



Legislative Bulletin.....April 24, 2002

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**H.R. 3763—Corporate and Auditing Accountability, Responsibility, and
Transparency Act (Oxley)**

Order of Business: The bill is scheduled to be considered on Wednesday, April 24th, subject to a structured rule (amendments summarized on page 4 below).

Summary: H.R. 3763 would create new and strengthen existing laws and regulations for auditing and corporate disclosures made pursuant to securities laws, as follows:

Auditor Oversight: The Securities and Exchange Commission (SEC) would be required to establish a “Public Regulatory Organization” (PRO) to oversee accountants who audit financial statements for publicly traded companies as required by securities laws or regulations. The SEC could not accept any such financial statement unless it had first been cleared by the PRO. The PRO, which would be given subpoena power, could also sanction an auditor as unqualified or as having conflicted interests with the entity being audited. The SEC would oversee the PRO.

The PRO, which the SEC would oversee, would operate on a “self-funded basis.” However, the PRO could not solely depend on the accounting profession for such funding and operations. The PRO would be required to report annually to the SEC and Congress on the PRO’s activities, revenues, budget, and other appropriate matters.

Prohibition of Both Audit and Consulting Services: An accountant could not provide both audit **and** consulting services to a single client. Specifically, if an accountant is auditing a client pursuant to securities laws, the accountant could not also help that client with financial information system design or implementation or with *internal* audit services (subject to additions, conditions, and exceptions prescribed by the SEC within nine months of this bill’s enactment).

The PRO would be charged with assuring (and reporting to the SEC violations of) auditor independence. The PRO could impose sanctions on accountants, subject to SEC review. All details regarding a pending SEC review of auditor independence would be confidential (and exempt from FOIA—the Freedom of Information Act).

The bill sets out detailed procedures for the PRO to file with the SEC any proposed rule or rule change regarding auditor oversight or independence.

The auditor oversight and accountant independence sections of this legislation would become effective with respect to any certified financial statement for any fiscal year that ends more than one year after the establishment of the PRO.

Enron and Arthur Andersen: Should any administrative or judicial proceeding mandate the disgorgement of funds by Enron or Arthur Andersen (including any civil penalties collected), such funds would be allocated with priority given to former Enron employees who had individual account plans through Enron and in proper proportion to the accrued benefit of each individual that was invested in Enron securities. The SEC would be authorized to set up a disgorgement fund, to which people could give gifts, bequests, and property for allocation as just described.

Improper Influence on Audits: This legislation would make it unlawful for any officer, director, or affiliated person of an issuer of any security to fraudulently “influence, coerce, manipulate, or mislead” any auditor to make certified financial statement “materially misleading.” This prohibition would not preempt, but would be in addition to, any other provision of law or regulation.

Real-Time Financial Disclosure: Every issuer of a security would be required to file the relevant financial disclosure information with the SEC (and disclose to the public) “on a rapid and essentially contemporaneous basis,” as the SEC determines by rule. Insider transactions (by an issuer of a security, a corporate officer, etc.) would have to be filed electronically with the SEC, disclosed to the public, and posted on the company website before the end of the next business day after the day on which the transaction occurs.

Prohibition on Insider Trades during Blackout Periods: This bill would make it illegal for an owner of more than ten percent of any class of any equity security (other than an exempted security) or a director or an officer of the issuer of such security to purchase, sell, or otherwise acquire or transfer any equity security of any issuer (other than an exempted security) during any “blackout period” with respect to such security.

Any profit realized by such sale or purchase during a blackout period would be recoverable by the security issuer (or by the owner of any security of the issuer in the name and on behalf of the issuer, subject to certain conditions), regardless of the intention of the insider. No suit to recover profits could be brought more than two years after such profits were realized.

“Blackout period” is defined in the bill as “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,” subject to certain restrictions and exceptions.

Increased Financial Disclosure: Within 90 days of enactment of this legislation, the SEC would be required to collect in disclosure statements:

- The security issuer's off-balance sheet transactions and relationships with unconsolidated entities or other persons that are "reasonably likely" to materially affect the financial operations of the issuer; and
- Loans extended to officers, directors, or other persons affiliated with the issuer on terms or conditions that are not otherwise available to the public.

The SEC would be directed to determine whether other information (in addition to current requirements and the new information required by this bill) would be appropriate to demand in financial disclosure statements. [The bill lists five suggested items for possible additional inclusion.]

The SEC would be directed to review financial disclosures on a "more regular and systematic" basis than what is in practice as of the enactment of this bill (and no less often than once every three years for each issuer).

Increased Disclosure of Insider Relationships: The SEC would be directed to propose changes in its rules and regulations regarding the reporting of relationships and transactions among insiders (e.g. the issuer, officers, employees) to the extent that such relationships and transactions create a conflict of interest for such insiders. The SEC would also be directed to propose reporting rules on top officers' relationships with philanthropic organizations (financial, political, and otherwise), with insider-controlled affiliated companies, with one another's joint property, and with one another's professional services (e.g. legal or medical services).

Code of Ethics: The three major American stock exchanges would have 180 days after enactment of this legislation to file rules with the SEC prohibiting the listing of any security from an issuer that has not adopted a senior financial officers code of ethics and other such standards of honest conduct to avoid conflicts of interest and promote "full, fair, accurate, timely and understandable" disclosure. Any code of ethics would be subject to SEC approval and would require immediate disclosure of any waiver of or change in such a code.

The SEC could prohibit (conditionally or unconditionally, temporarily or permanently) persons who it deems to be unfit from being an officer or director of a securities issuer.

Retention of Records: Auditors of publicly traded companies would be required to retain final audit work papers and other related documents for at least seven years.

Insider Trades before Statement Correction: The SEC would be directed to analyze whether and when any officer or director of a securities issuer should be required to disgorge profits from trades made prior to correcting erroneous financial statements. The SEC would then be responsible for promulgating such regulations, if deemed necessary.

SEC Studies and Reports to Congress Required:

- Equity research analysts' conflicts of interest.

- Current corporate governance standards and practices to determine whether such standards and practices are serving “the best interests of shareholders.” This study would address issues of financial disclosure, ethics codes, conflicts of interest, manipulation of auditors, auditor independence, and other such issues.
- Enforcement actions against violations of auditing, disclosure, and conflicts of interest.
- The role and function of credit rating agencies in the operation of the securities market.

GAO Studies and Reports to Congress Required:

- The role played by investment banks and financial advisors in assisting public companies in manipulating their earnings and disguising their true financial condition. This report would have to specifically look into the Enron and the Global Crossing situations, in addition to the general situation.
- The Model Rules of Professional Conduct promulgated by the American Bar Association and SEC rules of professional conduct applicable to attorneys.

Amendments: Only the five following amendments are in order under the structured rule. They are debatable for the amount of time indicated in parentheses. The plain text is taken from the summaries on the Rules Committee website. The ***bold italic*** text is text added by the RSC after review of the amendments.

Oxley—Manager’s Amendment: Makes various technical and conforming changes. Strikes provisions requiring companies listed on the stock exchanges to implement a code of ethics for senior corporate officers, ***yet*** retains provisions regarding disclosure of changes in issuer codes of conduct. (10 minutes)

Capuano: Clarifies that two members of the ***five-member PRO board*** must be individuals licensed to practice public accounting, ***that*** two ***other*** members may be individuals licensed to practice public accounting ***as long as*** they have not practiced within two years of being appointed, and ***that*** one member must not be licensed to practice public accounting. Specifies that all members of the PRO board must meet a standard of financial literacy as determined by the SEC. (20 minutes)

Sherman: Requires auditors of publicly-traded companies to meet a minimum net capital requirement of not less than one-half of the annual audit revenue received by the accountant from issuers registered with the SEC. ***“Net capital” is defined to include the sum of capital, reserves, and malpractice insurance available to the accountant for the performance of audits.*** (20 minutes)

Kucinich—Substitute: ***Strikes the entire bill and*** creates the Federal Bureau of Audits (FBA) ***as an independent regulatory agency*** to monitor corporate America’s books by ***annually*** auditing all publicly-traded companies (***and collecting fees from such companies for the auditing***). This new agency will be a part of the Securities and Exchange Commission (SEC), but maintain appropriate independence. ***The head of the FBA, a deputy director, and an inspector general would be appointed by the President, subject to Senate confirmation.***

These officers would serve in twelve-year terms, with the exception of the first officers appointed, who would serve for less time, as detailed in the amendment.

The SEC will set the basic rules of auditing by incorporating the generally accepted auditing standards rules and making further refinements that are “necessary and appropriate in the public interest and for the protection of investors.” The FBA’s integrity will be ensured by several conflict-of-interest provisions to ensure that American taxpayers, investors, and employees get an accurate assessment of a corporation.

\$5.15 billion would be authorized to be appropriated to the FBA for salaries and expenses in the first fiscal year. The authorizations of appropriations for the subsequent four fiscal years would be ***\$5.15 billion plus*** an amount determined by a formula detailed in the amendment.

Also includes the following seven findings:

- *“The failure of accounting firms to provide accurate audits of its clients is not a new or isolated problem.*
- *“Accounting firms have been implicated in failed audits that have cost investors billions of dollars when earnings restatements sent stock prices tumbling.*
- *“Auditors have an inherent conflict of interest. They are hired, and fired, by their audit clients.*
- *“This conflict of interest pressures auditors to sign off on substandard financial statements rather than risk losing a large client.*
- *“Auditing a public company for the benefit of small as well as large investors requires independence.*
- ***“Therefore the only truly independent audit is one by a governmental agency.***
- *“The Federal Bureau of Audits, closely regulated by the Commission, will provide honest audits of all publicly traded companies.”*

(20 minutes)

LaFalce—Substitute: Replaces the regulatory structure in the bill with one that requires establishment of a public regulator with specified duties and authority. Modifies definitions of non-audit services. Provides for approval of non-audit services by the audit committee. Replaces the executive responsibility provisions in the bill to require executive certification of financial statements to improve the ability of the SEC to bar officers and directors from future service in public companies. Enables the SEC to obtain disgorgement of stock bonuses from executives who have falsified financial statements. Places limits on analyst conflicts of interest and improves corporate governance by giving audit committees oversight of auditors. Establishes an independent nominating committee for independent directors.

Authorizes an additional appropriation of \$776.0 million to the SEC for fiscal year 2003.

(40 minutes)

Bush Administration Position: During a Financial Services Committee hearing on March 20, 2002, Peter Fisher, Under Secretary of the Treasury for Domestic Finance, expressed the Administration’s support for H.R. 3763, as it “most closely parallels the President’s plan.”

<http://www.house.gov/financialservices/032002pf.pdf>

Cost to Taxpayers: According to House Report 107-414 and the CBO website, a CBO cost estimate is not yet available.

Does the Bill Create New Federal Programs or Rules?: YES. Among other things, H.R. 3763 would create a new regulatory organization under the SEC to monitor auditors of publicly traded companies; new rules regarding auditing, consulting, financial disclosure, insider trading, codes of ethics, conflicts of interest, and records retention; new federal crimes; and a new engagement fund for the Enron/Arthur Andersen case. This bill would also mandate several SEC studies and two GAO studies.

Constitutional Authority: In House Report 107-414, the Financial Services Committee cites constitutional authority in Article I, Section 8, Clause 1 (relating to the general welfare of the United States) and Clause 3 (relating to the power to regulate interstate commerce).

Outside Organizations: The Business Roundtable, while supporting the “goal of stockholder protection” embodied in H.R. 3763, has urged Congress to consider SEC and private sector initiatives already underway to protect the stockholder from financial and ethics abuses.
<http://www.house.gov/financialservices/032002fr.pdf>

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Hooley Motion to Instruct Conferees on H.R. 2646, the Farm Security Act of 2001

The Hooley motion, which was announced last night and is therefore privileged today, is as follows:

Ms. Hooley moves that the managers on the part of the House at the conference on the disagreeing votes of the two Houses on the Senate amendment to bill H.R. 2646 be instructed to agree to the provisions contained in section 1001 of the Senate amendment and section 944 of the House bill, relating to country of origin labeling requirements for agricultural commodities, but to insist on the 6-month implementation deadline contained in the House bill.

Below is a comparison of current law, the House bill, and the Senate proposal:

Present Law	House Bill	Senate Bill
Most imports, including many food items, must bear labels informing the final purchaser of their country of origin. However, certain “natural products” including	Effective six months after enactment, requires retailers other than restaurants and other food service establishments to inform consumers of the country of	Requires retailers other than restaurants and other food service establishments to inform consumers of the country of origin of ground and muscle cuts of beef, lamb

<p>fresh fruits, vegetables, nuts, live and dead animals (e.g., meats), and fish, among others, generally are exempted. <i>[Section 304 of the Tariff Act of 1930 as amended; Federal Meat Inspection Act and Poultry Products Inspection Act as amended]</i></p>	<p>origin of perishable agricultural commodities” (fresh or fresh frozen fruits and vegetables) through labels, marks, or in-store information; specifies the daily fines (\$1,000 first day, \$250 thereafter) for violations. <i>[Title IX, Section 944]</i></p>	<p>and pork, of wild and farm-raised fish, of perishable agricultural commodities, and of peanuts, through labels, marks, or other in-store information. Defines what is meant by country of origin for each of these categories; authorizes the Secretary to set up a record-keeping system; authorizes but does not specify fines for violations. <i>[Title X, Section 1001]</i></p>
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