. jurisdiction other than with respect to controversies between such a firm and the Board.) The Board is authorized to determine that other foreign accounting firms play a sufficiently substantial role in the preparation and furnishing of such reports for particular issuers that their coverage under the Act is necessary or appropriate, in light of the purposes of the Act and in the public interest or for the protection of investors.

Section 106 also sets terms for the production in the United States by a foreign public accounting firm of its audit work papers, for any audit in which the foreign accounting firm issues an opinion or otherwise performs material services upon which an accounting firm registered under the Act relies in issuing all or part of an audit report for a public company.

Section 107. Commission oversight of the Board

Section 107 makes the Board generally subject to the same degree of control by the Commission as the National Association of Securities Dealers or the New York Stock Exchange. Section 107(b) provides that the Board's proposed rules must be filed with the

Commission and published by the Commission for public comment. No Board rule may take effect without Commission approval (except in limited situations), and the Commission retains the power not only to disapprove, but to abrogate or amend, any rules of the Board. Section 107(c) incorporates the provisions of section 19(d)(2) and (e)(1) of the Securities Exchange Act of 1934 to give the Commission full authority to review, modify, or cancel any disciplinary sanction imposed by the Board (including any sanction imposed for failure to comply with a demand for testimony or documents in the course of a Board investigation), either upon the Commission's own motion or on the motion of an aggrieved party. (The Commission may, in some cases, also review registration- or inspection-related disputes.) Finally, the Commission possesses authority to limit the authority and activities, or to censure, or even to remove members, of the Board itself, if the Commission finds that the Board, or a particular member, has violated, is unable to comply with, or has failed to enforce compliance with the Act, the Board's or the Commission's rules, or the securities laws, has failed to enforce compliance with professional standards, or, in the case of a particular Board member, has willfully abused his or her authority.

Section 108. Accounting standards

Section 108 amends section 19 of the Securities Act of 1933 specifically to allow the Commission to recognize as "generally accepted" (for securities law purposes) accounting principles established by a standard-setting body that meets certain criteria. First, the body must be a private entity and be funded by public companies in the same manner as the Board (provided in section 109 of the Act), and it must have adopted procedures, including acting by majority vote, to ensure prompt consideration of necessary changes to the body of accounting principles. Second, the Commission must determine that the standard-setting body has the ability to assist the Commission, because the standard-setting body has proved able to improve the accuracy and effectiveness of financial reporting and the protection of investors. Any such standard-setting body must report annually to the Commission. Finally, section 108 requires the Commission to conduct a study of the adoption by the U.S. financial reporting system of a principles-based accounting system.

Section 109. Funding

Section 109 provides that the Board and the accounting principles standard-setting body recognized under section 108 of title I are to be funded by an "accounting support fee." (The Board's budget, but not the budget of the standard-setting body, is to be subject to approval by the Commission.) In the case of both the Board and the standard-setting body, the annual support fee is to be assessed against each public company. Amounts payable by public companies to either body will generally be allocated among those companies based on relative average annual monthly market capitalization for the 12 months prior to the year to which the support fee relates; both the Board and the standard-setting body are permitted to differentiate among various classes of public companies, as necessary or appropriate, in allocating fees. Fees are to be collected in such manner as is deemed appropriate in each case.

TITLE II—AUDITOR INDEPENDENCE

Section 201. Services outside the auditor scope of practice

The Act restricts a registered public accounting firm in the non-audit services it may provide to its audit clients that are public companies in order to preserve the firm's independence. The Act specifies eight categories of activities that an auditor may not provide to a public company that is its audit client. These include: (1) bookkeeping or other services related to the accounting records or financial statements of the issuer; (2) financial information systems design and implementation consulting services; (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (4) actuarial services; (5) internal audit services; (6) any management or human resources function; (7) broker, dealer, investment adviser, or investment banking services; and (8) legal services and expert services unrelated to the auditing service. In addition, the Public Company Accounting Oversight Board may determine that any other non-audit service is prohibited. The Board has the authority to grant exemptions on a case-by-case basis to the extent necessary or appropriate in the public interest and consistent with the protection of investors, subject to SEC review. A registered public accounting firm would be permitted to perform for a public company audit client any other non-audit service, including tax services, that the public company's Audit Committee pre-approves in accordance with the requirements adopted in Section 202.

The Act would not affect the services that a registered public accounting firm provides to non-public companies or to public companies that are not its audit clients. Thus, a firm could provide any consulting service to any public company for which it does not provide audit services as well as to any non-public company.

Section 202. Pre-approval requirements

The Audit Committee of a public company must pre-approve all the services, both audit and non-audit, provided to that company by a registered public accounting firm. The public company is required to disclose the Audit Committee's approvals of non-audit services to shareholders in SEC filings. The pre-approval requirement is waived if an auditor provides a service that was not recognized to be a non-audit service at the time of the engagement and if the aggregate amount of all such non-audit services is 5% or less of total auditor fees and such services are promptly brought to the attention of the Audit Committee and approved by the Audit Committee prior to the completion of the audit. Approval may be made by one or more members of the Audit Committee, to whom such authority has been delegated. The decisions of any delegated member to pre-approve an activity shall be presented to the full Audit Committee at each of its meetings.

Section 203. Audit partner rotation

A registered public accounting firm must rotate its lead partner and review partner on its audits of a public company so that no partner performs an audit on the same issuer as a lead partner or review partner for more than five consecutive years.

Section 204. Auditor report to Audit Committees

A registered independent public accounting firm performing an audit for a public company will timely report to that company's Audit Committee the critical accounting policies and practices to be used and all alternative treatments of financial information within GAAP that have been discussed with management, any accounting disagreements between the auditor and management and other material written communications between the auditor and management.

Section 205. Conforming amendments

Section 206. Conflicts of interest

An accounting firm may not provide audit services for a public company if that company's chief executive officer, controller, chief financial officer, chief accounting officer, or other individual serving in an equivalent position, was employed by the accounting firm and worked on the audit of the public company during the one year before the start of the audit services.

Section 207. Study of mandatory rotation of registered public accounting firms

The GAO will study the potential effects of requiring the mandatory rotation of registered public accounting firms and report to Congress within one year.

Section 208. Commission authority

A registered independent public accounting firm must comply with the restrictions in sections 201–204 and 206 in order to perform an audit for a public company.

Section 209. Considerations by appropriate state regulatory authorities

It is the intent of this Act that in supervising non-registered accounting firms, state regulatory authorities should make an independent determination of the proper standards, and should not presume the standards applied by the Board under this Act to be applicable to small- and medium-sized non-registered accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

Section 301. Issuer Audit Committees

The Exchange Act is amended to require the SEC to draft rules directing national securities exchanges and national securities associations to require listed companies to make Audit Committees responsible for the appointment, compensation, and oversight of the work of auditors and to require auditors to report directly to the Audit Committee. The amendments also: bar Audit Committee members from accepting consulting fees or being affiliated persons of the issuer or the issuer's subsidiaries other than in the member's capacity as a member of the board of directors or any board committee; require Audit Committees to have in place procedures to receive and address complaints regarding accounting, internal control or auditing issues; require Audit Committees to establish proce-

dures for employees' anonymous submission of concerns regarding accounting or auditing matters; and require public companies to provide their Audit Committees with authority and funding to engage independent counsel and other advisers as they determine necessary.

Section 302. Corporate responsibility for financial reports

CEOs and CFOs must certify, in periodic reports containing financial statements filed with the Commission pursuant to section 13(a) or 15(d) of the Exchange Act, the appropriateness of financial statements and disclosures contained therein, and that those financials and disclosures fairly present the company's operations and financial condition.

Section 303. Prohibited influence

It is unlawful for any officer, director, or person acting under their direction to fraudulently influence, coerce, manipulate, or mislead any accountant engaged in preparing an audit report, for the purpose of rendering the audit report misleading.

Section 304. Forfeiture of certain bonuses and profits

In the case of accounting restatements that result from material non-compliance with SEC financial reporting requirements, CEOs and CFOs must disgorge bonuses and other incentive-based compensation and profits on stock sales, if the non-compliance results from misconduct. The required disgorgement applies to the 12 months after the first public issuance or filing of a financial document embodying such financial reporting requirement. The SEC may exempt any person from this requirement as it deems necessary and appropriate.

Section 305. Officer and director bars and penalties

The sanction of barring securities law violators from serving as officers or directors of public companies is strengthened by modifying the standard that governs judicial imposition of officer and director bars. In addition, courts may impose any equitable relief necessary or appropriate to protect, and mitigate harm to, investors.

Section 306. Insider trades during pension fund blackout periods prohibited

Directors and executive officers are prohibited from engaging in transactions involving any equity security of the issuer during a "blackout" period when at least half of the issuer's individual account plan participants are not permitted to purchase, sell or otherwise transfer their interest in that equity security. No blackout period may take effect until at least 30 days after written notice of the blackout is provided by the plan administrator to the participants or beneficiaries. Exceptions to the 30-day notice are allowed in cases: (1) where a deferral of the blackout period would violate ERISA fiduciary provisions; or (2) where the inability to provide the notice is due to unforeseeable events or circumstances beyond the reasonable control of the plan administrator.

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

Section 401. Disclosures in periodic reports

A public company in periodic reports filed with the SEC will present: (1) disclosures of financial information that reflect all material correcting adjustments that have been identified by the auditor in accordance with GAAP and (2) the material off-balance sheet transactions, arrangements, obligations, and other relationships of the issuer with unconsolidated entities or other persons that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses.

Issuers that disseminate "pro forma" financial information in their filings with the SEC, press releases or other public disclosures must present pro forma data in a manner that does not contain an untrue statement or omit to state a material fact necessary in order to make the information, in light of the circumstances under which it is presented, not misleading, and that reconciles it with the issuer's financial condition under GAAP.

Section 402. Enhanced disclosures of loans

An issuer in its current reports must disclose within 7 days, or such other time period determined to be appropriate by the SEC: (A) all loans, except credit card loans, made by the issuer and its affiliates to any executive officer or director, specifying amounts paid and balances owed on such obligations and (B) any conflicts of interest, as defined by the SEC.

Section 403. Disclosures of transactions involving management

Section 16(a) of the Exchange Act is amended to require directors, officers and 10% equity holders to report their purchases and sales of securities more promptly, by the end of the second day following the transaction or such other time established by the SEC in any case in which the two-day period is not feasible.

Section 404. Management assessment of internal controls

Annual reports filed with the SEC must be accompanied by a statement by the management of its responsibility for creating and maintaining adequate internal controls. Management must also present its assessment of the effectiveness of those controls. In addition, the company's auditor must report on and attest to management's assessment of the company's internal controls. Such attestation shall not be the subject of a separate engagement.

Section 405. Exemption

Investment companies are exempted from the disclosure requirements of sections 401, 402 and 404.

Section 406. Code of ethics for senior financial officers

Issuers are required to disclose whether or not they have adopted a code of ethics for senior financial officers, and if not, the reason therefor.

Section 407. Audit Committee financial expert

The SEC is required to adopt rules to require issuers to disclose whether their Audit Committees include among their members at least one "financial expert." In defining "financial expert," the SEC shall consider whether a person understands GAAP and financial statements, has experience preparing or auditing financials, has experience with internal accounting controls, and understands Audit Committee functions.

TITLE V—ANALYST CONFLICTS OF INTEREST

Section 501. Treatment of securities analysts by registered securities associations

The Act requires the Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, within one year to adopt rules designed to address conflicts of interest facing securities analysts. The rules will (A) foster greater public confidence in securities research and protect the objectivity and independence of stock analysts who publish research intended for the public by (i) prohibiting the pre-publication clearance of such research or recommendations by investment banking or other staff not directly responsible for investment research, (ii) limiting the supervision and compensatory evaluation of such research personnel to officials who are not engaged in investment banking activities, and (iii) protecting securities analysts from retaliation or threats of retaliation by investment banking staff because of negative or otherwise unfavorable research reports that might adversely affect investment banking relations with the issuer described in the report, provided that the rules shall not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such report in accordance with the firm's policies and procedures, (B) define periods during which broker-dealers who participate in a public offering of securities as underwriters or dealers shall not publish research or recommendations about the securities of the issuer, (C) establish structural and institutional safeguards within broker-dealers to assure that securities analysts preparing research reports are separated by appropriate informational partitions from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision, and (D) address such other issues as the SEC or the SROs deem appropriate.

The Act also requires the Commission, or upon the direction of the Commission, a registered securities association or national securities exchange, to adopt rules requiring disclosures about conflicts of interest in reports and public appearances. These disclosures include (A) the extent to which the analyst holds securities in the issuer, (B) whether compensation has been received from the issuer, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure of material non-public information regarding specific potential future investment banking transactions as is appropriate in the public interest and consistent with investor protection, (C) whether the issuer is or has recently been a client of the analyst's firm, and if so, the types of services provided, (D) whether the analyst received com-

pensation based on an affiliate's investment banking revenues, and (E) such other disclosures as the SEC or the SROs deem appropriate. The regulator would have the authority to amend its rules.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

Section 601. Authorization of appropriations

There is authorized an appropriation of $776,000,000 for the SEC for fiscal year 2003, of which: $102,700,000 would fund the pay parity of salary and benefits for SEC employees, as authorized in the Investor and Capital Markets Fee Relief Act (P.L. 107–123); $108,400,000 would fund information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and $98,000,000 would fund at least 200 more professionals to oversee auditors and auditing services, and additional staff to improve SEC investigative and disciplinary efforts and strengthen the SEC's oversight and regulation of market participants and of issuer disclosure, securities markets and investment companies.

Section 602. Appearance and practice before the SEC

The SEC is authorized to censure or deny, temporarily or permanently, the privilege of appearing or practicing before it to any person found by the SEC after notice and opportunity for hearing: (i) not to possess the requisite qualifications to represent others, (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws or the rules and regulations thereunder. This codifies Section 102(e) of the SEC's Rules of Practice.

Section 603. Federal court authority to impose penny stock bars

Federal courts are authorized to conditionally or unconditionally and temporarily or permanently prohibit a person from participating in a penny stock offering.

Section 604. Qualifications of associated persons of brokers and dealers

The SEC is authorized to bar from the securities industry persons who have been suspended or barred by a state securities, banking or insurance regulator because of fraudulent, manipulative or deceptive conduct.

TITLE VII—STUDIES AND REPORTS

Section 701. GAO study and report regarding consolidation of public accounting firms

The Comptroller General, in consultation with the SEC, similar regulatory agencies of the other G–7 nations, and the Department of Justice, is to conduct a study identifying the factors that have led to the consolidation of public accounting firms since 1989, the impact of such consolidation, and solutions to any problems caused by such consolidation. The study shall also examine the problems faced by businesses as a result of limited competition among public accounting firms, and consider whether federal or state regulations impede competition among public accounting firms. A report is to

be submitted to the Senate Banking Committee and the House Financial Services Committee within one year of enactment.

Section 702. Commission study and report regarding credit rating agencies

The SEC is to conduct a study of the role of credit rating agencies in the operation of the securities market, including an examination of the role of credit rating agencies in the evaluation of issuers, the importance of that role to investors, any impediments to the rating agencies' accurate appraisal of issuers, any barriers to entry into the business of acting as a credit rating agency, measures to improve the dissemination of information about issuers when credit rating agencies announce credit ratings, and any conflicts of interest in the operation of credit rating agencies. A report is to be submitted to the President, the Senate Banking Committee, and the House Financial Services Committee within 180 days of enactment.

CHANGES IN EXISTING LAW

On June 18, 2002, the Committee unanimously approved a motion by Senator Sarbanes to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with the requirement of section 12 of Rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

The bill make structural changes in various aspects of the federal securities laws. Titles I through IV and portions of title VI affect the auditing of public companies and financial disclosures by those companies and their managers. Title V affects conflicts of interest by employees of broker-dealers who issue research reports dealing with particular companies or industries.

There are, according to the SEC, approximately 16,500 public companies subject to the federal securities laws.[98] Fewer than 15 percent of the nation's accounting firms audit any public companies, and only 20 firms have more than 30 audit clients.[99] There are perhaps 75–100 registered broker-dealers that issue research reports of the type dealt with in title V, and perhaps as many as 5000 analysts who prepare those research reports.

The bill establishes a comprehensive framework to modernize and reform the oversight of public company auditing, improve quality and transparency in financial reporting by those companies, and strengthen the independence of auditors. It promotes competition among service providers, enhances accurate investor decision-mak-

[98] SEC budget testimony for FY 2003 gives the number as over 17,000, Testimony Concerning Appropriations for Fiscal 2003 by Harvey L. Pitt, Chairman, U.S. Securities & Exchange Commission, before the Subcommittee on Commerce, Justice, State, and the Judiciary, Committee on Appropriations, United States House of Representatives, April 17, 2002, while SEC Release 33–8109 gives the number as 16,242, SEC Release 33–8109 (Proposed Rule: Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process), http://www.sec.gov/rules/proposed/33–8109.htm at 71.

[99] See Proposed SEC Release 33–8109 at footnote 111, page 111.

ing throughout the capital markets, and seeks to correct shortcomings that have threatened the reputation of those markets for integrity.

The legislation should have little additional impact upon the privacy of particular individuals. Information and documents held by the Public Company Accounting Oversight Board created by the bill are generally confidential and privileged until made public in connection with a particular public enforcement proceeding. Corporate managers and others affected by the bill are already subject to extensive reporting requirements under the federal securities laws.

Specific rules issued by the SEC under various provisions of the bill will contain their own regulatory and paperwork estimates, as required by applicable law. Otherwise, it is difficult to measure, at this time, the extent to which the bill would impose additional costs beyond those described in the CBO estimate, below. In addition, the bill's net regulatory impact upon the economy can be positive, especially as its terms operate to reduce crises in corporate management and value of the sort the economy is now witnessing. Finally, the immediate regulatory impact of the bill must be weighed against the continuing serious adverse economic impact on investors, the markets, and the national economy of the failure of existing regulatory arrangements and the decline in investor confidence, here and abroad, that this failure has generated. For all of these reasons, the Committee has determined that more extensive compliance with rule XXVI(11)(b) than that contained above is impracticable.

COST OF LEGISLATION

Section 11(b) of rule XXVI of the Standing Rules of the Senate, and Section 403 of the Congressional Budget Impoundment and Control Act, require that each committee report on a bill contain a statement estimating the cost of the proposed legislation. The Congressional Budget Office has provided the following cost estimate and estimate of costs of private-sector mandates.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 27, 2002.

Hon. PAUL S. SARBANES,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Public Company Accounting Reform and Investor Protection Act of 2002.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Ken Johnson (for federal costs), Greg Waring (for the state and local impact), and Paige Piper/Bach (for the private-sector impact).

Sincerely,

ROBERT A. SUNSHINE
(For Dan L. Crippen, Director).

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

Public Company Accounting Reform and Investor Protection Act of 2002

Summary: The bill would establish two new organizations—the Public Company Accounting Oversight Board (Oversight Board) to regulate the accounting industry and the Standard-Setting Body to write national standards for accounting practices. The activities of these organizations would be overseen by the Securities and Exchange Commission (SEC). In addition, the bill would authorize the appropriation of $776 million in 2003 for the SEC's activities. Under the bill, both the SEC and the Oversight Board could assess civil penalties for violations of the bill's provisions. Any civil penalties collected by the Oversight Board would be spent on a scholarship program for accounting students. The bill also would require the General Accounting Office (GAO) to complete two studies of the accounting industry within one year of enactment.

Based on information from the SEC, CBO estimates that implementing this bill would cost about $787 million over the 2003–2007 period, assuming the appropriation of the necessary amounts. Under current law, the SEC's discretionary costs are offset by fees the agency collects from securities markets. Enactment of the bill would not change the amount of fees expected to be collected in the future. Assuming the continued collection of the regulatory fees assessed by the SEC, the commission would collect $1.3 billion in fees in 2003, and its net outlays would be −$621 million in that year. The two GAO studies also would cost an estimated $1 million in 2003, subject to the availability of appropriated funds. CBO estimates that the bill would have effects on revenues and direct spending, but that the net effect of those changes would be negligible each year. Because the bill would affect revenues and direct spending, pay-as-you-go procedures would apply.

The bill contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that complying with that mandate would result in no costs to state, local, or tribal governments. Therefore, the threshold established by UMRA ($58 million in 2002, adjusted annually for inflation) would not be exceeded.

The bill would impose several private-sector mandates, as defined by UMRA, on certain accounting firms, companies that issue registered securities, officers and directors of those companies, investment banking firms, and securities analysts. CBO cannot determine whether the direct cost of those mandates would exceed the annual threshold set by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation). The mandate costs are difficult to estimate because (1) we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted; (2) the cost to comply with several of the mandates would depend on rules soon to be prescribed by the SEC under current authority; and (3) the cost to comply with several of the mandates would depend on rules that would be prescribed by the SEC under the bill.

Estimated cost to the Federal Government: The estimated budgetary impact of the bill is shown in the following table. The costs of this legislation would fall within budget functions 370 (commerce

and housing credit—for the SEC) and 800 (general government—for GAO).

	By fiscal year, in millions of dollars—					
	2002	2003	2004	2005	2006	2007
SEC SPENDING—SUBJECT TO APPROPRIATION[1]						
Gross SEC spending under current law:						
Budget authority	409	0	0	0	0	0
Estimated outlays	408	90	0	0	0	0
Proposed changes:						
Authorization level	0	776	5	5	5	5
Estimated outlays	0	592	180	5	5	5
Gross SEC spending under the bill:						
Authorization level	409	776	5	5	5	5
Estimated outlays	408	682	180	5	5	5
CHANGES IN GAO SPENDING—SUBJECT TO APPROPRIATION						
Estimated authorization level	0	1	0	0	0	0
Estimated outlays	0	1	0	0	0	0
Memorandum						
Estimated SEC offsetting collections[2]	−1,135	−1,303	n.a.	n.a.	n.a.	n.a.

[1] Enactment of this legislation also would affect direct spending and revenues, but CBO estimates that the net amount of the effects would be negligible for each year.

[2] The SEC collects fees to the extent provided in advance in appropriation acts. The amount of fees collected is not dependent on the amount appropriated. (The authority to collect such fees in 2002 has been triggered by the 2002 appropriation, but there is no appropriation yet for 2003 or future years.)

Note.—n.a.—not applicable.

Basis of estimate

For this estimate, CBO assumes that the bill will be enacted by the end of fiscal year 2002. Assuming appropriation of the necessary funds, CBO estimates that implementing the bill would cost the SEC about $787 million and GAO about $1 million during the 2003–2007 period. We estimate that the bill also would affect both revenues and direct spending, but that the net impact of those effects would be negligible for each year.

The SEC is typically funded through fees the agency collects for registrations, transactions, and mergers of securities. Under current law, the fee rates are determined periodically by the SEC, and they are collected only to the extent provided in advance in appropriations acts. These fees are classified in the budget as offsets to the SEC's discretionary spending.

Spending subject to appropriation

The bill would authorize the appropriation of $776 million for all SEC activities in 2003. Of this amount, the bill would earmark $103 million for higher salaries for SEC employees, $108 million for security and information technology enhancements needed by the agency after the September 11th attacks, and $98 million for additional staff to monitor audit services. Based on the agency's historical spending patterns, CBO estimates that implementing this provision would result in gross outlays of about $592 million in 2003 and $768 million over the 2003–2004 period, assuming the appropriation of the necessary amounts. Adding these amounts to CBO's projections for fee collections in 2003, we estimate that the SEC's net spending would be −$621 million in that year.

The bill also would require the SEC to review any sanctions or rules proposed by the Oversight Board. CBO estimates that the cost of these activities would be roughly comparable to the SEC's

oversight of national securities exchanges and associations. Based on information from the SEC about the cost of such oversight, CBO estimates that the SEC would require about 40 staff members, at a cost of about $5 million a year, to review the rules and sanctions proposed by the new Oversight Board. Any amounts the SEC would spend to oversee accounting practices under the bill would be subject to the availability of appropriated funds.

Under the bill, GAO would complete two reports to the Congress on the accounting industry within one year of enactment. Based on information from GAO, CBO estimates that conducting these two studies would cost the agency about $1 million in 2003, subject to the availability of appropriated funds.

Revenues and direct spending

CBO estimates that implementing this bill also would affect direct spending and revenues. The effects would result from the bill's provisions creating an Oversight Board and a Standard-Setting Body to oversee the accounting industry and from provisions relating to civil penalties.

Costs of Creating the Oversight Board and Standard-Setting Body. The bill would require that annual financial reports filed by public companies under the securities laws must be audited by an accountant who is deemed qualified to do so by a new organization called the Public Company Accounting Oversight Board. CBO expects this provision would give the Oversight Board substantial authority to regulate and control entry into the accounting industry, thus exercising the sovereign power of the federal government. The fact that the board's rules, sanctions, funding sources, and annual budget would be approved by the SEC indicate a significant level of federal control over the board's operations and funding. For these reasons, CBO would consider the board's spending and the fees it would collect under the bill from public companies and accounting firms as part of the federal budget (even though the bill states it would not be part of the government).

The bill also would require the SEC to designate an organization called the Standard-Setting Body to write national standards for accounting practices. Under current law, all annual financial statements filed by public companies must comply with such standards. The bill also would mandate that the Standard-Setting body assess fees on public companies using a formula that would be approved by the SEC, thereby giving the federal government control over the Standard-Setting Body's funding. Therefore CBO also would consider this body's collections and spending a part of the federal budget (even though the bill states it would be organized as a private entity).

CBO expects that operating the Oversight Board, when fully implemented, would cost at least as much as similar activities that are now performed by the Public Oversight Board (POB) and the Independence Standards Board, and through peer reviews administered by the American Institute of Certified Public Accountants (AICPA). Before they recently disbanded, the POB and the Independence Standards Board spent about $8 million a year. The peer reviews administered by AICPA are conducted by other accounting firms. Based on information from AICPA, CBO estimates that these reviews could cost the Oversight Board at least $50 million

a year. Similarly, CBO expects that the annual costs of the Standard-Setting Board would approach the $20 million spent each year by the Federal Accounting Standards Board (FASB), which performs standard-setting duties today.

Under the bill, the Oversight Board and the Standard-Setting Body would assess fees on the public to cover their costs. CBO expects that the net effect of the two organizations' collections and spending under this bill would not be significant in any year. Whether such collections would be categorized in the budget as revenues or offsetting receipts is uncertain because we do not know how the organizations would assess those fees.

*Civil Penalties.*The bill also would authorize the SEC and the Oversight Board to enforce the bill's provisions with civil penalties. Such penalties are recorded in the budget as governmental receipts (revenues). Based on information from the SEC, CBO estimates that these provisions would increase revenues by less than $500,000 a year.

Under the bill, any civil penalties collected by the Oversight Board would be spent on scholarships for accounting students in undergraduate or graduate programs. Because the amounts spent would equal the penalties collected by the accounting board, CBO estimates that the increase in direct spending also would be less than $500,000 per year.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. CBO estimates that the net pay-as-you-go effects of this bill would be insignificant for each year.

Estimated impact on state, local, and tribal governments: Because it would preempt state authority to license or regulate the Public Company Accounting Oversight Board as a nonprofit corporation, the bill contains an intergovernmental mandate as defined in UMRA. CBO estimates that this preemption would not affect state budgets because, while it would limit the application of state law towards the board, it would not impose a duty on states that would result in additional spending. Therefore, the threshold established by UMRA ($58 million, in 2002, adjusted annually for inflation) would not be exceeded. The remaining provisions of the bill contain no intergovernmental mandates and would impose no costs on state, local, or tribal governments.

Estimated impact on the private sector

The bill would impose private-sector mandates, as defined by UMRA, on certain accounting firms, companies that issue registered securities, officers and directors of those companies, investment banking firms, and securities analysts. CBO cannot determine whether the direct cost of those mandates would exceed the annual threshold set by UMRA fro private-sector mandates ($115 million in 2002, adjusted annually for inflation). The mandate costs are difficult to estimate because (1) we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted; (2) the cost to comply with several of the mandates would depend on rules soon to be prescribed by the SEC under current authority; and (3) the

cost to comply with several of the mandates would depend on rules that would be prescribed by the SEC under the bill.

Regulation of accounting firms

Under the bill, a registered public accounting firm would be:

- Subject to a system of review by the Public Company Accounting Oversight Board to be established under the bill;
- Prohibited from offering both audit and certain non-audit consulting services (designing or implementing financial information systems or providing internal audit services); and
- Required to retain all audit work papers for at least seven years.

According to the American Institute of Certified Public Accountants (AICPA) and other industry representatives, the accounting industry currently:

- Sponsors a transitional private entity that reviews independent accountants:
- Has voluntarily stopped offering both audit and such non-audit consulting services; and
- Retains financial statement working papers and records for seven years.

Therefore, CBO estimates that the direct cost to comply with those new mandates would be small.

The bill would require an accounting firm to obtain a second review of audit reports from another auditor within the firm, and test and express an opinion on certain internal controls of public companies. The cost to obtain a second review and provide an opinion on compliance by a company would depend on rules to be prescribed by the SEC. Since the regulations have not been established, CBO cannot estimate the cost to comply with those mandates.

Registration and accounting support fees

The bill would require that the new Oversight Board and a designated Standard-Setting Body be independently funded by public companies. Based on information from the SEC, CBO estimates the annual cost of operating the oversight board and the standard-setting body would be approximately $80 million. The bill would require those organizations to levy fees on registered public accounting firms and an annual accounting support fee on issuers of securities. Currently, the accounting industry is self-regulated and voluntarily provides the funding for the regulatory organization, including peer reviews. According to the SEC and the industry, the cost of oversight and review required by the bill are similar to the costs now voluntarily incurred by the industry. Therefore the incremental cost to the private sector would be small.

Auditor independence

Section 203 of the bill would prohibit the lead and review partners of an accounting firm from providing audit services for the same company for more than five consecutive years. Based on information from the AICPA, CBO estimates that the direct cost to rotate lead and review partners would be minimal.

Section 206 would prohibit an accounting firm from providing audit services for a public company if that company's chief execu-

tive officer, financial officer, controller, or other equivalent position was employed by the accounting firm during the year before the start of the audit services. Based on information from the AICPA, CBO anticipates that some firms would lose business that other accounting firms would gain. Therefore, CBO estimates that total direct cost to the accounting industry would be negligible.

Corporate responsibility

The bill contains provisions that would require greater corporate responsibility for financial reports. The cost of complying with those requirements would depend on rules that the SEC has agreed to propose, but not yet promulgated. Therefore, CBO cannot estimate the direct costs of complying with the following mandates:

• Section 301 would require the audit committee of a corporate board to be responsible for the appointment, compensation, and oversight of the work of their auditors. This section also would prohibit national securities exchanges and associations from listing companies that do not comply with certain audit committee standards.

• Section 302 would require chief executive officers and chief financial officers of public companies to certify the appropriateness of their company's periodic reports and to ascertain that the financial reports fairly reflect the operations and conditions of their companies.

Periodic restrictions on insider trading

Section 306 would prohibit certain owners and officers of a company from selling equity securities issued by that company during periods (called "blackout" periods) when participants in the retirement plan are restricted in their ability to direct investments. Such periods may occur for administrative reasons—for example, when a plan changes recordkeepers. This restriction would increase the financial exposure of affected owners and officers and, thus, could impose a cost on them. CBO does not have sufficient information to estimate the amount of that cost.

Enhanced financial information disclosure

Section 403 would require officers and directors of companies that issue securities and certain owners of such securities to disclose to the SEC any insider trading by a certain time. According to the SEC, insider trading disclosure is currently required to be reported to the SEC by the tenth day following the month in which the trade occurred. Thus, CBO estimates that the cost of providing such information on an expedited basis would be small.

The bill also contains provisions that require increased disclosure of financial information. The cost of complying with those requirements would depend on rules that the SEC has agreed to propose, but not yet promulgated. Therefore, SEC cannot estimate the direct costs of complying with the following mandates:

• Under Title IV, the SEC would prescribe rules that would require companies that issue securities to report loans to insiders within a certain time period, to disclose material off balance sheet transactions and conflicts, and present pro forma data in a manner that is not misleading in periodic financial reports to the SEC.

• Section 404 would require a company and the company's auditor to attest to the company's internal control procedures in their annual reports. Public companies also would be required to disclose whether they have adopted a code of ethics for senior financial officers, and whether their audit committee has among its members a "financial expert."

Analyst conflicts of interest

Section 501 would require the SEC or a registered securities association or exchange to adopt rules to prohibit certain conflicts within investment banking firms that could compromise securities analysts' independence and to require security analysts to disclose other potential conflicts. The cost of prohibiting certain conflicts and disclosing additional information would depend on rules to be prescribed by the SEC or the directed authority. CBO does not have sufficient information to estimate the cost to comply with those mandates.

Previous CBO Estimate: On April 26, 2002, CBO transmitted a cost estimate for H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, as passed by the House of Representatives on April 24, 2002. H.R. 3763 would require the SEC to oversee a new board that would regulate the accounting industry and to accelerate its review of annual reports filed by public companies. CBO estimated that implementing H.R. 3763 would cost about $150 million over the 2003–2007 period, assuming the appropriation of the necessary amounts. Because of provisions that would create new civil penalties and a new accounting board that CBO considered part of the federal budget, CBO estimated that H.R. 3763 also would cause revenues and direct spending to rise to insignificant net amounts for each year.

For H.R. 3763, CBO identified similar private-sector mandates on accountants, companies that issue registered securities, officers and directors of those companies, and certain owners of the securities. CBO could not determine whether the total direct cost of those mandates would exceed the annual threshold established by UMRA for private-sector mandates as we did not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted.

Estimate prepared by: Federal costs: Ken Johnson; impact on state, local and tribal governments: Greg Waring; impact on the private sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

ADDITIONAL VIEWS OF SENATOR GRAMM

President Bush's Ten Point program for regulatory reform in corporate accounting and governance is an excellent plan, and he and his administration are to be commended for wasting no time in implementing it. The actions already being taken by the Securities and Exchange Commission, together with their published regulatory proposals, as well as the actions taken by our nation's stock markets, are firm, clear, and directed to the real problems. They represent substantial reform. It is also undeniable that changes are occurring in every board room, on every corporate audit committee, and with every accounting firm in America. But a legislative response is also called for.

First of all though, it would be hard to overestimate the importance of maintaining our system of private setting of accounting standards through the Financial Accounting Standards Board (FASB). Neither Congress nor any other agency of the government should be in the business of setting accounting standards. A bad accounting standard set by an independent board is better than a good standard set by Congress. But we do need to establish a stable, reliable funding mechanism for FASB.

With regard to legislation, the reported bill is better today than the bill as first proposed, yet the fundamental problems of the original bill remain. We should pass a bill that sets up an independent ethics supervisory board that will oversee and enforce the highest standards of ethics in public accounting. This board should be given power to determine what are conflicts of interest and to make determinations on questions of auditor independence. It should also be independently funded by a source that is committed to the purpose of funding that activity, and the funding source should be reliable.

Yet, even though some flexibility has been added, the structure of the bill is still troubling. If we are going to create this independent panel, we should create one in which we can place our confidence, allowing the panel, for example, to set the standards as to what represents a conflict of interest. While it is tempting to vote on these things and to set out in government writ for all time what we mean and what we want, if we are trying to make this board powerful, why would we want to prejudge what the panel is going to decide? There is a fundamental difference between having the board make decisions or having Congress make them.

When Congress prejudges the board's activities, we eliminate the flexibility that the board will need to apply statutory principles to the variety of circumstances that appear in the real world. The one-size-fits-all approach of the bill cripples the ability of the board to adjust to differences in situations among companies—particularly to distinguish between large and small companies—as well as to stay up to date with changes that occur over time.

This will be particularly hard on smaller companies. While the legislation allows for exceptions to its ban on auditors providing companies with additional services, these exceptions can only be obtained on a case-by-case basis. It is the smaller companies who routinely obtain a number of services from their auditor and who can least afford to pay for a second or third auditing firm to provide these additional services. These smaller business will be most likely to need the exemptions. But the smaller the company, the less likely it will be able to afford the legal services to get its needed exemptions from the new board. This is not a small problem, as the bill would impose its new regulatory requirements on 17,000 companies—the vast majority of which are small businesses—all across the country.

It may be easy to envision requiring that General Motors have six different accounting firms to comply with the conflict of interest rules. But it stretches reason and good judgment to legislate those same standards for Joe Green and Son Motor Repair of Texarkana. We should trust the board that we create and let them look at the feasibility for large and small companies, ask them to look at the benefits to shareholders, the integrity of the financial system and long term growth prospects. It is easy to envision that they might end up with standards that would be differentiated based on the size of accounting firms and the size of the businesses that are affected. We would preserve flexibility in doing this. One-size-fits-all will hurt a lot of shareholders and the businesses in which they have invested. And heaping unnecessary costs on struggling small enterprises, it will hurt the economy.

The point is, when you start setting out in law what auditing standards are, what the conflict of interest standard is, and the many other specific mandates in the bill, you eliminate flexibility, you eliminate the ability of the board to learn what works and what does not work, and you eliminate the ability of the board to differentiate between General Motors and Joe Green and Son, Incorporated. In the process of setting up a strong, independent board we have largely done our work. We ought not to be doing the board's work after that.

In addition, before this legislation becomes law, the concerns of constitutional experts with regard to the appointment, regulatory powers, and taxing authority of this new supervisory board will need to be resolved.

PHIL GRAMM.

ADDITIONAL VIEWS OF SENATOR ENZI

The collapse in the faith of corporate financial statements is alarming. Corporate executive abuses have shattered the savings and dreams of countless Americans. Broad and strong changes need to be implemented to restore that confidence and ensure these abuses do not take place in the future.

A wave of new regulations and legislative proposals have been introduced to protect America's investors against corporate abuses. The securities' self-regulatory organizations (SROs), the Securities and Exchange Commission (SEC), the White House, and Congress are all working on different approaches with the same goal—to ensure executives are providing accurate and reliable information to the public.

However, any approach must also be sensitive to the fact that auditors are a critical element in assuring the quality of a financial statement. Legislation that does not provide adequate liability protections for auditing firms will decrease the already minimal number of companies which can audit and evaluate complex and fast-growing companies. Without a competitive auditing industry, consumers may, at the end of the day, experience less reliable financial statements.

I believe this legislation, as reported by the Senate Banking Committee, will provide a disincentive for small accounting firms to continue to audit publicly traded companies. These small accounting firms may only audit a relatively few public companies, and my fear is that this legislation would increase their liability exponentially, thus the firms would decide to cease offering services to public companies. With current litigation downsizing an already limited number of accounting firms, we cannot allow additional regulations to drive more firms from offering auditing services to public companies.

The legislation also places a negative presumption on any approval of non-prohibited consulting services. Legislation should not mandate to audit committees that all consulting services are inherently conflicted. Audit committees should be left to make their own determination as to what services provided by their auditing companies is in the best interest of their shareholders.

I also have concerns that the setting of auditing standards will be taken out of the hands of accountants. Auditing standards are complicated and detailed and the setting of them requires the knowledge and expertise of individuals who understand and work in the field of accounting. I am hesitant to allow a Board, of which the majority must be non-accountants, to establish the standards under which accountants operate.

I continue to support reform of the accounting industry and will continue to work toward that goal with this legislation. I, however, will work to change aspects of the bill which I believe will impose severe unintended and unnecessary consequences on the accounting industry and their clients.

MIKE ENZI.

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II

Calendar No. 442

107TH CONGRESS
2D SESSION

S. 2673

To improve quality and transparency in financial reporting and independent audits and accounting services for public companies, to create a Public Company Accounting Oversight Board, to enhance the standard setting process for accounting practices, to strengthen the independence of firms that audit public companies, to increase corporate responsibility and the usefulness of corporate financial disclosure, to protect the objectivity and independence of securities analysts, to improve Securities and Exchange Commission resources and oversight, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 25, 2002

Mr. SARBANES, from the Committee on Banking, Housing, and Urban Affairs, reported the following original bill; which was read twice and placed on the calendar

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A BILL

To improve quality and transparency in financial reporting and independent audits and accounting services for public companies, to create a Public Company Accounting Oversight Board, to enhance the standard setting process for accounting practices, to strengthen the independence of firms that audit public companies, to increase corporate responsibility and the usefulness of corporate financial disclosure, to protect the objectivity and inde-

pendence of securities analysts, to improve Securities and Exchange Commission resources and oversight, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Public Company Accounting Reform and Investor Protection Act of 2002".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.
Sec. 2. Definitions.
Sec. 3. Commission rules and enforcement.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Sec. 101. Establishment; administrative provisions.
Sec. 102. Registration with the Board.
Sec. 103. Auditing, quality control, and independence standards and rules.
Sec. 104. Inspections of registered public accounting firms.
Sec. 105. Investigations and disciplinary proceedings.
Sec. 106. Foreign public accounting firms.
Sec. 107. Commission oversight of the Board.
Sec. 108. Accounting standards.
Sec. 109. Funding.

TITLE II—AUDITOR INDEPENDENCE

Sec. 201. Services outside the scope of practice of auditors.
Sec. 202. Preapproval requirements.
Sec. 203. Audit partner rotation.
Sec. 204. Auditor reports to audit committees.
Sec. 205. Conforming amendments.
Sec. 206. Conflicts of interest.
Sec. 207. Study of mandatory rotation of registered public accounting firms.
Sec. 208. Commission authority.
Sec. 209. Considerations by appropriate State regulatory authorities.

TITLE III—CORPORATE RESPONSIBILITY

Sec. 301. Public company audit committees.
Sec. 302. Corporate responsibility for financial reports.
Sec. 303. Improper influence on conduct of audits.

Sec. 304. Forfeiture of certain bonuses and profits.
Sec. 305. Officer and director bars and penalties.
Sec. 306. Insider trades during pension fund blackout periods prohibited.

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

Sec. 401. Disclosures in periodic reports.
Sec. 402. Enhanced conflict of interest disclosures.
Sec. 403. Disclosures of transactions involving management and principal stockholders.
Sec. 404. Management assessment of internal controls.
Sec. 405. Exemption.
Sec. 406. Code of ethics for senior financial officers.
Sec. 407. Disclosure of audit committee financial expert.

TITLE V—ANALYST CONFLICTS OF INTEREST

Sec. 501. Treatment of securities analysts by registered securities associations.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

Sec. 601. Authorization of appropriations.
Sec. 602. Appearance and practice before the Commission.
Sec. 603. Federal court authority to impose penny stock bars.
Sec. 604. Qualifications of associated persons of brokers and dealers.

TITLE VII—STUDIES AND REPORTS

Sec. 701. GAO study and report regarding consolidation of public accounting firms.
Sec. 702. Commission study and report regarding credit rating agencies.

SEC. 2. DEFINITIONS.

(a) IN GENERAL.—In this Act, the following definitions shall apply:

(1) APPROPRIATE STATE REGULATORY AUTHORITY.—The term ''appropriate State regulatory authority'' means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) AUDIT.—The term ''audit'' means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) AUDIT COMMITTEE.—The term ''audit committee'' means—

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) AUDIT REPORT.—The term ''audit report'' means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or

(ii) asserts that no such opinion can be expressed.

(5) BOARD.—The term ''Board'' means the Public Company Accounting Oversight Board established under section 101.

(6) COMMISSION.—The term ''Commission'' means the Securities and Exchange Commission.

(7) ISSUER.—The term ''issuer'' means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78*l*), or that is required to file reports pursuant to section 15(d) of that Act (15 U.S.C. 78o(d)), or that will be required to file such reports at the end of a fiscal year of the issuer in which a registration statement filed by such issuer has become effective pursuant to the Securities Act of 1933 (15 U.S.C. 77a et. seq.), unless its securities are registered under section 12 of the Securities Ex-

change Act of 1934 (15 U.S.C. 78c) on or before the end of such fiscal year.

(8) NON-AUDIT SERVICES.—The term ''non-audit services'' means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.—

(A) IN GENERAL.—The terms ''person associated with a public accounting firm'' (or with a ''registered public accounting firm'') and ''associated person of a public accounting firm'' (or of a ''registered public accounting firm'') mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) EXEMPTION AUTHORITY.—The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) PROFESSIONAL STANDARDS.—The term ''professional standards'' means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

(ii) relevant to audit reports for particular issues, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

(11) PUBLIC ACCOUNTING FIRM.—The term ''public accounting firm'' means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) REGISTERED PUBLIC ACCOUNTING FIRM.—The term ''registered public accounting

firm'' means a public accounting firm registered with the Board in accordance with this Act.

(13) RULES OF THE BOARD.—The term ''rules of the Board'' means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) SECURITY.—The term ''security'' has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(15) SECURITIES LAWS.—The term ''securities laws'' means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder.

(16) STATE.—The term ''State'' means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

(b) CONFORMING AMENDMENT.—Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) is amended by inserting ''the Public Company Accounting Reform and Investor Protection Act of 2002,'' before ''the Public''.

SEC. 3. COMMISSION RULES AND ENFORCEMENT.

(a) REGULATORY ACTION.—The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) ENFORCEMENT.—

(1) IN GENERAL.—A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2) INVESTIGATIONS, INJUNCTIONS, AND PROSECUTION OF OFFENSES.—Section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u) is amended

(A) in subsection (a)(1), by inserting ''the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,'' after ''is a participant,'';

(B) in subsection (d)(1), by inserting ''the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,'' after ''is a participant,'';

(C) in subsection (e), by inserting ''the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,'' after ''is a participant,''; and

(D) in subsection (f), by inserting ''or the Public Company Accounting Oversight Board'' after ''self-regulatory organization'' each place that term appears.

(3) CEASE-AND-DESIST PROCEEDINGS.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by inserting

"registered public accounting firm (as defined in section 2 of the Public Company Accounting Reform and Investor Protection Act of 2002)," after "government securities dealer,".

(c) EFFECT ON COMMISSION AUTHORITY.—Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;

(3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms, in accordance with section 105;

(5) perform such other duties or functions as the Board determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in

order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a dem-

onstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may im-

pose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to

any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

(g) RULES OF THE BOARD.—The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by

the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) ANNUAL REPORT TO THE COMMISSION.—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

SEC. 102. REGISTRATION WITH THE BOARD.

(a) MANDATORY REGISTRATION.—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to pre-

pare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) APPLICATIONS FOR REGISTRATION.—

(1) FORM OF APPLICATION.—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) CONTENTS OF APPLICATIONS.—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) CONSENTS.—Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in

accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) PUBLIC AVAILABILITY.—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public dis-

closure information reasonably identified by the subject accounting firm as proprietary information.

(f) REGISTRATION AND ANNUAL FEES.—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES.

(a) AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.—

"(1) IN GENERAL.—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) RULE REQUIREMENTS.—In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe the scope of the auditor's testing of the system of internal accounting controls of the issuer required by section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)), and

present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such system of internal accounting controls—

(aa) complies with the requirements of that section 13(b)(2); and

(bb) provides reasonable assurance that receipts and expenditures of the issuer comply with applicable law, and are being made in accordance with proper authorizations of the management and directors of the issuer; and

(III) a description of significant defects in such internal controls, and of any material noncompliance, of which the auditor should know on the basis of such testing; and

(B) shall include, in the quality control standards that it adopts with respect to the

issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, and advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(3) AUTHORITY TO ADOPT OTHER STANDARDS.—

(A) IN GENERAL.—In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the

Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) INDEPENDENCE STANDARDS AND RULES.—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.—

(1) IN GENERAL.—The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection

(a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) BOARD RESPONSES.—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) EVALUATION OF STANDARD SETTING PROCESS.—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) IN GENERAL.—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and

associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) INSPECTION FREQUENCY.—

(1) IN GENERAL.—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) ADJUSTMENTS TO SCHEDULES.—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take appropriate disciplinary action, if any, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and

by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably

identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be ''final agency action'' for purposes of section 704 of title 5, United States Code.

(3) TIMING.—Review under paragraph (1) may be sought during the 30-day period following the

date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS.

(a) IN GENERAL.—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

(b) INVESTIGATIONS.—

(1) AUTHORITY.—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) TESTIMONY AND DOCUMENT PRODUCTION.—In addition to such other actions as the

Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) NONCOOPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) REFERRAL.—The Board may refer an investigation under this section—

(A) to the Commission;

(B) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(C) at the direction of the Commission, to—

(i) the Attorney General of the United States;

(ii) the attorney general of 1 or more States; and

(iii) the appropriate State regulatory authority.

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—All information referred to in subparagraph (A) may, in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, and without the loss of its status as confidential and privileged in the

hands of the Board, be made available to the Commission, the Attorney General of the United States, to the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator, to State attorneys general in connection with any criminal investigation, and to any appropriate State regulatory authority, which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title;

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than $100,000 for a natural person or $2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than $750,000 for a natural person or $15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the appli-

cable statutory, regulatory, or professional standard.

(6) FAILURE TO SUPERVISE.—

(A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting

firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION.—

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of

reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.—

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending re-

view of any disciplinary action of the Board under this subsection.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.—

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that

such firm (or class of firms) should be treated as a public accounting firm (or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.—

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term ''foreign public accounting firm'' means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD.

(a) GENERAL OVERSIGHT RESPONSIBILITY.—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act.

(b) RULES OF THE BOARD.—

(1) DEFINITION.—In this section, the term ''proposed rule'' means any proposed rule of the Board, and any modification of any such rule.

(2) PRIOR APPROVAL REQUIRED.—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) APPROVAL CRITERIA.—The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) PROPOSED RULE PROCEDURES.—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a ''registered securities association'' for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase ''consistent with the requirements of this title and the rules and regu-

lations thereunder applicable to such organization'' in section 19(b)(2) of that Act shall be deemed to read ''consistent with the requirements of title I of the Public Company Accounting Reform and Investor Protection Act of 2002, and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors''; and

(B) the phrase ''otherwise in furtherance of the purposes of this title'' in section 19(b)(3)(C) of that Act shall be deemed to read ''otherwise in furtherance of the purposes of title I of the Public Company Accounting Reform and Investor Protection Act of 2002''.

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a ''registered securities association'' for purposes of that section 19(c), except that the phrase ''to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such orga-

nization, or otherwise in furtherance of the purposes of this title'' in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read ''to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Public Company Accounting Reform and Investor Protection Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board''.

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section

105(b)(3) of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to ''members'' of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase ''consistent with the purposes of this title'' in that section 19(e)(1) shall be deemed to read ''consistent with the purposes of this title and title I of the Public Company Accounting Reform and Investor Protection Act of 2002'';

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compli-

ance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove

from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

''(b) RECOGNITION OF ACCOUNTING STANDARDS.—

''(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commis-

sion may recognize, as 'generally accepted' for purposes of the securities laws, any accounting principles established by a standard setting body—

"(A) that—

"(i) is organized as a private entity;

"(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

"(iii) is funded as provided in section 109 of the Public Company Accounting Reform and Investor Protection Act of 2002;

"(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices;

"(v) considers, in adopting accounting principles, the need to keep standards cur-

rent in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

''(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

''(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.''.

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—

(1) STUDY.—

(A) IN GENERAL.—The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) STUDY TOPICS.—The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING.

(a) IN GENERAL.—The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) ANNUAL BUDGETS.—The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains. The budget of the Board shall be subject to approval by the Commission.

(c) SOURCES AND USES OF FUNDS.—

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e).

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—All funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be nec-

essary or appropriate to establish and maintain the Board.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (f), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.—The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (f), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(g) CONFORMING AMENDMENTS.—Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)) is amended—

(1) in subparagraph (A), by striking ''and'' at the end;

(2) in subparagraph (B), by striking the period at the end and inserting the following: ''; and

''(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a rea-

sonable annual accounting support fee or fees, determined in accordance with section 109 of the Public Company Accounting Reform and Investor Protection Act of 2002.''.

(h) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

TITLE II—AUDITOR INDEPENDENCE

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended by adding at the end the following:

''(g) PROHIBITED ACTIVITIES.—It shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit

required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Public Company Accounting Reform and Investor Protection Act of 2002 (in this section referred to as the 'Board'), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

"(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

"(2) financial information systems design and implementation;

"(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

"(4) actuarial services;

"(5) internal audit outsourcing services;

"(6) management functions or human resources;

"(7) broker or dealer, investment adviser, or investment banking services;

"(8) legal services and expert services unrelated to the audit; and

"(9) any other service that the Board determines, by regulation, is impermissible.

"(h) PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.—A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).".

(b) EXEMPTION AUTHORITY.—The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(i) PREAPPROVAL REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) AUDIT COMMITTEE ACTION.—All auditing services (which may entail providing comfort letters in connection with securities underwritings) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

"(B) DE MINIMUS EXCEPTION.—The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

"(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor;

"(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

"(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved by the audit committee prior to the completion of the audit, by 1 or more members of the

audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

"(2) DISCLOSURE TO INVESTORS.—Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

"(3) DELEGATION AUTHORITY.—The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

"(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES.—In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service

shall be deemed to have been preapproved for purposes of this subsection.''.

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

''(j) AUDIT PARTNER ROTATION.—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead audit partner (having primary responsibility for the audit) or the audit partner responsible for reviewing the audit that is assigned to perform those audit services has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.''.

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

''(k) REPORTS TO AUDIT COMMITTEES.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

''(1) all critical accounting policies and practices to be used;

"(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

"(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.".

SEC. 205. CONFORMING AMENDMENTS.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

"(58) AUDIT COMMITTEE.—The term 'audit committee' means—

"(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

"(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

"(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term 'registered public accounting firm' has the same meaning as in section 3 of the Public Company Accounting Reform and Investor Protection Act of 2002.".

(b) AUDITOR REQUIREMENTS.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended—

(1) by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm";

(2) by striking "the independent public accountant" each place that term appears and inserting "the registered public accounting firm";

(3) in subsection (c), by striking "No independent public accountant" and inserting "No registered public accounting firm"; and

(4) in subsection (b)—

(A) by striking "the accountant" each place that term appears and inserting "the firm";

(B) by striking ''such accountant'' each place that term appears and inserting ''such firm''; and

(C) in paragraph (4), by striking ''the accountant's report'' and inserting ''the report of the firm''.

(c) OTHER REFERENCES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 12(b)(1) (15 U.S.C. 78*l*(b)(1)), by striking ''independent public accountants'' each place that term appears and inserting ''a registered public accounting firm''; and

(2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking ''an independent public accountant'' each place that term appears and inserting ''a registered public accounting firm''.

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

''(*l*) CONFLICTS OF INTEREST.—It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer or any person serving in an equivalent

position for the issuer was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.''.

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) STUDY AND REVIEW REQUIRED.—The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section.

(c) DEFINITION.—For purposes of this section, the term ''mandatory rotation'' refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY.

(a) COMMISSION REGULATIONS.—Not later than 180 days after the date of enactment of this Act, the Commis-

sion shall issue final regulations to carry out each of subsections (g) through (*l*) of section 10A of the Securities Exchange Act of 1934, as added by this title.

(b) AUDITOR INDEPENDENCE.—It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (*l*) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES.

It is the intention of this Act that, in supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small- and medium-sized nonregistered public accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

SEC. 301. PUBLIC COMPANY AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following:

"(m) STANDARDS RELATING TO AUDIT COMMITTEES.—

"(1) COMMISSION RULES.—

"(A) IN GENERAL.—Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

"(B) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

"(2) RESPONSIBILITIES RELATING TO REGISTERED PUBLIC ACCOUNTING FIRMS.—The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

"(3) INDEPENDENCE.—

"(A) IN GENERAL.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

"(B) CRITERIA.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

"(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

"(ii) be an affiliated person of the issuer or any subsidiary thereof.

"(C) EXEMPTION AUTHORITY.—The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Commission determines appropriate in light of the circumstances.

"(4) COMPLAINTS.—Each audit committee shall establish procedures for—

"(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

"(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

"(5) AUTHORITY TO ENGAGE ADVISERS.—Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

"(6) FUNDING.—Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

"(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

"(B) to any advisers employed by the audit committee under paragraph (5).".

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) CERTIFICATION OF PERIODIC REPORTS.—Each periodic report containing financial statements filed by an issuer with the Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, shall be accompanied by a written statement by the chief executive officer and chief financial officer (or the equivalent thereof) of the issuer.

(b) CONTENT.—The statement required by subsection (a) shall certify the appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer.

SEC. 303. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) ENFORCEMENT.—In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment.

SEC. 304. FORFEITURE OF CERTAIN BONUSES AND PROFITS.

(a) ADDITIONAL COMPENSATION PRIOR TO NONCOMPLIANCE WITH COMMISSION FINANCIAL REPORTING REQUIREMENTS.—If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) COMMISSION EXEMPTION AUTHORITY.—The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

SEC. 305. OFFICER AND DIRECTOR BARS AND PENALTIES.

(a) UNFITNESS STANDARD.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(2)) is amended by striking ''substantial unfitness'' and inserting ''unfitness''.

(2) SECURITIES ACT OF 1933.—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking ''substantial unfitness'' and insert ''unfitness''.

(b) EQUITABLE RELIEF.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended—

(1) by redesignating paragraphs (2) through (4) as paragraphs (3) through (5), respectively; and

(2) by inserting after paragraph (1) the following:

''(2) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.''.

SEC. 306. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS PROHIBITED.

(a) PROHIBITION.—It shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security), during any blackout period with respect to such equity security, in accordance with any exception provided by rule of the Commission pursuant to subsection (d).

(b) EFFECTIVENESS.—

(1) NOTICE REQUIREMENTS.—Except as provided in paragraph (2), no blackout period may take effect earlier than 30 days after the date on which written notice of such blackout period is provided by the plan administrator to the participants or beneficiaries.

(2) EXCEPTION.—The 30-day notice requirement in paragraph (1) shall not apply, and notice under paragraph (1) shall be furnished as soon as is reasonably possible, in any case in which—

(A) a deferral of the blackout period would violate the requirements of subparagraph (A) or (B) of section 404(a)(1) of the Employment Retirement Income Security Act of 1974, and a fi-

duciary of the plan so reasonably determines in writing; or

(B) the inability to provide the 30-day notice is due to events that were unforeseeable, or circumstances beyond the reasonable control of the plan administrator, and a fiduciary of the plan so reasonably determines in writing.

(3) WRITTEN NOTICE.—The notice required to be provided under paragraph (1) shall be in writing, except that such notice may be in electronic form to the extent that such form is reasonably accessible to the recipient.

(c) REMEDY.—

(1) IN GENERAL.—Any profit realized by a director or executive officer referred to in subsection (a) from any purchase, sale, or other acquisition or transfer in violation of this section shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(2) ACTIONS TO RECOVER PROFITS.—An action to recover profits in accordance with this section may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and

in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(d) RULEMAKING AUTHORIZED.—The Commission may issue rules to clarify the application of this subsection, to ensure adequate notice to all persons affected by this subsection, and to prevent evasion thereof.

(e) DEFINITIONS.—For purposes of this section—

(1) the term ''blackout period'', with respect to the equity securities of any issuer—

(A) means any period during which the ability of not fewer than 50 percent of the participants or beneficiaries under all applicable individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan, is suspended by the issuer or a fiduciary of the plan; and

(B) does not include—

(i) a period in which the employees of an issuer may not allocate their interests

in the individual account plan due to an express investment restriction—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before joining the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an applicable individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction; and

(2) the term ''individual account plan'' has the same meaning as in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)).

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

SEC. 401. DISCLOSURES IN PERIODIC REPORTS.

(a) DISCLOSURES REQUIRED.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(i) ACCURACY OF FINANCIAL REPORTS.—Each financial report that is required to be prepared in accordance with generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

"(j) OFF-BALANCE SHEET TRANSACTIONS.—Not later than 180 days after the date of enactment of the Public Company Accounting Reform and Investor Protection Act of 2002, the Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condi-

tion, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.''.

(b) COMMISSION RULES ON PRO FORMA FIGURES.—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

SEC. 402. ENHANCED CONFLICT OF INTEREST DISCLOSURES.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

''(k) ENHANCED DISCLOSURES OF LOANS.—

"(1) IN GENERAL.—The Commission shall, by rule, require each issuer of any securities registered pursuant to section 12 to disclose to the Commission, in writing—

"(A) other than as provided in paragraph (2), each loan by that issuer, or an affiliate thereof, to a director or executive officer of that issuer, or a loan guarantee or similar arrangement from that issuer in favor of another person who lends, or agrees to lend, money to the director or executive officer of the issuer, including the amounts loaned and balances owed, not later than 7 calendar days after the date on which the loan, guarantee, or other arrangement is made, or such other time period, as determined appropriate by the Commission;

"(B) together with each report or other document required to be filed under this section in the case of each loan, guarantee, or similar arrangement described in subparagraph (A), whether—

"(i) the obligation has been forgiven;

"(ii) the issuer or its affiliate makes payment on the obligation; and

"(iii) any collateral is foreclosed upon with respect to the obligation; and

"(C) any conflict of interest, as defined by the Commission, on the part of any partner, officer, director, or other management official or affiliated person of the issuer.

"(2) EXCEPTIONS.—Paragraph (1)(A) does not require disclosure by an issuer of any extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)) that is—

"(A) made in the ordinary course of the consumer credit business of an issuer;

"(B) of a type that is generally made available by the issuer to the public; and

"(C) made on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such loans.

"(3) FORM OF DISCLOSURES.—Disclosures required by this subsection shall be in such form and subject to such terms and conditions as the Commission shall specify.".

SEC. 403. DISCLOSURES OF TRANSACTIONS INVOLVING MANAGEMENT AND PRINCIPAL STOCKHOLDERS.

Section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78p(a)) is amended—

(1) by striking ''security, shall file,'' and inserting the following:

''(1) shall file''; and

(2) by striking ''beneficial owner, and'' and all that follows through the end of the subsection and inserting the following: ''beneficial owner; and

''(2) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving such equity security, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement before the end of the second business day following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible, indicating ownership by that person at the date of filing, any such changes in such ownership, and such purchases and sales of the

security-based swap agreements as have occurred since the most recent such filing under this paragraph.''.

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board.

Any such attestation shall not be the subject of a separate engagement.

SEC. 405. EXEMPTION.

Nothing in section 401, 402, or 404, the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS.

(a) CODE OF ETHICS DISCLOSURE.—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer, comptroller or principal accounting officer, or persons performing similar functions.

(b) CHANGES IN CODES OF ETHICS.—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8–K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or

by other electronic means, by any issuer of any change in or waiver of the code of ethics of the issuer.

(c) DEFINITION.—In this section, the term ''code of ethics'' means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

SEC. 407. DISCLOSURE OF AUDIT COMMITTEE FINANCIAL EXPERT.

(a) RULES DEFINING ''FINANCIAL EXPERT''.—The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) CONSIDERATIONS.—In defining the term ''financial expert'' for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

TITLE V—ANALYST CONFLICTS OF INTEREST

SEC. 501. TREATMENT OF SECURITIES ANALYSTS BY REGISTERED SECURITIES ASSOCIATIONS.

(a) RULES REGARDING SECURITIES ANALYSTS.—Section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3) is amended by adding at the end the following:

''(n) RULES REGARDING SECURITIES ANALYSTS.—

"(1) ANALYST PROTECTIONS.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this subsection, rules reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed—

"(A) to foster greater public confidence in securities research, and to protect the objectivity and independence of securities analysts, by—

"(i) restricting the prepublication clearance or approval of research reports by persons employed by the broker or dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

"(ii) limiting the supervision and compensatory evaluation of securities analysts

to officials employed by the broker or dealer who are not engaged in investment banking activities; and

''(iii) requiring that a broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report, except that such rules may not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such research report in accordance with the policies and procedures of the firm;

''(B) to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or

otherwise distribute research reports relating to such securities or to the issuer of such securities;

"(C) to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision; and

"(D) to address such other issues as the Commission, or such association or exchange, determines appropriate.

"(2) DISCLOSURE.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this subsection, rules reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report, as applicable, conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the

time of the appearance or the date of distribution of the report, including—

"(A) the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report;

"(B) whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the securities analyst, from the issuer that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure by virtue of this subparagraph of material nonpublic information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors;

"(C) whether an issuer, the securities of which are recommended in the appearance or research report, currently is, or during the 1-year period preceding the date of the appearance or date of distribution of the report has been, a client of the registered broker or dealer,

and if so, stating the types of services provided to the issuer;

''(D) whether the securities analyst received compensation with respect to a research report, based upon (among any other factors) the investment banking revenues (either generally or specifically earned from the issuer being analyzed) of the registered broker or dealer; and

''(E) such other disclosures of conflicts of interest that are material to investors, research analysts, or the broker or dealer as the Commission, or such association or exchange, determines appropriate.

''(3) DEFINITIONS.—In this subsection—

''(A) the term 'securities analyst' means any associated person of a registered broker or dealer that is principally responsible for, and any associated person who reports directly or indirectly to a securities analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of 'securities analyst'; and

''(B) the term 'research report' means a written or electronic communication that in-

cludes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.''.

(b) ENFORCEMENT.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended by inserting ''15A(n),'' before ''15B''.

(c) COMMISSION AUTHORITY.—The Commission may promulgate and amend its regulations, or direct a registered securities association or national securities exchange to promulgate and amend its rules, to carry out section 15A(n) of the Securities Exchange Act of 1934, as added by this section, as is necessary for the protection of investors and in the public interest.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

SEC. 601. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

''SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

''In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $776,000,000 for fiscal year 2003, of which—

"(1) $102,700,000 shall be available to fund additional compensation, including salaries and benefits, as authorized in the Investor and Capital Markets Fee Relief Act (Public Law 107–123; 115 Stat. 2390 et seq.);

"(2) $108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and

"(3) $98,000,000 shall be available to add not fewer than an additional 200 qualified professionals to provide enhanced oversight of auditors and audit services required by the Federal securities laws, and to improve Commission investigative and disciplinary efforts with respect to such auditors and services, as well as for additional professional support staff necessary to strengthen the programs of the Commission involving Full Disclosure and Prevention and Suppression of Fraud, risk management, industry technology review, compliance, inspections, examinations, market regulation, and investment management.".

SEC. 602. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4B the following:

"SEC. 4C. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

"(a) AUTHORITY TO CENSURE.—The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—

"(1) not to possess the requisite qualifications to represent others;

"(2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or

"(3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

"(b) DEFINITION.—With respect to any registered public accounting firm, for purposes of this section, the term 'improper professional conduct' means—

"(1) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and

"(2) negligent conduct in the form of—

"(A) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm knows, or should know, that heightened scrutiny is warranted; or

"(B) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.".

SEC. 603. FEDERAL COURT AUTHORITY TO IMPOSE PENNY STOCK BARS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)), as amended by this Act, is amended by adding at the end the following:

"(7) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(A) IN GENERAL.—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(B) DEFINITION.—For purposes of this paragraph, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.

(b) SECURITIES ACT OF 1933.—Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following:

"(g) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(1) IN GENERAL.—In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(2) DEFINITION.—For purposes of this subsection, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

SEC. 604. QUALIFICATIONS OF ASSOCIATED PERSONS OF BROKERS AND DEALERS.

(a) BROKERS AND DEALERS.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by striking subparagraph (F) and inserting the following:

''(F) is subject to any order of the Commission barring or suspending the right of the person to be associated with a broker or dealer;''; and

(2) in subparagraph (G), by striking the period at the end and inserting the following: ''; or

''(H) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

''(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

''(ii) constitutes a final order based on violations of any laws or regulations that prohibit

fraudulent, manipulative, or deceptive conduct.''.

(b) INVESTMENT ADVISERS.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended by striking paragraphs (7) and (8) and inserting the following:

''(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser; or

''(8) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

''(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(c) CONFORMING AMENDMENTS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(A) in section 3(a)(39)(F) (15 U.S.C. 78c(a)(39)(F)), by inserting ", or is subject to an order or finding," before "enumerated";

(B) in each of sections 15(b)(6)(A)(i) (15 U.S.C. 78o(b)(6)(A)(i)), paragraphs (2) and (4) of section 15B(c) (15 U.S.C. 78o–4(c)), and subparagraphs (A) and (C) of section 15C(c)(1) (15 U.S.C. 78o–5(c)(1)) by striking "or omission" each place that term appears, and inserting ", or is subject to an order or finding,"; and

(C) in each of paragraphs (3)(A) and (4)(C) of section 17A(c) (15 U.S.C. 78q–1(c)), by inserting ", or is subject to an order or finding," before "enumerated" each place that term appears.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940

(15 U.S.C. 80b–3(f)) is amended, by inserting ''or (3)'' after ''paragraph (2)''.

TITLE VII—STUDIES AND REPORTS

SEC. 701. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF PUBLIC ACCOUNTING FIRMS.

(a) STUDY REQUIRED.—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms capable of providing audit services to large national and multi-national business organizations that are subject to the securities laws;

(B) the present and future impact of the condition described in subparagraph (A) on capital formation and securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing audit services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among public accounting firms, including—

(A) higher costs;

(B) lower quality of services;

(C) impairment of auditor independence; or

(D) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among public accounting firms.

(b) CONSULTATION.—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Commission;

(2) the regulatory agencies that perform functions similar to the Commission within the other member countries of the Group of Seven Industrialized Nations;

(3) the Department of Justice; and

(4) any other public or private sector organization that the Comptroller General considers appropriate.

(c) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General

shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 702. COMMISSION STUDY AND REPORT REGARDING CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the role of credit rating agencies in the evaluation of issuers of securities;

(B) the importance of that role to investors and the functioning of the securities markets;

(C) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(D) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(E) any measures which may be required to improve the dissemination of information

concerning such resources and risks when credit rating agencies announce credit ratings; and

(F) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

(b) REPORT REQUIRED.—The Commission shall submit a report on the study required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 180 days after the date of enactment of this Act.

Calendar No. 366

107TH CONGRESS, 2d Session | SENATE | REPORT 107–146

THE CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY ACT OF 2002

MAY 6, 2002.—Ordered to be printed

Mr. LEAHY, from the Committee on the Judiciary, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[Including the cost estimate of the Congressional Budget Office]

[To accompany S. 2010]

The Committee on the Judiciary, to which was referred the bill (S. 2010) to provide for criminal prosecution of persons who alter or destroy evidence in certain Federal investigations or defraud investors of publicly traded securities, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers against retaliation by their employers, and for other purposes, having considered the same, reports favorably thereon, with an amendment in the nature of a substitute, and recommends that the bill, as amended, do pass.

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99–010

I. PURPOSE

The purpose of S. 2010, the "Corporate and Criminal Fraud Accountability Act of 2002," is to provide for criminal prosecution and enhanced penalties of persons who defraud investors in publicly traded securities or alter or destroy evidence in certain Federal investigations, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers who report fraud against retaliation by their employers, and for other purposes.

II. BACKGROUND AND NEED FOR THE LEGISLATION

A. Introduction

The "Corporate and Criminal Fraud Accountability Act of 2002," S. 2010, was introduced by Senator Patrick Leahy, with Senators Daschle, Durbin, and Harkin as original cosponsors, on March 12, 2002. This legislation aims to prevent and punish corporate and criminal fraud, protect the victims of such fraud, preserve evidence of such fraud, and hold wrongdoers accountable for their actions.

In the wake of the continuing Enron Corporation ("Enron") debacle, the trust of the United States' investors and pensioners in the nation's stock market has been seriously eroded. This is bad for our markets, bad for our economy, and bad for the future growth of investment in American companies. This bill would play a crucial role in restoring trust in the financial markets by ensuring that the corporate fraud and greed may be better detected, prevented and prosecuted. While greed cannot be legislated against, the federal government must do its utmost to ensure that such greed does not succeed. This bill contains a number of provisions intended to increase the criminal penalties for serious fraud, ensure that evidence—both physical and testimonial—is preserved and available in fraud cases, provide prosecutors with the tools they need to prosecute those who commit securities fraud, and make sure that victims of securities fraud have a fair chance to pursue their claims and recoup their losses.

B. Enron's collapse

Enron began in 1985 as a pipeline company in Houston, Texas. It garnered profits by promising to deliver agreed-upon numbers of cubic feet of gas to a particular utility or business on a specific day at market price. That changed with the deregulation of electrical power markets, a change due in part to lobbying from senior Enron officials. Under the direction of former Chairman Kenneth L. Lay, Enron expanded into an energy broker, trading electricity and other commodities.

According to a Report of Investigation commissioned by a Special Investigative Committee of Enron's Board of Directors ("the Powers Report"), Enron apparently, with the approval or advice of its accountants, auditors and lawyers, used thousands of off-the-book entities to overstate corporate profits, understate corporate debts and inflate Enron's stock price.

The alleged activity Enron used to mislead investors was not the work of novices. It was the work of highly educated professionals, spinning an intricate spider's web of deceit. The partnerships—with names like Jedi, Chewco, Rawhide, Ponderosa and

Sundance—were used essentially to cook the books and trick both the public and federal regulators about how well Enron was doing financially. The actions of Enron's executives, accountants, and lawyers exhibit a "Wild West" attitude which valued profit over honesty.

Some Enron executives, with the knowledge and approval of its Board of Directors, managed these entities, reaped millions of dollars in salary and stock options, and received conflict-of-interest waivers from Enron's Board. As the Powers Report states, "[m]any of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve bona fide economic objectives or to transfer risk" (Powers Report at 4). Much of this conduct occurred with "extensive participation and structuring advice from [Arthur] Andersen," ("Andersen") which was simultaneously serving as both consultant and "independent" auditor for Enron.[1]

With the assistance of Andersen and its other auditors, Enron apparently successfully deceived the investing public and reaped millions for some select few insiders.[2] To the outside world, Enron and its auditors were either not reporting their massive debt at all, or were making "disclosures [that] were obtuse, did not communicate the essence of [Enron] transactions completely or clearly, and failed to convey the substance of what was going on between Enron and its partnerships" (Powers Report at 17). In short, through the use of sophisticated professional advice and complex financial structures, Enron and Andersen were able to paint for the investing public a very different picture of the company's financial health than the true picture revealed. By the fall of 2001, the painting bore little or no resemblance to the reality.

According to a federal indictment, on October 16, 2001, Enron announced a $618 million net loss for the third quarter of 2001 and that it would reduce shareholder equity by $1.2 billion.[3] Six days later, the Securities and Exchange Commission ("SEC") began investigating the financial practices of Enron and Andersen. On November 8, 2001, Enron announced that it had overstated earnings during the prior four years by $586 million and was responsible for $3 billion in obligations that were never publicly reported. Upon these disclosures, Enron stock fell to $8.41 a share and has since fallen to less than $1 (the stock had been trading at near $90 per share). Less than a month later Enron filed for bankruptcy—the largest corporate bankruptcy in the history of the United States.

On February 6, 2001, at a Senate Judiciary Committee hearing on "Accountability Issues: Lessons Learned from Enron's Fall" ("Committee hearing"), witnesses testified that Enron's sudden collapse left thousands of investors holding virtually worthless stock, and most Enron employees with a worthless retirement account.

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[1] Powers Report at 5. For example, Enron's records show that Andersen billed Enron $5.7 million for advice in connection with the now infamous "LJM" and "Chewco" transactions, beyond its regular audit fees. Id.

[2] For example, in one insider transaction, known as "Southhampton Place," insider Andrew Fastow, a senior Enron official, invested $25,000 and received $4.5 million in return in a period of two months. Powers Report at 16. On an annual basis, this represents a profit margin of over 100,000%.

[3] See Indictment, *United States* v. *Arthur Andersen LLP*, Cr. No. CRH–02–121, United States District Court for the Southern District of Texas at 2–3. ("Andersen Indictment"). The indictment, filed on March 7, 2002, charges Andersen with persuading others to destroy documents in violation of 18 U.S.C. § 1512(b)(2).

Pension funds nationwide, including state and union-owned pension funds, literally lost billions on Enron-related investments. Bruce Raynor, President of the Union of Needletrades, Industrial and Textile Employees ("UNITE") and Vice President of the American Federation of Labor-Congress of Industrial Organizations ("AFL–CIO"), and Co-Chair of the Council of Institutional Investors, testified that UNITE members lost millions in the Enron collapse and that institutional investments, such as pension funds, are "particularly vulnerable" to such fraud because of their reliance on index funds, which "rely on the market to accurately price securities." Firefighters, teachers, garment workers, and police officers who had no way of knowing or finding out about Enron's apparently deceitful conduct ahead of time lost millions in pension fund investments.

Mr. Raynor, Washington State Attorney General Christine O. Gregoire, and securities and legal ethics expert Professor Susan P. Koniak, of the Boston University School of Law, also testified that Enron was merely one extreme example of numerous other cases of fraud on investors. Like those cases, the few at Enron who profited appear to be senior officers and directors who cashed out while they and professionals from accounting firms, law firms and business consulting firms, who were paid millions to advise Enron on these practices, assured others that Enron was a solid investment.

C. The aftermath of Enron's collapse and the cover up

As investors and regulators attempted to ascertain both the extent and cause of their losses, employees from Andersen were allegedly shredding "tons" of documents, according to the Andersen Indictment. Instead of preserving records relevant and material to the later investigation of Enron or any private action against Enron, "Andersen partners assigned to the Enron engagement team launched on October 23, 2001, a wholesale destruction of documents at Andersen's offices in Houston, Texas." Moreover, "instead of being advised to preserve documentation so as to assist Enron and the SEC, Andersen employees on the Enron engagement team were instructed by Andersen partners and others to destroy immediately documentation relating to Enron, and told to work overtime if necessary to accomplish the destruction" (Andersen Indictment at 5–6).

The systematic destruction of records apparently extended beyond paper records and included efforts to "purge the computer hard drives and E-mail system of Enron related files" not only in Houston but in Andersen's offices in Portland, Chicago, Illinois, and London, England (Id. at 6). Indeed, the current rules on audit record retention are so vague that Andersen's lawyers issued ambiguous advice encouraging such document destruction—advice that they linked to highly questionable interpretations of current law. In addition to the indictment of Andersen, Andersen partner David Duncan, who did significant work for Enron, has pleaded guilty to the same obstruction charge. Allegedly, these actions were undertaken in anticipation of a SEC subpoena to Andersen for its auditing and consulting work related to Enron.

The apparent efforts to cover up any alleged misconduct by Enron or Andersen were not limited to Andersen and the destruction of physical evidence and documents. In a variety of instances

when corporate employees at both Enron and Andersen attempted to report or "blow the whistle" on fraud, but they were discouraged at nearly every turn. For instance, a shocking e-mail from Enron's outside lawyers to an Enron official was uncovered. This e-mail responds to a request for legal advice after a senior Enron employee, Sherron Watkins, tried to report accounting irregularities at the highest levels of the company in late August 2001. The outside lawyer's counseled Enron, in pertinent part, as follows:

> You asked that I include in this communication a summary of the possible risks associated with discharging (or constructively discharging) employees who report allegations of improper accounting practices: 1. Texas law does not currently protect corporate whistleblowers. The supreme court has twice declined to create a cause of action for whistleblowers who are discharged * * *

In other words, after this high level employee at Enron reported improper accounting practices, Enron did not consider firing Andersen; rather, the company sought advice on the legality of discharging the whistleblower. Of course, Enron's lawyers would claim that they merely provided their client with accurate legal advice—there is no protection for corporate whistleblowers under current Texas law. In the end, Ms. Watkins did not report the matter to the authorities until after she had been subpoenaed, and after "tons" of documents had been destroyed.[4]

According to media accounts, this was not an isolated example of whistleblowing associated with the Enron case. In addition, a financial adviser at UBS Paine Webber's Houston office claims that he was fired for e-mailing his clients to advise them to sell Enron stock.[5] A top Enron risk management official alleges he was cut off from financial information and later resigned from Enron after repeatedly warning both orally and in writing as early as 1999 of improprieties in some of the company's off-balance sheet partnerships.[6] An Andersen partner was apparently removed from the Enron account when he expressed reservations about the firm's financial practices in 2000.[7] These examples further expose a culture, supported by law, that discourage employees from reporting fraudulent behavior not only to the proper authorities, such as the FBI and the SEC, but even internally. This "corporate code of silence" not only hampers investigations, but also creates a climate where ongoing wrongdoing can occur with virtual impunity. The consequences of this corporate code of silence for investors in publicly traded companies, in particular, and for the stock market, in general, are serious and adverse, and they must be remedied.

D. The legal and ethical landscape and the need for reform

The Committee hearing of February 6, 2002, revealed that while Enron and Andersen were taking advantage of a system that allowed them to behave in an apparently fraudulent manner, as well as engage in both the destruction of valuable evidence and retalia-

[4] "Enron Changes Climate for Whistle-blowers," The Christian Science Monitor, March 1, 2002.
[5] "Man Says Advice to Sell Enron Led to Firing," New York Times, March 5, 2002.
[6] "Economist Raised Doubts About Partnerships; Enron Researcher Raised Issue in '99," Houston Chronicle, March 19, 2002.
[7] "Andersen Whistleblower was Removed," New York Times, April 3, 2002.

tion against potential witnesses, the regulators, the victims of fraud, and the corporate whistleblowers were faced with daunting challenges to punish the wrongdoers and protect the victims' rights. The legal regime that, on one hand, allowed this conduct to take place, and, on the other, may serve as an impediment to punishing all the wrongdoers and protecting all the victims has led to widespread calls for reform and support for S. 2010, in particular.

The following groups and individuals have written in support of S. 2010: a bipartisan group of State Attorneys General from Kansas, Oklahoma, Oregon, Georgia, Washington, Ohio, and Vermont, including both the current and incoming heads of the National Association of Attorneys General; the North American Securities Administrators Association, whose membership consists of the securities administrators in all fifty states, the District of Columbia, Canada, Mexico, and Puerto Rico; the AFL–CIO; numerous whistleblower protection groups, including the Government Accountability Project, Taxpayers Against Fraud, and the National Whistleblower Center; consumer protection groups, including the Consumers Union and the Consumer Federation of America; the Vermont Department of Banking, Insurance, Securities and Health Care Administration; and the California State Teachers' Retirement System.

Outlined below are some of the shortcomings in current law that the Enron matter has publicly exposed.

First, unlike bank fraud, health care fraud, and bankruptcy fraud, there is no specific "securities fraud" provision in the criminal code to outlaw the breadth of schemes and artifices to defraud investors in publicly traded companies.[8] Currently, in securities fraud cases, prosecutors must rely on generic mail and wire charges that carry maximum penalties of up to only five years imprisonment and require prosecutors to carry the sometimes awkward burden of proving the use of the mail or the interstate wires to carry out the fraud. Alternatively, prosecutors may charge a willful violation of certain specific securities laws or regulations, but such regulations often contain technical legal requirements, and proving willful violations of these complex regulations allows defendants to argue that they did not possess the requisite criminal intent.[9] There is no logical reason for imposing such awkward and heightened burdens on the prosecution of criminal securities fraud cases. The investing public is entitled to no less protection than those who keep money in federally insured financial institutions enjoy under the bank fraud statute.

Second, current federal obstruction of justice statutes relating to document destruction is riddled with loopholes and burdensome proof requirements. Those provisions are a patchwork of various prohibitions that have been interpreted very narrowly by federal courts. For instance, certain current provisions in Title 18, such as section 1512(b), make it a crime to persuade another person to destroy documents, but not a crime for a person to destroy the same documents personally. Other provisions, such section 1503, have

[8] See 18 U.S.C. 1344 (bank fraud), 1347 (health care fraud), and 157 (bankruptcy fraud).

[9] See e.g., *SEC* v. *Zandford,* 238 F.3d 559 (4th Cir. 559) (holding that straight out stealing of investors' money did not violate SEC rule 10b–5 because stealing was not sufficiently related to technical "purchase or sale" requirement), cert. granted, 122 S. Ct. 510 (2001). This case is one, although not the only example, of why federal prosecutors are justifiably hesitant to include technical SEC regulations as part of a criminal indictment.

been narrowly interpreted by courts, including the Supreme Court in *United States* v. *Aguillar,* 115 S. Ct. 593 (1995), and the First Circuit in *United States* v. *Frankhauser,* 80 F.3d 641 (1st Cir. 1996), to apply only to situations when the obstruction of justice may be closely tied to a judicial proceeding. Still other provisions, such as sections 152(8), 1517 and 1518, apply to obstruction in certain limited types of cases, such as bankruptcy fraud, examinations of financial institutions, and healthcare fraud. In short, the current laws regarding destruction of evidence are full of ambiguities and limitations that must be corrected.

Indeed, even in the current Andersen case, prosecutors have been forced to use the "witness tampering" statute, 18 U.S.C. 1512, and to proceed under the legal fiction that the defendants are being prosecuted for telling other people to shred documents, not simply for destroying evidence themselves. Although prosecutors have been able to bring charges thus far in the case, in a case with a single person doing the shredding, this legal hurdle might present an insurmountable bar to a successful prosecution. When a person destroys evidence with the intent of obstructing any type of investigation and the matter is within the jurisdiction of a federal agency, overly technical legal distinctions should neither hinder nor prevent prosecution and punishment.

Even more surprising, in the context of audits and reviews conducted under the Securities and Exchange Act of 1934, there is currently no clear statutory requirement that accountants retain the most basic work papers to support the conclusions reached and opinions expressed in their audits, much less more detailed records, to facilitate determinations by federal regulators and law enforcement officials of whether a corporation or its accountants tried to mislead the public, as in the Enron matter.

Third, federal sentences sufficiently neither punish serious frauds and obstruction of justice nor take into account all aggravating factors that should be considered in order to enhance sentences for the most serious fraud and obstruction of justice cases. Currently, United States Sentencing Guidelines (U.S.S.G.) § 2J1.2 recognizes that a wide variety of conduct falls under the offense of "obstruction of justice." For obstruction cases involving the murder of a witness or another crime, the Guidelines allow, by cross reference, significant enhancements based on the underlying crimes, such as murder or attempted murder. For cases when obstruction is the only offense, however, the guidelines provide little assistance in differentiating between different types of obstruction—including the organized, large scale shredding that apparently occurred in the Enron/Andersen matter.

The current fraud sentencing guidelines also fail to provide for sufficient additional punishment based upon certain important aggravating factors. For instance, the fraud guidelines in U.S.S.G. § 2B1.1, require the sentencing judge to take the number of victims into account, but only to very limited degrees in small and medium-sized cases. Specifically, once there are more than fifty victims, the guidelines do not require any further enhancement of the sentence, so that a case with fifty-one victims may be treated the same as a case with five thousand victims. As the Enron matter demonstrates, serious frauds, especially for cases in which publicly traded securities are involved, can leave thousands of victims

robbed of their life savings. In addition, while the 2B1.1 guidelines provide a specific offense characteristic to enhance sentences where a financial institution's solvency is jeopardized, there is no similar enhancement for the risk of devastating a substantial number of private fraud victims, which is instead treated only as a ground for departure. That distinction is unsound and should be reconsidered. Finally, the Chapter 8 Guidelines relating to Sentencing Organizations for criminal conduct are outdated and do not sufficiently deter organizational or corporate misconduct.

Fourth, innocent, defrauded investors attempting to recoup their losses face unfair time limitations under current law. The current statute of limitations for most securities fraud cases is three years from the date of the fraud or one year after the fraud was discovered. This can unfairly limit recovery for defrauded investors in some cases. As Washington State Attorney General Gregoire testified at the Committee hearing, in the Enron state pension fund litigation, the current short statute of limitations has forced some states to forgo claims against Enron based on alleged securities fraud in1997 and 1998. In Washington state alone, the short statute of limitations may cost hard-working state employees, firefighters and police officers nearly $50 million in lost Enron investments, which they will never recover.

Especially in complex securities fraud cases, the current short statute of limitations may insulate the worst offenders from accountability and rewards those who can successfully cover up their misconduct for at least a year. As Justices O'Connor and Kennedy said in their dissent in *Lampf, Pleva. Lipkind, Prupis, & Petigrow* v. *Gilbertson,* 111 S. Ct. 2773 (1991), the 5–4 Supreme Court decision that changed decades of presumably settled law, and imposed a uniform, short statute of limitations in most securities fraud cases, the current "one and three" limitations period makes securities fraud actions "all but a dead letter for injured investors who by no conceivable standard of fairness or practicality can be expected to file suit within three years after the violation occurred."[10]

Other experts agree with Justices Kennedy and O'Connor. In fact, the last two SEC Chairmen supported extending the statute of limitations in securities fraud cases. Then Chairman Arthur Levitt testified before a Senate subcommittee in 1995 that "extending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud, who successfully conceals its existence for more than three years." Before Chairman Levitt, in the first Bush administration, then SEC Chairman Richard Breeden also testified before Congress in favor of extending the statute of limitations in securities fraud cases. Reacting to the *Lampf* opinion, Breeden stated in 1991 that "[e]vents only come to light years after the original distribution of securities, and the *Lampf* cases could well

[10] *Lampf, Pleva. Lipkind, Prupis, & Petigrow* v. *Gilbertson,* 111 S. Ct. 2773, 2790 (1991). In *Lampf*, the 5–4 majority changed the decades old practice of deferring to state limitations period in securities fraud cases, and it adopted a national statute of limitations instead. In addition, as opposed to adopting the longer federal limitations period that the SEC and then Solicitor General Kenneth Starr supported from a 1988 securities law, *id.* at 2781, the Court held not only that the shorter "1 and 3" period imported from § 9(e) of the 1934 Act (15 U.S.C. § 78i(e)) governed, but that fraud victims did not even have the right to raise the customary doctrine of "equitable tolling," which can protect them in cases where they can demonstrate that the defendant took affirmative steps to conceal the fraud. Id. at 2782. In short, current law encourages fraud artists to game the system.

mean that by the time investors discover they have a case, they are already barred from the courthouse." Both the FDIC and the State securities regulators joined the SEC in calling for a legislative reversal of the *Lampf* decisions at that time.

The one year statute of limitations from the date the fraud is discovered is also particularly harsh on innocent defrauded investors. This short limitations period has the effect of placing true fraud victims on a "stop watch," from the moment they know that they have been cheated. As most prosecutors and victims will confirm, however, the best cons are designed so that even after victims are cheated, they will not know who cheated them, or how. Especially in securities fraud cases, the complexities of how the fraud was executed often take well over a year to unravel, even after the fraud is discovered. Even with use of the full resources of the FBI, a Special Task Force of Justice Department Attorneys, and the power of a federal grand jury, complex fraud cases such as Enron are difficult to unravel and rarely can be charged within a year.

This one year "stop watch" is even more unfair when considered in light of the significant obstacles that current law places between a victim and the courthouse in securities fraud cases. A lead plaintiff must be selected by the court, a process that can take months. Discovery is automatically stayed during the pendency of any motion to dismiss, consideration of which can take over a year in itself. During that period the stop watch continues to run on the claim, even though the victim has little or no ability to find out more about exactly who participated in the fraudulent activity and how the fraud was accomplished. With the higher pleading standards that also govern securities fraud victims, it is unfair to expect victims to be able to negotiate such obstacles in the span of 12 months (See 15 U.S.C. § 78u–4).

In short, by the time a victim learns enough facts to file a complaint under a heightened pleading standard, survives a motion to dismiss, begins discovery, and learns that an additional wrongdoer or theory should be added to the case, that claim is likely to be time barred, then the wrongdoer is able to avoid liability and the victim is left holding the proverbial bag. Moreover, current law sets up a perverse incentive for victims to race into court, so as not to be barred by time, and immediately sue. Plaintiffs who wish to spend more time investigating the matter or trying to resolve the matter without litigation are punished under the current law.

Furthermore, the short statute of limitations does nothing to discourage frivolous cases, as a plaintiff operating in bad faith would have little trouble meeting the one year deadline and simply throwing in every possible defendant and every claim. After all, by definition of the so-called "strike suit," filing occurs almost immediately upon a change in the stock price. Instead of stopping bad faith suits, the short statute merely blocks the meritorious claims of fraud victims. Statutes of limitations are simply not proper means of deciding legitimate cases which should be decided on the merits—that is the role of the underlying substantive law.

In many securities fraud cases the short limitations period under current law is an invitation to take sophisticated steps to conceal the deceit. The experts have long agreed on that point, and unfortunately they have been proven right. Based on the Enron and Andersen cases, it only takes a few seconds to warm up the shredder,

but it will take years for victims to put this complex case back together again. It is time that the law is changed to provide victims the time they need to prove their cases to recoup their losses.

Fifth, victims of securities fraud can be thwarted from fair recovery when a debtor, such as Enron, declares bankruptcy. Current bankruptcy law permits wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations. This loophole in the law should be closed to help defrauded investors recoup their losses and to hold accountable those who incur debts by violating our securities laws.

State regulators are also unfairly disadvantaged under the current system. Under current laws, state regulators are often forced to "re-prove" their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action. Moreover, settlements may not have the same collateral estoppel effect as judgments obtained through fully litigated legal proceedings. In short, with limited resources already stretched to protect fraud victims, state regulators must plow the same ground twice in securities fraud cases.[11]

Sixth, corporate whistleblowers are left unprotected under current law. This is a significant deficiency because often, in complex fraud prosecutions, these insiders are the only firsthand witnesses to the fraud. They are the only people who can testify as to "who knew what, and when," crucial questions not only in the Enron matter but in all complex securities fraud investigations. Although current law protects many government employees who act in the public interest by reporting wrongdoing, there is no similar protection for employees of publicly traded companies who blow the whistle on fraud and protect investors. With one in every two Americans investing in public companies, this distinction fails to serve the public good.

Corporate employees who report fraud are subject to the patchwork and vagaries of current state laws, although most publicly traded companies do business nationwide. Thus, a whistleblowing employee in one state may be far more vulnerable to retaliation than a fellow employee in another state who takes the same actions. Unfortunately, as demonstrated in the tobacco industry litigation and the Enron case, efforts to quiet whistleblowers and retaliate against them for being "disloyal" or "litigation risks" transcend state lines. This corporate culture must change, and the law can lead the way. That is why S. 2010 is supported by public interest advocates, such as the National Whistleblower Center, the Government Accountability Project, and Taxpayers Against Fraud, who have called this bill "the single most effective measure possible to prevent recurrences of the Enron debacle and similar threats to the nation's financial markets."

E. The future

Many people and institutions contributed to the Enron debacle, including the corporate officers and directors whose actions led to

[11] The North American Securities Administrators Association (NASAA) has endorsed S. 2010, stating that it would "enhance the ability of state and federal regulators to help defrauded investors recoup their losses and to hold accountable those who perpetrate securities fraud." See letter from Joseph P. Borg, NASAA President and Director of Alabama Securities Commission.

Enron's failure, the well-paid professionals who helped create, carry out, and cover up the complicated corporate ruse when they should have been raising concerns, the regulators who did not protect the public and our public markets, and the Congress and the courts, which have thrown obstacles in the way of securities fraud victims. Now Congress must contribute to making the Enron situation right and ensuring that this never happens again. Without discipline, professionalism, an effective legal structure, and accountability, greed can run rampant, with devastating results. Unfortunately, business failures during a permissive era rarely happen in isolation.

Accountability is important and must be restored because Enron is not alone. It is only a case study exposing the shortcomings in our current laws. At the Committee hearing, experts gave investors the grave warnings that it is likely that there are more "Enrons" lurking out there, simply eluding discovery. Future debacles wait to be discovered not only by investigators or the media, but by the more than one in two Americans who depend on the transparency and integrity of our public markets.

The majority of Americans depend on capital markets to invest in the future needs of their families—from their children's college fund to their retirement nest eggs. American investors deserve action. Congress must act now to restore confidence in the integrity of the public markets and deter fraud artists who believe their crimes will go unpunished. Restoring such accountability is the aim of the Corporate and Criminal Fraud Accountability Act of 2002.

Accountability and transparency help our markets work as they should, in ways that benefit investors, employees, consumers and our national economy. The Enron debacle has arrived on our doorstep, and our job is to make sure that there are adequate doses of accountability in our legal system to prevent such occurrences in the future, and to offer a constructive remedy and decisive punishment should they occur. The time has come for Congress to rethink and reform our laws in order to prevent corporate deceit, to protect investors and to restore full confidence in the capital markets.

III. Section-by-Section Analysis and Discussion

S. 2010 has three major components that will enhance accountability. First, it provides prosecutors with new and better tools to effectively prosecute and punish those who defraud investors, which means ensuring criminal laws are flexible enough to keep pace with the most sophisticated and clever con artists. It also means providing for criminal penalties tough enough to make them think twice before defrauding the public.

Second, this bill establishes tools to improve the ability of investigators and regulators to collect and preserve evidence which proves fraud. This ensures that corporate whistleblowers are protected and that those who destroy evidence of fraud are punished.

Third, the bill protects victims' rights to recover from those who have cheated them. In short, S. 2010 will not only save documents from the shredder, but also send wrongdoers to jail once they are caught.

SECTION-BY-SECTION ANALYSIS

Section 1.—Title. "Corporate and Criminal Fraud Accountability Act."

Section 2. Criminal penalties for altering documents

This section provides two new criminal statutes which would clarify and plug holes in the current criminal laws relating to the destruction or fabrication of evidence and the preservation of financial and audit records.

First, this section would create a new 10-year felony which could be effectively used in a wide array of cases where a person destroys or creates evidence with the intent to obstruct an investigation or matter that is within the jurisdiction of any federal agency or any bankruptcy.

Second, the section creates a new 5-year felony which applies specifically to the willful failure to preserve audit papers of companies that issue securities. Section (a) of the statute has two sections which apply to accountants who conduct audits under the provisions of the Securities and Exchange Act of 1934. Subsection (a)(1) is an independent criminal prohibition on the destruction of audit or review work papers for five years, as that term is widely understood by regulators and in the accounting industry. Subsection (a)(2) requires the SEC to promulgate reasonable and necessary regulations within 180 days, after the opportunity for public comment, regarding the retention of categories of electronic and non electronic audit records which contain opinions, conclusions, analysis or financial data, in addition to the actual work papers. Willful violation of such regulations would be a crime. Neither the statute nor any regulations promulgated under it would relieve any person of any independent legal obligation under state or federal law to maintain or refrain from destroying such records.

Section 3.—Debts nondischargeable if incurred in violation of securities fraud laws

This provision would amend the federal bankruptcy code to make judgments and settlements arising from state and federal securities law violations brought by state or federal regulators and private individuals non-dischargeable. Current bankruptcy law may permit wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and securities law violations.

Section 4.—Statute of limitations

This section would set the statute of limitations in private securities fraud cases to the earlier of five years after the date of the fraud or two years after the fraud was discovered. The current statute of limitations for most private securities fraud cases is the earlier of three years from the date of the fraud or one year from the date of discovery. This provision states that it is not meant to create any new private cause of action, but only to govern already existing private causes of action under federal securities laws.

Section 5.—Review and enhancement of criminal sentences in cases of fraud and evidence destruction

This section would require the United States Sentencing Commission ("Commission") to review and consider enhancing, as appropriate, criminal penalties in cases involving obstruction of justice and in serious fraud cases. The Commission is also directed to generally review the U.S.S.G. Chapter 8 guidelines relating to sentencing organizations for criminal misconduct, to ensure that such guidelines are sufficient to punish and deter criminal misconduct by corporations.

Subsection 1 requires that the Commission generally review all the base offense level and sentencing enhancements under U.S.S.G. § 2J1.2. Subsection 2 specifically directs the Commission to consider including enhancements or specific offense characteristics for cases based on various factors including the destruction, alteration, or fabrication of physical evidence, the amount of evidence destroyed, the number of participants, or otherwise extensive nature of the destruction, the selection of evidence that is particularly probative or essential to the investigation, and whether the offense involved more than minimal planning or the abuse of a special skill or position of trust. Subsection 3 requires the Commission to establish appropriate punishments for the new obstruction of justice offenses created in this Act.

Subsections 4 and 5 require the Commission to review guideline offense levels and enhancements under U.S.S.G. § 2B1.1, relating to fraud. Specifically, the Commission is requested to review the fraud guidelines and consider enhancements for cases involving significantly greater than 50 victims and cases in which the solvency or financial security of a substantial number of victims is endangered. Subsection 6 requires a comprehensive review of Chapter 8 guidelines relating to sentencing organizations.

Section 6.—Whistleblower protection for employees of publicly traded companies

This section would provide whistleblower protection to employees of publicly traded companies. It specifically protects them when they take lawful acts to disclose information or otherwise assist criminal investigators, federal regulators, Congress, supervisors (or other proper people within a corporation), or parties in a judicial proceeding in detecting and stopping fraud. If the employer does take illegal action in retaliation for lawful and protected conduct, subsection (b) allows the employee to file a complaint with the Department of Labor, to be governed by the same procedures and burdens of proof now applicable in the whistleblower law in the aviation industry.[12] The employee can bring the matter to federal court only if the Department of Labor does not resolve the matter in 180 days (and there is no showing that such delay is due to the bad faith of the claimant) as a normal case in law or equity, with no amount in controversy requirement. Subsection (c) governs remedies and provides for the reinstatement of the whistleblower, backpay, and compensatory damages to make a victim whole, in-

[12] See 49 U.S.C. § 42121 *et seq.*

cluding reasonable attorney fees and costs, as remedies if the claimant prevails.

Section 7.—Criminal penalties for securities fraud

This provision would create a new 10-year felony for defrauding shareholders of publicly traded companies. The provision would supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes.

DISCUSSION

S. 2010 is one part of the response needed to solve the problems exposed by Enron's fall. Securities law experts, consumer protection groups, and others in Congress, both in the Senate and the House of Representatives, have made various proposals and introduced legislation that deserve careful consideration. Certainly, in light of recent events, careful reexamination is required of both the decisions of the Supreme Court and current laws. Despite the best of intentions, federal laws may have helped create an environment in which greed was inflated and integrity devalued. S. 2010 is an important starting point in that process. Following is a discussion and analysis of the bill's provisions.

Section 2 of the bill would create two new felonies to clarify and close loopholes in the existing criminal laws relating to the destruction or fabrication of evidence and the preservation of financial and audit records. First, it creates a new general anti shredding provision, 18 U.S.C. § 1519, with a 10-year maximum prison sentence. Currently, provisions governing the destruction or fabrication of evidence are a patchwork that have been interpreted, often very narrowly, by federal courts. For instance, certain current provisions make it a crime to persuade another person to destroy documents, but not a crime to actually destroy the same documents yourself.[13] Other provisions, such as 18 U.S.C. § 1503, have been narrowly interpreted by courts, including the Supreme Court in *United States* v. *Aguillar,* 115 S. Ct. 593 (1995), to apply only to situations where the obstruction of justice can be closely tied to a pending judicial proceeding. Still other statutes have been interpreted to draw distinctions between what type of government function is obstructed.[14] Still other provisions, such as sections 152(8), 1517 and 1518 apply to obstruction in certain limited types of cases, such as bankruptcy fraud, examinations of financial institutions, and healthcare fraud. In short, the current laws regarding destruction of evidence are full of ambiguities and technical limitations that should be corrected. This provision is meant to accomplish those ends.

Section 1519 is meant to apply broadly to any acts to destroy or fabricate physical evidence so long as they are done with the intent to obstruct, impede or influence the investigation or proper administration of any matter, and such matter is within the jurisdiction of an agency of the United States, or such acts done either in relation to or in contemplation of such a matter or investigation. This statute is specifically meant not to include any technical require-

[13] See 18 U.S.C. § 1512(b).

[14] See *United States* v. *Frankhauser,* 80 F.3d 641 (1st Cir. 1996) (1503 prohibits destroying evidence to thwart grand jury investigation, but not FBI investigation).

ment, which some courts have read into other obstruction of justice statutes, to tie the obstructive conduct to a pending or imminent proceeding or matter. It is also sufficient that the act is done "in contemplation" of or in relation to a matter or investigation. It is also meant to do away with the distinctions, which some courts have read into obstruction statutes, between court proceedings, investigations, regulatory or administrative proceedings (whether formal or not), and less formal government inquiries, regardless of their title. Destroying or falsifying documents to obstruct any of these types of matters or investigations, which in fact are proved to be within the jurisdiction of any federal agency are covered by this statute.[15] Questions of criminal intent are, as in all cases, appropriately decided by a jury on a case-by-cases basis. It also extends to acts done in contemplation of such federal matters, so that the timing of the act in relation to the beginning of the matter or investigation is also not a bar to prosecution. The intent of the provision is simple; people should not be destroying, altering, or falsifying documents to obstruct any government function. Finally, this section could also be used to prosecute a person who actually destroys the records himself in addition to one who persuades another to do so, ending yet another technical distinction which burdens successful prosecution of wrongdoers.[16]

Second, Section 2 creates a five-year felony, 18 U.S.C. § 1520, to punish the willful failure to preserve financial audit papers of companies that issue securities as defined in the Securities Exchange Act of 1934. The new statute, in subsection (a)(1), would independently require that accountants preserve audit work papers for five years from the conclusion of the audit. Subsection (b) would make it a felony to knowingly and willfully violate the five-year audit retention period in (1)(a). The materials covered in subsection (1)(b), which requires the SEC to issues reasonable rules and regulations, are intended to include additional records which contain conclusions, opinions, analysis, and financial data relevant to an audit or review. The regulations are intended to cover the retention of such substantive material, whether or not the conclusions, opinions, analyses or data in such records support the final conclusions reached by the auditor or expressed in the final audit or review so that state and federal law enforcement officials and regulators can conduct more effective inquiries into the decisions and determinations made by accountants in auditing public corporations. Nonsubstantive materials, however, such as administrative records, which are not relevant to the conclusions or opinions expressed (or not expressed), need not be included in such retention regulations. The language of the provision is clear. The SEC "shall" promulgate regulations relating to the retention of the categories of items which are specifically enumerated in the statutory provision. Willful violation of these regulations will also be a crime under this section.

In light of the apparent massive document destruction by Andersen, and the company's apparently misleading document retention policy, even in light of its prior SEC violations, it is intended that the SEC promulgate rules and regulations that require the reten-

[15] See 18 U.S.C. § 1001.
[16] See 18 U.S.C. § 1512(b).

tion of such substantive material, including material which casts doubt on the views expressed in the audit of review, for such a period as is reasonable and necessary for effective enforcement of the securities laws and the criminal laws, most of which have a five-year statute of limitations. It should also be noted that criminal tax violations, which many of these documents relate to, have a six-year statute of limitations. By granting the SEC the power to issue such regulations, it is not intended that the SEC be prohibited from consulting with other government agencies, such as the Department of Justice, which has primary authority regarding enforcement of federal criminal law or pertinent state regulatory agencies. Nor is it the intention of this provision that the general public, private or institutional investors, or other investor or consumer protection groups be excluded from the SEC rulemaking process. These views of these groups, who often represent the victims of fraud, should be considered at least on an equal footing with "industry experts" and others who participate in the rulemaking process at the SEC.

This section not only penalizes the willful failure to maintain specified audit records, but also will result in clear and reasonable rules that will require accountants to put strong safeguards in place to ensure that such corporate audit records are retained. Had such clear requirements and policies been established at the time Andersen was considering what to do with its audit documents, countless documents might have been saved from the shredder. The idea behind the statute is not only to provide for prosecution of those who obstruct justice, but to ensure that important financial evidence is retained so that law enforcement officials, regulators, and victims can assess whether the law was broken to begin with and, if so, whether or not such was done intentionally, or with or without the knowledge or assistance of an auditor.

Section 3 of this bill would amend the Bankruptcy Code to make judgments and settlements based upon securities law violations non-dischargeable, protecting victims' ability to recover their losses. Current bankruptcy law may permit such wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations. This loophole in the law should be closed to help defrauded investors recoup their losses and to hold accountable those who violate securities laws after a government unit or private suit results in a judgement or settlement against the wrongdoer.

State securities regulators have indicated their strong support for this change in the bankruptcy law. Under current laws, state regulators are often forced to "reprove" their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action. Moreover, settlements may not have the same collateral estoppel effect as judgments obtained through fully litigated legal proceedings. In short, with their resources already stretched to the breaking point, state regulators must plow the same ground twice in securities fraud cases. By ensuring securities law judgments and settlements in state cases are non-dischargeable, precious state enforcement resources will be preserved and directed at preventing fraud in the first place.

Section 4 of S. 2010 would protect victims by extending the statute of limitations in private securities fraud cases. It would set the statute of limitations in private securities fraud cases to the earlier of five years after the date of the fraud or two years after the fraud was discovered. The current statute of limitations for most such fraud cases is three years from the date of the fraud or one year after discovery, which can unfairly limit recovery for defrauded investors in some cases. As Attorney General Gregoire testified at the Committee hearing, in the Enron state pension fund litigation the current short statute of limitations has forced some states to forgo claims against Enron based on alleged securities fraud in 1997 and 1998. In Washington state alone, the short statute of limitations may cost hard-working state employees, firefighters and police officers nearly $50 million in lost Enron investments which they can never recover.

Especially in complex securities fraud cases, the current short statute of limitations may insulate the worst offenders from accountability. As Justices O'Connor and Kennedy said in their dissent in *Lampf, Pleva. Lipkind, Prupis, & Petigrow* v. *Gilbertson,* 111 S. Ct. 2773 (1991), the 5–4 decision upholding this short statute of limitations in most securities fraud cases, the current "one and three" limitations period makes securities fraud actions "all but a dead letter for injured investors who by no conceivable standard of fairness or practicality can be expected to file suit within three years after the violation occurred." The Consumers Union and Consumer Federation of America, along with the AFL-CIO and other institutional investors, strongly support the bill, and view this section in particular as a needed measure to protect investors.

The experts agree with that view. In fact, the last two SEC Chairmen supported extending the statute of limitations in securities fraud cases. Former Chairman Arthur Levitt testified before a Senate Subcommittee in 1995 that "extending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud, who successfully conceals its existence for more than three years." Before Chairman Levitt, in the last Bush administration, then SEC Chairman Richard Breeden also testified before Congress in favor of extending the statute of limitations in securities fraud cases. Reacting to the *Lampf* opinion, Breeden stated in 1991 that "[e]vents only come to light years after the original distribution of securities, and the *Lampf* cases could well mean that by the time investors discover they have a case, they are already barred from the courthouse." Both the FDIC and the State securities regulators joined the SEC in calling for a legislative reversal of the *Lampf* decisions at that time.

In fraud cases the short limitations period under current law is an invitation to take sophisticated steps to conceal the deceit. The experts have long agreed on that point, but unfortunately they have been proven right again. As recent experience shows, it only takes a few seconds to warm up the shredder, but unfortunately it will take years for victims to put this complex case back together

again.[17] It is time that the law is changed to give victims the time they need to prove their fraud cases.

Section 5 of S. 2010 ensures that those who destroy evidence or perpetrate fraud are appropriately punished. It would require the Commission to consider enhancing criminal penalties in cases involving obstruction of justice and serious fraud cases where a large number of victims are injured or when the victims face financial ruin.

Currently, the U.S.S.G. recognize that a wide variety of conduct falls under the offense of "obstruction of justice." For obstruction cases involving the murder of a witness or another crime, the U.S.S.G. allow, by cross reference, significant enhancements based on the underlying crimes, such as murder or attempted murder. For cases when obstruction is the only offense, however, they provide little guidance on differentiating between different types of obstruction. This provision requests that the Commission consider raising the penalties for obstruction where no cross reference is available and defining meaningful specific enhancements and adjustments for cases where evidence and records are actually destroyed or fabricated (and for more serious cases even within that category of case) so as to thwart investigators, a serious form of obstruction.

This provision, in subsections (4) and (5), also requires that the Commission consider enhancing the penalties in fraud cases which are particularly extensive or serious, even in addition to the recent amendments to the Chapter 2 guidelines for fraud cases. The current fraud guidelines require that the sentencing judge take the number of victims into account, but only to a very limited degree in small and medium-sized cases. Specifically, once there are more than 50 victims, the guidelines do not require any further enhancement of the sentence. A case with 51 victims, therefore, may be treated the same as a case with 5,000 victims. As the Enron matter demonstrates, serious frauds, especially in cases where publicly traded securities are involved, can affect thousands of victims.

In addition, current guidelines allow only very limited consideration of the extent of devastation that a fraud offense causes its victims. Judges may only consider whether a fraud endangers the "solvency or financial security" of a victim to impose an upward departure from the recommended sentencing range. This is not a factor in establishing the range itself unless the victim is a financial institution. Subsection (5) requires the Commission to consider requiring judges to consider the extent of such devastation in setting the actual recommended sentencing range in cases such as the Enron matter, when many private victims, including individual investors, have lost their life savings. Finally this provision requires a complete review of the Chapter 8 corporate misconduct guidelines, which are outdated and need to be toughened to deter corporate crime.

Section 6 of the bill would provide whistleblower protection to employees of publicly traded companies who report acts of fraud to federal officials with the authority to remedy the wrongdoing or to

[17] Of course, the allegations in the Enron case as set forth in this report are still being investigated, and 8 months after the public disclosures of Enron's conduct, not one Enron executive has been charged, even with the resources of the FBI available. That is another example of why a one year statute of limitations for such complex fraud cases is simply unreasonable.

supervisors or appropriate individuals within their company. Although current law protects many government employees who act in the public interest by reporting wrongdoing, there is no similar protection for employees of publicly traded companies who blow the whistle on fraud and protect investors. With an unprecedented portion of the American public investing in these companies and depending upon their honesty, this distinction does not serve the public good.

In addition, corporate employees who report fraud are subject to the patchwork and vagaries of current state laws, even though most publicly traded companies do business nationwide. Thus, a whistleblowing employee in one state (e.g., Texas, see supra) may be far more vulnerable to retaliation than a fellow employee in another state who takes the same actions. Unfortunately, companies with a corporate culture that punishes whistleblowers for being "disloyal" and "litigation risks" often transcend state lines, and most corporate employers, with help from their lawyers, know exactly what they can do to a whistleblowing employee under the law. U.S. laws need to encourage and protect those who report fraudulent activity that can damage innocent investors in publicly traded companies. S. 2010 is supported by groups such as the National Whistleblower Center, the Government Accountability Project, and Taxpayers Against Fraud, all of whom have written a letter placed in the Committee record calling this bill "the single most effective measure possible to prevent recurrences of the Enron debacle and similar threats to the nation's financial markets."

This bill would create a new provision protecting employees when they take lawful acts to disclose information or otherwise assist criminal investigators, federal regulators, Congress, their supervisors (or other proper people within a corporation), or parties in a judicial proceeding in detecting and stopping actions which they reasonably believe to be fraudulent. Since the only acts protected are "lawful" ones, the provision would not protect illegal actions, such as the improper public disclosure of trade secret information. In addition, a reasonableness test is also provided under the subsection (a)(1), which is intended to impose the normal reasonable person standard used and interpreted in a wide variety of legal contexts (See generally *Passaic Valley Sewerage Commissioners* v. *Department of Labor,* 992 F. 2d 474, 478). Certainly, although not exclusively, any type of corporate or agency action taken based on the information, or the information constituting admissible evidence at any later proceeding would be strong indicia that it could support such a reasonable belief.

Under new protections provided by S. 2010, if the employer does take illegal action in retaliation for such lawful and protected conduct, subsection (b) allows the employee to elect to file an administrative complaint at the Department of Labor, as is the case for employees who provide assistance in aviation safety. Only if there is no final agency decision within 180 days of the complaint (and such delay is not shown to be due to the bad faith of the claimant) may he or she may bring a de novo case in federal court with a jury trial available (See United States Constitution, Amendment VII; Title 42 United States Code, Section 1983). Should such a case be brought in federal court, it is intended that the same burdens of proof which would have governed in the Department of Labor

will continue to govern the action. Subsection (c) of this section requires both reinstatement of the whistleblower, backpay, and compensatory damages to make a victim whole should the claimant prevail. The bill does not supplant or replace state law, but sets a national floor for employee protections in the context of publicly traded companies.

Section 7 of the bill would create a new ten-year felony under Title 18 for defrauding shareholders of publicly traded companies. Currently, unlike bank fraud or health care fraud, there is no generally accessible statute that deals with the specific problem of securities fraud. In these cases, federal investigators and prosecutors are forced either to resort to a patchwork of technical Title 15 offenses and regulations, which may criminalize particular violations of securities law, or to treat the cases as generic mail or wire fraud cases and to meet the technical elements of those statutes, with their five year maximum penalties.

This bill, then, would create a new ten-year felony for securities fraud—a more general and less technical provision comparable to the bank fraud and health care fraud statutes in Title 18. It adds a provision to Chapter 63 of Title 18 at section 1348 which would criminalize the execution or attempted execution of any scheme or artifice to defraud persons in connection with securities of publicly traded companies or obtain their money or property. The provision should not be read to require proof of technical elements from the securities laws, and is intended to provide needed enforcement flexibility in the context of publicly traded companies to protect shareholders and prospective shareholders against all the types schemes and frauds which inventive criminals may devise in the future. The intent requirements are to be applied consistently with those found in 18 U.S.C. §§ 1341, 1343, 1344, 1347.

By covering all "schemes and artifices to defraud" (see 18 U.S.C. §§ 1344, 1341, 1343, 1347), new § 1348 will be more accessible to investigators and prosecutors and will provide needed enforcement flexibility and, in the context of publicly traded companies, protection against all the types schemes and frauds which inventive criminals may devise in the future.

This bill is only part of the needed response to the problems exposed by the Enron debacle. For instance, a provision granting State Attorneys General and the SEC the authority to use the civil RICO statute would have been another important tool in battling fraud and protecting investors. The SEC has tremendous expertise in protecting investors, and the States, whose officials are more directly accountable to the public than federal officials, have traditionally played a major positive role in responsibly exercising their authority to protect our nation's investors and consumers. The tobacco industry litigation is but one recent example of this important role played by the States. Although the provision had received bipartisan support from State Attorneys General around the nation, it was removed from S. 2010 as a compromise, after objections were raised that such elected state officials could not be entrusted with the same enforcement powers as the federal government.

Changes are clearly needed to restore accountability in U.S. markets, which have already been adversely affected by recent events. Instead of acting as gatekeepers who detect and deter fraud, it appears that Enron's accountants and lawyers brought all their skills

and knowledge to bear in assisting the fraud to succeed and then in covering it up. Congress must reconsider the incentive system that has been set up that encourages accountants and lawyers who come across fraud in their work to remain silent.

IV. Committee Consideration

On Thursday, April 25, 2002, the full Committee met in open session and ordered favorably reported the bill, S. 2010, by unanimous consent, with an amendment in the nature of a substitute sponsored by Senator Leahy and, after adopting an amendment sponsored by Senator Hatch and cosponsored by Senator Leahy and Senator Schumer, an amendment sponsored by Senator Feinstein and cosponsored by Senator Cantwell, and an amendment sponsored by Senator Grassley and cosponsored by Senator Leahy, a quorum being present.

V. Votes of the Committee

First, Senator Leahy offered an amendment in the nature of a substitute, clarifying that the statute of limitations provision in Section 5 of S. 2010 was not intended to establish any new private right of action, amending Section 7 of S. 2010 dealing with whistleblowers, removing Section 3 from S. 2010, which would have authorized State Attorneys General and the Securities and Exchange Commission to bring suits under 18 U.S.C. § 1964 [civil provision of the Racketeering Influenced Corrupt Organizations Act ("RICO")], and renumbering the remaining provisions accordingly. This substitute was accepted by unanimous consent.

Second, Senator Hatch offered an amendment to the substitute, cosponsored by Senator Leahy and Senator Schumer, to make technical corrections to the criminal provisions, defining a publicly traded company in Section 7 of the substitute, narrowing the scope of the new audit records destruction crime created in Section 2 of the substitute, raising the maximum penalty for the general anti-shredding provision created in Section 2 of the substitute (new 18 U.S.C. § 1519) from 5 to 10 years, and modifying and adding additional provisions to Section 5 of the substitute relating to review of the sentencing guidelines in fraud and obstruction of justice cases a well as for organizational misconduct. The amendment was adopted by vote of 18 yeas to 0 nays.

Yeas	Nays
Leahy	
Kennedy (proxy)	
Biden (proxy)	
Kohl	
Feinstein	
Feingold	
Schumer	
Durbin	
Cantwell	
Edwards (proxy)	
Hatch	
Thurmond (proxy)	
Grassley	
Kyl (proxy)	
DeWine	
Sessions (proxy)	
Brownback	
McConnell (proxy)	

Third, Senator Feinstein offered an amendment, cosponsored by Senator Cantwell, to Section 4 of the substitute to lower the statute of limitations created in that provision from the earlier of 3 years from the date of discovery of the fraud or five years from the fraud to the earlier of 2 years from the date of discovery of the fraud or 5 years from the fraud. Senator Hatch offered a second degree amendment to the Feinstein-Cantwell amendment to strike the statute of limitations provision in Section 4 of the substitute. Senator Hatch's second degree amendment was rejected by vote of 7 yeas to 11 nays.

Yeas	Nays
Hatch	Leahy
Thurmond (proxy)	Kennedy (proxy)
Grassley	Biden (proxy)
Kyl (proxy)	Kohl
DeWine	Feinstein
Sessions (proxy)	Feingold
McConnell (proxy)	Schumer
	Durbin
	Cantwell
	Edwards (proxy)
	Brownback

The Feinstein-Cantwell amendment was then adopted by voice vote.

Fourth, Senator Grassley offered an amendment, cosponsored by Senator Leahy, to Section 5 of the substitute dealing with whistleblower rights. This amendment replaced the option for immediate suit in federal court with an administrative remedy and resort to federal court if the administrative decision is not made within six months, removed enhanced penalties in whistleblower matters, removed the provision dealing with arbitration agreements, and lowered the statute of limitations in whistleblower cases from 180 to 90 days. The amendment was adopted by unanimous consent.

The Committee agreed to favorably report S. 2010, as amended, by unanimous consent.

VI. Congressional Budget Office Cost Estimate

In compliance with paragraph 11(a) of rule XXVI of the standing rules of the Senate, the Committee sets forth, with respect to the bill, S. 2010, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 403 of the Congressional Budget Act of 1974:

VII. Regulatory Impact Statement

U.S. Congress,
Congressional Budget Office,
Washington, DC, May 2, 2002.

Hon. Patrick J. Leahy,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for S. 2010, the Corporate and Criminal Fraud Accountability Act of 2002.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Ken Johnson (for federal costs), Susan Sieg Tompkins (for the state and local costs), and Paige Piper/Bach (for the private-sector impact).

Sincerely,

Barry B. Anderson
(For Dan L. Crippen, Director).

Encloures:

S. 2010—Corporate and Criminal Fraud Accountability Act of 2002

Summary: S. 2010 would create new crimes for persons who destroy records that could aid a federal investigation, people who commit securities fraud, or auditors who intentionally fail to retain certain audit records five years. In addition, the bill would prohibit certain fines assessed for violations of securities laws from being discharged in bankruptcy proceedings. Under S. 2010, employees who aid the SEC with investigations of publicly traded companies and who are subsequently discriminated against by their employer would have access to the Occupational Safety and Health Administration's (OSHA's) program for investigating illegal discrimination and termination of whistleblowers.

CBO estimates that implementing S. 2010 would cost about $2 million over the 2003–2007 period, subject to the availability of appropriated funds. The bill also would increase direct spending and receipts by less than $500,000 a year; therefore, pay-as-you-go procedures would apply.

S. 2010 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. This legislation would impose private-sector mandates, as defined by UMRA, but CBO estimates that the direct cost of the mandates would fall well below the annual threshold established by UMRA ($115 million in 2002, adjusted annually for inflation).

Estimated cost to the Federal Government: CBO estimates that implementing S. 2010 would cost about $2 million over the 2003–2007 period, subject to the availability of appropriated funds. This bill also would increase direct spending and receipts by less than $500,000 a year. The costs of this legislation fall within budget functions 370 (mortgage and housing credit) and 550 (health).

Basis of estimate: For this estimate, CBO assumes that S. 2010 will be enacted before the start of fiscal year 2003, and that the necessary amounts will be appropriate each fiscal year. Components of the estimated costs are described below.

Spending subject to appropriation

Under S. 2010, employees who provide information or otherwise assist investigations could file claims with OSHA in the event of discrimination or termination by their employer as a result of their whistleblowing activities. OSHA currently investigates whistleblower claims of discrimination against employers who violate occupational or environmental laws and regulations. To handle the additional claims that would arise if S. 2010 were enacted. CBO assumes OSHA would have to hire three additional employees. Subject to the availability of appropriated funds, CBO estimates that implementing the bill would cost less than $500,000 in 2003 and about $2 million over the 2003–2007 period.

Under S. 2010, the federal government would be able to pursue cases that it otherwise would not be able to prosecute. CBO expects that any increase in federal costs for law enforcement, court proceedings, or prison operations would not be significant, however, because of the small number of cases likely to be involved. Any such additional costs would be subject to the availability of appropriated funds.

Direct Spending and Revenues

Because those prosecuted and convicted under S. 2010 could be subject to criminal fines, the federal government might collect additional fines if the bill is enacted. Collections of such fines are recorded in the budget as governmental receipts (revenues), which are deposited in the Crime Victims Fund and spent in subsequent years. CBO expects that any additional receipts and direct spending would be less than $500,000 each year.

S. 2010 also would affect revenues by preventing certain fines the SEC assesses for violations for securities laws from being discharged in bankruptcy proceedings. This provision would apply to disgorgement funds, under which the SEC collects payments from violators and distributes them directly to the victims of the violation. Typically, these disgorgement funds are deposited in the Treasury only if the administrative costs of distributing the funds to the victims are prohibitive. Under current law, a violator could escape paying disgorgement funds under bankruptcy proceedings. S. 2010 would no longer allow such payments to be discharged in bankruptcy, and therefore, in certain cases could result in an increase of receipts to the Treasury. CBO estimates that any such increase would not be significant.

Pay-as-you-go-considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for leg-

islation affecting direct spending or receipts through 2006. CBO estimates that any such effects would be less than $500,000 a year.

Estimated impact on state, local, and tribal governments: S. 2010 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimated impact on the private sector: S. 2010 would impose private-sector mandates, as defined by UMRA, but CBO estimates that the direct cost of the mandates would fall well below the annual threshold established by UMRA ($115 million in 2002, adjusted annually for inflation).

The bill would impose a private-sector mandate by requiring that any accountant who conducts certain corporate audits to maintain all audit or review work papers for a five-year time period. According to the American Institute of Certified Public Accountants and industry representatives, the accounting industry currently retains financial statement working papers and records for seven years. Therefore, CBO estiamtes that the direct cost, if any, to comply with this mandate would be small.

The bill also would protect employees of certain publicly traded companies who provide information to the U.S. government (whistleblowers). Those companies would not be able to discharge, demote, suspend, threaten, harass, or discriminate against such employees in the terms and conditions of their employment. Based on information from the Occupational Safety and Health Administration, the agency that would enforce this provision, CBO estimates that those publicly traded companies would incur minimal, if any, direct cost to comply with the whistleblower protection requirements.

Estimate prepared by: Federal Costs: Ken Johnson and Alexis Ahlstrom; Impact on State, Local, and Tribal Government: Susan Sieg Tompkins; and Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VIII. ADDITIONAL VIEWS OF SENATORS HATCH, THURMOND, GRASSLEY, KYL, DEWINE, SESSIONS, BROWNBACK, AND MCCONNELL

A. GENERAL

The Chairman's Report contains a lengthy dissertation of facts and circumstances that allegedly gave rise to Enron's bankruptcy. We do not ascribe to the particulars outlined in the Report because at this point, a determination of the facts is the subject of ongoing investigations and court proceedings. We also do not necessarily agree that the Enron situation can be attributed to loopholes in current law; rather, it appears to be the result of bad actors violating existing laws.

In its amended form, S. 2010 is a marked improvement from the original version as introduced, and thus, the bill passed out of this committee unanimously by voice vote. We note that the amended version incorporates some of the provisions Senator Hatch included in his original amendment to S. 2010. Specifically, it further strengthens and refines prosecutorial tools and penalties for criminal conduct. In addition, as amended, S. 2010 removes a particularly troubling and unnecessary provision that would have extended the Department of Justice's (DOJ) automatic standing to bring suit under the civil provision of the Racketeer Influenced and Corrupt Organizations Act (RICO) to the 50 State Attorneys General and the Securities and Exchange Commission (SEC). To date, the Enron situation has left no doubt that the DOJ and SEC are aggressively investigating and bringing charges against offending parties. Moreover, to allow all 50 State Attorneys General and the SEC to bring multiple and duplicative civil RICO actions would result in inconsistent applications of the statute and undermine DOJ's proper role in this area. We know that other members of this committee, on both sides, shared these concerns, and we are pleased that we were able to remove this section from the bill.

Another improvement to S. 2010 resulted from a revision to the proposed new protections for corporate whistleblowers. As originally drafted, the proposal would have provided for overly expansive damage awards which could have encouraged frivolous claims that abuse the protections we seek to bestow. We believe that protections for corporate whistleblowers should track those already existing for airline employees. Those protections, contained in the Aviation Safety Protection Act of 2000, do not include a private cause of action, excessive damages or voluntary arbitration. To reach a compromise, we agreed to allow whistleblowers access to federal district court in cases where the Secretary of Labor has failed to issue a final decision on a whistleblower claim within 6 months.

Despite these improvements, we believe that S. 2010 still contains language that is problematic and even unnecessary to address the concerns that have arisen in light of the Enron bankruptcy, the consequences of which have indeed been devastating to a great many people. We are hopeful that improvements to S. 2010 will continue.

Below we clarify our intent and understanding with regard to specific provisions of S. 2010, as amended.

B. Specific Provisions

SECTION 2.—CRIMINAL PENALTIES FOR ALTERING DOCUMENTS

Section 2 of S. 2010 creates two new Title 18 offenses: an obstruction statute specifically directed to the destruction of documents, 18 U.S.C. 1519, and a document retention provision that applies to auditors of publicly traded securities, 18 U.S.C. 1520. Although it certainly appears, to date, that existing criminal obstruction of justice statutes are adequate to prosecute those who may be culpable in the Enron matter, we support providing prosecutors with all the tools they need to ensure that individuals who destroy evidence with the intent to impede a pending or future criminal investigation are punished. We also support the view that there is a need for a baseline retention standard that will apply to audit or review workpapers, which are the most critical documents relating to audits of publicly traded companies.

Section 1519

We recognize that section 1519 overlaps with a number of existing obstruction of justice statutes, but we also believe it captures a small category of criminal acts which are not currently covered under existing laws—for example, acts of destruction committed by an individual acting alone and with the intent to obstruct a future criminal investigation.

We have voiced our concern that section 1519, and in particular, the phrase "or proper administration of any matter within the jurisdiction of any department or agency of the United States" could be interpreted more broadly than we intend. In our view, section 1519 should be used to prosecute only those individuals who destroy evidence with the specific intent to impede or obstruct a pending or future criminal investigation, a formal administrative proceeding, or bankruptcy case. It should not cover the destruction of documents in the ordinary course of business, even where the individual may have reason to believe that the documents may tangentially relate to some future matter within the conceivable jurisdiction of an arm of the federal bureaucracy.

Section 1520

Although the scope of section 1520, the document retention provision, has been significantly narrowed since S. 2010 was introduced, we are concerned that the Chairman's Report does not reflect the full extent to which this provision was narrowed.

As we made clear before S. 2010 was amended, we strongly believe that a broad federal mandate requiring accountants of publicly traded companies to retain all documents sent, received or cre-

ated in connection with any audit, review or other similar engagement, would create an unworkable standard—one that would require auditors to retain warehouses of documents, including those immaterial to an audit's conclusions. We believe that any such mandate would have a substantial and adverse effect on this nation's economy.

In its current form, section 1520 requires accountants of publicly traded companies to maintain audit and review workpapers for a period of 5 years. It does not impose any such requirement with respect to other documents, such as memoranda, correspondence, communications, and electronic records. Instead, with respect to other such documents, section 1520(a)(2) directs the SEC to promulgate, after adequate notice and opportunity for comment from industry experts, regulators and government agencies, such rules and regulations "as are reasonably necessary".

It is our intention that the SEC will exercise its discretion prudently in determining the necessity for and the scope of document retention regulations. In so doing, we anticipate that the SEC may well determine that the retention of many documents that fall within the list of categories of documents enumerated in section 1520(a)(2) is unecessary. Similarly, the SEC may also determine that it is unreasonable to apply a 5-year retention period, to all regulated documents.

We understand that the accounting profession has implemented standards relating to the retention of workpapers. We encourage the profession to review their existing standards, and we urge the SEC to consider such standards when implementing regulations pursuant to section 1520(a)(2).

In supporting section 1520, it is our intention to strike a fair balance between the legitimate needs of investigators and the accounting profession. In our view, it is not the role of Congress to impose unnecessary and draconian retention requirements on a profession, particularly where broad criminal obstruction statutes serve to deter and punish severely those who destroy documents with the intent to impede a pending or future investigation.

SECTION 4.—STATUTE OF LIMITATIONS

1. General views

We believe current law likely provides an adequate length of time in which people who have been defrauded can file suit—one year after an individual knows he or she has been defrauded or three years after the date of the fraud. This period mirrors legislatively enacted limitations that apply to statutory claims that are most analogous to those contemplated here. Such statutes of limitations provide for certainty in the markets and adequately protect genuinely aggrieved consumers. There has been no evidence to indicate that the time period after a claimant has discovered a fraud needs to be doubled, let alone tripled, as was proposed originally in S. 2010. It is worthy to note that even though they dissented from the majority holding in *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson,* 501 U.S. 350, 369, 374 (1991) Justices O'Connor and Kennedy were clear in their support for the current one-year limitation after discovery of the fraud. Regrettably, the

sponsors of S. 2010 prevailed in their effort to extend the current statute of limitations, and we would like to clarify our understanding of the intended parameters of that extension.

Section 4(a) of this bill amends section 1658 of Title 28, United States Code to address the *Lampf* holding. Specifically, it sets a five-year outer limit on implied private rights of action involving a claim of fraud, deceit, manipulation, or contrivance, which are in contravention of a regulatory requirement concerning the federal securities laws. Consequently, section 4(a) is not intended to conflict with existing limitations periods for any express private rights of action under the federal securities laws.

2. Five-year maximum limit

In addition, because of the two-year limitation provided in section 1658(b)(2) of Title 28, United States Code, as amended by this bill, the five-year outer limit is not subject to equitable tolling. This is consistent with existing law applying statutes of limitation to securities fraud actions. Where there is a bifurcated limitations period, with an inner limit running from the time when the fraud was or should have been discovered, the inner limit "by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary. The [outer limit] is a period of repose inconsistent with tolling." *Lampf,* 501 U.S. at 363.

3. Two-year discovery limit

Section 4 of this bill is not intended to change existing case law holding that an objective standard should be used to measure the starting point as to when a securities fraud should have been discovered for purposes of a limitations period. In other words, this provision is intended to be consistent with established case law in that the "discovery" limitations period for private antifraud actions under section 10(b) of the Exchange Act begins to run when the plaintiff is on "inquiry notice" of a fraud. Rather than requiring actual knowledge to begin the running of the statute of limitations, the limitations period begins to run after discovery should have been made by exercise of reasonable diligence. This requirement, which has "long applied in fraud cases outside as well as in the securities field," *Tregenza* v. *Great American Communications Co.,* 12 F.3d 717, 722 (7th Cir. 1993) and cases cited therein, is necessary to limit "the opportunistic use of federal securities law to protect investors against market risk." Id. When "the circumstances would suggest to an investor of ordinary intelligence that she has been defrauded, a duty of inquiry arises, and knowledge will be imputed to the investor who does not make such an inquiry." *Dodds* v. *Cigna Sec., Inc.,* 12 F.3d 346, 350 (2d Cir. 1993), *cert. denied,* 511 U.S. 1019 (1994). *See also, inter alia, Menowitz* v. *Brown,* 991 F.2d 36, 41 (2d Cir. 1993); *Kahn* v. *Kohlberg, Kravis, Roberts & Co.,* 970 F.2d 1030, 1042 (2d Cir.), *cert. denied,* 506 U.S. 986 (1992).

4. No expansion of existing private rights of action

We agree that Section 4 of this bill is not intended to create a new private right of action or to broaden any existing private right of action.

SECTION 5.—REVIEW AND ENHANCEMENT OF CRIMINAL SENTENCES IN CASES OF FRAUD AND EVIDENCE DESTRUCTION

We support the provisions of section 5 which have incorporated many of our suggestions. We strongly endorse the view that the Sentencing Commission should revisit the guidelines that apply to corporate misconduct, as well as to those that apply to obstruction of justice and fraud offenses. We believe that tougher penalties, coupled with new criminal offenses, will enhance the ability of prosecutors to respond to egregious acts of obstruction and fraud.

SECTION 6.—WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES

This bill provides federal protection for corporate whistleblowers, who should be shielded from illegal retaliatory action. The amendment offered by Senators Grassley and Leahy revises the original bill to make these protections consistent with the Aviation Safety Protection Act of 2000 in which we provided whistleblower protections to another class of non-government employees. Because we had already extended whistleblower protections to non civil service employees, we thought it best to track those protections as closely as possible.

To make the corporate whistleblower protections consistent with those provided to airline employees, the amendment struck the excessive damages included in the original bill and subsequent compromises. It also removed a provision that allowed immediate access to federal district courts. However, this compromise does provide whistleblowers with access to federal court in the event the Secretary of Labor fails to issue a final decision within 6 months.

SECTION 7.—CRIMINAL PENALTIES FOR SECURITIES FRAUD

Although we believe that existing criminal statutes are adequate to prosecute criminal acts involving securities fraud, we support the creation of a new securities fraud offense. In our view, this provision will make it easier, in a limited class of cases, for prosecutors to prove securities fraud by eliminating, for example, the element that the mails or wires were used to further the scheme to defraud.

This new securities fraud offense does not lower the standard of criminal intent prosecutors must meet to convict securities fraud offenders. Like the bank and health care fraud statutes on which this provision is modeled, prosecutors must prove that a defendant knowingly engaged in a scheme or artifice to defraud, or knowingly made false statements or representations to obtain money in a securities transaction. This standard, which includes knowledge and intent elements, is consistent with existing securities fraud statutes.

3. CONCLUSION

As we consider legislative reforms to address concerns highlighted by the Enron debacle, it should be noted that there are a host of issues, many of which are outside of the jurisdiction of this Committee. While S. 2010 tightens and strengthening criminal penalties, among other things, it does not address issues relating

to corporate and professional responsibility and disclosure. Complementary legislation is necessary to address these issues which are the focus of the President's "10 Point Plan" and debate in other Senate and House committees.

Not only does legislation need to address corporate and professional responsibility and disclosure, it also must be deliberate and measured so that our economy is not adversely affected. We look forward to working with the full Senate, the other legislative chamber and the President to find the appropriate balanced solution to these complex issues.

ORRIN G. HATCH.
STROM THURMOND.
CHUCK E. GRASSLEY.
JON KYL.
MIKE DEWINE.
JEFF SESSIONS.
SAM BROWNBACK.
MITCH MCCONNELL.

IX. Changes in Existing Law Made by the Bill, as Reported

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by S. 2010, as reported, are shown as follows (existing law proposed to be omitted is enclosed in brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

UNITED STATES CODE

* * * * * * *

TITLE 11—BANKRUPTCY

Chap.		Sec.
1.	General Provisions	101
3.	Case Administration	301
5.	Creditors, the Debtor, and the Estate	501

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CHAPTER 5—CREDITORS, THE DEBTOR, AND THE ESTATE

Subchapter I—Creditors and Claims

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SUBCHAPTER II—DEBTOR'S DUTIES AND BENEFITS

Sec.
521. Debtor's duties.
522. Exemptions.
523. Exceptions to discharge.

* * * * * * *

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

* * * * * * *

(17) for a fee imposed by a court for the filing of a case, motion, complaint, or appeal, or for other costs and expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under section 1915(b) or (f) of title 28, or the debtor's status as a prisoner, as defined in section 1915(h) of this title 28; [or]

(18) owed under State law to a State or municipality that is—

(B) enforceable under part D of title IV of the Social Security Act (42 U.S.C. 601 et seq.)[.]*; or*

(19) that—

(A) arises under a claim relating to—

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulations or orders issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, in relation to any claim described in subparagraph (A), from—

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

* * * * * * *

TITLE 18—CRIMES AND CRIMINAL PROCEDURE

Part **Section**

I. CRIMES 1

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PART I—CRIMES

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CHAPTER 63—MAIL FRAUD

Sec.

1341. Frauds and swindles.

* * * * * * *

1347. Health care fraud.

1348. Securities fraud.

* * * * * * *

§ 1341. Frauds and swindles

Whoever, having devised * * *

* * * * * * *

§ 1347. Health care fraud

Whoever knowingly and willfully executes, or attempts to execute, a scheme or artifice—

(1) to defraud any health care benefit program; or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any of the money or property owned by, or under the custody or control of, any health care benefit program.

in connection with the delivery of or payment for health care benefits, items, or services, shall be fined under this title or imprisoned not more than 10 years, or both. If the violation results in serious bodily injury (as defined in section 1365 of this title), such person shall be fined under this title or imprisoned not more than 20 years, or both; and if the violation results in death, such person shall be fined under this title, or imprisoned for any term of years or for life, or both.

§ 1348. Securities fraud

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 10 years, or both.

* * * * * * *

CHAPTER 73—OBSTRUCTION OF JUSTICE

Sec.
1501. Assault on process server.
* * * * * * *
1514. Civil action to restrain harassment of a victim or witness.
1514A. Civil action to protect against retaliation in fraud cases.
* * * * * * *
1518. Obstruction of criminal investigations of health care offenses.
1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.
1520. Destruction of corporate audit records.

§ 1501. Assault on process server

Whoever knowingly * * *

* * * * * * *

§ 1514. Civil action to restrain harassment of a victim or witness

(a)(1) A United States * * *

* * * * * * *

(c) As used in this section—

(1) the term "harassment" means a course of conduct directed at a specific person that—

(A) causes substantial emotional distress in such person; and

(B) serves no legitimate purpose; and

(2) the term "course of conduct" means a series of acts over a period of time, however short, indicating a continuity of purpose.

§ 1514A. Civil action to protect against retaliation in fraud cases

(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of sections 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

(A) a Federal regulatory or law enforcement agency;

(B) any Member of Congress or any committee of Congress; or

(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of sections 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

(b) ENFORCEMENT ACTION.—

(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violoation of subsection (a) may seek relief under subsection (c), by—

(A) filing a complaint with the Secretary of Labor; or

(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

(2) PROCEDURE.—

(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs.

(c) REMEDIES.—

(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

(B) the amount of back pay, with interest; and

(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privilege, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.

§ 1518. Obstruction of criminal investigation of health care offenses.

(a) Whoever willfully prevents, obstructs, misleads, delays or attempts to prevent, obstruct, mislead, or delay the communication of information or records relating to a violation of a Federal health care offense to a criminal investigator shall be fined under this title or imprisoned not more than 5 years, or both.

(b) As used in this section the term "criminal investigator" means any individual duly authorized by a department, agency, or armed force of the United States to conduct or engage in investigations for prosecutions for violations of health care offenses.

§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 10 years, or both.

§ 1529. Destruction of corporate audit records

(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies.

(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 5 years, or both.

(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation, imposed by Federal or State law or regulation, to maintain, or refrain from destroying, any document.

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TITLE 28—JUDICIARY AND JUDICIAL PROCEDURE

Part **Sec.**
I. ORGANIZATION OF COURTS 1

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V. PROCEDURE 1651

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PART V—PROCEDURE

Chapter **Sec.**
III. General Provisions 1651

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CHAPTER 111—GENERAL PROVISIONS

Sec.
1651. Writs.

* * * * * * *

1658. Time limitations on the commencement of civil actions arising under Acts of Congress.

§ 1658. Time limitations on the commencement of civil actions arising under Acts of Congress

(a) Except as otherwise provided by law, a civil action arising under an Act of Congress enacted after the date of the enactment

of this section may not be commenced later than 4 years after the cause of action accrues.

(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

(1) 5 years after the date on which the alleged violation occurred; or

(2) 2 years after the date on which the alleged violation was discovered.

* * * * * * *

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II

Calendar No. 366

107TH CONGRESS
2D SESSION

S. 2010

[Report No. 107–146]

To provide for criminal prosecution of persons who alter or destroy evidence in certain Federal investigations or defraud investors of publicly traded securities, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers against retaliation by their employers, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 12, 2002

Mr. LEAHY (for himself, Mr. DASCHLE, Mr. DURBIN, Mr. HARKIN, Ms. STABENOW, Mr. CLELAND, and Mr. EDWARDS) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

MAY 6, 2002

Reported by Mr. LEAHY, from the Committee on the Judiciary, with an amendment

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To provide for criminal prosecution of persons who alter or destroy evidence in certain Federal investigations or defraud investors of publicly traded securities, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers against retaliation by their employers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Corporate and Criminal Fraud Accountability Act of 2002''.

SEC. 2. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

''§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

''Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 5 years, or both.

''§ 1520. Destruction of corporate audit records

''(a) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies,

shall maintain all documents (including electronic documents) sent, received, or created in connection with any audit, review, or other engagement for such issuer for a period of 5 years from the end of the fiscal period in which the audit, review, or other engagement was concluded.

"(b) Whoever knowingly and willfully violates subsection (a) shall be fined under this title, imprisoned not more than 5 years, or both.

"(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation, imposed by Federal or State law or regulation, to maintain, or refrain from destroying, any document.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

"1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.
"1520. Destruction of corporate audit records.".

SEC. 3. ENHANCED ENFORCEMENT OF LAWS AFFECTING RACKETEER-INFLUENCED AND CORRUPT ORGANIZATIONS.

Section 1964 of title 18, United States Code, is amended—

(1) in subsection (b), by inserting after "The Attorney General" the following: ", the Attorney

General of any State, or the Securities and Exchange Commission"; and

(2) in subsection (d), by inserting before the period the following: "or any State".

SEC. 4. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking "or" after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting "; or"; and

(3) by adding at the end, the following:

"(19) that—

"(A) arises under a claim relating to—

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulations or orders issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

~~"(B) results, in relation to any claim described in subparagraph (A), from—~~

~~"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;~~

~~"(ii) any settlement agreement entered into by the debtor; or~~

~~"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".~~

~~SEC. 5. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.~~

~~(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—~~

~~(1) by inserting "(a)" before "Except"; and~~

~~(2) by adding at the end the following:~~

~~"(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—~~

~~"(1) 5 years after the date on which the alleged violation occurred; or~~

~~"(2) 3 years after the date on which the alleged violation was discovered.".~~

~~(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.~~

~~SEC. 6. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.~~

~~Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—~~

~~(1) the guideline offense levels and enhancements for an obstruction of justice offense are adequate in cases where documents or other physical evidence are actually destroyed or fabricated;~~

~~(2) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this Act, are sufficient to deter and punish that activity;~~

(3) the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50; and

(4) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of 1 or more victims.

SEC. 7. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

"§ 1514A. Civil action to protect against retaliation in fraud cases

"(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with securities registered under section 6 of the Securities Act of 1933 (15 U.S.C. 77f) or section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*,

~~78o(d)), or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—~~

~~"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—~~

~~"(A) a Federal regulatory or law enforcement agency;~~

~~"(B) any Member of Congress or any committee of Congress; or~~

~~"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or~~

~~"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.~~

~~"(b) ELECTION OF ACTION.—~~

~~"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—~~

~~"(A) filing a complaint with the Secretary of Labor; or~~

~~"(B) bringing an action at law or equity in the appropriate district court of the United States.~~

~~"(2) PROCEDURE.—~~

~~"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.~~

~~"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United~~

States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 180 days after the date on which the violation occurs.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) (A) or (B) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) 2 times the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, in-

~~cluding litigation costs, expert witness fees, and reasonable attorney fees.~~

~~"(3) PUNITIVE DAMAGES.—~~

~~"(A) IN GENERAL.—In a case in which the finder of fact determines that the protected conduct of the employee under subsection (a) involved a substantial risk to the health, safety, or welfare of shareholders of the employer or the public, the finder of fact may award punitive damages to the employee.~~

~~"(B) FACTORS.—In determining the amount, if any, to be awarded under this paragraph, the finder of fact shall take into account—~~

~~"(i) the significance of the information or assistance provided by the employee under subsection (a) and the role of the employee in advancing any investigation, proceeding, congressional inquiry or action, or internal remedial process, or in protecting the health, safety, or welfare of shareholders of the employer or of the public;~~

~~"(ii) the nature and extent of both the actual and potential discrimination to~~

which the employee was subjected as a result of the protected conduct of the employee under subsection (a); and

"(iii) the nature and extent of the risk to the health, safety, or welfare of shareholders or the public under subparagraph (A).

"(d) RIGHTS RETAINED BY EMPLOYEE.—

"(1) OTHER REMEDIES UNAFFECTED.—Nothing in this section shall be deemed to diminish the rights, privilege, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.

"(2) VOLUNTARY ADJUDICATION.—No employee may be compelled to adjudicate his or her rights under this section pursuant to an arbitration agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

"1514A. Civil action to protect against retaliation in fraud cases.".

SEC. 8. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Securities fraud

"Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud any person in connection with any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*, 78o(d)) or section 6 of the Securities Act of 1933 (15 U.S.C. 77f); or

"(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*, 78o(d)) or section 6 of the Securities Act of 1933 (15 U.S.C. 77f),

shall be fined under this title, or imprisoned not more than 10 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new

~~item:~~

~~"1348. Securities fraud.".~~

SECTION 1. SHORT TITLE.

This Act may be cited as the "Corporate and Criminal Fraud Accountability Act of 2002".

SEC. 2. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

"§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

"Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 10 years, or both.

"§ 1520. Destruction of corporate audit records

"(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies, shall maintain all audit or review workpapers for a period of

5 years from the end of the fiscal period in which the audit or review was concluded.

"(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies.

"(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 5 years, or both.

"(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation, imposed by Federal or State law or regulation, to maintain, or refrain from destroying, any document.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

"1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.
"1520. Destruction of corporate audit records.".

SEC. 3. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking "or" after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting "; or"; and

(3) by adding at the end, the following:

"(19) that—

"(A) arises under a claim relating to—

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), any State securities laws, or any regulations or orders issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results, in relation to any claim described in subparagraph (A), from—

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".

SEC. 4. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—

(1) by inserting "(a)" before "Except"; and

(2) by adding at the end the following:

"(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

"(1) 5 years after the date on which the alleged violation occurred; or

"(2) 2 years after the date on which the alleged violation was discovered.".

(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

(c) NO CREATION OF ACTIONS.—Nothing in this section shall create a new, private right of action.

SEC. 5. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.

Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—

(1) the base offense level and existing enhancements contained in United States Sentencing Guideline 2J1.2 relating to obstruction of justice are sufficient to deter and punish that activity;

(2) the enhancements and specific offense characteristics relating to obstruction of justice are adequate in cases where—

(A) documents and other physical evidence are actually destroyed, altered or fabricated;

(B) the destruction, alteration, or fabrication of evidence involves—

(i) a large amount of evidence, a large number of participants, or is otherwise extensive;

(ii) the selection of evidence that is particularly probative or essential to the investigation; or

(iii) more than minimal planning; or

(C) the offense involved abuse of a special skill or a position of trust;

(3) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this Act, are sufficient to deter and punish that activity;

(4) the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(5) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of a substantial number of victims; and

(6) the guidelines that apply to organizations in United States Sentencing Guidelines, Chapter 8, are sufficient to deter and punish organizational criminal misconduct.

SEC. 6. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

"§ 1514A. Civil action to protect against retaliation in fraud cases

"(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such com-

pany, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

"(A) a Federal regulatory or law enforcement agency;

"(B) any Member of Congress or any committee of Congress; or

"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343,

1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

"(b) ENFORCEMENT ACTION.—

"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

"(A) filing a complaint with the Secretary of Labor; or

"(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

"(2) PROCEDURE.—

"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, in-

cluding litigation costs, expert witness fees, and reasonable attorney fees.

"(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privilege, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

"1514A. Civil action to protect against retaliation in fraud cases.".

SEC. 7. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Securities fraud

"Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

"(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or

property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 10 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1348. Securities fraud.".

107TH CONGRESS
2D SESSION

H. R. 3763

AN ACT

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ''Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002''.

(b) TABLE OF CONTENTS.—

Sec. 1. Short title; table of contents.
Sec. 2. Auditor oversight.
Sec. 3. Improper influence on conduct of audits.
Sec. 4. Real-time disclosure of financial information.
Sec. 5. Insider trades during pension fund blackout periods prohibited.
Sec. 6. Improved transparency of corporate disclosures.
Sec. 7. Improvements in reporting on insider transactions and relationships.
Sec. 8. Codes of conduct.
Sec. 9. Enhanced oversight of periodic disclosures by issuers.
Sec. 10. Retention of records.
Sec. 11. Commission authority to bar persons from serving as officers or directors.
Sec. 12. Disgorging insiders profits from trades prior to correction of erroneous financial statements.
Sec. 13. Securities and Exchange Commission authority to provide relief.
Sec. 14. Study of rules relating to analyst conflicts of interest.
Sec. 15. Review of corporate governance practices.
Sec. 16. Study of enforcement actions.
Sec. 17. Study of credit rating agencies.
Sec. 18. Study of investment banks and other financial institutions.
Sec. 19. Study of model rules for attorneys of issuers.
Sec. 20. Enforcement authority.
Sec. 21. Exclusion for investment companies.
Sec. 22. Definitions.

SEC. 2. AUDITOR OVERSIGHT.

(a) CERTIFIED FINANCIAL STATEMENT REQUIREMENTS.—If a financial statement is required by the securities laws or any rule or regulation thereunder to be certified by an independent public or certified accountant, an accountant shall not be considered to be qualified to certify such financial statement, and the Securities and Exchange Commission shall not accept a financial statement certified by an accountant, unless such accountant—

(1) is subject to a system of review by a public regulatory organization that complies with the requirements of this section and the rules prescribed by the Commission under this section; and

(2) has not been determined in the most recent review completed under such system to be not qualified to certify such a statement.

(b) ESTABLISHMENT OF PRO.—The Commission shall by rule establish the criteria by which a public regulatory organization may be recognized for purposes of this section. Such criteria shall include the following requirements:

(1)(A) The board of such organization shall be comprised of five members—

(i) two of whom shall be persons who are licensed to practice public accounting and who have recent experience in auditing public companies;

(ii) two of whom may be persons who are licensed to practice public accounting, if such person has not worked in the accounting profession for any of the last two years prior to the date of such person's appointment to the board; and

(iii) one of whom shall be a person who has never been licensed to practice public accounting.

(B) Each member of the board of such organization shall be a person who meets such standards of financial literacy as are determined by the Commission.

(2) Such organization is so organized and has the capacity—

(A) to be able to carry out the purposes of this section and to comply, and to enforce compliance by accountants and persons associated with accountants, with the provisions of this Act, professional ethics and competency standards, and the rules of the organization;

(B) to perform a review of the work product (including the quality thereof) of an accountant or a person associated with an accountant; and

(C) to perform a review of any potential conflicts of interest between an accountant (or a person associated with an accountant) and the issuer, the issuer's board of directors and committees thereof, officers, and affiliates of

such issuer, that may result in an impairment of auditor independence.

(3) Such organization shall have the authority to impose sanctions, which, if there is a finding of knowing or intentional misconduct, may include a determination that an accountant is not qualified to certify a financial statement, or any categories of financial statements, required by the securities laws, or that a person associated with an accountant is not qualified to participate in such certification, if, after conducting a review and providing fair procedures and an opportunity for a hearing, the organization finds that—

(A) such accountant or person associated with an accountant has violated the standards of independence, ethics, or competency in the profession;

(B) such accountant or person associated with an accountant has been found by the Commission or a court of competent jurisdiction to have violated the securities laws or a rule or regulation thereunder (provided in both cases that any applicable time period for appeal has expired);

(C) an audit conducted by such accountant or any person associated with an accountant has been materially affected by an impairment of auditor independence;

(D) such accountant or person associated with an accountant has performed both auditing services and consulting services in violation of the rules prescribed by the Commission pursuant to subsection (c); or

(E) such accountant or any person associated with an accountant has impeded, obstructed, or otherwise not cooperated in such review.

(4) Any such organization shall disclose publicly, and make available for public comment, proposed procedures and methods for conducting such reviews.

(5) Any such organization shall have in place procedures to minimize and deter conflicts of interest involving the public members of such organization, and have in place procedures to resolve such conflicts.

(6) Any such organization shall have in place procedures for notifying the boards of accountancy

of the States of the results of reviews and evidence under paragraphs (2) and (3).

(7) Any such organization shall have in place procedures for notifying the Commission of any findings of such reviews, including any findings regarding suspected violations of the securities laws.

(8) Any such organization shall consult with boards of accountancy of the States.

(9) Any such organization shall have in place a mechanism to allow the organization to operate on a self-funded basis. Such funding mechanism shall ensure that such organization is not solely dependent upon members of the accounting profession for such funding and operations.

(10) Any such organization shall have the authority to request, in a manner established by the Commission, that the Commission, by subpoena or otherwise, compel the testimony of witnesses or the production of any books, papers, correspondence, memoranda, or other records relevant to any accountant review proceeding or necessary or appropriate for the organization to carry out its purposes. The Commission shall comply with any such request from such an organization if the Commission determines that compliance with the request would assist

the organization in its accountant review proceeding or in carrying out its purposes, unless the Commission determines that compliance would not be in the public interest. The issuance and enforcement of a subpoena requested under this paragraph shall be deemed to be made pursuant to, and shall be made in accordance with, the provisions of subsections (b) and (c) of section 21 of the Securities and Exchange Act of 1934 (15 U.S.C. 78u(b)–(c)). For purposes of taking evidence, the Commission in its discretion may designate the Board, or any member thereof, as officers pursuant to section 21(b) of such Act.

(c) PROHIBITION ON THE OFFER OF BOTH AUDIT AND CONSULTING SERVICES.—

(1) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations pertaining to auditor independence to require that an accountant shall not be considered independent with respect to an audit client if the accountant provides to the client the following nonaudit services, as such terms are defined in such regulations as in effect on the date of enactment of this Act, and subject to such conditions and exemptions as the Commission shall prescribe:

(A) financial information system design or implementation; or

(B) internal audit services.

(2) REVIEW OF PROHIBITED NONAUDIT SERVICES.—The Commission is authorized to review the impact on the independence of auditors of the scope of services provided by auditors to issuers in order to determine whether the list of prohibited nonaudit services under paragraph (1) shall be modified. In conducting such review, the Commission shall consider the impact of the provision of a service on an auditor's independence where provision of the service creates a conflict of interest with the audit client.

(3) ADDITIONS BY RULE.—After conducting the review required by paragraph (2) and at any other time, the Commission may, by rule consistent with the protection of investors and the public interest, modify the list of prohibited nonaudit services under paragraph (1).

(4) REPORT.—The Commission shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on its conduct of any reviews as required by this section. The report shall include a discussion of regulatory or

legislative steps that are recommended or that may be necessary to address concerns identified in the reviews.

(5) CONFORMING REVISION.—The Commission shall revise its regulations pertaining to accountant fee disclosure items, as set forth in paragraphs (e)(1) through (e)(3) of item 9 from Schedule 14A (17 CFR 240.14a–101), in light of paragraph (1) of this subsection and after making a determination as to whether such disclosures are necessary.

(6) DEADLINE FOR RULEMAKING.—The Commission shall—

(A) within 90 days after the date of enactment of this Act, propose, and

(B) within 270 days after such date, prescribe,

the revisions to its regulations required by this subsection.

(d) PRO ACCOUNTANT REVIEW PROCEEDINGS.—

(1) REVIEW PROCEEDING FINDINGS.—Any findings made pursuant to an accountant review conducted under this section that a financial statement audited by such accountant and submitted to the Commission may have been materially affected by an impairment of auditor independence, or by a viola-

tion of professional ethics and competency standards, shall be submitted to the Commission. The Commission shall promptly notify an issuer of any such finding that relates to the financial statements of such issuer.

(2) CONFIDENTIAL TREATMENT OF PROCEEDINGS PENDING SEC REVIEW.—

(A) NO DISCLOSURE.—Except as otherwise provided in this section, but notwithstanding any other provision of law, neither the Commission, a recognized public regulatory organization, nor any other person shall disclose any information concerning any accountant review or proceeding and the findings therein.

(B) SPECIFIC WITHHOLDING NOT AUTHORIZED.—Nothing in this subsection shall—

(i) authorize a recognized public regulatory organization to withhold information from the Commission;

(ii) authorize such organization or the Commission to withhold information concerning an accountant review proceeding from an accountant or person associated with an accountant that is the subject of such proceeding;

(iii) authorize the Commission to withhold information from Congress; or

(iv) prevent the Commission from complying with a request for information from any other Federal department or agency requesting information for purposes within the scope of its jurisdiction, or complying with an order of a court of the United States in an action brought by the United States or the Commission.

(C) DURATION OF WITHHOLDING.—Neither the Commission nor the recognized public regulatory organization shall disclose the results of any such finding until the completion of any review by the Commission under subsections (e) and (f), or the conclusion of the 30-day period for seeking review if no motion seeking review is filed within such period.

(D) TREATMENT UNDER FOIA.—For purposes of section 552 of title 5, United States Code, this subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552.

(3) NONPRECLUSIVE EFFECT OF PRO FINDINGS.—A finding by a recognized public regulatory

organization that an individual audit of an issuer met or failed to meet any applicable standard with respect to the quality of such audit shall not be construed in any action arising out of the securities laws as indicative of compliance or noncompliance with the securities laws or with any standard of liability arising thereunder.

(e) REVIEW OF SANCTIONS.—

(1) NOTICE.—If any recognized public regulatory organization—

(A) makes a finding with respect to or imposes any final disciplinary sanction on any accountant;

(B) prohibits or limits any person in respect to access to services offered by such organization; or

(C) makes a finding with respect to or imposes any final disciplinary sanction on any person associated with an accountant or bars any person from becoming associated with an accountant,

the recognized public regulatory organization shall promptly submit notice thereof with the Commission. The notice shall be in such form and contain such information as the Commission, by rule, may pre-

scribe as necessary or appropriate in furtherance of the purposes of this section.

(2) REVIEW BY COMMISSION.—Any action with respect to which a recognized public regulatory organization is required by paragraph (1) of this subsection to submit notice shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within 30 days after the date such notice was filed with the Commission and received by such aggrieved person, or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

(f) CONDUCT OF COMMISSION REVIEW.—

(1) BASIS FOR ACTION.—In any proceeding to review a final disciplinary sanction imposed by a rec-

ognized public regulatory organization on an accountant or a person associated with such accountant, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the recognized public regulatory organization and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction)—

(A) if the Commission finds that such accountant or person associated with an accountant has engaged in such acts or practices, or has omitted such acts, as the recognized public regulatory organization has found him to have engaged in or omitted, that such acts or practices, or omissions to act, are in violation of such provisions of this section, or of professional ethics and competency standards, and that such provisions are, and were applied in a manner, consistent with the purposes of this section, the Commission, by order, shall so declare and, as appropriate, affirm the sanction imposed by the recognized public regulatory organization, modify the sanction in accordance with paragraph (2) of this subsection, or re-

mand to the recognized public regulatory organization for further proceedings; or

(B) if the Commission does not make any such finding, it shall, by order, set aside the sanction imposed by the recognized public regulatory organization and, if appropriate, remand to the recognized public regulatory organization for further proceedings.

(2) REDUCTION OF SANCTIONS.—If the Commission, having due regard for the public interest and the protection of investors, finds after a proceeding in accordance with paragraph (1) of this subsection that a sanction imposed by a recognized public regulatory organization upon an accountant or person associated with an accountant imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this Act or is excessive or oppressive, the Commission may cancel, reduce, or require the remission of such sanction.

(g) REVIEW AND APPROVAL OF RULES.—

(1) SUBMISSION, PUBLICATION, AND COMMENT.—Each recognized public regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change

in, addition to, or deletion from the rules of such recognized public regulatory organization (hereinafter in this subsection collectively referred to as a ''proposed rule change'') accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) APPROVAL OR PROCEEDINGS.—Within 35 days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the recognized public regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change; or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to 60 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the recognized public regulatory organization consents.

(3) BASIS FOR APPROVAL OR DISAPPROVAL.—The Commission shall approve a proposed rule change of a recognized public regulatory organization if it finds that such proposed rule change is consistent with the requirements of this Act and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a

proposed rule change of a recognized public regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(4) RULES EFFECTIVE UPON FILING.—

(A) Notwithstanding the provisions of paragraph (2) of this subsection, a proposed rule change may take effect upon filing with the Commission if designated by the recognized public regulatory organization as (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the recognized public regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the recognized public regulatory organization, or (iii) concerned solely with the administration of the recognized public regulatory organization or other matters which the Commission, by rule, consistent with the public interest and the purposes of this sub-

section, may specify as outside the provisions of such paragraph (2).

(B) Notwithstanding any other provision of this subsection, a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, or otherwise in accordance with the purposes of this title. Any proposed rule change so put into effect shall be filed promptly thereafter in accordance with the provisions of paragraph (1) of this subsection.

(C) Any proposed rule change of a recognized public regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this paragraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this Act, the securities laws, the rules and regulations thereunder, and applicable Federal and State law. At any time within 60 days of the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) of this subsection, the Commission summarily may abrogate the change in the rules of the recognized public regulatory organization made thereby and require

that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of paragraph (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act. Commission action pursuant to the preceding sentence shall not affect the validity or force of the rule change during the period it was in effect, shall not be subject to court review, and shall not be deemed to be ''final agency action'' for purposes of section 704 of title 5, United States Code.

(h) COMMISSION ACTION TO CHANGE RULES.—The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as ''amend'') the rules of a recognized public regulatory organization as the Commission deems necessary or appropriate to insure the fair administration of the recognized public regulatory organization, to conform its rules to requirements of this Act, the securities laws, and the rules and regulations thereunder applicable to such orga-

nization, or otherwise in furtherance of the purposes of this Act, in the following manner:

(1) The Commission shall notify the recognized public regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the recognized public regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the recognized public regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any facts on which the Commission considers its determination so to amend the rules of the recognized public regulatory agency to be based, including the reasons for

the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of title 5, United States Code, for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under the securities laws.

(C) Any amendment to the rules of a recognized public regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes to be part of the rules of such recognized public regulatory organization and shall not be considered to be a rule of the Commission.

(i) COMMISSION OVERSIGHT OF THE PRO.—

(1) RECORDS AND EXAMINATIONS.—A public regulatory organization shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as

the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws.

(2) ADDITIONAL DUTIES; SPECIAL REVIEWS.—A public regulatory organization shall perform such other duties or functions as the Commission, by rule or order, determines are necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this Act and the securities laws, including conducting a special review of a particular public accounting firm's quality control system or a special review of a particular aspect of some or all public accounting firms' quality control systems.

(3) ANNUAL REPORT; PROPOSED BUDGET.—

(A) SUBMISSION OF ANNUAL REPORT AND BUDGET.—A public regulatory organization shall submit an annual report and its proposed budget to the Commission for review and approval, by order, at such times and in such form as the Commission shall prescribe.

(B) CONTENTS OF ANNUAL REPORT.—Each annual report required by subparagraph (A) shall include—

(i) a detailed description of the activities of the public regulatory organization;

(ii) the audited financial statements of the public regulatory organization;

(iii) a detailed explanation of the fees and charges imposed by the public regulatory organization under subsection (b)(9); and

(iv) such other matters as the public regulatory organization or the Commission deems appropriate.

(C) TRANSMITTAL OF ANNUAL REPORT TO CONGRESS.—The Commission shall transmit each approved annual report received under subparagraph (A) to the Committee on Financial Services of the United States House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the United States Senate. At the same time it transmits a public regulatory organization's annual report under this subparagraph, the Commission shall include a written statement of its views of the functioning and operations of the public regulatory organization.

(D) PUBLIC AVAILABILITY.—Following transmittal of each approved annual report under subparagraph (C), the Commission and the public regulatory organization shall make the approved annual report publicly available.

(4) DISAPPROVAL OF ELECTION OF PRO MEMBER.—The Commission is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, to disapprove the election of any member of a public regulatory organization if the Commission determines, after notice and opportunity for hearing, that the person elected is unfit to serve on the public regulatory organization.

(j) CLARIFICATION OF APPLICATION OF PRO AUTHORITY.—The authority granted to any such organization in this section shall only apply to the actions of accountants related to the certification of financial statements required by securities laws and not other actions or actions for other clients of the accounting firm or any accountant that does not certify financial statements for publicly traded companies.

(k) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe, rules to implement this section.

(l) EFFECTIVE DATE; TRANSITION PROVISIONS.—

(1) EFFECTIVE DATE.—Except as provided in paragraph (2), subsection (a) of this section shall be effective with respect to any certified financial statement for any fiscal year that ends more than one year after the Commission recognizes a public regulatory organization pursuant to this section.

(2) DELAY IN ESTABLISHMENT OF BOARD.—If the Commission has failed to recognize any public regulatory organization pursuant to this section within one year after the date of enactment of this Act, the Commission shall perform the duties of such organization with respect to any certified financial statement for any fiscal year that ends before one year after any such board is recognized by the Commission.

SEC. 3. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors for any

officer, director, or affiliated person of an issuer of any security registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of such issuer for the purpose of rendering such financial statements materially misleading. In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder.

(b) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation thereunder.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe, the rules or regulations required by this section.

SEC. 4. REAL-TIME DISCLOSURE OF FINANCIAL INFORMATION.

(a) REAL-TIME ISSUER DISCLOSURES REQUIRED.—

(1) OBLIGATIONS.—Every issuer of a security registered under section 12 of the Securities Ex-

change Act of 1934 (15 U.S.C. 78l) shall file with the Commission and disclose to the public, on a rapid and essentially contemporaneous basis, such information concerning the financial condition or operations of such issuer as the Commission determines by rule is necessary in the public interest and for the protection of investors. Such rule shall—

(A) specify the events or circumstances giving rise to the obligation to disclose or update a disclosure;

(B) establish requirements regarding the rapidity and timeliness of such disclosure;

(C) identify the means whereby the disclosure required shall be made, which shall ensure the broad, rapid, and accurate dissemination of the information to the public via electronic or other communications device;

(D) identify the content of the information to be disclosed; and

(E) without limiting the Commission's general exemptive authority, specify any exemptions or exceptions from such requirements.

(2) ENFORCEMENT.—The Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder in civil proceedings.

(b) ELECTRONIC DISCLOSURE OF INSIDER TRANSACTIONS.—

(1) DISCLOSURES OF TRADING.—The Commission shall, by rule, require—

(A) that a disclosure required by section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) of the sale of any securities of an issuer, or any security futures product (as defined in section 3(a)(56) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(56))) or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) that is based in whole or in part on the securities of such issuer, by an officer or director of the issuer of those securities, or by a beneficial owner of such securities, shall be made available electronically to the Commission and to the issuer by such officer, director, or beneficial owner before the end of the next business day after the day on which the transaction occurs;

(B) that the information in such disclosure be made available electronically to the public by the Commission, to the extent permitted under applicable law, upon receipt, but in no case

later than the end of the next business day after the day on which the disclosure is received under subparagraph (A); and

(C) that, in any case in which the issuer maintains a corporate website, such information shall be made available by such issuer on that website, before the end of the next business day after the day on which the disclosure is received by the Commission under subparagraph (A).

(2) TRANSACTIONS INCLUDED.—The rule prescribed under paragraph (1) shall require the disclosure of the following transactions:

(A) Direct or indirect sales or other transfers of securities of the issuer (or any interest therein) to the issuer or an affiliate of the issuer.

(B) Loans or other extensions of credit extended to an officer, director, or other person affiliated with the issuer on terms or conditions not otherwise available to the public.

(3) OTHER FORMATS; FORMS.—In the rule prescribed under paragraph (1), the Commission shall provide that electronic filing and disclosure shall be in lieu of any other format required for such disclosures on the day before the date of enactment of this

subsection. The Commission shall revise such forms and schedules required to be filed with the Commission pursuant to paragraph (1) as necessary to facilitate such electronic filing and disclosure.

SEC. 5. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS PROHIBITED.

(a) PROHIBITION.—It shall be unlawful for any person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or who is a director or an officer of the issuer of such security, directly or indirectly, to purchase (or otherwise acquire) or sell (or otherwise transfer) any equity security of any issuer (other than an exempted security), during any blackout period with respect to such equity security.

(b) REMEDY.—Any profit realized by such beneficial owner, director, or officer from any purchase (or other acquisition) or sale (or other transfer) in violation of this section shall inure to and be recoverable by the issuer irrespective of any intention on the part of such beneficial owner, director, or officer in entering into the transaction. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the

issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within 60 days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than 2 years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap (as defined in section 206B of the Gramm-Leach-Bliley Act) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purposes of this subsection.

(c) RULEMAKING PERMITTED.—The Commission may issue rules to clarify the application of this subsection, to ensure adequate notice to all persons affected by this subsection, and to prevent evasion thereof.

(d) DEFINITIONS.—For purposes of this section, the terms ''officer'', ''director'', and ''beneficial owner'' have the meanings provided such terms in rules or regulations issued by the Securities and Exchange Commission under section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p).

SEC. 6. IMPROVED TRANSPARENCY OF CORPORATE DISCLOSURES.

(a) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations under the securities laws pertaining to the disclosures required in periodic financial reports and registration statements to require such reports to include adequate and appropriate disclosure of—

(1) the issuer's off-balance sheet transactions and relationships with unconsolidated entities or other persons, to the extent they are not disclosed in the financial statements and are reasonably likely to materially affect the liquidity or the availability of, or requirements for, capital resources, or the financial condition or results of operations of the issuer; and

(2) loans extended to officers, directors, or other persons affiliated with the issuer on terms or conditions that are not otherwise available to the public.

(b) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe, the revisions to its regulations required by subsection (a).

(c) ANALYSIS REQUIRED.—

(1) TRANSPARENCY, COMPLETENESS, AND USEFULNESS OF FINANCIAL STATEMENTS.—The Commission shall conduct an analysis of the extent to which, consistent with the protection of investors and the public interest, disclosure of additional or reorganized information may be required to improve the transparency, completeness, or usefulness of financial statements and other corporate disclosures filed under the securities laws.

(2) ALTERNATIVES TO BE CONSIDERED.—In conducting the analysis required by paragraph (1), the Commission shall consider—

(A) requiring the identification of the key accounting principles that are most important to the issuer's reported financial condition and results of operation, and that require management's most difficult, subjective, or complex judgments;

(B) requiring an explanation, where material, of how different available accounting principles applied, the judgments made in their application, and the likelihood of materially different reported results if different assumptions or conditions were to prevail;

(C) in the case of any issuer engaged in the business of trading non-exchange traded contracts, requiring an explanation of such trading activities when such activities require the issuer to account for contracts at fair value, but for which a lack of market price quotations necessitates the use of fair value estimation techniques;

(D) establishing requirements relating to the presentation of information in clear and understandable format and language; and

(E) requiring such other disclosures, included in the financial statements or in other disclosure by the issuer, as would in the Commission's view improve the transparency of such issuer's financial statements and other required corporate disclosures.

(3) RULES REQUIRED.—If the Commission, on the basis of the analysis required by this subsection, determines that it is necessary in the public interest or for the protection of investors and would improve the transparency of issuer financial statements, the Commission may prescribe rules reflecting the results of such analysis and the considerations required by paragraph (2). In prescribing such rules,

the Commission may seek to minimize the paperwork and cost burden on the issuer consistent with achieving the public interest and investor protection purposes of such rules.

SEC. 7. IMPROVEMENTS IN REPORTING ON INSIDER TRANSACTIONS AND RELATIONSHIPS.

(a) SPECIFIC OBJECTIVES.—The Commission shall initiate a proceeding to propose changes in its rules and regulations with respect to financial reporting to improve the transparency and clarity of the information available to investors and to require increased financial disclosure with respect to the following:

(1) INSIDER RELATIONSHIPS AND TRANSACTIONS.—Relationships and transactions—

(A) between the issuer, affiliates of the issuer, and officers, directors, or employees of the issuer or such affiliates; and

(B) between officers, directors, employees, or affiliates of the issuer and entities that are not otherwise affiliated with the issuer,

to the extent such arrangement or transaction creates a conflict of interest for such persons. Such disclosure shall provide a description of such elements of the transaction as are necessary for an understanding of the business purpose and economic sub-

stance of such transaction (including contingencies). The disclosure shall provide sufficient information to determine the effect on the issuer's financial statements and describe compensation arrangements of interested parties to such transactions.

(2) RELATIONSHIPS WITH PHILANTHROPIC ORGANIZATIONS.—Relationships between the registrant or any executive officer of the registrant and any not-for-profit organization on whose board a director or immediate family member serves or of which a director or immediate family member serves as an officer or in a similar capacity. Relationships that shall be disclosed include contributions to the organization in excess of $10,000 made by the registrant or any executive officer in the last five years and any other activity undertaken by the registrant or any executive officer that provides a material benefit to the organization. Material benefit includes lobbying.

(3) INSIDER-CONTROLLED AFFILIATES.—Relationships in which the registrant or any executive officer exercises significant control over an entity in which a director or immediate family member owns an equity interest or to which a director or immediate family member has extended credit. Significant control should be defined with reference to the con-

tractual and governance arrangements between the registrant or executive officer, as the case may be, and the entity.

(4) JOINT OWNERSHIP.—Joint ownership by a registrant or executive officer and a director or immediate family member of any real or personal property.

(5) PROVISION OF SERVICES BY RELATED PERSONS.—The provision of any professional services, including legal, financial advisory or medical services, by a director or immediate family member to any executive officer of the registrant in the last five years.

(b) DEADLINES.—The Commission shall complete the rulemaking required by this section within 180 days after the date of enactment of this Act.

SEC. 8. CODES OF CONDUCT.

Within 180 days after the date of enactment of this Act, the Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8K to require the immediate disclosure, by means of such Form and by the Internet or other electronic means, by any issuer of any change in, or waiver of, the code of ethics of such issuer.

SEC. 9. ENHANCED OVERSIGHT OF PERIODIC DISCLOSURES BY ISSUERS.

(a) REGULAR AND SYSTEMATIC REVIEW.—The Securities and Exchange Commission shall review disclosures made by issuers pursuant to the Securities Exchange Act of 1934 (including reports filed on form 10–K) on a basis that is more regular and systematic than that in practice on the date of enactment on this Act. Such review shall include a review of an issuer's financial statements.

(b) RISK RATING SYSTEM.—For purposes of the reviews required by subsection (a), the Commission shall establish a risk rating system whereby issuers receive a risk rating by the Commission, which shall be used to determine the frequency of such reviews. In designing such a risk rating system the Commission shall consider, among other factors the following:

(1) Emerging companies with disparities in price to earning ratios.

(2) Issuers with the largest market capitalization.

(3) Issuers whose operations significantly impact any material sector of the economy.

(4) Systemic factors such as the effect on niche markets or important subsectors of the economy.

(5) Issuers that experience significant volatility in their stock price as compared to other issuers.

(6) Any other factor the Commission may consider relevant.

(c) MINIMUM REVIEW PERIOD.—In no event shall an issuer be reviewed less than once every three years by the Commission.

(d) PROHIBITION OF DISCLOSURE OF RISK RATING.—Notwithstanding any other provision of law, the Commission shall not disclose the risk rating of any issuer described in subsection (b).

SEC. 10. RETENTION OF RECORDS.

(a) DUTY TO RETAIN RECORDS.—Any independent public or certified accountant who certifies a financial statement as required by the securities laws or any rule or regulation thereunder shall prepare and maintain for a period of no less than 7 years, final audit work papers and other information related to any accountant's report on such financial statements in sufficient detail to support the opinion or assertion reached in such accountant's report. The Commission may prescribe rules specifying the application and requirements of this section.

(b) ACCOUNTANT'S REPORT.—For purposes of subsection (a), the term ''accountant's report'' means a document in which an accountant identifies a financial statement and sets forth his or her opinion regarding such fi-

nancial statement or an assertion that he or she cannot express an opinion.

SEC. 11. COMMISSION AUTHORITY TO BAR PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) COMMISSION AUTHORITY TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—Notwithstanding any other provision of the securities laws, in any cease-and-desist proceeding under section 8A(a) of the Securities Act of 1933 or section 21C(a) of the Securities and Exchange Act of 1934, the Commission may issue an order to prohibit, conditionally or unconditionally, permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934 (or any rule or regulation thereunder) from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934 or that is required to file reports pursuant to section 15(d) of such Act if the person's conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer.

(b) FINDING OF SUBSTANTIAL UNFITNESS.—In making any determination that a person's conduct demonstrates substantial unfitness to serve as an officer or

director of any such issuer, the Commission shall consider—

(1) the severity of the persons conduct giving rise to the violation, and the persons role or position when he engaged in the violation;

(2) the person's degree of scienter;

(3) the person's economic gain as a result of the violation; and

(4) the likelihood that the conduct giving rise to the violation, or similar conduct as defined in subsection (a), may recur if the person is not so prohibited.

(c) AUTOMATIC STAY PENDING APPEAL.—The enforcement of any Commission order pursuant to subsection (a) shall be stayed—

(1) for a period of at least 60 days after the entry of any such order or decision; and

(2) upon the filing of a timely application for judicial review of such order or decision, pending the entry of a final order resolving the application for judicial review.

SEC. 12. DISGORGING INSIDERS PROFITS FROM TRADES PRIOR TO CORRECTION OF ERRONEOUS FINANCIAL STATEMENTS.

(a) ANALYSIS REQUIRED.—The Commission shall conduct an analysis of whether, and under what conditions, any officer or director of an issuer should be required to disgorge profits gained, or losses avoided, in the sale of the securities of such issuer during the six month period immediately preceding the filing of a restated financial statement on the part of such issuer.

(b) DISGORGEMENT RULES AUTHORIZED.—If the Commission determines that imposing the requirement described in subsection (a) is necessary or appropriate in the public interest or for the protection investors, and would not unduly impair the operations of issuers or the orderly operation of the securities markets, the Commission shall prescribe a rule requiring the disgorgement of all profits gained or losses avoided in the sale of the securities of the issuer by any officer or director thereof. Such rule shall—

(1) describe the conditions under which any officer or director shall be required to disgorge profits, including what constitutes a restatement for purposes of operation of the rule;

(2) establish exceptions and exemptions from such rule as necessary to carry out the purposes of this section;

(3) identify the scienter requirement that should be used in order to determine to impose the requirement to disgorge; and

(4) specify that the enforcement of such rule shall lie solely with the Commission, and that any profits so disgorged shall inure to the issuer.

(c) NO PREEMPTION OF OTHER LAW.—Unless otherwise specified by the Commission, in the case of any rule promulgated pursuant to subsection (b), such rule shall be in addition to, and shall not supersede or preempt, the Commission's authority to seek disgorgement under any other provision of law.

SEC. 13. SECURITIES AND EXCHANGE COMMISSION AUTHORITY TO PROVIDE RELIEF.

(a) PROCEEDS OF ENRON AND ANDERSEN ENFORCEMENT ACTIONS.—If in any administrative or judicial proceeding brought by the Securities and Exchange Commission against—

(1) the Enron Corporation, any subsidiary or affiliate of such Corporation, or any officer, director, or principal shareholder of such Corporation, sub-

sidiary, or affiliate for any violation of the securities laws; or

(2) Arthur Andersen L.L.C., any subsidiary or affiliate of Arthur Andersen L.L.C., or any general or limited partner of Arthur Andersen L.L.C., or such subsidiary or affiliate, for any violation of the securities laws with respect to any services performed for or in relation to the Enron Corporation, any subsidiary or affiliate of such Corporation, or any officer, director, or principal shareholder of such Corporation, subsidiary, or affiliate;

the Commission obtains an order providing for an accounting and disgorgement of funds, such disgorgement fund (including any addition to such fund required or permitted under this section) shall be allocated in accordance with the requirements of this section.

(b) PRIORITY FOR FORMER ENRON EMPLOYEES.—The Commission shall, by order, establish an allocation system for the disgorgement fund. Such system shall provide that, in allocating the disgorgement fund amount the victims of the securities laws violations described in subsection (a), the first priority shall be given to individuals who were employed by the Enron Corporation, or a subsidiary or affiliate of such Corporation, and who were participants in an individual account plan established by such

Corporation, subsidiary, or affiliate. Such allocations among such individuals shall be in proportion to the extent to which the nonforfeitable accrued benefit of each such individual under the plan was invested in the securities of such Corporation, subsidiary, or affiliate.

(c) ADDITION OF CIVIL PENALTIES.—If, in any proceeding described in subsection (a), the Commission assesses and collects any civil penalty, the Commission shall, notwithstanding section 21(d)(3)(C)(i) or 21A(d)(1) of the Securities Exchange Act of 1934, or any other provision of the securities laws, be payable to the disgorgement fund.

(d) ACCEPTANCE OF ADDITIONAL DONATIONS.—The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United States for the disgorgement fund. Gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (b).

(e) DEFINITIONS.—As used in this section:

(1) DISGORGEMENT FUND.—The term ''disgorgement fund'' means a disgorgement fund es-

tablished in any administrative or judicial proceeding described in subsection (a).

(2) SUBSIDIARY OR AFFILIATE.—The term ''subsidiary or affiliate'' when used in relation to a person means any entity that controls, is controlled by, or is under common control with such person.

(3) OFFICER, DIRECTOR, OR PRINCIPAL SHAREHOLDER.—The term ''officer, director, or principal shareholder'' when used in relation to the Enron Corporation, or any subsidiary or affiliate of such Corporation, means any person that is subject to the requirements of section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) in relation to the Enron Corporation, or any subsidiary or affiliate of such Corporation.

(4) NONFORFEITABLE; ACCRUED BENEFIT; INDIVIDUAL ACCOUNT PLAN.—The terms ''nonforfeitable'', ''accrued benefit'', and ''individual account plan'' have the meanings provided such terms, respectively, in paragraphs (19), (23), and (34) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(19), (23), (34)).

SEC. 14. STUDY OF RULES RELATING TO ANALYST CONFLICTS OF INTEREST.

(a) STUDY AND REVIEW REQUIRED.—The Commission shall conduct a study and review of any final rules by any self-regulatory organization registered with the Commission related to matters involving equity research analysts conflicts of interest. Such study and report shall include a review of the effectiveness of such final rules in addressing matters relating to the objectivity and integrity of equity research analyst reports and recommendations.

(b) REPORT REQUIRED.—The Commission shall submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on such study and review no later than 180 days after any such final rules by any self-regulatory organization registered with the Commission are delivered to the Commission. Such report shall include recommendations to the Congress, including any recommendations for additional self-regulatory organization rulemaking regarding matters involving equity research analysts. The Commission shall annually submit an update on such review.

SEC. 15. REVIEW OF CORPORATE GOVERNANCE PRACTICES.

(a) STUDY OF CORPORATE PRACTICES.—The Commission shall conduct a study and review of current corporate governance standards and practices to determine whether such standards and practices are serving the best interests of shareholders. Such study and review shall include an analysis of—

(1) whether current standards and practices promote full disclosure of relevant information to shareholders;

(2) whether corporate codes of ethics are adequate to protect shareholders, and to what extent deviations from such codes are tolerated;

(3) to what extent conflicts of interests are aggressively reviewed, and whether adequate means for redressing such conflicts exist;

(4) to what extent sufficient legal protections exist or should be adopted to ensure that any manager who attempts to manipulate or unduly influence an audit will be subject to appropriate sanction and liability, including liability to investors or shareholders pursuing a private cause of action for such manipulation or undue influence;

(5) whether rules, standards, and practices relating to determining whether independent directors are in fact independent are adequate;

(6) whether rules, standards, and practices relating to the independence of directors serving on audit committees are uniformly applied and adequate to protect investor interests;

(7) whether the duties and responsibilities of audit committees should be established by the Commission; and

(8) what further or additional practices or standards might best protect investors and promote the interests of shareholders.

(b) PARTICIPATION OF STATE REGULATORS.—In conducting the study required under subsection (a), the Commission shall seek the views of the securities and corporate regulators of the various States.

(c) REPORT REQUIRED.—The Commission shall submit a report on the analysis required under subsection (a) as a part of the Commission's next annual report submitted after the date of enactment of this Act.

SEC. 16. STUDY OF ENFORCEMENT ACTIONS.

(a) STUDY REQUIRED.—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements im-

posed under the securities laws, and restatements of financial statements, over the last five years to identify areas of reporting that are 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.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days of the date of enactment of this Act and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 17. STUDY OF CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market. Such study shall examine—

(1) the role of the credit rating agencies in the evaluation of issuers of securities;

(2) the importance of that role to investors and the functioning of the securities markets;

(3) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(4) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings;

(5) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers; and

(6) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

(b) REPORT REQUIRED.—The Commission shall submit a report on the analysis required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after the date of enactment of this Act. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 18. STUDY OF INVESTMENT BANKS

(a) GAO STUDY.—The Comptroller General shall conduct a study on whether investment banks and financial advisors in assisted public companies in manipulating their earnings and obfuscating their true financial condition. The study should address the role of the investment banks—

(1) in the collapse of the Enron Corporation, including with respect to the design and implementation of derivatives transactions, transactions involving special purpose vehicles, and other financing arrangements that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company;

(2) in the failure of Global Crossing, including with respect to transactions involving swaps of fiber optic cable capacity, in designing transactions that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company; and

(3) generally, in creating and marketing transactions which may have been designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks faced

by the companies or any other mechanism to obscure a company's financial picture.

(b) REPORT.—The General Accounting Office shall report to the Congress within 180 days after the date of enactment of this Act on the results of the study required by this section. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 19. STUDY OF MODEL RULES FOR ATTORNEYS OF ISSUERS.

(a) IN GENERAL.—The Comptroller General shall conduct a study of the Model Rules of Professional Conduct promulgated by the American Bar Association and rules of professional conduct applicable to attorneys established by the Commission to determine—

(1) whether such rules provide sufficient guidance to attorneys representing corporate clients who are issuers required to file periodic disclosures under section 13 or 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o), as to the ethical responsibilities of such attorneys to—

(A) warn clients of possible fraudulent or illegal activities of such clients and possible consequences of such activities;

(B) disclose such fraudulent or illegal activities to appropriate regulatory or law enforcement authorities; and

(C) manage potential conflicts of interests with clients; and

(2) whether such rules provide sufficient protection to corporate shareholders, especially with regards to conflicts of interest between attorneys and their corporate clients.

(b) REPORT REQUIRED.—The Comptroller General shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on the results of the study required by this section. Such report shall include any recommendations of the General Accounting Office with regards to—

(1) possible changes to the Model Rules and the rules of professional conduct applicable to attorneys established by the Commission to provide increased protection to shareholders;

(2) whether restrictions should be imposed to require that an attorney, having represented a corporation or having been employed by a firm which represented a corporation, may not be employed as

general counsel to that corporation until a certain period of time has expired; and

(3) regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 20. ENFORCEMENT AUTHORITY.

For the purposes of enforcing and carrying out this Act, the Commission shall have all of the authorities granted to the Commission under the securities laws. Actions of the Commission under this Act, including actions on rules or regulations, shall be subject to review in the same manner as actions under the securities laws.

SEC. 21. EXCLUSION FOR INVESTMENT COMPANIES.

Sections 4, 6, 7, 8, 9, and 15 of this Act shall not apply to an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 22. DEFINITIONS.

As used in this Act:

(1) BLACKOUT PERIOD.—The term ''blackout period'' with respect to the equity securities of any issuer—

(A) means any period during which the ability of at least fifty percent of the participants or beneficiaries under all applicable indi-

107TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPORT 107–414

CORPORATE AND AUDITING ACCOUNTABILITY, RESPONSIBILITY, AND TRANSPARENCY ACT OF 2002

APRIL 22, 2002.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. OXLEY, from the Committee on Financial Services, submitted the following

REPORT

together with

MINORITY, ADDITIONAL, AND DISSENTING VIEWS

[To accompany H.R. 3763]

The Committee on Financial Services, to whom was referred the bill (H.R. 3763) to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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99–006

AMENDMENT

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002".

(b) TABLE OF CONTENTS.—

Sec. 1. Short title; table of contents.
Sec. 2. Auditor oversight.
Sec. 3. Improper influence on conduct of audits.
Sec. 4. Real-time disclosure of financial information.
Sec. 5. Insider trades during pension fund blackout periods prohibited.
Sec. 6. Improved transparency of corporate disclosures.
Sec. 7. Improvements in reporting on insider transactions and relationships.
Sec. 8. Codes of conduct.
Sec. 9. Enhanced oversight of periodic disclosures by issuers.
Sec. 10. Retention of records.
Sec. 11. Commission authority to bar persons from serving as officers or directors.
Sec. 12. Disgorging insiders profits from trades prior to correction of erroneous financial statements.
Sec. 13. Securities and Exchange Commission authority to provide relief.
Sec. 14. Study of rules relating to analyst conflicts of interest.
Sec. 15. Review of corporate governance practices.
Sec. 16. Study of enforcement actions.
Sec. 17. Study of credit rating agencies.
Sec. 18. Study of investment banks and other financial institutions.
Sec. 19. Study of model rules for attorneys of issuers.
Sec. 20. Enforcement authority.
Sec. 21. Exclusion for investment companies.
Sec. 22. Definitions.

SEC. 2. AUDITOR OVERSIGHT.

(a) CERTIFIED FINANCIAL STATEMENT REQUIREMENTS.—If a financial statement is required by the securities laws or any rule or regulation thereunder to be certified by an independent public or certified accountant, an accountant shall not be considered to be qualified to certify such financial statement, and the Securities and Exchange Commission shall not accept a financial statement certified by an accountant, unless such accountant—

(1) is subject to a system of review by a public regulatory organization that complies with the requirements of this section and the rules prescribed by the Commission under this section; and

(2) has not been determined in the most recent review completed under such system to be not qualified to certify such a statement.

(b) ESTABLISHMENT OF PRO.—The Commission shall by rule establish the criteria by which a public regulatory organization may be recognized for purposes of this section. Such criteria shall include the following requirements:

(1)(A) The board of such organization shall be comprised of five members, three of whom shall be public members who are not members of the accounting profession and two of whom shall be persons licensed to practice public accounting and who have recent experience in auditing public companies.

(B) Each member of the board of such organization shall be a person who meets such standards of financial literacy as are determined by the Commission.

(C) For purposes of this paragraph, a person shall not be considered a member of the accounting profession if such person has not worked in such profession for any of the last two years prior to the date of such person's appointment to the board.

(2) Such organization is so organized and has the capacity—

(A) to be able to carry out the purposes of this section and to comply, and to enforce compliance by accountants and persons associated with accountants, with the provisions of this Act, professional ethics and competency standards, and the rules of the organization;

(B) to perform a review of the work product (including the quality thereof) of an accountant or a person associated with an accountant; and

(C) to perform a review of any potential conflicts of interest between an accountant (or a person associated with an accountant) and the issuer, the issuer's board of directors and committees thereof, officers, and affiliates of such issuer, that may result in an impairment of auditor independence.

(3) Such organization shall have the authority to impose sanctions, which, if there is a finding of knowing or intentional misconduct, may include a determination that an accountant is not qualified to certify a financial statement, or any categories of financial statements, required by the securities laws, or that a person associated with an accountant is not qualified to participate in such

certification, if, after conducting a review and providing fair procedures and an opportunity for a hearing, the organization finds that—

(A) such accountant or person associated with an accountant has violated the standards of independence, ethics, or competency in the profession;

(B) such accountant or person associated with an accountant has been found by the Commission or a court of competent jurisdiction to have violated the securities laws or a rule or regulation thereunder (provided in both cases that any applicable time period for appeal has expired);

(C) an audit conducted by such accountant or any person associated with an accountant has been materially affected by an impairment of auditor independence;

(D) such accountant or person associated with an accountant has performed both auditing services and consulting services in violation of the rules prescribed by the Commission pursuant to subsection (c); or

(E) such accountant or any person associated with an accountant has impeded, obstructed, or otherwise not cooperated in such review.

(4) Any such organization shall disclose publicly, and make available for public comment, proposed procedures and methods for conducting such reviews.

(5) Any such organization shall have in place procedures to minimize and deter conflicts of interest involving the public members of such organization, and have in place procedures to resolve such conflicts.

(6) Any such organization shall have in place procedures for notifying the boards of accountancy of the States of the results of reviews and evidence under paragraphs (2) and (3).

(7) Any such organization shall have in place procedures for notifying the Commission of any findings of such reviews, including any findings regarding suspected violations of the securities laws.

(8) Any such organization shall consult with boards of accountancy of the States.

(9) Any such organization shall have in place a mechanism to allow the organization to operate on a self-funded basis. Such funding mechanism shall ensure that such organization is not solely dependent upon members of the accounting profession for such funding and operations.

(10) Any such organization shall have the authority to request, in a manner established by the Commission, that the Commission, by subpoena or otherwise, compel the testimony of witnesses or the production of any books, papers, correspondence, memoranda, or other records relevant to any accountant review proceeding or necessary or appropriate for the organization to carry out its purposes. The Commission shall comply with any such request from such an organization if the Commission determines that compliance with the request would assist the organization in its accountant review proceeding or in carrying out its purposes, unless the Commission determines that compliance would not be in the public interest. The issuance and enforcement of a subpoena requested under this paragraph shall be deemed to be made pursuant to, and shall be made in accordance with, the provisions of subsections (b) and (c) of section 21 of the Securities and Exchange Act of 1934 (15 U.S.C. 78u(b)–(c)). For purposes of taking evidence, the Commission in its discretion may designate the Board, or any member thereof, as officers pursuant to section 21(b) of such Act.

(c) PROHIBITION ON THE OFFER OF BOTH AUDIT AND CONSULTING SERVICES.—

(1) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations pertaining to auditor independence to require that an accountant shall not be considered independent with respect to an audit client if the accountant provides to the client the following nonaudit services, as such terms are defined in such regulations as in effect on the date of enactment of this Act, and subject to such conditions and exemptions as the Commission shall prescribe:

(A) financial information system design or implementation; or

(B) internal audit services.

(2) REVIEW OF PROHIBITED NONAUDIT SERVICES.—The Commission is authorized to review the impact on the independence of auditors of the scope of services provided by auditors to issuers in order to determine whether the list of prohibited nonaudit services under paragraph (1) shall be modified. In conducting such review, the Commission shall consider the impact of the provision of a service on an auditor's independence where provision of the service creates a conflict of interest with the audit client.

(3) ADDITIONS BY RULE.—After conducting the review required by paragraph (2) and at any other time, the Commission may, by rule consistent with the protection of investors and the public interest, modify the list of prohibited nonaudit services under paragraph (1).

(4) REPORT.—The Commission shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on its conduct of any reviews as required by this section. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

(5) CONFORMING REVISION.—The Commission shall revise its regulations pertaining to accountant fee disclosure items, as set forth in paragraphs (e)(1) through (e)(3) of item 9 from Schedule 14A (17 CFR 240.14a–101), in light of paragraph (1) of this subsection and after making a determination as to whether such disclosures are necessary.

(6) DEADLINE FOR RULEMAKING.—The Commission shall—

(A) within 90 days after the date of enactment of this Act, propose, and

(B) within 270 days after such date, prescribe,

the revisions to its regulations required by this subsection.

(d) PRO ACCOUNTANT REVIEW PROCEEDINGS.—

(1) REVIEW PROCEEDING FINDINGS.—Any findings made pursuant to an accountant review conducted under this section that a financial statement audited by such accountant and submitted to the Commission may have been materially affected by an impairment of auditor independence, or by a violation of professional ethics and competency standards, shall be submitted to the Commission. The Commission shall promptly notify an issuer of any such finding that relates to the financial statements of such issuer.

(2) CONFIDENTIAL TREATMENT OF PROCEEDINGS PENDING SEC REVIEW.—

(A) NO DISCLOSURE.—Except as otherwise provided in this section, but notwithstanding any other provision of law, neither the Commission, a recognized public regulatory organization, nor any other person shall disclose any information concerning any accountant review proceeding and the findings therein.

(B) SPECIFIC WITHHOLDING NOT AUTHORIZED.—Nothing in this subsection shall—

(i) authorize a recognized public regulatory organization to withhold information from the Commission;

(ii) authorize such board or the Commission to withhold information concerning an accountant review proceeding from an accountant or person associated with an accountant that is the subject of such proceeding;

(iii) authorize the Commission to withhold information from Congress; or

(iv) prevent the Commission from complying with a request for information from any other Federal department or agency requesting information for purposes within the scope of its jurisdiction, or complying with an order of a court of the United States in an action brought by the United States or the Commission.

(C) DURATION OF WITHHOLDING.—Neither the Commission nor the recognized public regulatory organization shall disclose the results of any such finding until the completion of any review by the Commission under subsections (e) and (f), or the conclusion of the 30-day period for seeking review if no motion seeking review is filed within such period.

(D) TREATMENT UNDER FOIA.—For purposes of section 552 of title 5, United States Code, this subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552.

(3) NONPRECLUSIVE EFFECT OF PRO FINDINGS.—A finding by a recognized public regulatory organization that an individual audit of an issuer met or failed to meet any applicable standard with respect to the quality of such audit shall not be construed in any action arising out of the securities laws as indicative of compliance or noncompliance with the securities laws or with any standard of liability arising thereunder.

(e) REVIEW OF SANCTIONS.—

(1) NOTICE.—If any recognized public regulatory organization—

(A) makes a finding with respect to or imposes any final disciplinary sanction on any accountant;

(B) prohibits or limits any person in respect to access to services offered by such organization; or

(C) makes a finding with respect to or imposes any final disciplinary sanction on any person associated with an accountant or bars any person from becoming associated with an accountant,

the recognized public regulatory organization shall promptly submit notice thereof with the Commission. The notice shall be in such form and contain such

information as the Commission, by rule, may prescribe as necessary or appropriate in furtherance of the purposes of this section.

(2) REVIEW BY COMMISSION.—Any action with respect to which a recognized public regulatory organization is required by paragraph (1) of this subsection to submit notice shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within 30 days after the date such notice was filed with the Commission and received by such aggrieved person, or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

(f) CONDUCT OF COMMISSION REVIEW.—

(1) BASIS FOR ACTION.—In any proceeding to review a final disciplinary sanction imposed by a recognized public regulatory organization on an accountant or a person associated with such accountant, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the recognized public regulatory organization and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction)—

(A) if the Commission finds that such accountant or person associated with an accountant has engaged in such acts or practices, or has omitted such acts, as the recognized public regulatory organization has found him to have engaged in or omitted, that such acts or practices, or omissions to act, are in violation of such provisions of this section, or of professional ethics and competency standards, and that such provisions are, and were applied in a manner, consistent with the purposes of this section, the Commission, by order, shall so declare and, as appropriate, affirm the sanction imposed by the recognized public regulatory organization, modify the sanction in accordance with paragraph (2) of this subsection, or remand to the recognized public regulatory organization for further proceedings; or

(B) if the Commission does not make any such finding, it shall, by order, set aside the sanction imposed by the recognized public regulatory organization and, if appropriate, remand to the recognized public regulatory organization for further proceedings.

(2) REDUCTION OF SANCTIONS.—If the Commission, having due regard for the public interest and the protection of investors, finds after a proceeding in accordance with paragraph (1) of this subsection that a sanction imposed by a recognized public regulatory organization upon an accountant or person associated with an accountant imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this Act or is excessive or oppressive, the Commission may cancel, reduce, or require the remission of such sanction.

(g) REVIEW AND APPROVAL OF RULES.—

(1) SUBMISSION, PUBLICATION, AND COMMENT.—Each recognized public regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such recognized public regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) APPROVAL OR PROCEEDINGS.—Within 35 days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the recognized public regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change; or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be con-

cluded within 180 days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to 60 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the recognized public regulatory organization consents.

(3) BASIS FOR APPROVAL OR DISAPPROVAL.—The Commission shall approve a proposed rule change of a recognized public regulatory organization if it finds that such proposed rule change is consistent with the requirements of this Act and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a recognized public regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(4) RULES EFFECTIVE UPON FILING.—

(A) Notwithstanding the provisions of paragraph (2) of this subsection, a proposed rule change may take effect upon filing with the Commission if designated by the recognized public regulatory organization as (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the recognized public regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the recognized public regulatory organization, or (iii) concerned solely with the administration of the recognized public regulatory organization or other matters which the Commission, by rule, consistent with the public interest and the purposes of this subsection, may specify as outside the provisions of such paragraph (2).

(B) Notwithstanding any other provision of this subsection, a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, or otherwise in accordance with the purposes of this title. Any proposed rule change so put into effect shall be filed promptly thereafter in accordance with the provisions of paragraph (1) of this subsection.

(C) Any proposed rule change of a recognized public regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this paragraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this Act, the securities laws, the rules and regulations thereunder, and applicable Federal and State law. At any time within 60 days of the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) of this subsection, the Commission summarily may abrogate the change in the rules of the recognized public regulatory organization made thereby and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of paragraph (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act. Commission action pursuant to the preceding sentence shall not affect the validity or force of the rule change during the period it was in effect, shall not be subject to court review, and shall not be deemed to be "final agency action" for purposes of section 704 of title 5, United States Code.

(h) COMMISSION ACTION TO CHANGE RULES.—The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as "amend") the rules of a recognized public regulatory organization as the Commission deems necessary or appropriate to insure the fair administration of the recognized public regulatory organization, to conform its rules to requirements of this Act, the securities laws, and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this Act, in the following manner:

(1) The Commission shall notify the recognized public regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the recognized public regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the recognized public regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any facts on which the Commission considers its determination so to amend the rules of the recognized public regulatory agency to be based, including the reasons for the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of title 5, United States Code, for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under the securities laws.

(C) Any amendment to the rules of a recognized public regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes to be part of the rules of such recognized public regulatory organization and shall not be considered to be a rule of the Commission.

(i) COMMISSION OVERSIGHT OF THE PRO.—

(1) RECORDS AND EXAMINATIONS.—A public regulatory organization shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws.

(2) ADDITIONAL DUTIES; SPECIAL REVIEWS.—A public regulatory organization shall perform such other duties or functions as the Commission, by rule or order, determines are necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this Act and the securities laws, including conducting a special review of a particular public accounting firm's quality control system or a special review of a particular aspect of some or all public accounting firms' quality control systems.

(3) ANNUAL REPORT; PROPOSED BUDGET.—

(A) SUBMISSION OF ANNUAL REPORT AND BUDGET.—A public regulatory organization shall submit an annual report and its proposed budget to the Commission for review and approval, by order, at such times and in such form as the Commission shall prescribe.

(B) CONTENTS OF ANNUAL REPORT.—Each annual report required by subparagraph (A) shall include—

(i) a detailed description of the activities of the public regulatory organization;

(ii) the audited financial statements of the public regulatory organization;

(iii) a detailed explanation of the fees and charges imposed by the public regulatory organization under subsection (b)(9); and

(iv) such other matters as the public regulatory organization or the Commission deems appropriate.

(C) TRANSMITTAL OF ANNUAL REPORT TO CONGRESS.—The Commission shall transmit each approved annual report received under subparagraph (A) to the Committee on Financial Services of the United States House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the United States Senate. At the same time it transmits a public regulatory organization's annual report under this subparagraph, the Commission shall include a written statement of its views of the functioning and operations of the public regulatory organization.

(D) PUBLIC AVAILABILITY.—Following transmittal of each approved annual report under subparagraph (C), the Commission and the public regulatory organization shall make the approved annual report publicly available.

(4) DISAPPROVAL OF ELECTION OF PRO MEMBER.—The Commission is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, to disapprove the election of any member of a public regulatory organization if the Commission determines, after notice and opportunity for hearing, that the person elected is unfit to serve on the public regulatory organization.

(j) CLARIFICATION OF APPLICATION OF PRO AUTHORITY.—The authority granted to any such organization in this section shall only apply to the actions of accountants

related to the certification of financial statements required by securities laws and not other actions or actions for other clients of the accounting firm or any accountant that does not certify financial statements for publicly traded companies.

(k) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe,

rules to implement this section.

(l) EFFECTIVE DATE; TRANSITION PROVISIONS.—

(1) EFFECTIVE DATE.—Except as provided in paragraph (2), subsection (a) of this section shall be effective with respect to any certified financial statement for any fiscal year that ends more than one year after the Commission recognizes a public regulatory organization pursuant to this section.

(2) DELAY IN ESTABLISHMENT OF BOARD.—If the Commission has failed to recognize any public regulatory organization pursuant to this section within one year after the date of enactment of this Act, the Commission shall perform the duties of such organization with respect to any certified financial statement for any fiscal year that ends before one year after any such board is recognized by the Commission.

SEC. 3. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors for any officer, director, or affiliated person of an issuer of any security registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of such issuer for the purpose of rendering such financial statements materially misleading. In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder.

(b) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation thereunder.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe,

the rules or regulations required by this section.

SEC. 4. REAL-TIME DISCLOSURE OF FINANCIAL INFORMATION.

(a) REAL-TIME ISSUER DISCLOSURES REQUIRED.—

(1) OBLIGATIONS.—Every issuer of a security registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) shall file with the Commission and disclose to the public, on a rapid and essentially contemporaneous basis, such information concerning the financial condition or operations of such issuer as the Commission determines by rule is necessary in the public interest and for the protection of investors. Such rule shall—

(A) specify the events or circumstances giving rise to the obligation to disclose or update a disclosure;

(B) establish requirements regarding the rapidity and timeliness of such disclosure;

(C) identify the means whereby the disclosure required shall be made, which shall ensure the broad, rapid, and accurate dissemination of the information to the public via electronic or other communications device;

(D) identify the content of the information to be disclosed; and

(E) without limiting the Commission's general exemptive authority, specify any exemptions or exceptions from such requirements.

(2) ENFORCEMENT.—The Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder in civil proceedings.

(b) ELECTRONIC DISCLOSURE OF INSIDER TRANSACTIONS.—

(1) DISCLOSURES OF TRADING.—The Commission shall, by rule, require—

(A) that a disclosure required by section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) of the sale of any securities of an issuer, or any security futures product (as defined in section 3(a)(56) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(56))) or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) that is based in whole or in part on the securities of such issuer, by an officer or director of the issuer of those securities, or by a beneficial owner of such securities, shall be made available electronically to the Commission and to the issuer by such officer, director, or beneficial owner before the end of the next business day after the day on which the transaction occurs;

(B) that the information in such disclosure be made available electronically to the public by the Commission, to the extent permitted under applicable law, upon receipt, but in no case later than the end of the next business day after the day on which the disclosure is received under subparagraph (A); and

(C) that, in any case in which the issuer maintains a corporate website, such information shall be made available by such issuer on that website, before the end of the next business day after the day on which the disclosure is received by the Commission under subparagraph (A).

(2) TRANSACTIONS INCLUDED.—The rule prescribed under paragraph (1) shall require the disclosure of the following transactions:

(A) Direct or indirect sales or other transfers of securities of the issuer (or any interest therein) to the issuer or an affiliate of the issuer.

(B) Loans or other extensions of credit extended to an officer, director, or other person affiliated with the issuer on terms or conditions not otherwise available to the public.

(3) OTHER FORMATS; FORMS.—In the rule prescribed under paragraph (1), the Commission shall provide that electronic filing and disclosure shall be in lieu of any other format required for such disclosures on the day before the date of enactment of this subsection. The Commission shall revise such forms and schedules required to be filed with the Commission pursuant to paragraph (1) as necessary to facilitate such electronic filing and disclosure.

SEC. 5. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS PROHIBITED.

(a) PROHIBITION.—It shall be unlawful for any person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) or who is a director or an officer of the issuer of such security, directly or indirectly, to purchase (or otherwise acquire) or sell (or otherwise transfer) any equity security of any issuer (other than an exempted security), during any blackout period with respect to such equity security.

(b) REMEDY.—Any profit realized by such beneficial owner, director, or officer from any purchase (or other acquisition) or sale (or other transfer) in violation of this section shall inure to and be recoverable by the issuer irrespective of any intention on the part of such beneficial owner, director, or officer in entering into the transaction. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within 60 days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than 2 years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap (as defined in section 206B of the Gramm-Leach-Bliley Act) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purposes of this subsection.

(c) RULEMAKING PERMITTED.—The Commission may issue rules to clarify the application of this subsection, to ensure adequate notice to all persons affected by this subsection, and to prevent evasion thereof.

(d) DEFINITION.—For purposes of this section, the term "beneficial owner" has the meaning provided such term in rules or regulations issued by the Securities and Exchange Commission under section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p).

SEC. 6. IMPROVED TRANSPARENCY OF CORPORATE DISCLOSURES.

(a) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations under the securities laws pertaining to the disclosures required in periodic financial reports and registration statements to require such reports to include adequate and appropriate disclosure of—

(1) the issuer's off-balance sheet transactions and relationships with unconsolidated entities or other persons, to the extent they are not disclosed in the financial statements and are reasonably likely to materially affect the liquidity or the availability of, or requirements for, capital resources, or the financial condition or results of operations of the issuer; and

(2) loans extended to officers, directors, or other persons affiliated with the issuer on terms or conditions that are not otherwise available to the public.

(b) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) within 90 days after the date of enactment of this Act, propose, and

(2) within 270 days after such date, prescribe,

the revisions to its regulations required by subsection (a).

(c) ANALYSIS REQUIRED.—

(1) TRANSPARENCY, COMPLETENESS, AND USEFULNESS OF FINANCIAL STATEMENTS.—The Commission shall conduct an analysis of the extent to which, consistent with the protection of investors and the public interest, disclosure of additional or reorganized information may be required to improve the transparency, completeness, or usefulness of financial statements and other corporate disclosures filed under the securities laws.

(2) ALTERNATIVES TO BE CONSIDERED.—In conducting the analysis required by paragraph (1), the Commission shall consider—

(A) requiring the identification of the key accounting principles that are most important to the issuer's reported financial condition and results of operation, and that require management's most difficult, subjective, or complex judgments;

(B) requiring an explanation, where material, of how different available accounting principles applied, the judgments made in their application, and the likelihood of materially different reported results if different assumptions or conditions were to prevail;

(C) in the case of any issuer engaged in the business of trading non-exchange traded contracts, requiring an explanation of such trading activities when such activities require the issuer to account for contracts at fair value, but for which a lack of market price quotations necessitates the use of fair value estimation techniques;

(D) establishing requirements relating to the presentation of information in clear and understandable format and language; and

(E) requiring such other disclosures, included in the financial statements or in other disclosure by the issuer, as would in the Commission's view improve the transparency of such issuer's financial statements and other required corporate disclosures.

(3) RULES REQUIRED.—If the Commission, on the basis of the analysis required by this subsection, determines that it is necessary in the public interest or for the protection of investors and would improve the transparency of issuer financial statements, the Commission may prescribe rules reflecting the results of such analysis and the considerations required by paragraph (2). In prescribing such rules, the Commission may seek to minimize the paperwork and cost burden on the issuer consistent with achieving the public interest and investor protection purposes of such rules.

SEC. 7. IMPROVEMENTS IN REPORTING ON INSIDER TRANSACTIONS AND RELATIONSHIPS.

(a) SPECIFIC OBJECTIVES.—The Commission shall initiate a proceeding to propose changes in its rules and regulations with respect to financial reporting to improve the transparency and clarity of the information available to investors and to require increased financial disclosure with respect to the following:

(1) INSIDER RELATIONSHIPS AND TRANSACTIONS.—Relationships and transactions—

(A) between the issuer, affiliates of the issuer, and officers, directors, or employees of the issuer or such affiliates; and

(B) between officers, directors, employees, or affiliates of the issuer and entities that are not otherwise affiliated with the issuer,

to the extent such arrangement or transaction creates a conflict of interest for such persons. Such disclosure shall provide a description of such elements of the transaction as are necessary for an understanding of the business purpose and economic substance of such transaction (including contingencies). The disclosure shall provide sufficient information to determine the effect on the issuer's financial statements and describe compensation arrangements of interested parties to such transactions.

(2) RELATIONSHIPS WITH PHILANTHROPIC ORGANIZATIONS.—Relationships between the registrant or any executive officer of the registrant and any not-for-profit organization on whose board a director or immediate family member serves or of which a director or immediate family member serves as an officer or in a similar capacity. Relationships that shall be disclosed include contributions to the organization in excess of $10,000 made by the registrant or any executive officer in the last five years and any other activity undertaken by the registrant or any executive officer that provides a material benefit to the organization. Material benefit includes lobbying.

(3) INSIDER-CONTROLLED AFFILIATES.—Relationships in which the registrant or any executive officer exercises significant control over an entity in which a director or immediate family member owns an equity interest or to which a director or immediate family member has extended credit. Significant control should be defined with reference to the contractual and governance arrange-

ments between the registrant or executive officer, as the case may be, and the entity.

(4) JOINT OWNERSHIP.—Joint ownership by a registrant or executive officer and a director or immediate family member of any real or personal property.

(5) PROVISION OF SERVICES BY RELATED PERSONS.—The provision of any professional services, including legal, financial advisory or medical services, by a director or immediate family member to any executive officer of the registrant in the last five years.

(b) DEADLINES.—The Commission shall complete the rulemaking required by this section within 180 days after the date of enactment of this Act.

SEC. 8. CODES OF CONDUCT.

(a) RULES REQUIRED.—Within 180 days after the date of enactment of this Act, the New York Stock Exchange, the American Stock Exchange and the Nasdaq Stock Market (or any successor to such entities), shall file with the Commission proposed rule changes that would prohibit the listing of any security issued by an issuer that has not adopted a senior financial officers code of ethics applicable to its principal financial officer, its comptroller or principal accounting officer, or persons performing similar functions that establishes such standards as are reasonably necessary to promote honest and ethical conduct, the avoidance of conflicts of interest, full, fair, accurate, timely and understandable disclosure in the issuer's periodic reports and compliance with applicable governmental rules and regulations. The Commission shall approve such proposed rule changes pursuant to the requirement of section 19(b)(2) of the Securities Act of 1934.

(b) OTHER EXCHANGES.—The Commission, by rule or regulation, may require any other national securities exchange, to propose rule changes necessary to comply with the provisions of subsection (a) of this section if the Commission determines such action is necessary or appropriate in the public interest and consistent with the protection of investors.

(c) FURTHER STANDARDS.—In addition to the requirements of subsections (a) and (b), the Commission may, by rule or regulation, prescribe further standards of conduct for senior financial officers as necessary or appropriate in the public interest and consistent with the protection of investors.

(d) CHANGES IN CODES OF CONDUCT.—Within 180 days after the date of enactment of this Act, the Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8K to require the immediate disclosure, by means of such Form and by the Internet or other electronic means, by any issuer of any change in, or waiver of, the code of ethics of such issuer.

SEC. 9. ENHANCED OVERSIGHT OF PERIODIC DISCLOSURES BY ISSUERS.

(a) REGULAR AND SYSTEMATIC REVIEW.—The Securities and Exchange Commission shall review disclosures made by issuers pursuant to the Securities Exchange Act of 1934 (including reports filed on form 10–K) on a basis that is more regular and systematic than that in practice on the date of enactment on this Act. Such review shall include a review of an issuer's financial statements.

(b) RISK RATING SYSTEM.—For purposes of the reviews required by subsection (a), the Commission shall establish a risk rating system whereby issuers receive a risk rating by the Commission, which shall be used to determine the frequency of such reviews. In designing such a risk rating system the Commission shall consider, among other factors the following:

(1) Emerging companies with disparities in price to earning ratios.

(2) Issuers with the largest market capitalization.

(3) Issuers whose operations significantly impact any material sector of the economy.

(4) Systemic factors such as the effect on niche markets or important subsectors of the economy.

(5) Issuers that experience significant volatility in their stock price as compared to other issuers.

(6) Any other factor the Commission may consider relevant.

(c) MINIMUM REVIEW PERIOD.—In no event shall an issuer be reviewed less than once every three years by the Commission.

(d) PROHIBITION OF DISCLOSURE OF RISK RATING.—Notwithstanding any other provision of law, the Commission shall not disclose the risk rating of any issuer described in subsection (b).

SEC. 10. RETENTION OF RECORDS.

(a) DUTY TO RETAIN RECORDS.—Any independent public or certified accountant who certifies a financial statement as required by the securities laws or any rule or regulation thereunder shall prepare and maintain for a period of no less than 7 years, final audit work papers and other information related to any accountants

report on such financial statements in sufficient detail to support the opinion or assertion reached in such accountants report. The Commission may prescribe rules specifying the application and requirements of this section.

(b) ACCOUNTANT'S REPORT.—For purposes of subsection (a), the term "accountant's report" means a document in which an accountant identifies a financial statement and sets forth his opinion regarding such financial statement or an assertion that an opinion cannot be expressed.

SEC. 11. COMMISSION AUTHORITY TO BAR PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) COMMISSION AUTHORITY TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—Notwithstanding any other provision of the securities laws, in any cease-and-desist proceeding under section 8A(a) of the Securities Act of 1933 or section 21C(a) of the Securities and Exchange Act of 1934, the Commission may issue an order to prohibit, conditionally or unconditionally, permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) of the Securities Act of 1933 or section 10(b) of the Securities Exchange Act of 1934 (or any rule or regulation thereunder) from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934 or that is required to file reports pursuant to section 15(d) of such Act if the person's conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer.

(b) FINDING OF SUBSTANTIAL UNFITNESS.—In making any determination that a person's conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer, the Commission shall consider—

(1) the severity of the persons conduct giving rise to the violation, and the persons role or position when he engaged in the violation;

(2) the person's degree of scienter;

(3) the person's economic gain as a result of the violation; and

(4) the likelihood that the conduct giving rise to the violation, or similar conduct as defined in subsection (a), may recur if the person is not so prohibited.

(c) AUTOMATIC STAY PENDING APPEAL.—The enforcement of any Commission order pursuant to subsection (a) shall be stayed—

(1) for a period of at least 60 days after the entry of any such order or decision; and

(2) upon the filing of a timely application for judicial review of such order or decision, pending the entry of a final order resolving the application for judicial review.

SEC. 12. DISGORGING INSIDERS PROFITS FROM TRADES PRIOR TO CORRECTION OF ERRONEOUS FINANCIAL STATEMENTS.

(a) ANALYSIS REQUIRED.—The Commission shall conduct an analysis of whether, and under what conditions, any officer or director of an issuer should be required to disgorge profits gained, or losses avoided, in the sale of the securities of such issuer during the six month period immediately preceding the filing of a restated financial statement on the part of such issuer.

(b) DISGORGEMENT RULES AUTHORIZED.—If the Commission determines that imposing the requirement described in subsection (a) is necessary or appropriate in the public interest or for the protection investors, and would not unduly impair the operations of issuers or the orderly operation of the securities markets, the Commission shall prescribe a rule requiring the disgorgement of all profits gained or losses avoided in the sale of the securities of the issuer by any officer or director thereof. Such rule shall—

(1) describe the conditions under which any officer or director shall be required to disgorge profits, including what constitutes a restatement for purposes of operation of the rule;

(2) establish exceptions and exemptions from such rule as necessary to carry out the purposes of this section;

(3) identify the scienter requirement that should be used in order to determine to impose the requirement to disgorge; and

(4) specify that the enforcement of such rule shall lie solely with the Commission, and that any profits so disgorged shall inure to the issuer.

(c) NO PREEMPTION OF OTHER LAW.—Unless otherwise specified by the Commission, in the case of any rule promulgated pursuant to subsection (b), such rule shall be in addition to, and shall not supersede or preempt, the Commission's authority to seek disgorgement under any other provision of law.

SEC. 13. SECURITIES AND EXCHANGE COMMISSION AUTHORITY TO PROVIDE RELIEF.

(a) PROCEEDS OF ENRON AND ANDERSEN ENFORCEMENT ACTIONS.—If in any administrative or judicial proceeding brought by the Securities and Exchange Commission against—

(1) the Enron Corporation, any subsidiary or affiliate of such Corporation, or any officer, director, or principal shareholder of such Corporation, subsidiary, or affiliate for any violation of the securities laws; or

(2) Arthur Andersen L.L.C., any subsidiary or affiliate of Arthur Andersen L.L.C., or any general or limited partner of Arthur Andersen L.L.C., or such subsidiary or affiliate, for any violation of the securities laws with respect to any services performed for or in relation to the Enron Corporation, any subsidiary or affiliate of such Corporation, or any officer, director, or principal shareholder of such Corporation, subsidiary, or affiliate;

the Commission obtains an order providing for an accounting and disgorgement of funds, such disgorgement fund (including any addition to such fund required or permitted under this section) shall be allocated in accordance with the requirements of this section.

(b) PRIORITY FOR FORMER ENRON EMPLOYEES.—The Commission shall, by order, establish an allocation system for the disgorgement fund. Such system shall provide that, in allocating the disgorgement fund amount the victims of the securities laws violations described in subsection (a), the first priority shall be given to individuals who were employed by the Enron Corporation, or a subsidiary or affiliate of such Corporation, and who were participants in an individual account plan established by such Corporation, subsidiary, or affiliate. Such allocations among such individuals shall be in proportion to the extent to which the nonforfeitable accrued benefit of each such individual under the plan was invested in the securities of such Corporation, subsidiary, or affiliate.

(c) ADDITION OF CIVIL PENALTIES.—If, in any proceeding described in subsection (a), the Commission assesses and collects any civil penalty, the Commission shall, notwithstanding section 21(d)(3)(C)(i) or 21A(d)(1) of the Securities Exchange Act of 1934, or any other provision of the securities laws, be payable to the disgorgement fund.

(d) ACCEPTANCE OF ADDITIONAL DONATIONS.—The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United States for the disgorgement fund. Gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (b).

(e) DEFINITIONS.—As used in this section:

(1) DISGORGEMENT FUND.—The term "disgorgement fund" means a disgorgement fund established in any administrative or judicial proceeding described in subsection (a).

(2) SUBSIDIARY OR AFFILIATE.—The term "subsidiary or affiliate" when used in relation to a person means any entity that controls, is controlled by, or is under common control with such person.

(3) OFFICER, DIRECTOR, OR PRINCIPAL SHAREHOLDER.—The term "officer, director, or principal shareholder" when used in relation to the Enron Corporation, or any subsidiary or affiliate of such Corporation, means any person that is subject to the requirements of section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) in relation to the Enron Corporation, or any subsidiary or affiliate of such Corporation.

(4) NONFORFEITABLE; ACCRUED BENEFIT; INDIVIDUAL ACCOUNT PLAN.—The terms "nonforfeitable", "accrued benefit", and "individual account plan" have the meanings provided such terms, respectively, in paragraphs (19), (23), and (34) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(19), (23), (34)).

SEC. 14. STUDY OF RULES RELATING TO ANALYST CONFLICTS OF INTEREST.

(a) STUDY AND REVIEW REQUIRED.—The Commission shall conduct a study and review of any final rules by any self-regulatory organization registered with the Commission related to matters involving equity research analysts conflicts of interest. Such study and report shall include a review of the effectiveness of such final rules in addressing matters relating to the objectivity and integrity of equity research analyst reports and recommendations.

(b) REPORT REQUIRED.—The Commission shall submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on such study and review no later than 180 days after any such final rules by any self-regulatory organization registered with the Commission are delivered to the Commission. Such report shall in-

clude recommendations to the Congress, including any recommendations for additional self-regulatory organization rulemaking regarding matters involving equity research analysts. The Commission shall annually submit an update on such review.

SEC. 15. REVIEW OF CORPORATE GOVERNANCE PRACTICES.

(a) STUDY OF CORPORATE PRACTICES.—The Commission shall conduct a study and review of current corporate governance standards and practices to determine whether such standards and practices are serving the best interests of shareholders. Such study and review shall include an analysis of—

(1) whether current standards and practices promote full disclosure of relevant information to shareholders;

(2) whether corporate codes of ethics are adequate to protect shareholders, and to what extent deviations from such codes are tolerated;

(3) to what extent conflicts of interests are aggressively reviewed, and whether adequate means for redressing such conflicts exist;

(4) to what extent sufficient legal protections exist or should be adopted to ensure that any manager who attempts to manipulate or unduly influence an audit will be subject to appropriate sanction and liability, including liability to investors or shareholders pursuing a private cause of action for such manipulation or undue influence;

(5) whether rules, standards, and practices relating to determining whether independent directors are in fact independent are adequate;

(6) whether rules, standards, and practices relating to the independence of directors serving on audit committees are uniformly applied and adequate to protect investor interests;

(7) whether the duties and responsibilities of audit committees should be established by the Commission; and

(8) what further or additional practices or standards might best protect investors and promote the interests of shareholders.

(b) PARTICIPATION OF STATE REGULATORS.—In conducting the study required under subsection (a), the Commission shall seek the views of the securities and corporate regulators of the various States.

(c) REPORT REQUIRED.—The Commission shall submit a report on the analysis required under subsection (a) as a part of the Commission's next annual report submitted after the date of enactment of this Act.

SEC. 16. STUDY OF ENFORCEMENT ACTIONS.

(a) STUDY REQUIRED.—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws, and restatements of financial statements, over the last five years to identify areas of reporting that are 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.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days of the date of enactment of this Act and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 17. STUDY OF CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market. Such study shall examine—

(1) the role of the credit rating agencies in the evaluation of issuers of securities;

(2) the importance of that role to investors and the functioning of the securities markets;

(3) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(4) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings;

(5) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers; and

(6) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

(b) REPORT REQUIRED.—The Commission shall submit a report on the analysis required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after the date of enactment of this Act. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 18. STUDY OF INVESTMENT BANKS

(a) GAO STUDY.—The Comptroller General shall conduct a study on the role played by investment banks and financial advisors in assisting public companies in manipulating their earnings and obfuscating their true financial condition. The study should address the role of the investment banks—

(1) in the collapse of the Enron Corporation, including with respect to the design and implementation of derivatives transactions, transactions involving special purpose vehicles, and other financing arrangements that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company;

(2) in the failure of Global Crossing, including with respect to transactions involving swaps of fiber optic cable capacity, in designing transactions that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company; and

(3) generally, in creating and marketing transactions designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks faced by the companies or any other mechanism to obscure a company's financial picture.

(b) REPORT.—The General Accounting Office shall report to the Congress within 180 days after the date of enactment of this Act on the results of the study required by this section. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 19. STUDY OF MODEL RULES FOR ATTORNEYS OF ISSUERS.

(a) IN GENERAL.—The Comptroller General shall conduct a study of the Model Rules of Professional Conduct promulgated by the American Bar Association and rules of professional conduct applicable to attorneys established by the Commission to determine—

(1) whether such rules provide sufficient guidance to attorneys representing corporate clients who are issuers required to file periodic disclosures under section 13 or 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o), as to the ethical responsibilities of such attorneys to—

(A) warn clients of possible fraudulent or illegal activities of such clients and possible consequences of such activities;

(B) disclose such fraudulent or illegal activities to appropriate regulatory or law enforcement authorities; and

(C) manage potential conflicts of interests with clients; and

(2) whether such rules provide sufficient protection to corporate shareholders, especially with regards to conflicts of interest between attorneys and their corporate clients.

(b) REPORT REQUIRED.—The Comptroller General shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on the results of the study required by this section. Such report shall include any recommendations of the General Accounting Office with regards to—

(1) possible changes to the Model Rules and the rules of professional conduct applicable to attorneys established by the Commission to provide increased protection to shareholders;

(2) whether restrictions should be imposed to require that an attorney, having represented a corporation or having been employed by a firm which represented a corporation, may not be employed as general counsel to that corporation until a certain period of time has expired; and

(3) regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 20. ENFORCEMENT AUTHORITY.

For the purposes of enforcing and carrying out this Act, the Commission shall have all of the authorities granted to the Commission under the securities laws. Actions of the Commission under this Act, including actions on rules or regulations, shall be subject to review in the same manner as actions under the securities laws.

SEC. 21. EXCLUSION FOR INVESTMENT COMPANIES.

Sections 4, 6, 9, and 15 of this Act shall not apply to an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 22. DEFINITIONS.

As used in this Act:

(1) BLACKOUT PERIOD.—The term "blackout period" with respect to the equity securities of any issuer—

(A) means any period during which the ability of at least fifty percent of the participants or beneficiaries under all applicable individual account plans maintained by the issuer to purchase (or otherwise acquire) or sell (or otherwise transfer) an interest in any equity of such issuer is suspended by the issuer or a fiduciary of the plan; but

(B) does not include—

(i) a period in which the employees of an issuer may not allocate their interests in the individual account plan due to an express investment restriction—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before joining the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an applicable individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction.

(2) BOARDS OF ACCOUNTANCY OF THE STATES.—The term "boards of accountancy of the States" means any organization or association chartered or approved under the law of any State with responsibility for the registration, supervision, or regulation of accountants.

(3) COMMISSION.—The term "Commission" means the Securities and Exchange Commission.

(4) INDIVIDUAL ACCOUNT PLAN.—The term "individual account plan" has the meaning provided such term in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)).

(5) ISSUER.—The term "issuer" shall have the meaning set forth in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(6) PERSON ASSOCIATED WITH AN ACCOUNTANT.—The term "person associated with an accountant" means any partner, officer, director, or manager of such accountant (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such accountant, or any employee of such accountant who performs a supervisory role in the auditing process.

(7) RECOGNIZED PUBLIC REGULATORY ORGANIZATION.—The term "recognized public regulatory organization" means a public regulatory organization that the Commission has recognized as meeting the criteria established by the Commission under subsection (b) of section 2.

(8) SECURITIES LAWS.—The term "securities laws" means 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.), notwithstanding any contrary provision of any such Act.

PURPOSE AND SUMMARY

H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, will protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws. The bill achieves this goal through increased supervision of accountants that audit public companies, strengthened corporate responsibility, increased transparency of corporate financial statements, and protections for employee access to retirement accounts.

With regard to increasing the supervision of accountants, the purpose of the legislation is to allow for the creation of a public regulatory organization or organizations, comprised of persons skilled

and knowledgeable in issues related to the audit of public companies, to perform quality or other reviews of the activities of certified public accountants who report on financial statements that are required to be filed with the Securities and Exchange Commission (SEC). The legislation envisions that such an organization will enforce compliance by accountants with professional ethics and competency standards applicable to audits of such financial statements and establish such rules as are deemed necessary to provide for their review and enforcement, and provides for the oversight of such organizations by the Commission.

The legislation also requires that the SEC promulgate rules that would bar the provision by auditors of certain nonaudit services to their audit clients. The Committee heard testimony that two nonaudit services—financial systems design and implementation and internal audit outsourcing—were perceived to raise issues about auditor independence. Because of the importance of public perceptions in this area, the Committee believes these services should be prohibited. The SEC had proposed to prohibit them during a rulemaking in 2000, but ultimately decided to allow them, subject to certain conditions.

Although financial systems and internal audit work are the two nonaudit services that have raised significant investor concerns, the SEC is also authorized to modify its rules if auditing firms begin to offer other services that raise similarly significant independence concerns. Indeed, it is appropriate that these issues be considered carefully by an entity with the Commission's resources and expertise, and that whatever standards are established apply uniformly to public companies throughout the markets. A non-federal approach would lead to uncertainty in our capital markets, particularly if the standards applicable to public companies and audit firms varied by jurisdiction. The Committee believes that it is appropriate to continue dealing with nonaudit services by having the Commission proscribe specific services rather than casting doubt on a broad range of nonaudit services. In this regard, the Committee heard testimony that a broader ban on nonaudit services could undermine rather than improve audit quality, since certain such services can improve the auditor's understanding of the audit client's business activities. Likewise, a broader ban could reduce corporate efficiencies and impair auditing firms' ability to attract and retain tax and other nonaudit personnel who are essential to the audit process.

The legislation will also ensure that the SEC has sufficient authority to bar individuals from serving as officers or directors of public companies if they demonstrate they are substantially unfit to serve and that company officials disgorge any profits they receive from selling their own shares of their company's stock prior to a restatement of the company's financial statements. The bill also prohibits any company official from fraudulently misleading an auditor and requires the SEC to conduct studies of several areas related to corporate responsibility in order to evaluate other areas of corporate conduct and disclosure which may need reform.

The legislation requires the SEC to issue rules increasing the accuracy and transparency of company disclosures and will strengthen the SEC's procedures for reviewing the financial statements of issuers that play a significant role in the economy. Further, the bill

will require that the SEC explore the effectiveness of SRO rules relating to analysts, and report on the role and function of credit rating agencies.

Finally, the legislation will protect employee access to their retirement accounts by preventing company insiders from trading their own shares in a company when their employees cannot do so because of a "blackout" in a company sponsored employee retirement account.

The legislation is also designed to strengthen the SEC's procedures for reviewing the financial statements of issuers that play a significant role in the economy, explore the effectiveness of SRO rules relating to analysts, and report on the role and function of credit rating agencies.

BACKGROUND AND NEED FOR LEGISLATION

The Federal securities laws are designed to ensure that public companies provide investors with full and accurate disclosure of the true financial condition of the company. Following the bankruptcies of Enron Corporation and Global Crossing LLC, and restatements of earnings by several prominent market participants, regulators, investors and others expressed concern about the adequacy of the current disclosure regime for public companies.

Additionally, they expressed concerns about the role of auditors in approving corporate financial statements. Questions regarding the independence of auditors of public companies led to calls for greater supervision of the profession. The SEC raised the need for the creation of a new oversight body to review compliance of public auditors with the profession's standards of ethics and competency; this suggestion received widespread support.

The bankruptcy of Enron Corporation also raised issues relating to the security of employee retirement accounts. When allegations arose that some Enron insiders were able to sell their company stock even as Enron employees were prohibited from doing so because of an administrative lockdown in the company's retirement plan, new calls arose for protecting the access of employees to their accounts to the same degree as insiders.

The securities laws, and in particular the Securities Exchange Act of 1934, provide a host of protections for investors with regard to their access to company information. Reflecting the technology available to public companies and investors at that time, the securities laws largely reflect the paper-based system of reporting information that was prevalent up until the advent of the electronic age. With the creation of the internet and continuous televised coverage of the capital markets, the regulatory regime for speeding the availability of company information has been unable to keep pace with the nearly instantaneous demand for investor access to that information. On-line trading of securities broadly expanded both the number of participants in the securities markets and the volume of trading in those markets. This development also heightened the need for more rapid disclosure of company news.

The increased public participation in the securities markets and the broader coverage of those markets also raised the profile of securities analysts that provide recommendations regarding equity securities. Responding to the concerns of some that analysts for companies that also underwrite and trade in the securities mar-

kets, the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises held a series of hearings on the role of analysts in reporting on equity securities. Following these hearings, the securities industry developed a statement of best practices guiding analysts and their employers in avoiding conflicts of interest. This statement was later followed by a proposed rule by the self regulatory organizations (SROs) establishing guidelines for analysts and their employers to ensure that analyst recommendations are fair and unbiased. This proposal is currently under review by the SEC.

The Committee's hearings on the Enron matter, the collapse of Global Crossing LLC, and the operations of the Nation's capital markets all indicated that reforms were necessary both for the regulators and the regulated. Further, the President's Plan to Improve Corporate Responsibility and Protect America's Investors, announced on March 7, 2002, outlined a path by which corporations and their investors can continue their partnership in growing the Nation's economy, and do so on fair and equal footing. This legislation responds to the problems of the marketplace through a fair and balanced approach that ensures that the Nation's capital markets continue to be the strongest in the world.

HEARINGS

On March 13 and March 20, 2002, the Committee held legislative hearings on H.R. 3763. The following witnesses testified on March 13: former SEC Chairman Roderick Hills; Mr. Marc Lackritz, President, Securities Industry Association; Mr. Barry Melancon, President and CEO, American Institute of Certified Public Accountants; Mr. James Glassman, American Enterprise Institute; Mr. Ted White, California Public Employees' Retirement System; Mr. Lynn Turner, former Chief Accountant, Securities and Exchange Commission; and Ms. Barbara Roper, Director of Investor Protection for the Consumer Federation of America.

On March 20, the following witnesses testified: SEC Chairman Harvey Pitt; Mr. Franklin Raines, appearing on behalf of the Business Roundtable; Mr. Phillip Livingston, President and CEO, Financial Executives International; Mr. H. Carl McCall, Comptroller, State of New York; Mr. Joseph V. DelRaso, Pepper Hamilton LLP; Mr. Jerry Jasinowski, President, National Association of Manufacturers; and Mr. Peter Chapman, TIAA–CREF. The Committee also received the written testimony of Deputy Undersecretary of the Treasury Mr. Peter Fisher.

Pursuant to clause 2(j)(1) of rule XI of the Rules of the House of Representatives and rule 3(d) of the rules of the Committee on Financial Services, the Committee held another day of hearings at the request of the minority on April 9, 2002. The following witnesses testified: Mr. David Walker, Comptroller General of the United States, General Accounting Office; Mr. Richard Breeden, former Chairman, Securities and Exchange Commission; Mr. Donald Langevoort, Professor of Law, Georgetown University Law Center; and Mr. Damon Silvers, Associate General Counsel, AFL–CIO.

COMMITTEE CONSIDERATION

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises was discharged from the further consideration of H.R. 3763 on April 8, 2002.

The Committee on Financial Services met in open session on April 11 and April 16, 2002 and ordered H.R. 3763 reported to the House with a favorable recommendation by a record vote of 49 yeas and 12 nays, a quorum being present.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. A motion by Mr. Oxley to report the bill to the House with a favorable recommendation was agreed to by a record vote of 49 yeas and 12 nays (Record vote no. 37), a quorum being present. The names of members voting for and against follow:

YEAS	NAYS
Mr. Oxley	Mr. LaFalce
Mr. Leach	Mr. Frank
Mrs. Roukema	Mr. Kanjorski
Mr. Bereuter	Ms. Waters
Mr. Baker	Mr. Sanders
Mr. Bachus	Mrs. Maloney of New York
Mr. Castle	Mr. Ackerman
Mr. King	Ms. Lee
Mr. Royce	Mr. Inslee
Mr. Ney	Ms. Schakowsky
Mr. Barr of Georgia	Mr. Capuano
Mrs. Kelly	Mr. Clay
Mr. Gillmor	
Mr. Cox	
Mr. Weldon of Florida	
Mr. Ryun of Kansas	
Mr. LaTourette	
Mr. Manzullo	
Mr. Ose	
Mrs. Biggert	
Mr. Green of Wisconsin	
Mr. Toomey	
Mr. Shays	
Mr. Shadegg	
Mr. Fossella	
Mr. Gary G. Miller of California	
Mr. Cantor	
Mr. Grucci	
Ms. Hart	
Mrs. Capito	
Mr. Ferguson	
Mr. Rogers of Michigan	
Mr. Tiberi	
Mr. Watt of North Carolina	

Mr. Bentsen
Mr. Maloney of Connecticut
Ms. Hooley of Oregon
Ms. Carson of Indiana
Mr. Sherman
Mr. Sandlin
Mr. Moore
Mr. Gonzalez
Mr. Ford
Mr. Hinojosa
Mr. Lucas of Kentucky
Mr. Shows
Mr. Crowley
Mr. Israel
Mr. Ross

Record votes were held on the adoption of the following amendments. The names of members voting for and against follow:

An amendment to the amendment in the nature of a substitute by Mr. LaFalce (as modified by unanimous consent), no. 1a, establishing the Public Accounting Regulatory Board, was not agreed to by a record vote of 26 yeas and 33 nays (Record vote no. 25).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Leach
Mr. Kanjorski	Mr. Bereuter
Ms. Waters	Mr. Baker
Mr. Sanders	Mr. Castle
Mrs. Maloney of New York	Mr. King
Mr. Gutierrez	Mr. Royce
Mr. Watt of North Carolina	Mr. Ney
Mr. Ackerman	Mr. Barr of Georgia
Ms. Hooley of Oregon	Mrs. Kelly
Ms. Carson of Indiana	Mr. Weldon of Florida
Mr. Sherman	Mr. Ryun of Kansas
Mr. Sandlin	Mr. Riley
Mr. Meeks of New York	Mr. LaTourette
Ms. Lee	Mr. Manzullo
Mr. Mascara	Mr. Ose
Mr. Inslee	Mrs. Biggert
Ms. Schakowsky	Mr. Green of Wisconsin
Mr. Moore	Mr. Toomey
Mr. Gonzalez	Mr. Shadegg
Mrs. Jones of Ohio	Mr. Fossella
Mr. Capuano	Mr. Gary G. Miller of California
Mr. Hinojosa	Mr. Cantor
Mr. Clay	Mr. Grucci
Mr. Israel	Ms. Hart
Mr. Ross	Mrs. Capito
	Mr. Ferguson
	Mr. Rogers of Michigan
	Mr. Tiberi
	Mr. Bentsen

Mr. Maloney of Connecticut
Mr. Lucas of Kentucky
Mr. Shows

An amendment to the amendment in the nature of a substitute by Mrs. Biggert, no. 1b, disgorgement of bonuses and other incentives, as amended, part 1 (page 1, line 1 through page 3, line 13) was agreed to by a voice vote and part 2 (page 3, line 14 through page 5, line 2), was agreed to by a record vote 36 yeas and 25 nays (Record vote no. 28).

YEAS	NAYS
Mr. Oxley	Mr. LaFalce
Mr. Leach	Mr. Frank
Mr. Bereuter	Mr. Kanjorski
Mr. Baker	Ms. Waters
Mr. Bachus	Mr. Sanders
Mr. Castle	Mrs. Maloney of New York
Mr. King	Mr. Watt of North Carolina
Mr. Royce	Mr. Ackerman
Mr. Lucas of Oklahoma	Mr. Bentsen
Mr. Ney	Mr. Maloney of Connecticut
Mr. Barr of Georgia	Ms. Hooley of Oregon
Mrs. Kelly	Ms. Carson of Indiana
Mr. Paul	Mr. Sherman
Mr. Gillmor	Mr. Meeks of New York
Mr. Cox	Ms. Lee
Mr. Weldon of Florida	Mr. Mascara
Mr. Ryun of Kansas	Mr. Inslee
Mr. LaTourette	Ms. Schakowsky
Mr. Manzullo	Mr. Moore
Mr. Jones of North Carolina	Mr. Gonzalez
Mr. Ose	Mrs. Jones of Ohio
Mrs. Biggert	Mr. Capuano
Mr. Green of Wisconsin	Mr. Shows
Mr. Toomey	Mr. Crowley
Mr. Shays	Mr. Ross
Mr. Shadegg	
Mr. Fossella	
Mr. Gary G. Miller of California	
Mr. Cantor	
Mr. Grucci	
Ms. Hart	
Mrs. Capito	
Mr. Ferguson	
Mr. Rogers of Michigan	
Mr. Tiberi	
Mr. Lucas of Kentucky	

An amendment by Mr. LaFalce to the amendment by Mrs. Biggert, no. 1b(2), addressing the disgorgement of bonuses and other incentives, was not agreed to by a record vote of 25 yeas and 30 nays (Record vote no. 26).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Bereuter
Mr. Kanjorski	Mr. Baker
Ms. Waters	Mr. Bachus
Mrs. Maloney of New York	Mr. Castle
Mr. Watt of North Carolina	Mr. King
Mr. Bentsen	Mr. Royce
Mr. Maloney of Connecticut	Mr. Ney
Ms. Hooley of Oregon	Mrs. Kelly
Ms. Carson of Indiana	Mr. Paul
Mr. Sherman	Mr. Weldon of Florida
Mr. Sandlin	Mr. Ryun of Kansas
Mr. Meeks of New York	Mr. Riley
Ms. Lee	Mr. LaTourette
Mr. Mascara	Mr. Manzullo
Mr. Inslee	Mr. Ose
Mr. Moore	Mrs. Biggert
Mr. Gonzalez	Mr. Green of Wisconsin
Mrs. Jones of Ohio	Mr. Toomey
Mr. Capuano	Mr. Shadegg
Mr. Hinojosa	Mr. Fossella
Mr. Shows	Mr. Gary G. Miller of California
Mr. Crowley	Mr. Cantor
Mr. Clay	Mr. Grucci
Mr. Israel	Ms. Hart
	Mrs. Capito
	Mr. Ferguson
	Mr. Rogers of Michigan
	Mr. Tiberi
	Mr. Lucas of Kentucky

An amendment by Mr. LaFalce to the amendment by Mrs. Biggert, no. 1b(4), allowing for the removal of unfit corporate officers or directors and prohibiting unfit persons from serving as an officer or director, was not agreed to by a record vote for 24 yeas and 25 nays (Record vote no. 27).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Leach
Mr. Kanjorski	Mr. Bereuter
Ms. Waters	Mr. Baker
Mr. Sanders	Mr. Castle
Mrs. Maloney of New York	Mr. King
Mr. Gutierrez	Mr. Ney
Mr. Watt of North Carolina	Mr. Barr of Georgia
Mr. Ackerman	Mrs. Kelly
Mr. Bentsen	Mr. Weldon of Florida
Mr. Maloney of Connecticut	Mr. Ryun of Kansas
Ms. Hooley of Oregon	Mr. LaTourette
Ms. Carson of Indiana	Mr. Jones of North Carolina
Mr. Sherman	Mrs. Biggert
Mr. Mascara	Mr. Green of Wisconsin
Mr. Inslee	Mr. Toomey

Ms. Schakowsky
Mr. Gonzalez
Mr. Capuano
Mr. Lucas of Kentucky
Mr. Shows
Mr. Crowley
Mr. Israel
Mr. Ross

Mr. Shays
Mr. Fossella
Mr. Gary G. Miller of California
Mr. Cantor
Mr. Grucci
Ms. Hart
Mr. Ferguson
Mr. Rogers of Michigan
Mr. Tiberi

An amendment to the amendment in the nature of a substitute by Mr. Sherman, no. 1k, providing for auditor capital requirements, was not agreed to by a record vote of 9 yeas and 49 nays (Record vote no. 29).

YEAS

Mr. LaFalce
Mr. Sanders
Mr. Gutierrez
Mr. Sherman
Mr. Sandlin
Mr. Meeks of New York
Ms. Lee
Ms. Schakowsky
Mr. Clay

NAYS

Mr. Oxley
Mr. Leach
Mr. Bereuter
Mr. Baker
Mr. Bachus
Mr. Castle
Mr. King
Mr. Royce
Mr. Ney
Mr. Barr of Georgia
Mrs. Kelly
Mr. Paul
Mr. Gillmor
Mr. Weldon of Florida
Mr. Ryun of Kansas
Mr. LaTourette
Mr. Manzullo
Mrs. Biggert
Mr. Green of Wisconsin
Mr. Toomey
Mr. Shays
Mr. Shadegg
Mr. Fossella
Mr. Gary G. Miller of California
Mr. Cantor
Mr. Grucci
Ms. Hart
Mrs. Capito
Mr. Ferguson
Mr. Tiberi
Mr. Frank
Mr. Kanjorski
Ms. Waters
Mrs. Maloney of New York
Mr. Watt of North Carolina
Mr. Bentsen
Mr. Maloney of Connecticut
Ms. Hooley of Oregon

Ms. Carson of Indiana
Mr. Mascara
Mr. Inslee
Mr. Moore
Mrs. Jones of Ohio
Mr. Capuano
Mr. Lucas of Kentucky
Mr. Shows
Mr. Crowley
Mr. Israel
Mr. Ross

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1l, requiring that the CEO or CFO must certify financial statements, was not agreed to by a record vote of 29 yeas and 30 nays (Record vote no. 30).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Leach
Mr. Kanjorski	Mr. Bereuter
Ms. Waters	Mr. Baker
Mr. Sanders	Mr. Castle
Mrs. Maloney of New York	Mr. King
Mr. Gutierrez	Mr. Royce
Mr. Watt of North Carolina	Mr. Ney
Mr. Bentsen	Mr. Barr of Georgia
Mr. Maloney of Connecticut	Mrs. Kelly
Ms. Hooley of Oregon	Mr. Paul
Ms. Carson of Indiana	Mr. Gillmor
Mr. Sherman	Mr. Weldon of Florida
Mr. Sandlin	Mr. Ryun of Kansas
Mr. Meeks of New York	Mr. LaTourette
Ms. Lee	Mr. Manzullo
Mr. Mascara	Mrs. Biggert
Mr. Inslee	Mr. Green of Wisconsin
Ms. Schakowsky	Mr. Toomey
Mr. Moore	Mr. Shays
Mr. Gonzalez	Mr. Shadegg
Mrs. Jones of Ohio	Mr. Fossella
Mr. Capuano	Mr. Cantor
Mr. Hinojosa	Mr. Grucci
Mr. Shows	Ms. Hart
Mr. Crowley	Mrs. Capito
Mr. Clay	Mr. Ferguson
Mr. Israel	Mr. Rogers of Michigan
Mr. Ross	Mr. Tiberi
	Mr. Lucas of Kentucky

An amendment to the amendment in the nature of a substitute by Mr. LaFalce (as modified by unanimous consent), no. 1m, addressing analysts conflicts of interest, was not agreed to by a record vote of 25 yeas and 37 nays (Record vote no. 31).

YEAS	NAYS
Mr. Leach	Mr. Oxley
Mr. Bachus	Mr. Bereuter
Mr. Castle	Mr. Baker
Mr. LaFalce	Mr. King
Mr. Frank	Mr. Royce
Mr. Kanjorski	Mr. Ney
Ms. Waters	Mr. Barr of Georgia
Mr. Sanders	Mrs. Kelly
Mrs. Maloney of New York	Mr. Paul
Mr. Gutierrez	Mr. Gillmor
Mr. Watt of North Carolina	Mr. Cox
Ms. Carson of Indiana	Mr. Weldon of Florida
Mr. Sherman	Mr. Ryun of Kansas
Mr. Sandlin	Mr. LaTourette
Mr. Meeks of New York	Mr. Manzullo
Ms. Lee	Mr. Ose
Mr. Mascara	Mrs. Biggert
Mr. Inslee	Mr. Toomey
Ms. Schakowsky	Mr. Shays
Mr. Gonzalez	Mr. Shadegg
Mrs. Jones of Ohio	Mr. Fossella
Mr. Capuano	Mr. Gary G. Miller of California
Mr. Hinojosa	Mr. Cantor
Mr. Clay	Mr. Grucci
Mr. Israel	Ms. Hart
	Mrs. Capito
	Mr. Ferguson
	Mr. Rogers of Michigan
	Mr. Tiberi
	Mr. Bentsen
	Mr. Maloney of Connecticut
	Ms. Hooley of Oregon
	Mr. Moore
	Mr. Lucas of Kentucky
	Mr. Shows
	Mr. Crowley
	Mr. Ross

An amendment to the amendment in the nature of a substitute by Mr. Sherman, no. 1n, addressing attestation authority, was not agreed to by a record vote of 16 yeas and 46 nays (Record vote no. 32).

YEAS	NAYS
Mr. Bereuter	Mr. Oxley
Mr. LaFalce	Mr. Leach
Mr. Frank	Mr. Baker
Ms. Waters	Mr. Bachus
Mr. Sanders	Mr. Castle
Mr. Gutierrez	Mr. King
Mr. Sherman	Mr. Royce
Mr. Sandlin	Mr. Lucas of Oklahoma
Mr. Meeks of New York	Mr. Ney
Ms. Lee	Mr. Barr of Georgia

Mr. Mascara
Ms. Schakowsky
Mr. Gonzalez
Mrs. Jones of Ohio
Mr. Hinojosa
Mr. Clay

Mrs. Kelly
Mr. Paul
Mr. Gillmor
Mr. Weldon of Florida
Mr. Ryun of Kansas
Mr. Riley
Mr. LaTourette
Mr. Manzullo
Mr. Ose
Mrs. Biggert
Mr. Shays
Mr. Shadegg
Mr. Fossella
Mr. Gary G. Miller of California
Mr. Cantor
Mr. Grucci
Ms. Hart
Mrs. Capito
Mr. Ferguson
Mr. Rogers of Michigan
Mr. Tiberi
Mr. Kanjorski
Mrs. Maloney of New York
Mr. Watt of North Carolina
Mr. Bentsen
Mr. Maloney of Connecticut
Ms. Hooley of Oregon
Ms. Carson of Indiana
Mr. Inslee
Mr. Moore
Mr. Capuano
Mr. Lucas of Kentucky
Mr. Shows
Mr. Crowley
Mr. Israel
Mr. Ross

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1v, requiring audit committee approval of nonaudit services, was not agreed to by a record vote of 19 yeas and 31 nays (Record vote no. 33).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Bereuter
Mr. Kanjorski	Mr. Baker
Mr. Sanders	Mr. Bachus
Mrs. Maloney of New York	Mr. Castle
Mr. Watt of North Carolina	Mr. King
Mr. Ackerman	Mr. Royce
Mr. Bentsen	Mr. Lucas of Oklahoma
Ms. Hooley of Oregon	Mr. Ney
Ms. Carson of Indiana	Mrs. Kelly
Mr. Sherman	Mr. Gillmor
Mr. Inslee	Mr. Weldon of Florida

Ms. Schakowsky
Mr. Gonzalez
Mr. Capuano
Mr. Ford
Mr. Hinojosa
Mr. Crowley
Mr. Israel

Mr. Ryun of Kansas
Mr. LaTourette
Mr. Manzullo
Mr. Jones of North Carolina
Mr. Ose
Mrs. Biggert
Mr. Green of Wisconsin
Mr. Shays
Mr. Fossella
Mr. Cantor
Mr. Grucci
Ms. Hart
Mr. Ferguson
Mr. Rogers of Michigan
Mr. Tiberi
Mr. Maloney of Connecticut
Mr. Moore
Mr. Lucas of Kentucky
Mr. Shows

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, 1cc, prohibiting independent directors from serving as consultants, was not agreed to by a record vote of 20 yeas and 38 nays (Record vote no. 34).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Leach
Mr. Kanjorski	Mrs. Roukema
Ms. Waters	Mr. Bereuter
Mr. Sanders	Mr. Baker
Mrs. Maloney of New York	Mr. Bachus
Mr. Ackerman	Mr. Castle
Mr. Maloney of Connecticut	Mr. King
Ms. Hooley of Oregon	Mr. Ney
Ms. Carson of Indiana	Mr. Barr of Georgia
Mr. Sherman	Mrs. Kelly
Mr. Inslee	Mr. Gillmor
Ms. Schakowsky	Mr. Cox
Mr. Moore	Mr. Weldon of Florida
Mr. Gonzalez	Mr. Ryun of Kansas
Mr. Capuano	Mr. LaTourette
Mr. Hinojosa	Mr. Manzullo
Mr. Clay	Mr. Jones of North Carolina
Mr. Israel	Mr. Ose
Mr. Ross	Mrs. Biggert
	Mr. Green of Wisconsin
	Mr. Toomey
	Mr. Shays
	Mr. Shadegg
	Mr. Fossella
	Mr. Gary G. Miller of California
	Mr. Cantor
	Mr. Grucci
	Ms. Hart

Mrs. Capito
Mr. Ferguson
Mr. Rogers of Michigan
Mr. Tiberi
Mr. Watt of North Carolina
Mr. Bentsen
Mr. Lucas of Kentucky
Mr. Shows
Mr. Crowley

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1dd, providing for shareholder approval executive stock option plans, was not agreed to by a record vote of 22 yeas and 34 nays (Record vote no. 35).

YEAS	NAYS
Mr. Leach	Mr. Oxley
Mrs. Roukema	Mr. Baker
Mr. Bereuter	Mr. Bachus
Mr. Castle	Mr. King
Mr. Gillmor	Mr. Royce
Mr. LaFalce	Mr. Ney
Mr. Kanjorski	Mr. Barr of Georgia
Ms. Waters	Mrs. Kelly
Mr. Sanders	Mr. Cox
Mrs. Maloney of New York	Mr. Weldon of Florida
Mr. Watt of North Carolina	Mr. Ryun of Kansas
Mr. Ackerman	Mr. LaTourette
Mr. Bentsen	Mr. Manzullo
Ms. Hooley of Oregon	Mr. Jones of North Carolina
Ms. Carson of Indiana	Mr. Ose
Mr. Sherman	Mrs. Biggert
Mr. Moore	Mr. Green of Wisconsin
Mr. Gonzalez	Mr. Toomey
Mr. Capuano	Mr. Shays
Mr. Ford	Mr. Shadegg
Mr. Hinojosa	Mr. Fossella
Mr. Shows	Mr. Cantor
	Mr. Grucci
	Ms. Hart
	Mrs. Capito
	Mr. Ferguson
	Mr. Rogers of Michigan
	Mr. Tiberi
	Mr. Maloney of Connecticut
	Mr. Inslee
	Mr. Lucas of Kentucky
	Mr. Crowley
	Mr. Israel
	Mr. Ross

An amendment to the amendment in the nature of a substitute by Mr. Ackerman, no. 1hh, auditor independence, was not agreed to by a record vote of 18 yeas and 40 nays (record vote no. 36).

YEAS	NAYS
Mr. LaFalce	Mr. Oxley
Mr. Frank	Mr. Leach
Mr. Kanjorski	Mrs. Roukema
Ms. Waters	Mr. Bereuter
Mr. Sanders	Mr. Baker
Mrs. Maloney of New York	Mr. Bachus
Mr. Watt of North Carolina	Mr. Castle
Mr. Ackerman	Mr. King
Ms. Carson of Indiana	Mr. Royce
Mr. Sherman	Mr. Barr of Georgia
Ms. Lee	Mrs. Kelly
Mr. Inslee	Mr. Gillmor
Mr. Capuano	Mr. Cox
Mr. Ford	Mr. Weldon of Florida
Mr. Hinojosa	Mr. Ryun of Kansas
Mr. Crowley	Mr. LaTourette
Mr. Clay	Mr. Manzullo
Mr. Israel	Mr. Ose
	Mrs. Biggert
	Mr. Green of Wisconsin
	Mr. Toomey
	Mr. Shays
	Mr. Shadegg
	Mr. Fossella
	Mr. Gary G. Miller of California
	Mr. Cantor
	Mr. Grucci
	Ms. Hart
	Mrs. Capito
	Mr. Ferguson
	Mr. Rogers of Michigan
	Mr. Tiberi
	Mr. Bentsen
	Mr. Maloney of Connecticut
	Ms. Hooley of Oregon
	Mr. Moore
	Mr. Gonzalez
	Mr. Lucas of Kentucky
	Mr. Shows
	Mr. Ross

The following other amendments were also considered by the Committee:

An amendment in the nature of a substitute by Mr. Oxley, no. 1, making various technical and substantive changes to the bill, was agreed to by a voice vote.

An amendment by Mr. Lucas of Kentucky to the amendment by Mrs. Biggert, no. 1b(1), addressing the composition of the PRO, was agreed to by a voice vote.

An amendment by Mr. Watt to the amendment by Mrs. Biggert, no. 1b(3), striking the scienter requirement, was NOT AGREED TO by a voice vote.

An amendment by Ms. Hooley of Indiana and Mr. Maloney of Connecticut to the amendment by Mrs. Biggert, no. 1b(5), requiring that any independent public or certified accountant who certifies a financial statement to maintain the audit work papers and other related information for a minimum of 7 years, was agreed to by a voice vote.

An amendment by Mr. Watt to the amendment by Mrs. Biggert, no. 1b(6), striking certain language from the amendment, was not agreed to by a voice vote.

An amendment by Mr. Capuano to the amendment by Mrs. Biggert, no. 1b(7), addressing the qualification time of public members of the PRO, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mrs. Maloney of New York, no. 1c, making changes in the code of ethics, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Watt, no. 1d, striking a requirement to consult with State regulators, an amendment to the amendment in the nature of a substitute by Mr. Watt, no. 1e, addressing the filing of disclosures in other formats, an amendment to the amendment in the nature of a substitute by Mr. Bentsen, no. 1f, addressing transactions involving real time disclosure, an amendment to the amendment in the nature of a substitute by Mr. Bentsen, no. 1g, calling for improved transparency of loans to officers and directors, an amendment to the amendment in the nature of a substitute by Ms. Waters, no. 1h, providing that disgorgement funds be distributed to pension fund victims, an amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1i, addressing enhanced oversight of periodic disclosures by issuers, and an amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1j, addressing disclosure of insider and director relationships, were agreed to en bloc by unanimous consent.

An amendment to the amendment in the nature of a substitute, by Mr. Gonzalez, (as amended by unanimous consent), no. 1o, requiring a GAO study of certain standards of professional conduct for attorneys and their protection of investors, was agreed to by a voice vote.

An amendment by Mr. Watt to the amendment by Mr. Gonzales, no. 1o(1), requiring the report to identify pertinent regulatory or legislative steps, was AGREED TO by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1p, addressing real time disclosure of financial information, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Watt, no. 1q, requiring recommendations for regulatory and statutory changes to studies, and an amendment to the amendment in the nature of a sub-

stitute by Mr. Watt, no. 1r, addressing regulations for penalties for manipulation of auditors, were offered en bloc and were agreed to by a voice vote

An amendment to the amendment in the nature of a substitute by Mr. Watt, (as modified by unanimous consent), no. 1s, minimizing burdensome rules on issuers for disclosures required under the bill, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mrs. Maloney, no. 1t, restoring oversight of energy derivatives to the Commodity Futures Trading Commission, was withdrawn.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1u, addressing auditor independence, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Sherman, no. 1w, addressing the scope of non-audit practice, was withdrawn.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce (as modified by unanimous consent), no. 1x, addressing auditor/issuer employment restrictions (cooling-off period), was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1y, addressing the role of audit committee, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Bentsen and Mr. Watt (as modified by unanimous consent), no. 1z, providing authority to bar additional nonaudit services, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Kanjorski (as modified by unanimous consent), no. 1aa, lengthening the statute of limitations for certain private rights of action, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1bb, addressing the removal of unfit corporate officers, was not agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce (as modified by unanimous consent), no. 1ee, requesting a GAO study of investment banks, was AGREED TO by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. LaFalce, no. 1ff, requiring the mandatory rotation of auditors every 8 years, was withdrawn.

An amendment to the amendment in the nature of a substitute by Mr. Kanjorski, no. 1gg, restoring aiding and abetting liability, was withdrawn.

An amendment to the amendment in the nature of a substitute by Mr. Capuano and Mr. Lucas of Kentucky, no. 1ii, clarifying PRO activity, was agreed to by a voice vote.

An amendment to the amendment in the nature of a substitute by Mr. Inslee, no. 1jj, addressing energy pricing disclosure, was withdrawn.

Substitute amendment to the amendment in the nature of a substitute offered by Mr. LaFalce, no. 1kk, was not agreed to by a voice vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee held a hearing and made findings that are reflected in this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

H.R. 3763 authorizes the Commission to take steps designed to increase the oversight of accountants that certify financial statements required under the securities laws, increase transparency of financial statements filed with the Commission, and increase the accountability of officers and directors of public companies. The legislation promotes these goals and objectives by directing the Commission to undertake rule makings and studies in areas related to the above goals.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee finds that this legislation would result in no new budget authority, entitlement authority, or tax expenditures or revenues.

COMMITTEE COST ESTIMATE

A cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974 was not available in time for the filing of this report. The Committee estimates that budget authority will be made available to the SEC at approximately the levels authorized in the legislation.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, a cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974 was not made available to the Committee in time for the filing of this report. The Chairman of the Committee shall cause such estimate to be printed in the *Congressional Record* upon its receipt by the Committee.

FEDERAL MANDATES STATEMENT

An estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act was not made available to the Committee in time for the filing of this report. The Chairman of the Committee shall cause such estimate to be printed in the *Congressional Record* upon its receipt by the Committee.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the United States) and clause 3 (relating to the power to regulate interstate commerce).

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short Title

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

Section 2. Auditor Oversight

Subsection 2(a). The Federal securities laws, and the rules and regulations thereunder, require that certain financial statements of public companies be audited by an independent public or certified public accountant and filed with the Securities and Exchange Commission. The legislation requires the establishment of a public regulatory organization (PRO) to perform certain review and disciplinary functions with respect to accountants who audit those financial statements. Subsection 2(a) provides that the Commission may not accept any 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 audit the statements.

Subsection 2(b). Subsection 2(b) requires the Commission to adopt rules establishing criteria by which an organization may become a "recognized PRO." Subsection 2(b) 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. The board must be composed of five members, at least three of whom are "public members" and two of whom are members of the accounting profession with recent experience in auditing public companies. The Board will often be faced with complex and specialized issues related to financial reporting and the application of professional and other competency standards in real-world settings. Board members who are licensed, practicing accountants and who understand the issues involved in audits of public companies will bring a valuable perspective and needed expertise to the Board's deliberations.

Paragraph 2(b)(1) further provides that each member of the Board shall meet such standards of financial literacy as determined

by the Commission. This requirement is intended to ensure that only individuals whose background demonstrates a solid understanding of the purposes and methods of financial reporting, and the auditing of financial statements, shall serve on the Board.

The details of the Board's specific operations, such as the frequency of Board meetings, staffing levels, and the full- or part-time nature of service on the Board, are left to the discretion of the Commission.

Subsection 2(b) also makes clear that a PRO must have the capacity to enforce compliance by accountants, and persons associated with accountants, with the provisions of the bill, professional ethics and competency standards, and the PRO's own rules. A PRO must have the authority to impose sanctions, including the power to bar accountants temporarily or permanently from reviewing financial statements of public companies if the PRO finds that the accountant acted knowingly or intentionally. A PRO must also be organized, and have the capacity, to review accountants' work product and to review potential conflicts of interest involving accountants. As subsection 2(j) further clarifies, such reviews are not intended to include work performed for non-public companies or any nonaudit work.

A PRO must also 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. Paragraph 2(b)(9) provides that the PRO have a mechanism to allow the organization to operate on a self-funded basis and to ensure that the organization is not solely dependent upon members of the accounting profession for funding. The phrase "not solely dependent" is intended to require that the PRO have a mechanism to obtain funding from other users of audited financial statements who will benefit from the PRO's oversight of accountants and persons associated with accountants.

An organization that satisfies the criteria to be a recognized PRO is granted the authority to impose sanctions against the accountants it reviews. Sanctions may be imposed only after the PRO has conducted a review and provided an opportunity for a fair 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) has been found by the Commission or a court of competent jurisdiction to have 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. By referring to the profession's standards of independence, ethics, or competency, subparagraph 2(b)(3)(A) authorizes the PRO to sanction violations of the Code of Professional Conduct, U.S. Auditing Standards, and the profession's Statements on Quality Control Standards as they exist today or may be modified in the future. The PRO will have the authority to enforce these standards, but

standard-setting powers will remain with the SEC and/or the profession as is the case today.

Subparagraph 2(b)(3)(C) empowers the PRO to impose sanctions on an accountant when the PRO finds that the accountant (or an associated person) has conducted an audit that was materially affected by an impairment of auditor independence. Subparagraph 2(b)(3)(C), which requires a determination of material impact on the audit, should govern most instances of alleged violations of independence, although there may be certain serious violations that could result in sanctions under subparagraph 2(b)(3)(A) even though a material impact is lacking.

The PRO's 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. Paragraph 2(b)(3) is not intended to require the PRO to conclude, in all cases of knowing or intentional misconduct, that a particular person or audit firm is not qualified to participate in the certification of financial statements. Moreover, as subsection 2(j) states expressly, because the PRO's jurisdiction runs to the qualification of accountants to perform audit services for public companies, disqualification by the PRO does not preclude an accountant or a person associated with an accountant from performing audit services for non-public companies or from performing any nonaudit services.

The PRO is given the authority to request the SEC subpoena or otherwise compel the testimony of witnesses or the production of documents for purposes of conducting auditor reviews. This subpoena power should be exercised in order to ensure that relevant information is obtained from persons or entities not otherwise within the PRO's sanctioning authority. The taking of evidence referred to in the last sentence of this subsection includes both the taking of testimony and the production of documentary evidence.

Subsection 2(c). Paragraph 2(c)(1) 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. Paragraph 2(c)(2) authorizes the Commission to review the impact of nonaudit services on auditor independence in the event services that have not previously been the subject of Commission or congressional scrutiny are offered by accounting firms, in order to determine whether the list of prohibited nonaudit services should be modified. Subsection 2(c) does not mandate that the Commission prescribe new rules relating to nonaudit services and is intended only to clarify that the Commission must report the results of any such review to the Committee. Paragraph 2(c)(5) requires that the Commission revise its regulations regarding disclosures of audit and other services if such disclosures are still deemed necessary in light of the new prohibitions on financial systems design and implementation and internal audit outsourcing, and to ensure that audit services, services provided in connection with an audit, and all other services are appropriately categorized. Under Paragraph

2(c)(6), the Commission is required to propose and make final such revisions within 90 and 270 days, respectively, of the enactment of the bill.

Subsection 2(d). Subsection 2(d) sets out certain procedures to govern the PRO review and hearing process. Paragraph 2(d)(1) provides that any finding made pursuant to an accountant review that a financial statement audited by an accountant and submitted to the Commission may have been materially affected by an impairment of auditor independence, or by a violation of professional ethics and competency standards, must be submitted to the Commission, and that the Commission must promptly notify an issuer of any such finding that relates to the issuer's financial statements. The Board should act in all instances with regard for fairness and due process. For this reason, the notifications required by this subsection should be made only after the accountant or audit firm is formally notified of the Board's finding and provided a meaningful opportunity to contest it, pursuant to procedures to be established by the Board.

Neither the Commission, the PRO, nor any other person shall disclose any information concerning an accountant review proceeding or the findings therein except as is authorized by the Act, and are exempt from disclosure under the Freedom of Information Act. Paragraph 2(d)(2) provides for protection against disclosure, whether voluntarily or through discovery, compulsory process, or any other rule, statute, or law, of information developed by or submitted to the PRO during its review and investigatory activity and its review proceedings, subject to the provisions of subparagraphs (2)(B) and (2)(C). These confidentiality provisions govern with regard to other provisions of this legislation, including any provisions relating to any notifications required by this section. Neither the Commission nor the PRO may disclose the results of any finding until the completion of Commission review, or the conclusion of the 30–day period for seeking review, if no motion for review is filed within the period. This provision does not authorize the Commission to withhold information from Congress, or prevent the Commission from complying with a request from another Federal agency, or a Federal court order in an action brought by the United States, or the Commission. If the PRO provides information to a Federal department or agency other than the SEC, such information remains subject to the protections against disclosure otherwise provided for by this subsection. Paragraph (d)(3) provides that the findings of the PRO are made inadmissible in any civil proceeding as evidence of any alleged violation of the securities laws, and are not to be accorded collateral estoppel effect as to compliance or noncompliance with the law or any standard of liability, in any judicial or administrative proceeding.

Subsection 2(e). Subsection 2(e) sets out certain procedures for Commission review of PRO proceedings. The Commission is authorized to review PRO findings and sanctions and is authorized to affirm, modify, or set aside the sanctions. The reference to the submission of affidavits and the presentation of oral arguments in paragraph 2(e)(2) is not meant to preclude the submission of legal briefs or memoranda on the issues before the Commission.

Subsection 2(f). Commission review must 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. While the hearing before the Commission must consist of the record before the PRO and arguments for or against affirmation, modification, or rejection of the PRO's findings and conclusions, this limitation is not meant to preclude the Commission from considering newly discovered evidence for which there is a reasonable explanation as to why it was not available or presented in the PRO's proceeding, nor is it meant to preclude the Commission from taking into account evidence that the Commission concludes that the PRO improperly failed to consider.

Subsection 2(g). 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 must approve any such proposed rule if the Commission finds that the proposal is consistent with the requirements of this bill and the relevant rules and regulations thereunder. Certain categories of rules may be given effect immediately upon being filed with the Commission, though the Commission has authority summarily to abrogate any such rule and require that it be filed as a proposed rule for notice and comment.

Subsection 2(h). Subsection 2(h) authorizes the Commission 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.

Subsection 2(i). Subsection 2(i) provides that a PRO shall make and keep for prescribed periods such records and reports as the Commission by rule requires. Paragraph 2(i)(2) authorizes the Commission, by rule or order, to enable a PRO to perform duties and functions that the Commission determines are necessary and appropriate for the public interest or the protection of investors, and to carry out the purposes of this bill and the securities laws.

Consistent with other provisions throughout this section, a PRO cannot be authorized under this subsection to enforce the securities laws or to promulgate accounting, audit or other professional standards. A PRO has power to make rules for its internal processes and for its enforcement activities. The Commission may not delegate any substantive rulemaking power that it has to a PRO.

Subsection 2(j). Subsection 2(j) confirms that the authority of any PRO reaches only the actions of accountants related to the review or audit of public companies.

Subsection 2(k). Subsection 2(k) provides that the Commission must propose rules to implement section 2 within 90 days and shall implement such rules within 270 days of prescribing them.

Subsection 2(l). Subsection 2(l) establishes effective dates and transition periods. Paragraph 2(l)(2) provides that if the Commission has failed to recognize any PRO within one year after the date of enactment of the Act, the Commission must perform the duties of the PRO with respect to any certified financial statement for any fiscal year that ends before one year after any PRO is recognized by the Commission. This subsection is not intended to expand the powers of the Commission or the size of the federal bureaucracy but rather to have the specified functions performed by a PRO. The

Commission should devote the resources necessary to ensure that a qualified PRO is recognized within one year after the date of enactment of the bill and should recognize any qualified PRO on a timely basis. In the event that it is not possible to recognize a PRO within one year, the Commission should ensure that a PRO is approved as soon as possible after that one-year deadline, and in the interim the Commission should not act to assume or to exercise the functions of the PRO beyond the degree necessary for investor protection.

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 a rule adopted by the Commission, to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in auditing that issuer's financial statements, for the purpose of rendering such financial statements materially misleading. The Commission has exclusive civil authority to enforce section 3 and any rule or regulation thereunder. The authority conferred by this section is in addition to, and does not preempt, any other authority of the Commission with respect to this area, such as the Commission's current authority under Exchange Act Rule 13b2–2, which prohibits making materially false or misleading statements to auditors, and the Commission's cease-and-desist authority under Section 21C of the Exchange Act or its injunctive powers under Section 21 of the Act with respect to third parties who cause others to violate, or aid and abet violations of, the securities laws and rules and regulations thereunder.

Section 4. Real-Time Disclosure of Financial Information

Section 4 amends section 13 of the Securities Exchange Act of 1934 (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. The Commission has exclusive civil authority to enforce this provision and any rule or regulation thereunder.

Section 4 also provides that the Commission must 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 must be made electronically to the Commission before the end of the business day following the day of the transaction, and must 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 the 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 must also 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 any person who holds, directly or indirectly, beneficial ownership of more than 10 percent of any class of equity securities (other than exempted securities) registered pursuant to section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or is a director or officer of the issuer of those securities, to purchase or sell, directly or indirectly, any equity securities of the issuer (other than exempted securities) during a blackout period. A "blackout period" is defined in section 22 of this bill.

Section 5 also provides for recovery, by the issuer, of any profit resulting from a trade made in violation of this provision. If the issuer fails to bring a suit within 60 days of a request to do so, or fails to prosecute the suit diligently, an owner of any security of the issuer may bring a suit in the issuer's name. No suit may be brought after 2 years from the date the profit was realized. Section 5 does not govern transactions where the beneficial owner was not such at both the time of the purchase and sale, or any transaction exempted by the Commission as not within the purposes of section 5. Section 5 permits the Commission to issue rules clarifying the application of this provision, to ensure adequate notice to all persons affected, and to prevent evasion of this provision.

Section 6. Improved Transparency of Corporate Disclosures

Section 6 requires the Commission to revise its regulations under the securities laws 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 reported in the issuer's financial statements at fair value, and are reasonably likely to materially affect the issuer's liquidity or availability of, or requirements for, capital resources, or the financial condition or results of operations of the issuer. The Committee intends that these disclosures would be made on a fair value basis. Issuers must also disclose loans extended to officers, directors or other persons affiliated with the issuer on terms or conditions that are not otherwise available to the public.

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, where 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 where 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. Improvements in Reporting on Insider Transactions and Relationships

Section 7 requires the Commission to initiate a proceeding to propose changes in its rules and regulations with respect to financial reporting to require increased disclosure of relationships between the issuer and affiliates of the issuer and officers, directors or employees of the issuer; and officers, directors or employees of the affiliate and unrelated other entities to the extent such relationships create a conflict of interest for those individuals. The proceeding must examine relationships with philanthropic organizations, insider controlled affiliates, joint ownership interests in real property, and the provision of services by related persons. If a rulemaking is initiated pursuant to this section, the Commission is directed to do so within 180 days of the enactment of the bill.

Section 8. Codes of Conduct

Section 8 directs the New York Stock Exchange, the American Stock Exchange and the Nasdaq stock market to file with the Commission proposed rules that would prohibit their listing any security for a company that has not adopted a code of ethics for the company's senior officials. The Commission is given the authority to impose this requirement on any other national securities exchange.

Section 8 requires that the Commission revise its regulations pertaining to disclosures on form 8K to require the immediate disclosure of any change or waiver of such code of ethics of an issuer.

Section 9. Enhanced Oversight of Periodic Disclosures by Issuers

Section 9 directs the Commission to review disclosures of issuers required to file statements under the securities laws on a more regular and systematic basis. The Commission is directed to create a risk rating system to determine the frequency of such reviews. The Commission is directed to ensure that no issuer shall be reviewed less than once every three years. The section provides that the Commission may not disclose the risk rating of any issuer.

Section 10. Retention of Records

Subsection 10(a) requires CPAs who certify financial statements under the securities laws to prepare and maintain final audit work papers and other information that are necessary to support an accountants report on such financial statements for a period of no less than 7 years. The term "work papers" was used as a term of art, to be defined with reference to the professional standards governing the subject.

Subsection 10(b) defines the term "accountants report" to mean a document in which an accountant identifies a financial statement and sets forth his opinion regarding that financial statement or an assertion that an opinion cannot be expressed.

The purpose of this section is to ensure that necessary auditing documents are retained in the event that a CPA's conclusions are subsequently reviewed. At the same time, the legislation is not intended to impose unnecessary or excessively costly burdens on accountants, or to require that every document, or every iteration of a document, be preserved. The requirements of this section may be satisfied through the use of electronic records.

Section 11. Commission Authority to Bar Persons from Serving as Officers or Directors

Section 11 gives the Commission authority to issue an order in connection with a cease-and-desist proceeding to bar a person who has violated section 17(a)(1) of the Securities Act of 1933 (Securities Act) or section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) from acting as an officer or director of a company that is registered with or required to file reports with the Commission (public company), if that person's conduct demonstrates substantial unfitness to serve as an officer or director of a public company. Under current law, section 20(e) of the Securities Act and section 21(d)(2) of the Exchange Act, the Commission can only obtain such a bar in a Federal court proceeding.

The administrative bar authority granted in section 11 is an extraordinary remedy, allowing the Commission effectively to deprive a person of his or her livelihood. In other circumstances where the Commission or other Federal agencies have similar authority, the agency generally has plenary regulatory authority over the industry in which the individual is employed and the bar extends only to that industry. For example, under section 15(b)(6) of the Exchange Act, the Commission has the authority to bar an individual from being associated with a broker or dealer, and section 203(f) of the Investment Advisers Act of 1940 gives the Commission authority to bar an individual from being associated with an investment adviser. Brokers, dealers and investment advisers are all subject to comprehensive regulatory schemes overseen by the Commission. *See also* 12 U.S.C. 1818(e)(1) (2002) (permitting debarment of banking officials); 15 U.S.C. 80a–35 (2002) (permitting debarment of officers, directors or members of investment company advisory boards). On the other hand, while the securities laws require disclosure by public companies, there has been no legislative mandate to the Commission to create a comprehensive regulatory scheme applicable to public companies or their employees and directors. Such a mandate would be antithetical to the disclosure philosophy of our securities laws, which has been the basis for the development of our strong securities markets. Moreover, while an individual barred from the securities industry may seek employment in many other industries, an individual barred from serving as an officer or director of a public company is prohibited from employment in such capacity by over 17,000 companies.

The Committee has therefore included several protections in section 11 to make clear that the standard for the Commission to apply in issuing a bar order is high, and to ensure that the Commission exercises this authority with care and only in circumstances where it is justified by the magnitude of the individual's offense and the need to protect investors from potential recidivism by the individual.

The first protection is the requirement in paragraph (a) that the Commission must find that a person's conduct demonstrates "substantial unfitness" to serve as an officer or director of a public company before he or she can be barred. This is the same standard that is applicable to Federal court proceedings in which the Commission seeks to bar an individual from serving as an officer or director of a public company.

The Committee also believes it is appropriate to set forth factors for the Commission to consider in making a determination whether an individual's conduct demonstrates substantial unfitness. These factors are derived from case law interpreting this standard under section 20(e) of the Securities Act and section 21(d)(2) of the Exchange Act. *See, e.g., SEC* v. *McCaskey,* 2001 U.S. Dist. LEXIS 13571 (S.D.N.Y. 2001); *SEC* v. *Farrell,* 1996 U.S. Dist. LEXIS 22681 (W.D.N.Y. 1996); *SEC* v. *Patel,* 61 F.3d 137 (2d Cir. 1995); *SEC* v. *Shah,* 1993 U.S. Dist. LEXIS 10347 (S.D.N.Y. 1993); *see also* Jayne W. Barnard, *When is a Corporate Executive "Substantially Unfit to Serve,"* 70 N.C.L. Rev. 1489 (1992). They are: (1) the severity of the person's conduct giving rise to the violation, and the person's role or position when engaged in the violation; (2) the person's degree of scienter; (3) the person's economic gain as a result of the violation; and (4) the likelihood that the conduct giving rise to the violation, or similar conduct as defined in subsection (a), may recur if the person is not so prohibited. Paragraph (b) omits one of the factors considered by the courts, whether the person is a "repeat offender." The Committee believes that repeat offender status is an implicit consideration in the fourth factor, the likelihood that similar conduct will recur.

An additional protection is provided in paragraph (c), which stays the enforcement of a Commission bar order during the period in which application may be made for judicial review of the bar order and, if a timely application for judicial review is made, pending the entry of a final order resolving the application. This will prevent an individual from losing his or her position while exercising the right of appeal to a Federal court. Without this stay provision, the Committee is concerned that an administrative bar would have its intended effect even if ultimately deemed by a court to have been inappropriate, in that the individual would have been deprived of his or her livelihood in the intervening period and might have a difficult time attaining a comparable position to that lost due to the improper bar.

Finally, the Committee notes that section 11 provides, as does section 20(e) of the Securities Act and section 21(d)(2) of the Exchange Act, that the Commission may issue an order to bar an individual *conditionally or unconditionally,* and *permanently or for such period of time as it shall determine* (emphasis added). Accordingly, the Committee expects that the Commission will, as the courts have done, issue orders tailored to the individuals and facts before it. *See SEC* v. *McCaskey,* 2001 U.S. Dist. LEXIS 13571 (S.D.N.Y. 2001) (rejecting permanent bar order in favor of six-year bar); *SEC* v. *Farrell,* 1996 U.S. Dist. LEXIS 22681 (W.D.N.Y 1996) (rejecting comprehensive bar order in favor of industry specific bar).

Section 12. Disgorging Insiders Profits From Trades Prior to Correction of Erroneous Financial Statements

Section 12 directs the Commission to conduct an analysis of whether any officer or director of an issuer should be required to disgorge profits gained or losses avoided from the sale of the securities of such issuer during the six month period preceding the filing of a restated financial statement. The Commission is authorized to issue rules requiring disgorgement under those circumstances. The Committee intends that, if the Commission chooses to issue rules pursuant to this section, it do so only after providing safeguards and exemptions to ensure that such disgorgement is required only in cases where the Commission can prove extreme misconduct on the part of that officer or director. The Committee intends that the Commission would, in establishing any such rules, ensure fair and impartial procedures, with a right to appeal, for the adjudication of any action to require disgorgement.

Section 13. Securities and Exchange Commission Authority To Provide Relief

Section 13 provides that, if the Commission obtains funds pursuant to a disgorgement proceeding from Enron Corporation, Arthur Andersen LLC, or any affiliate, subsidiary, officer, director or principal shareholder thereof, the Commission will establish an allocation system for those funds that will give priority to former employees of Enron Corporation who were participants in its employee retirement plan. The section directs that any monies in payment of a civil penalty against Enron or Arthur Andersen must be paid into the disgorgement fund. The section also authorizes the Commission to accept donations for the disgorgement fund.

Section 14. Study of Rules Relating to Analyst Conflicts of Interest

Section 14 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 14 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 15. Review of Corporate Governance Practices

Section 15 requires the Commission 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 Commission must seek the views of State securities and corporate regulators, and must report on its analysis in its next annual report to Congress.

The study must include an analysis of whether current standards and practices promote full disclosure to shareholders of relevant information; whether corporate codes of ethics are adequate for shareholder protection; the extent to which conflicts of interest are

aggressively reviewed; 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; whether the rules, standards and practices relating to determining whether independent directors are in fact independent are adequate; whether rules relating to the independence of directors serving on audit committees are adequate to protect investors and are uniformly applied; whether the duties and responsibilities of audit committees should be established by the Commission; and what further or additional practices or standards might best protect investors and promote the interests of shareholders.

Section 16. Study of Enforcement Actions

Section 16 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 17. Study of Credit Rating Agencies

Section 17 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 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; any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers; any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; any barriers to entry into the business of acting as a credit rating agency and measures needed to remove such barriers; and any conflicts of interests in the operation of credit rating agencies and measures to prevent those conflicts or ameliorate their consequences.

Section 18. Study of Investment Banks

Section 18 directs the General Accounting Office (GAO) to conduct a study on the role of investment banks and financial advisors in assisting public companies in manipulating their earnings and obfuscating their true financial condition. The section directs the GAO to address the role of investment banks in the bankruptcy of Enron Corporation, the failure of Global Crossing, and in the creation and marketing of transactions designed to obfuscate a company's financial picture. The GAO is directed to report to Congress within 180 days of enactment of the bill.

Section 19. Study of Model Rules for Attorneys of Issuers

Section 19 directs the Comptroller General to conduct a study of the Model Rules of Professional Conduct promulgated by the American Bar Association and rules of professional conduct applicable to attorneys established by the Commission to determine whether such rules provide adequate guidance to attorneys with respect to their ethical obligations. The Comptroller General is ordered to report to the House Financial Services Committee and the Senate Banking Committee.

Section 20. Enforcement Authority

Section 20 grants the Commission all of the authorities granted to it under the securities laws in order to enforce the bill. Commission actions under the legislation, including actions on rules and regulations, are subject to review in the same manner as actions under the securities laws.

Section 21. Exclusion for Investment Companies

Section 21 clarifies that certain provisions of the bill are not meant to apply to investment companies registered with the Commission under the Investment Company Act of 1940. Because those companies are already subject to a thorough regulatory regime, the application of these provisions would be inappropriate.

Section 22. Definitions

Section 22 defines terms used in the bill.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

The bill does not amend existing law.

MINORITY VIEWS

The collapse of the Enron Corporation provided irrefutable evidence of serious, systemic problems in our financial reporting system and our capital markets. Far from being an isolated instance, Enron was only the most spectacular example of what has become a common phenomenon—earnings manipulation and deceptive accounting by our largest companies. Before Enron, company after company—Waste Management, Sunbeam, Cendant, W.R. Grace, and many others—were found to have manipulated their accounting to present a picture to investors that did not match reality. As evidenced by the record number of investigations opened by the SEC thus far this year, the problem has only become more acute.

The safeguards that should protect investors from such practices have failed at every level in company after company, overwhelmed by the temptation for companies to cheat, overstate, or obscure their financial disclosure to improve short-term results and meet analyst or investor expectations. The stock prices of many companies have been whipsawed by any suggestion of possible accounting problems, indicating a clear decline in confidence in our financial reporting system. While this system has long been viewed as the best in the world, its reputation has suffered from a string of record financial restatements and prosecutions of some of our largest companies.

Virtually all of the witnesses heard by the Committee spoke of the need for auditors to be willing to stand up to management and for audit committees to take real responsibility for audits and auditors. To do this, we must significantly alter the relationship of the auditor to its client, strengthen the functioning of audit committees, and provide meaningful ongoing oversight of the auditing profession. We should use this opportunity to restore the vitality of critical investor safeguards by ensuring that auditors and audit committees can once again act as the first line of defense in protecting investors. The market alone cannot provide an effective or lasting solution to these problems.

To restore confidence in the integrity of our markets, this Congress should enact tough and credible legislation to address the serious and growing problem of earnings management and accounting fraud. There are a number of important areas in which the bill reported out of the Financial Services Committee should be improved:

Oversight of the accounting industry. In spite of the critical role that auditors play in the financial reporting system for publicly traded companies under our securities laws, oversight of the industry has been left entirely to the industry itself, with little input from either the SEC or the public. While a broad consensus has formed on the need for a new public oversight body for the accounting profession, there are major differences on the attributes such

a regulator must have to be credible and effective. The bill reported out of committee leaves these matters to SEC rulemaking, effectively allowing these issues to remain open to debate even after Congress has acted.

Given the importance of these decisions to the effectiveness of the new regulator, Congress should not delegate this task. Without a clear mandate from Congress, the structure and role of the new regulator will be the subject of continued debate and will be more limited than needed to effectively oversee the auditing industry. Delegating decisions on its duties and powers to the SEC provide an opportunity for the authority of the new regulator to be weakened.

The new regulator should have authority to set audit quality and independence standards, rather than just enforcing the standards set by industry bodies. While the regulator could chose to rely on existing industry standards if it determines they are adequate to ensure high-quality audits, the regulator should be able to use the results of the experience gained from reviewing auditors and audits to determine where new or more explicit standards are needed in problematic areas. Congress should strengthen the bill reported by Committee to provide this authority.

The new regulator also should have clear disciplinary and investigative powers. Unlike the tangled jumble of existing industry organizations, the new regulator must be given the tools to provide meaningful quality control and to conduct timely investigations and disciplinary actions. It must have the ability to draw on its experiences to strengthen the industry standards as necessary to provide the high level of quality and independence that we expect of auditors of public companies. Clarifying the authority of the regulator will enable it to better coordinate with the SEC, rather than waiting years until after SEC actions are completed. The provisions of the bill reported out by the committee should be significantly improved in this regard.

Auditor independence. While an auditor's first duty should be to the public, auditors currently are beholden to their audit clients for fees for non-audit services that may far exceed the audit fees they receive. Data now available under the Security and Exchange Commission's disclosure rule on non-audit fees makes clear that, for the auditors of many large public companies, audit fees are a minute percentage of the fees they receive. The non-audit services that auditors provide to the public companies they audit must be limited and must be made subject to real oversight by the audit committees.

The bill reported out of committee includes no real limits on the non-audit services that auditors provide to their audit clients. While H.R. 3763 includes a provision that purports to prohibit auditors from providing audit clients with two non-audit services, financial information design and implementation and internal audit outsourcing. The language of the provision references the existing SEC rules in a way that includes only the limited restrictions that the SEC currently places on these services. By codifying existing regulatory carve-outs, the provision effectively makes no change in existing law, not even going as far as the accounting industry has announced it is willing to go voluntarily.

The bill reported out of committee should have included real limits on the non-audit services that auditors provide to their audit clients where those services create conflicts for auditors, such as services that result in the auditor auditing its own work. Additionally, while some non-audit services do not create conflicts for auditors or are difficult to separate from audit work, the provision of such services by an auditor to its audit client should be carefully examined to ensure that the full scope of services provided are in the best interests of shareholders, rather than auditors or management.

Congress should strengthen the bill reported by the committee to include provisions to ensure that the full scope of the relationship between an auditor and its audit client are subject to the control of the audit committee in order to enable the audit committee to effectively oversee the auditor. A requirement for audit committee approval of non-audit services would promote the independence of the audit by ensuring that it is responsible to the audit committee and shareholders, rather than to management. Such a provision would enable an audit committee to determine what makes sense for the individual company and its auditor in light of the full range of services and activities of its auditor.

The role of the audit committee. The bill reported out of committee calls for a study of corporate governance, but does not in any meaningful way address to whom the outsider auditors report. In our view, the bill should have included a provision that would have required an issuer's auditor to be appointed by and report to the audit committee of the board of directors. In addition, it is vital that the audit committee has an ongoing dialogue with the outside auditor as a critical check on the veracity of the financial statements and internal controls of the company.

The record before this Committee demonstrates that the audit committee has the responsibility to shareholders to make sure that their auditors are doing their job, raise the tough questions, and ensure that the financial picture of the company is accurate and portrays the true nature of the financial condition of the company. It is clear from the Enron case, as the special committee of the board of directors of Enron concluded, that at every level corporate oversight failed, including and perhaps most acutely at the audit committee level. It is important to vest the audit committee with the clear authority to closely oversee the work of the auditors and take seriously their oversight responsibilities.

Mr. Harvey Pitt, Chairman of the Securities and Exchange Commission, said in a recent speech, "while shareholder approval of outside auditors is now a well established aspect of corporate governance, I believe we should also explore whether the audit committee should be vested with the initial decision about which firm is recommended to the shareholders. I also believe that audit committees should have the authority to fire outside auditors (or prevent management from firing them)."

Independent directors serving as consultants. The bill reported out of the Committee does not include provisions to ensure that independent directors are truly independent. The bill should have included a provision that would prevent the practice of paying independent directors as "consultants" while they serve on the board.

Lynn Turner, former Chief Accountant of the SEC, among others, have argued that paying directors as consultants is back door compensation that fundamentally undermines their independence. The critical question is whether "independent" directors who are receiving significant consulting compensation would challenge the same management that is paying them to serve as consultants. Such a provision is a simple step in ensuring that directors act in the best interests of shareholders.

Analysts conflicts. The role of many securities analysts in continuing to push Enron's stock even as the company was collapsing is well recognized. In spite of the evidence before us, the committee failed to address the core issues that undermine securities analysts' independence. That is, compensation arrangements of analysts at investment banks provide incentives to win and retain business, rather than provide investors with high-quality unbiased research.

To ensure securities analyst independence Congress should have adopted a provision that would require:

- That the self regulatory organizations adopt rules to ban equity research analysts from holding equity interests in the companies that they cover;
- That analyst compensation not be based on investment banking revenue, but permit compensation to be based on the overall success of the firm;
- That the investment banking department have no input into the compensation, hiring, firing and promotion of securities analysts.
- That SROs establish criteria for evaluating analyst research quality and require that analyst compensation be principally based on the quality of an analyst's research.

Disgorgement of bonuses and other incentives. In an attempt to restore accountability among corporate officers, the President unveiled a 10 point plan. One of the meritorious items in that plan was a call to require disgorgement of incentive-based compensation from officers and directors in cases of false or misleading statements made by such officers that required an accounting restatement. Instead of attempting to implement this straightforward and common sense proposal, the Committee simply tasked the SEC to study the question of disgorgement. Additionally, the report language attempts to raise the bar to use of this remedy by stating that it should be used only where the Commission can prove "extreme misconduct". Establishing such a high standard will make it very difficult, if not impossible, for the Commission to obtain disgorgement of millions of dollars that executives have earned from stock sales at the same time they were committing securities fraud.

We, however, believe that Congress should act quickly to provide the SEC with the power to require disgorgement of compensation in an administrative proceeding. Congress should have adopted a provision that requires the SEC to prescribe regulations to require disgorgement in certain proceedings to seek disgorgement of salaries, commissions, fees, bonuses and other incentive-based compensation obtained by an officer or director of an issuer who made or caused to be made the filing of financial statements that were at the time false or misleading.

In addition, the bill should have included a provision that provides in any action or proceeding brought or instituted by the Commission under the securities laws against any person who made or caused to be made the filing of financial statements that were at the time false or misleading or for causing, or aiding and abetting any other violation of the securities laws may be required to disgorge salaries, commissions, fees, bonuses and other incentive-based compensation.

CEO and CFO certification of financial statements. Another important policy initiative advanced by the President was a recommendation that the principal executive officer or officers and the principal financial officer or officers (CEO and CFO), or persons performing similar functions, certify to the accuracy of the financial statements included in each annual or quarterly report filed or submitted to the SEC. It reasonable to expect that corporate officers stand behind the company's public disclosure and be subject to sanction should they violate that certification. Regrettably, the bill reported out of the Committee did not include this worthwhile policy initiative. Congress should implement this initiative by including provisions to require the CEO and the CFO to certify that:

1. Such officer has reviewed the report.
2. To the officer's knowledge, the report does not contain any untrue statement of material fact or omit to state a material fact to make the statements made, not misleading.
3. Based on the officer's knowledge, the financial statements, and other financial information fairly present the financial condition and results of the company as of, and for, the periods presented in the report.
4. Such officers have created and maintained internal procedures to ensure that material information relating to the company is made known to them by others within the company.
5. The company has evaluated its internal controls including the fact that the singing officers have disclosed to the auditors and the audit committee that: (a) all significant deficiencies in such controls and (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls. In addition, the signing officers have indicated in the report to shareholders whether or not there were significant changes in internal controls subsequent to the date of the evaluation of internal controls and whether any corrective actions have been taken.

If such provisions are adopted, the SEC would have available to it civil money penalties and injunctive power to enforce these provisions as provided in the Securities Exchange Act of 1934. Morever, a willful violation of these certifications would carry criminal sanctions under Section 32 of the Securities Exchange Act of 1934.

Officer and director bars. An amendment sponsored by the majority that was ultimately adopted has made it more difficult rather than less for the SEC in an administrative proceeding to seek an officer and director bar against individuals who are guilty of misconduct. The bill purports to authorize the SEC to bar officers and directors from serving as an officer or director in proceedings brought by the Commission under Section 21(c) of the Securities and Exchange Act of 1934. Such a bar would be permitted if the

"person's conduct demonstrates substantial unfitness to serve as an officer or director of any issuer." In determining unfitness the Commission *shall consider* several factors including "the likelihood that the conduct giving rise to the violation, or similar conduct * * * may recur if the person is not so prohibited."

Congress provided the SEC with explicit authority to seek officer and director bars in 1990. Current statutory authority provides the Commission the power to seek an officer and director bar against any individual who violates Section 10(b) of the Securities Exchange Act or Section 17(a)(1) of the Securities Act, and whose "conduct demonstrates substantial unfitness to serve as an officer or director" of a public company. Unfortunately, the Commission's ability to obtain officer and director bars, however, has been limited by judicial interpretations of the phrase "substantial unfitness" that have created a very high standard for obtaining a bar. Several courts apply a six-part test which require, among other factors, a showing that the misconduct is likely to recur. This is precisely the same test that the bill reported out by this Committee codified. The Director of Enforcement of the SEC has said in a recent speech, "the result has been, unbelievably, that in some cases courts have refused to impose permanent officer and director bars on individuals who have engaged in egregious—even criminal—misconduct." The argument that this bill facilitates officer and director bars for those guilty of serious misconduct is an illusion. It codifies exactly the barriers that the SEC says are the problem.

The bill should have included legislative modifications to existing law that facilitate officer and director removal in either a court proceeding or in an administrative action. For example, the Committee should have adopted a sensible and real approach to the problem by deleting the word "substantial" before unfitness in Section 21(d)(2) of the Exchange Act. The effect would have been to lessen the unreasonable barriers imposed by some courts on the SEC to obtain such bars. In addition, the Committee should have been empowered as a remedy in its own administrative proceeding to seek an officer and director bar without going to district court to seek such a bar, without imposing unreasonable factors that serve only to frustrate their efforts.

These provisions, had they been adopted, would have given effect to the President's plan to make it easier for the SEC to bar officers and directors who have been determined to have committed serious misconduct. The majority amendment approved by the Committee on a party-line vote has only succeeded in making much more difficult, while claiming that they have enacted real reform.

Shareholder approval of stock option plans. SEC Chairman Pitt has expressed his concern that stock options no longer serve to align the interests of management with those of shareholders and described specific measures that he felt were needed to make option plans work as intended. He stated that all stock option plans that allow a director or officer to acquire stock should be approved by shareholders, that decisions on granting options to senior management should be entrusted to a committee of independent directors, and that corporate boards should consider whether officers demonstrate sustained, long-term growth before options can be exercised.

The growing evidence that many executives have reaped significant rewards from stock option plans even as their companies' earnings and stock prices have plummented calls for measures to realign shareholder and executive interests. The bill reported out of committee failed to include such provisions. Institutional investors, pension plans, and others have urged that shareholders be permitted to vote on stock option plans that are used to provide executive compensation. The manner in which stock options and other compensation is provided to executives is an important factor in aligning the interests of shareholders and executives, and should be subject to shareholder approval.

Private litigants' rights. The Committee bill fails to address very serious problems that confront pension funds and other investors who seek compensation for securities fraud. In the 1991 *Lampf* case, in a 5–to–4 decision, the Supreme Court significantly shortened the period of time in which investors may bring securities fraud action. The decision requires the victims of fraud to bring suit by the earlier of 1 year from the discovery of the fraud or 3 years from the fraudulent act.

Securities fraud is very difficult to detect because the guilty parties often hide or destroy incriminating evidence. The shorter period provide by *Lampf* does not allow individual investors adequate time to discover and pursue violations of securities laws. Moreover as the dissenting Justices in *Lampf* argued, the case's strict statute of limitations runs counter to the almost uniform rule in the United States rejecting short statutes of limitations for fraud-based causes of action.

The unreasonably brief statue of limitations has already had an adverse impact in the Enron debacle. In February of this year, in testimony before the Senate Judiciary Committee, Christine O. Gregorie, the Attorney General for the State of Washington, testified that Washington State Pension fund suffered over $100 million in losses because of the misleading financial statements issued by Enron and audited by Andersen, but, was only able to make a claim for approximately $50 million because of the restricted statute of limitations that applies to securities fraud cases.

Both Democratic and Republican past-SEC Chairman have stressed the integral role of private lawsuits in maintaining investor confidence. However, since the Supreme Court's 1994 decision in the *Central Bank of Denver* case, the victims of fraud have not been able to bring claims against the accountants, lawyers, investment banks and others who aid and abet issuers in misleading the public about the real state of company balance sheets.

Our market regulatory system depends on the independent professionals who verify and analyze the disclosures of publicly held companies. The reduced threat of legal liability for these "gatekeepers" that has existed since 1994 has helped to create an environment of laxity, where gatekeepers do not do all that they reasonably can to protect the investing public.

Although the Private Securities Litigation Reform Act partially overturned the *Central Bank of Denver* decision by restoring some of the SEC's authority to pursue aiders and abettors of securities fraud, that legislation failed to give the victims of fraud the right to sue those who aid issuers in misleading and defrauding the pub-

lic. Moreover, the 1995 legislation made it harder for the SEC to prove the complicity of aiders and abettors. The 1995 law requires the SEC to prove that a defendant had actual knowledge of the fraud. The 1995 law does not permit the SEC to prosecute aiders and abettors who acted recklessly with regard to their client's fraud, which was the standard prior to the 1994 Supreme Court case.

In 1995, both Federal and State securities regulators, academics and others (including a principal sponsor of the 1995 legislation), urged Congress to overturn the *Lampf* and the *Central Bank of Denver* decisions. We should now heed these recommendations and provide investors a fairer system of redress in the courts.

First, Congress should now enact a statute of limitations that provides that a private securities fraud case may be brought not later than the earlier of five years after the date on which the alleged violation occurred or three years after the date in which the alleged violation was discovered. Such a provision would provide a reasonable period of time in which to uncover and investigate fraud and, then, bring meritorious claims.

Second, Congress should reverse the trend toward laxity by restoring a private right of action against those gatekeepers who are guilty of aiding securities fraud and by restoring the pre-1994 liability standards for the professionals who are supposed to protect the public.

JOHN J. LAFALCE.
PAUL E. KANJORSKI.
BERNARD SANDERS.
LUIS V. GUTIERREZ.
JANICE D. SCHAKOWSKY.

ADDITIONAL VIEWS OF MR. LAFALCE

Auditor Rotation. The bill reported out by the Committee does not contain a provision relating to auditor rotation. Moreover, the bill does not provide for rotation of the audit partner as suggested by Chairman Pitt in his testimony before the Committee. Enron's failure heightened concerns about the sufficiency of the current rules and independence standards for auditors, particularly concerning the scope of non-audit services that auditors perform for their audit clients. Enron's auditor, for instance, received a very significant portion of its fees from Enron for services that were not related to its audit responsibilities. It also raised the real concern that auditors' were more interested in the client than their duty to the public.

The bill should have included a provision to mandate rotation. Auditor rotation would provide a number of important benefits including:

1. A new audit firm would bring to bear a skepticism and fresh perspective that a long-term auditor may lack;
2. Second, auditors tend to rely excessively on prior years' working papers, including prior tests of client's internal control structure, particularly if fees are concerned;
3. Long-time auditors may come to believe that they understand the totality of the client's issues, and may look for those issues in the next audit rather than staying open to the other possibilities; and
4. An auditor may place less emphasis on retaining a client relationship even at the cost of a compromised audit if it knows the engagement will end after several years.

Auditor/Issuer Employment Restrictions. The bill reported out by the Committee does not provide for any restrictions on hiring of audit firm partners and other employees of an audit client. It therefore fails to address a critical issue that compromises the independence of an audit. As we saw dramatically in Enron and Global Crossing, members of the audit team often move to work for their audit clients. The bill should have included provisions that limit the practice of hiring members of an audit team who will then become the client of their former audit team colleagues. This dynamic creates a revolving door system that compromises the ability for auditors to challenge management regarding their accounting practices and public disclosure.

JOHN J. LAFALCE.

ADDITIONAL VIEWS OF MR. SHERMAN

Mr. Chairman, I voted for H.R. 3763 with the hope that, on the House floor, we will improve this legislation. I do not know if I will support this legislation on the floor, if we are unable to improve it. As approved by the Committee, the bill is a modest but inadequate step forward.

BRAD SHERMAN.

ADDITIONAL VIEWS OF MESSRS. BENTSEN AND WATT

The Bentsen/Watt amendment adopted by the Committee to H.R. 3763, the Corporate and Auditing Accountability, Responsibility and Transparency Act of 2002, is designed to enhance the Securities and Exchange Commission's (the "SEC") authority with respect to scope of services provided by auditors deemed to be independent under the bill. Specifically, the Bentsen/Watt amendment authorizes the SEC to review services provided by auditors of public companies to audit clients to determine whether the provision of such services would impact the auditor's independence. Additionally, the amendment provides authority for the SEC to adopt rules to modify the list of prohibited services in order to cure any such conflict. Finally, the amendment directs the SEC to report to Congress periodically on such reviews and rules.

We offered this amendment because we believed that the underlying bill insufficiently addressed the need for ongoing oversight by the SEC of potential conflicts between auditors and their clients to the detriment of investors. Failure to adequately ensure auditor independence potentially puts investors at risk and undermines confidence in markets. Additionally, we believed efforts to expand the list of prohibited services by statute, while well intentioned, to be inflexible and would be better handled by regulators. While some have argued, not incorrectly, that the SEC has existing authority to address conflicts of auditors of public issuers, we also believe the Congress should be on record endorsing and encouraging such authority when necessary to protect investors and ensure confidence in the markets.

KEN BENTSEN.
MELVIN L. WATT.

DISSENTING VIEWS OF MR. PAUL

Seldom in history have supporters of increased state power failed to take advantage of a real or perceived crisis to increase government interference in our economic and/or personal lives. Therefore we should not be surprised that the events surrounding the Enron bankruptcy are being used to justify the expansion of federal regulatory power contained in H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 (CARTA).

So ingrained is the idea that new federal regulations will prevent future Enrons, that the debate on H.R. 3763 has largely been between CARTA's supporters and those who believe this bill does not provide enough federal regulation and control. I would like to suggest that before Congress imposes new regulations on the accounting profession, perhaps we should consider whether the problems the regulations are designed to address were at least in part caused by prior government interventions into the market. Perhaps Congress could even consider the almost heretical idea that reducing federal control of the markets is in the public's best interest. Congress should also consider whether the new regulations will have costs which might outweigh any (marginal) gains. Finally, Congress should contemplate whether we actually have any constitutional authorization to impose these new regulations, instead of simply stretching the Commerce Clause to justify the program de jour.

CARTA establishes a new bureaucracy with enhanced oversight authority of accounting firms, as well as the authority to impose new mandates on these firms. CARTA also imposes new regulations regarding investing in stocks and enhances the power of the Securities and Exchange Commission (SEC). However, companies are already required by federal law to comply with numerous mandates, including obtaining audited financial statements from certified accountants. These mandates have enriched accounting firms and may have given them market power beyond what they could obtain in a free market. These laws also give corrupt firms an opportunity to attempt to use political power to gain special treatment for federal lawmakers and regulators at the expense of their competitors and even, as alleged in the Enron case, their employees and investors.

When Congress establishes a regulatory state it creates an opportunity for corruption. Unless CARTA eliminates original sin, it will not eliminate fraud. In fact, by creating a new bureaucracy and further politicizing the accounting profession, CARTA may create new opportunities for the unscrupulous to manipulate the system to their advantage.

Even if CARTA transformed all (or at least all accountants) into angels, it could still harm individual investors. First, new regula-

tions inevitably raise the overhead costs of investing. This will affect the entire economy as it lessens the capital available to businesses, thus leading to lower rates of economic growth and job creation. Meanwhile, individual investors will have less money for their retirement, their children's education, or to make a down payment on a new home.

Government regulations also harm investors by inducing a sense of complacency. Investors are much less likely to invest prudently and ask tough questions of the companies they are investing in when they believe government regulations are protecting their investments. However, as mentioned above, government regulations are unable to prevent all fraudulent activity, much less prevent all instances of imprudent actions. In fact, as also pointed out above, complex regulations create opportunities for illicit actions by both the regulator and the regulated. Publicly held corporations already comply with massive amounts of SEC regulations, including the filing of quarterly reports that disclose minute details of assets and liabilities. If these disclosure rules failed to protect Enron investors, will more red tape really solve anything?

In truth, investing carries risk, and it is not the role of the federal government to bail out every investor who loses money. In a true free market, investors are responsible for their own decisions, good or bad. This responsibility leads them to vigorously analyze companies before they invest, using independent financial analysts. In our heavily regulated environment, however, investors and analysts equate SEC compliance with reputability. The more we look to the government to protect us from investment mistakes, the less competition there is for truly independent evaluations of investment risk.

Increased federal interference in the market could also harm consumers by crippling innovative market mechanism to hold corporate managers accountable to their shareholders. As former Treasury official Bruce Bartlett pointed out in a recent Washington Times column, during the 1980s, so-called corporate raiders helped keep corporate management accountable to shareholders through devices such as the "junk" bond, which made corporate takeovers easier. Thanks to the corporate raiders, managers knew they had to be responsive to shareholder needs or they would become a potential target for a takeover.

Unfortunately, the backlash against corporate raiders, led by demographic politicians and power-hungry bureaucrats eager to expand the financial police state, put an end to hostile takeovers. Bruce Bartlett, in the Washington Times column sited above, described the effects of this action on shareholders, "Without the threat of a takeover, managers have been able to go back to ignoring shareholders, treating them like a nuisance, and giving themselves bloated salaries and perks, with little oversight from corporate boards. Now insulated from shareholders once again, managers could engage in unsound practices with little fear of punishment for failure." Ironically, the federal power grab which killed the corporate raider may have set the stage for the Enron debacle, which is now being used as an excuse for yet another federal power grab!

The free market, if left alone by Congress, is perfectly capable of disciplining businesses who engage in unsound practices. After all, before the government intervened, Arthur Anderson and Enron had already begun to pay a stiff penalty, a penalty delivered by individual investors acting through the market. This shows that not only can the market deliver punishment, but it can also deliver this punishment swifter and more efficiently than the government. We cannot know what efficient means of disciplining companies would emerge from a market process but we can know they would be better at meeting the needs of investors than a top-down regulatory approach.

Of course, while the supporters of increased regulation claim Enron as a failure of "ravenous capitalism," the truth is Enron was a phenomenon of the mixed economy, rather than the operations of the free market. Enron provides a perfect example of the dangers of corporate subsidies. The company was (and is) one of the biggest beneficiaries of Export-Import (Ex-Im) Bank and Overseas Private Investment Corporation (OPIC) subsidies. These programs make risky loans to foreign governments and businesses for projects involving American companies. While they purport to help developing nations, Ex-Im and OPIC are in truth nothing more than naked subsidies for certain politically-favored American corporations, particularly corporations like Enron that lobby hard and give huge amounts of cash to both political parties. Rather than finding ways to exploit the Enron mess to expand federal power, perhaps Congress should stop aiding corporations like Enron pick the taxpayer's pockets through Ex-Im and OPIC.

If nothing else, Enron's success at obtaining state favors is another reason to think twice abut expanding political control over the economy. After all, allegations have been raised that Enron used the same clout by which it received corporate welfare to obtain other "favors" from regulators and politicians, such as exemptions from regulations that applied to their competitors. This is not an uncommon phenomenon when one has a regulatory state, the result of which is that winners and losers are picked according to who has the most political clout.

Congress should also examine the role the Federal Reserve played in the Enron situation. Few in Congress seem to understand how the Federal Reserve system artificially inflates stock prices and causes financial bubbles. Yet, what other explanation can there be when a company goes from a market value of more than $75 billion to virtually nothing in just a few months? The obvious truth is that Enron was never really worth anything near $75 billion, but the media focuses only on the possibility of deceptive practices by management, ignoring the primary cause of stock overvaluations: Fed expansion of money and credit.

The Fed consistently increased the money supply (by printing dollars) throughout the 1990s, while simultaneously lowering interest rates. When dollars are plentiful, and interest rates are artificially low, the cost of borrowing becomes cheap. This is why so many Americans are more deeply in debt than ever before. This easy credit environment made it possible for Enron to secure hundreds of millions in uncollateralized loans, loans that now cannot be repaid. The cost of borrowing money, like the cost of everything

else, should be established by the free market—not by government edict. Unfortunately, however, the trend toward overvaluation will continue until the Fed stops creating money out of thin air and stops keeping interest rates artificially low.

Finally, I would remind my colleagues that Congress has no constitutional authority to regulate the financial markets or the accounting profession. Instead, responsibility for enforcing laws against fraud are under the jurisdiction of the state and local governments. This decentralized approach actually reduces the opportunity for the type of corruption referred to above—after all, it is easier to corrupt one federal official than 50 state officials!

In conclusion, H.R. 3763 expands federal power over the accounting profession and the financial markets. By creating new opportunities for unscrupulous actors to maneuver through the regulatory labyrinth, increasing the costs of investing, and preempting the market's ability to come up with creative ways to hold corporate officials accountable, this legislation harms the interests of individual workers and investors. Furthermore, this legislation exceeds the constitutional limits on federal power, interfering in matters the 10th amendment reserves to state and local law enforcement. I therefore urge my colleagues to reject this bill. Instead, Congress should focus on ending corporate welfare programs which provide taxpayer dollars to large politically-connected companies, and ending the misguided regulatory and monetary policies that helped create the Enron debacle.

RON PAUL.

DISSENTING VIEWS OF MR. CAPUANO

The Enron and Global Crossing bankruptcies and the increase in corporate earnings restatements have shaken the public's confidence in our financial system. Congress has a responsibility to help restore this confidence by enacting legislation that strengthens oversight of our accounting system, improves corporate governance, and modernizes financial reporting standards. While this legislation makes a number of significant reforms, I oppose H.R. 3763 because I have serious concerns with two provisions in the legislation reported by the Financial Services Committee.

The first provision addresses the composition of the Public Regulatory Organization (PRO) created by the legislation. Under an amendment that was adopted, the board will consist of five members, with at least two of these being persons licensed to practice public accounting and with significant experience auditing public companies. The three other board members must be members of the public.

Unfortunately, the definition of the public members of the board in the amendment is troubling. It specifically allows members of the accounting profession to serve as public members of the board as long as they have not practiced in at least two years. In addition, the legislation fails to adequately define "members of the accounting profession." This would potentially allow the entire board to be comprised of practicing and non-practicing members of the accounting profession.

While I strongly believe that members of the accounting profession should serve on the PRO, and that all members should meet a standard of financial literacy, I also believe that at least one public member of the board should come from the accounting profession. Individuals working in other professions, including those managing pension funds, trading in the financial markets, those involved with corporate governance issues, or governmental experts on budgeting and finance could bring important knowledge, experience and perspective to the board. In addition, appointing members from outside the accounting profession will give the PRO greater credibility as a protector of investor interests.

The second provision directs the Securities and Exchange Commission (SEC) to analyze whether officers and directors of issuers should be required to disgorge profits gained or losses avoided by the sale of securities related to the filing of a restatement of earnings on the part of the issuer. However, the bill only directs the SEC to investigate requiring disgorgement for transactions undertaken in the six months prior to the restatement. Since many SEC investigations uncover earnings manipulation over a span of several years, requiring disgorgements of inappropriate gains over a limited time period will not give an accurate picture of the profits

gained by the manipulation of financial statements by insiders. This arbitrary six-month limit should be lifted.

Without significant changes to these provisions to address these concerns, I cannot support this legislation.

MICHAEL E. CAPUANO.

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107TH CONGRESS
2D SESSION

H. R. 3763

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 14, 2002

Mr. OXLEY (for himself, Mr. BAKER, Mr. BOEHNER, Mrs. ROUKEMA, Mr. BEREUTER, Mr. BACHUS, Mrs. KELLY, Mr. CASTLE, Mr. ROYCE, Mr. NEY, Mr. GILLMOR, Mr. COX, Mr. LATOURETTE, Mr. MANZULLO, Mr. JONES of North Carolina, Mr. OSE, Mr. GREEN of Wisconsin, Mr. TOOMEY, Mr. SHADEGG, Mr. FOSSELLA, Mr. CANTOR, Ms. HART, Mr. FERGUSON, Mr. ROGERS of Michigan, and Mr. TIBERI) introduced the following bill; which was referred to the Committee on Financial Servcies

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A BILL

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002".

SEC. 2. AUDITOR OVERSIGHT.

(a) CERTIFIED FINANCIAL STATEMENT REQUIREMENTS.—If a financial statement is required by the securities laws or any rule or regulation thereunder to be certified by an independent public or certified accountant, such accountant shall not be considered to be qualified to certify such financial statement, and the Securities and Exchange Commission shall not accept a financial statement certified by such accountant, unless such accountant—

(1) is subject to a system of review by a public regulatory organization that complies with the requirements of this section and the rules prescribed by the Commission under this section; and

(2) has not been determined in the most recent review completed under such system to be not qualified to certify such a statement.

(b) ESTABLISHMENT OF PRO.—The Commission shall by rule establish the criteria by which a public regulatory organization may be recognized for purposes of this section. Such criteria shall include the following requirements:

(1) The board of such organization shall be comprised of both members of the accounting profession and public members who are not members of the accounting profession, and such public members

shall comprise at least two-thirds of the board of such organization.

(2) Such organization is so organized and has the capacity—

(A) to be able to carry out the purposes of this section and to comply, and to enforce compliance by accountants and persons associated with accountants, with the provisions of this Act, the securities laws, the rules and regulations thereunder, and the rules of the organization;

(B) to perform a review of the work product (including the quality thereof) of an accountant or a person associated with an accountant; and

(C) to perform a review of any potential conflicts of interest between an accountant (or a person associated with an accountant) and the issuer, the issuer's board of directors and committees thereof, officers, and affiliates of such issuer, that may result in an impairment of auditor independence.

(3) Such organization shall have the authority to impose sanctions, including a determination that an accountant is not qualified to certify a financial

statement, or any categories of financial statements, required by the securities laws, or that a person associated with an accountant is not qualified to participate in such certification, if, after conducting a review and providing an opportunity for a hearing, the organization finds that—

(A) such accountant or person associated with an accountant has violated the standards of independence, ethics, or competency in the profession;

(B) such accountant or person associated with an accountant has violated the securities laws or a rule or regulation thereunder;

(C) an audit conducted by such accountant or any person associated with an accountant has been materially affected by an impairment of auditor independence;

(D) such accountant or person associated with an accountant has performed both auditing services and consulting services in violation of the rules prescribed by the Commission pursuant to subsection (c); and

(E) such accountant or any person associated with an accountant has impeded, ob-

structed, or otherwise not cooperated in such review.

(4) Any such organization shall disclose publicly, and make available for public comment, proposed procedures and methods for conducting such reviews.

(5) Any such organization shall have in place procedures to minimize and deter conflicts of interest involving the public members of such organization, and have in place procedures to resolve such conflicts.

(6) Any such organization shall have in place procedures for notifying the boards of accountancy of the States of the results of reviews, including any findings under paragraphs (2) and (3).

(7) Any such organization shall have in place procedures for notifying the Commission of any findings of such reviews, including any findings regarding suspected violations of the securities laws.

(8) Any such organization shall consult with boards of accountancy of the States.

(9) Any such organization shall have in place a mechanism to allow the organization to operate on a self-funded basis. Such funding mechanism shall ensure that such organization is not solely depend-

ent upon members of the accounting profession for such funding and operations.

(c) PROHIBITION ON THE OFFER OF BOTH AUDIT AND CONSULTING SERVICES.—

(1) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations pertaining to auditor independence to require that an accountant shall not be considered independent with respect to an audit client if the accountant provides to the client the following non-audit services (as such term is defined in such regulations as in effect on the date of enactment of this Act)—

(A) financial information system design or implementation; or

(B) internal audit services.

(2) DEADLINE FOR RULEMAKING.—The Commission shall prescribe the revisions to its regulations required by paragraph (1) within 180 days after the date of enactment of this Act.

(d) PRO ACCOUNTANT REVIEW PROCEEDINGS.—

(1) REVIEW PROCEEDING FINDINGS.—Any accountant review conducted under this section shall include any finding that a financial statement audited by such accountant and submitted to the Com-

mission may have been materially affected by an impairment of independence, or by a violation of the securities laws or a rule or regulation thereunder. Such findings shall be submitted to the Commission. The Commission shall immediately notify an issuer of any such finding that relates to the financial statements of such issuer.

(2) CONFIDENTIAL TREATMENT OF PROCEEDINGS PENDING SEC REVIEW.—Except as otherwise provided in this section, but notwithstanding any other provision of law, neither the Commission nor a recognized public regulatory organization shall be compelled to disclose any information concerning any accountant review proceeding and the findings therein. Nothing in this subsection shall authorize the Commission to withhold information from Congress, or prevent the Commission from complying with a request for information from any other Federal department or agency requesting information for purposes within the scope of its jurisdiction, or complying with an order of a court of the United States in an action brought by the United States or the Commission. Neither the Commission nor the recognized public regulatory organization shall disclose the results of any such finding until the com-

pletion of any review by the Commission under subsections (d) and (e), or the conclusion of the 30-day period for seeking review if no motion seeking review is filed within such period. For purposes of section 552 of title 5, United States Code, this subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552.

(e) REVIEW OF SANCTIONS.—

(1) NOTICE.—If any recognized public regulatory organization—

(A) makes a finding with respect to or imposes any final disciplinary sanction on any accountant;

(B) prohibits or limits any person in respect to access to services offered by such organization; or

(C) makes a finding with respect to or imposes any final disciplinary sanction on any person associated with an accountant or bars any person from becoming associated with an accountant,

the recognized public regulatory organization shall promptly submit notice thereof with the Commission. The notice shall be in such form and contain such information as the Commission, by rule, may pre-

scribe as necessary or appropriate in furtherance of the purposes of this section.

(2) REVIEW BY COMMISSION.—Any action with respect to which a recognized public regulatory organization is required by paragraph (1) of this subsection to submit notice shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within 30 days after the date such notice was filed with the Commission and received by such aggrieved person, or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

(f) CONDUCT OF COMMISSION REVIEW.—

(1) BASIS FOR ACTION.—In any proceeding to review a final disciplinary sanction imposed by a rec-

ognized public regulatory organization on an accountant or a person associated with such accountant, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the recognized public regulatory organization and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction)—

(A) if the Commission finds that such accountant or person associated with an accountant has engaged in such acts or practices, or has omitted such acts, as the recognized public regulatory organization has found him to have engaged in or omitted, that such acts or practices, or omissions to act, are in violation of such provisions of this section, the securities laws, the rules or regulations thereunder, or the rules of the recognized public regulatory organization, as have been specified in the determination of the public regulatory organization, and that such provisions are, and were applied in a manner, consistent with the purposes of this section, the Commission, by order, shall so declare and, as appropriate, affirm the sanction imposed by the recognized public regulatory or-

ganization, modify the sanction in accordance with paragraph (2) of this subsection, or remand to the recognized public regulatory organization for further proceedings; or

(B) if the Commission does not make any such finding, it shall, by order, set aside the sanction imposed by the recognized public regulatory organization and, if appropriate, remand to the recognized public regulatory organization for further proceedings.

(2) REDUCTION OF SANCTIONS.—If the Commission, having due regard for the public interest and the protection of investors, finds after a proceeding in accordance with paragraph (1) of this subsection that a sanction imposed by a recognized public regulatory organization upon an accountant or person associated with an accountant imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this Act or is excessive or oppressive, the Commission may cancel, reduce, or require the remission of such sanction.

(g) REVIEW AND APPROVAL OF RULES.—

(1) SUBMISSION, PUBLICATION, AND COMMENT.—Each recognized public regulatory organization shall file with the Commission, in accordance

with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such recognized public regulatory organization (hereinafter in this subsection collectively referred to as a ''proposed rule change'') accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) APPROVAL OR PROCEEDINGS.—Within 35 days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so find-

ing or as to which the recognized public regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change; or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to 60 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the recognized public regulatory organization consents.

(3) BASIS FOR APPROVAL OR DISAPPROVAL.—The Commission shall approve a proposed rule change of a recognized public regulatory organization if it finds that such proposed rule change is consistent with the requirements of this Act and the

rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a recognized public regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(4) RULES EFFECTIVE UPON FILING.—

(A) Notwithstanding the provisions of paragraph (2) of this subsection, a proposed rule change may take effect upon filing with the Commission if designated by the recognized public regulatory organization as (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the recognized public regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the recognized public regulatory organization, or (iii) concerned solely with the administration of the recognized public regulatory organization or other matters which the Commission, by rule, consistent with the

public interest and the purposes of this subsection, may specify as outside the provisions of such paragraph (2).

(B) Notwithstanding any other provision of this subsection, a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, or otherwise in the public interest. Any proposed rule change so put into effect shall be filed promptly thereafter in accordance with the provisions of paragraph (1) of this subsection.

(C) Any proposed rule change of a recognized public regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this paragraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this Act, the securities laws, the rules and regulations thereunder, and applicable Federal and State law. At any time within 60 days of the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) of this subsection, the Commission summarily may abrogate the change in the rules of the recognized public reg-

ulatory organization made thereby and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of paragraph (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act. Commission action pursuant to the preceding sentence shall not affect the validity or force of the rule change during the period it was in effect, shall not be subject to court review, and shall not be deemed to be ''final agency action'' for purposes of section 704 of title 5, United States Code.

(h) COMMISSION ACTION TO CHANGE RULES.—The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as ''amend'') the rules of a recognized public regulatory organization as the Commission deems necessary or appropriate to insure the fair administration of the recognized public regulatory organization, to conform its rules to requirements of this Act, the securities laws, and the rules and regulations thereunder applicable to such orga-

nization, or otherwise in furtherance of the purposes of this Act, in the following manner:

(1) The Commission shall notify the recognized public regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the recognized public regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the recognized public regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any facts on which the Commission considers its determination so to amend the rules of the recognized public regulatory agency to be based, including the reasons for

the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of title 5, United States Code, for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under the securities laws.

(C) Any amendment to the rules of a recognized public regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes to be part of the rules of such recognized public regulatory organization and shall not be considered to be a rule of the Commission.

(i) RULEMAKING DEADLINE.—The Commission shall prescribe rules to implement this section within 180 days after the date of enactment of this Act.

(j) EFFECTIVE DATE; TRANSITION PROVISIONS.—

(1) EFFECTIVE DATE.—Except as provided in paragraph (2), subsection (a) of this section shall be effective with respect to any certified financial statement for any fiscal year that ends more than one year after the Commission recognizes a public regulatory organization pursuant to this section.

(2) DELAY IN ESTABLISHMENT OF BOARD.—If the Commission has failed to recognize any public regulatory organization pursuant to this section within one year after the date of enactment of this Act, the Commission shall perform the duties of such organization with respect to any certified financial statement for any fiscal year that ends before one year after any such board is recognized by the Commission.

SEC. 3. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

It shall be unlawful in contravention of such rules and regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors for any officer, director, or affiliated person of an issuer of any security registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) to take any action to willfully and improperly influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance

of an audit of the financial statements of such issuer for the purpose of rendering such financial statements materially misleading. In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder.

SEC. 4. REAL-TIME DISCLOSURE OF FINANCIAL INFORMATION.

(a) REAL-TIME ISSUER DISCLOSURES REQUIRED.—

(1) OBLIGATIONS.—Every issuer of a security registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) shall file with the Commission and disclose to the public, on a rapid and essentially contemporaneous basis, such information concerning the financial condition or operations of such issuer as the Commission determines by rule is necessary in the public interest and for the protection of investors. Such rule shall—

(A) specify the events or circumstances giving rise to the obligation to disclose or update a disclosure;

(B) establish requirements regarding the rapidity and timeliness of such disclosure;

(C) identify the means whereby the disclosure required shall be made, which shall ensure the broad, rapid, and accurate dissemination of

the information to the public via electronic or other communications device;

(D) identify the content of the information to be disclosed; and

(E) without limiting the Commission's general exemptive authority, specify any exemptions or exceptions from such requirements.

(2) ENFORCEMENT.—The Commission shall have exclusive authority to enforce this section and any rule or regulation hereunder in civil proceedings.

(b) ELECTRONIC DISCLOSURE OF INSIDER AND AFFILIATE TRANSACTIONS.—

(1) DISCLOSURES OF TRADING.—The Commission shall, by rule, require that any disclosure required by the securities laws or any rule or regulation thereunder of the sale of any securities by an officer, director, or other affiliated person of the issuer of those securities shall be made available electronically—

(A) to the Commission by the officer, director, or affiliated person, before the end of the next business day after the day on which the transaction occurs;

(B) to the public by the Commission, to the extent permitted under applicable law, upon

receipt, but in no case later than the end of the next business day after the day on which the disclosure is received under subparagraph (A); and

(C) in any case in which the issuer maintains a corporate website, on that website, before the end of the next business day after the day on which the disclosure is received by the Commission under subparagraph (A).

(2) OTHER FORMATS; FORMS.—In the rule prescribed under paragraph (1), the Commission shall provide that electronic filing and disclosure shall be in lieu of any other format required for such disclosures on the day before the date of enactment of this subsection. The Commission shall revise all forms and schedules required to be filed with the Commission pursuant to paragraph (1) in order to facilitate such electronic filing and disclosure.

SEC. 5. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS PROHIBITED.

(a) PROHIBITION.—It shall be unlawful for any person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered under section 12 of the Securities Exchange Act of 1934

(15 U.S.C. 78*l*) or who is a director or an officer of the issuer of such security, directly or indirectly, to purchase (or otherwise acquire) or sell (or otherwise transfer) any equity security of any issuer (other than an exempted security), during any blackout period with respect to such equity security.

(b) REMEDY.—Any profit realized by such beneficial owner, director, or officer from any purchase (or other acquisition) or sale (or other transfer) in violation of this section shall inure to and be recoverable by the issuer irrespective of any intention on the part of such beneficial owner, director, or officer in entering into the transaction. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within 60 days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than 2 years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap (as defined in section 206B of the Gramm-Leach-Bliley Act) involved, or any transaction or

transactions which the Commission by rules and regulations may exempt as not comprehended within the purposes of this subsection.

(c) RULEMAKING PERMITTED.—The Commission may issue rules to clarify the application of this subsection, to ensure adequate notice to all persons affected by this subsection, and to prevent evasion thereof.

SEC. 6. IMPROVED TRANSPARENCY OF CORPORATE DISCLOSURES.

(a) MODIFICATION OF REGULATIONS REQUIRED.—The Commission shall revise its regulations under the securities laws pertaining to the disclosures required in periodic financial reports and registration statements to require such reports to include adequate and appropriate disclosure of—

(1) the issuer's off-balance sheet transactions and relationships with unconsolidated entities or other persons, to the extent they are not disclosed in the financial statements and are reasonably likely to materially affect liquidity or the availability of, or requirements for, capital resources, or otherwise expose the issuer to material current or future possible liability, obligations, expenses, or cash flow changes, or affect the recognition of revenue, carrying value,

or potential impairment of assets, credit ratings, earnings, cash flows, or stock price; and

(2) relationships and material transactions with related or other persons or entities that may involve transactions on terms that differ materially from those that would likely be negotiated with third parties, including a description of the elements of the transactions that are necessary for an understanding of their business purpose and economic substance, their effects on the financial statements, and the special risks or contingencies arising from the transactions.

(b) DEADLINE FOR RULEMAKING.—The Commission shall prescribe the revisions to its regulations required by paragraph (1) within 180 days after the date of enactment of this Act.

(c) ANALYSIS REQUIRED.—

(1) TRANSPARENCY, COMPLETENESS, AND USEFULNESS OF FINANCIAL STATEMENTS.—The Commission shall conduct an analysis of the extent to which, consistent with the protection of investors and the public interest, disclosure of additional or reorganized information may be required to improve the transparency, completeness, or usefulness of fi-

nancial statements and other corporate disclosures filed under the securities laws.

(2) ALTERNATIVES TO BE CONSIDERED.—In conducting the analysis required by paragraph (1), the Commission shall consider—

(A) 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 management's most difficult, subjective, or complex judgments;

(B) requiring an explanation, where material, of how different available accounting principles applied, the judgments made in their application, and the likelihood of materially different reported results if different assumptions of conditions were to prevail;

(C) in the case of any issuer engaged in the business of trading non-exchange traded contracts, requiring an explanation of such trading activities when such activities require the issuer to account for contracts at fair value, but for which a lack of market price quotations necessitates the use of fair value estimation techniques;

(D) establishing requirements relating to the presentation of information in plain language; and

(E) requiring such other disclosures, included in the financial statements or in other disclosure by the issuer, as would in the Commission's view improve the transparency of such issuer's financial statements and other required corporate disclosures.

(3) RULES REQUIRED.—If the Commission, on the basis of the analysis required by this subsection, determines that it is necessary in the public interest or for the protection of investors, would improve the transparency of issuer financial statements, and would not be unduly burdensome on issuers, the Commission shall prescribe rules reflecting the results of such analysis and the considerations required by paragraph (2).

SEC. 7. STUDY OF RULES RELATING TO ANALYST CONFLICTS OF INTEREST.

(a) STUDY AND REVIEW REQUIRED.—The Commission shall conduct a study and review of any final rules by any self-regulatory organization registered with the Commission related to matters involving equity research analysts conflicts of interest. Such study and report shall

include a review of the effectiveness of such final rules in addressing matters relating to the objectivity and integrity of equity research analyst reports and recommendations.

(b) REPORT REQUIRED.—The Commission shall submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on such study and review no later than 180 days after any such final rules by any self-regulatory organization registered with the Commission are delivered to the Commission. Such report shall include recommendations to the Congress, including any recommendations for additional self-regulatory organization rulemaking regarding matters involving equity research analysts. The Commission shall annually submit an update on such review.

SEC. 8. OVERSIGHT OF FINANCIAL DISCLOSURES.

(a) MINIMUM PERIODIC REVIEW REQUIREMENTS.—The Commission shall set minimum periodic review requirements to ensure that issuers with the largest market capitalization, most actively traded securities, or most widely held securities will be subject to a regular and thorough review by the Commission, including substantive comments where appropriate on the issuer's financial statements and all other disclosures.

(b) ANNUAL REPORTS REQUIRED.—The Securities and Exchange Commission shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on an annual basis on its compliance with these requirements.

SEC. 9. REVIEW OF CORPORATE GOVERNANCE PRACTICES.

(a) STUDY OF CORPORATE PRACTICES.—The President's Working Group on Financial Markets shall conduct a study and review of current corporate governance standards and practices to determine whether such standards and practices are serving the best interests of shareholders. Such study and review shall include an analysis of—

(1) whether current standards and practices promote full disclosure of relevant information to shareholders;

(2) whether corporate codes of ethics are adequate to protect shareholders, and to what extent deviations from such codes are tolerated;

(3) to what extent conflicts of interests are aggressively reviewed, and whether adequate means for redressing such conflicts exist;

(4) to what extent sufficient legal protections exist to ensure that any manager who attempts to

manipulate or unduly influence an audit is subject to appropriate sanction and liability;

(5) whether rules, standards, and practices relating to determining whether independent directors are in fact independent are adequate;

(6) whether rules, standards, and practices relating to the independence of directors serving on audit committees are uniformly applied and adequate to protect investor interests;

(7) whether the duties and responsibilities of audit committees should be established by the Commission; and

(8) what further or additional practices or standards might best protect investors and promote the interests of shareholders.

(b) PARTICIPATION OF STATE REGULATORS.—In conducting the study required under subsection (a), the President's Working Group on Financial Markets shall seek the views of, and consult with, the securities and corporate regulators of the various States.

(c) REPORT REQUIRED.—The President's Working Group on Financial Markets shall submit a report on the analysis required under subsection (a) to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs

of the Senate no later than 180 days after the date of enactment of this Act.

SEC. 10. STUDY OF ENFORCEMENT ACTIONS.

(a) STUDY REQUIRED.—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws, and all restatements of financial statements, over the last five years to identify areas of reporting that are 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.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days of the date of enactment of this Act and shall use such findings to revise its rules and regulations, as necessary.

SEC. 11. STUDY OF CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market. Such study shall examine—

(1) the role of the credit rating agencies in the evaluation of issuers of securities;

(2) the importance of that role to investors and the functioning of the securities markets;

(3) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(4) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(5) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and

(6) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

(b) REPORT REQUIRED.—The Commission shall submit a report on the analysis required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after the date of enactment of this Act.

SEC. 12. ENFORCEMENT AUTHORITY.

For the purposes of enforcing and carrying out this Act, the Commission shall have all of the authorities granted to the Commission under the securities laws. Actions of the Commission under this Act, including actions on rules or regulations, shall be subject to review in the same manner as actions under the securities laws.

SEC. 13. DEFINITIONS.

As used in this Act:

(1) BLACKOUT PERIOD.—The term ''blackout period'' with respect to the equity securities of any issuer—

(A) means any period during which the employees of such issuer are precluded from purchasing (or otherwise acquiring) or selling (or otherwise transferring) their interest in any equity security of such issuer held in an individual account plan of such issuer; but

(B) does not include a period in which the employees of an issuer may not allocate their interests in the individual account plan due to an express investment restriction—

(i) incorporated into the individual account plan; and

(ii) timely disclosed to employees before joining the individual account plan or as a subsequent amendment to the plan.

(2) BOARDS OF ACCOUNTANCY OF THE STATES.—The term ''boards of accountancy of the States'' means any organization or association chartered or approved under the law of any State with responsibility for the registration, supervision, or regulation of accountants.

(3) COMMISSION.—The term ''Commission'' means the Securities and Exchange Commission.

(4) INDIVIDUAL ACCOUNT PLAN.—The term ''individual account plan'' has the meaning provided such term in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)).

(5) ISSUER.—The term ''issuer'' shall have the meaning set forth in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(6) PERSON ASSOCIATED WITH AN ACCOUNTANT.—The term ''person associated with an accountant'' means any partner, officer, director, or manager of such accountant (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling,

controlled by, or under common control with such accountant, or any employee of such accountant who performs a supervisory role in the auditing process.

(7) RECOGNIZED PUBLIC REGULATORY ORGANIZATION.—The term ''recognized public regulatory organization'' means a public regulatory organization that the Commission has recognized as meeting the criteria established by the Commission under subsection (b) of section 2.

(8) SECURITIES LAWS.—The term ''securities laws'' means 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.), notwithstanding any contrary provision of any such Act.

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