



## **Congress Responds to the Corporate Scandals**

**\*\* UPDATED: November 26, 2002 \*\***

Since the accounting and pension scandals about Enron, WorldCom, and other corporate leaders were revealed, Congress has responded with legislation aimed at exposing and punishing acts of corruption, moving corporate accounting out of the shadows, and protecting small investors and pension holders.

NOTE: The RSC will update this document as the House considers additional legislation in response to the corporate scandals.

### **Items Passed by the House on Which the Senate Has Not Acted:**

Pension Security (p. 3)

Permanent Pension Reform (p. 4)

- **Sarbanes-Oxley**. The President signed into law a bill (popularly known as “Sarbanes-Oxley,” after its Senate and House authors) that creates new and strengthens earlier laws and regulations for auditing and corporate disclosures made pursuant to securities laws, and increases penalties for accounting and auditing improprieties. The law’s main provisions are as follows:

[Note: “issuer” refers to a publicly traded company.]

- Establishes the Public Company Accounting Oversight Board (created as a nonprofit corporate entity) to oversee the audit of public companies that are subject to the securities laws and related matters. Though the Securities and Exchange Commission (SEC) has oversight and enforcement authority over the five-member Board, the Board is **not** an agency of the federal government. Soon, no public accounting firm will be allowed to prepare audits related to a securities issuer without being registered with the Board.
- Establishes sanctions for any accounting firm (domestic *and foreign*) that knowingly violates or repeatedly neglects the rules of the Board or the securities laws related to auditing. Sanctions could also be applied to a firm that has failed to properly supervise the conduct of auditors.
- Prevents conflicts of interest by making it unlawful for a registered public accounting firm to perform for an issuer any audit service 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 accounting firm and participated in any capacity in the audit of that issuer during the one-year period preceding the date of the initiation of the audit.

- Makes it unlawful for an accounting firm to provide both audit and consulting services to a single client.
- Mandates the pre-approval of all auditing services (and non-audit services provided with Board approval) by the audit committee of the issuer being audited.
- Prevents a corporate inversion from altering the requirements of this legislation for a securities issuer.
- Prohibits any individual lead auditor or audit partner responsible for the review of an audit from providing audit services to the same client for more than five consecutive years.
- Authorizes the SEC, should any administrative or judicial proceeding mandate the disgorgement of funds by a securities issuer (including any civil penalties collected), to set up a disgorgement fund (for the distribution of such funds to employees), to which people could give gifts, bequests, and property for such allocation.
- Makes 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 statements “materially misleading.”
- Directs the chief executive officer and chief financial officer of an issuer that is required to prepare an accounting re-statement due to the material noncompliance of the issuer to reimburse the issuer for:
  - 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
  - any profits realized from the sale of securities of the issuer during that 12-month period.
- Requires every issuer of a security to file the relevant financial disclosure information with the SEC (and disclose to the public) “on a rapid and current basis,” as the SEC determines by rule.
- Makes it illegal for a director or an officer of the issuer of any class of any equity security (other than an exempted 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.
- Instructs auditors of publicly traded companies to retain final audit work papers and other related documents for at least seven years.
- Requires that auditors attest to the soundness of an issuer’s internal corporate structure (regarding financial conflicts of interest, etc.) and report any weaknesses thereto.
- Grants whistleblower protection to employees of publicly traded companies who provide information regarding the violation of securities, auditing, or other laws addressed in this legislation.
- Increases penalties** as follows:
  - The law increases the maximum jail terms for mail and wire fraud from five years to 20 years and creates a new 25-year maximum prison term for securities fraud (intentionally defrauding a person in connection with a security or obtaining money from the purchase or sale of a security based on false pretenses).
  - Corruptly altering, destroying, mutilating, or concealing a record or document with the intent to impair an official proceeding or otherwise obstruct such proceeding would carry a 20-year maximum prison term.

- Criminal penalties for pension law violations would be increased from a fine of \$5,000 to \$100,000 and from maximum jail time of one year to ten years.
  - Any debts incurred in violation of securities laws would be nondischargeable.
  - The *careless* failure of top corporate officers to certify periodic financial reports in writing would trigger up to ten years in prison and/or a \$1 million fine.
  - The *willful* failure of top corporate officers to certify periodic financial reports in writing would trigger up to 20 years in prison and/or a \$5 million fine.
  - Attempts and conspiracies to commit *any* federal offense would be subject to the same penalties as if the offense had actually been committed.
  - Attempts to retaliate against informants would carry a maximum ten-year prison term and/or fines under SEC laws.
  - In general, willful and criminal violations of securities laws would carry a new maximum fine of \$5 million (up from \$1 million) and a new maximum prison-term of 20 years (up from ten years). If the violator is not an American citizen, the fine would increase to \$25 million.
- Authorizes \$776 million to the SEC for FY2003 (a 77% increase over the fiscal year 2002 appropriation of \$437.9 million).

For a more detailed summary of this legislation, please visit this website:

<http://www.house.gov/burton/RSC/LB72502CorpAcctCR.pdf>

*(H.R. 3763 Conference Report; Public Law 107-204)*

- **Pension Security**. The House passed a bill that would protect employees pensions and increase their rights regarding their pensions, as follows:
  - Requires managers of defined contribution individual account plans to provide participants at least quarterly benefit statements that include information about the value of investments allocated to their account, the value of any assets held in the form of employer securities, the non-forfeitable pensions benefits that have accrued, information on the importance of diversifying retirement plans, and information on the risk of holding more than 25% of a portfolio in any one security.
  - Requires defined benefit plan managers to provide benefit statements at least once every three years that includes information on the total benefits accrued and the non-forfeitable pensions benefits.
  - Requires that benefit statements be understandable and may be in electronic form.
  - Authorizes a civil penalty of up to \$1,000 per day against any plan administrator who fails or refuses to provide the required quarterly statements.
  - Requires new participants in pension plans to be provided with an investment education notice containing information about the plan and the importance of diversification. Willful failure to provide notices would result in a \$100-per-incident fine, capped at \$50,000 each calendar year.
  - Requires that plan participants be notified 30 days in advance of any action which will suspend, limit, or otherwise restrict the ability of a participant to direct or diversify their account for more than three consecutive business days (i.e. "blackout periods").
  - Authorizes a \$100-a-day fine from the date of failure or refusal to provide notice to a participant. Each participant is who is not provided the proper notice is treated as a separate violation.

- Prohibits company executives and those who own more than 10% of any equity security from purchasing or selling any employer securities while plan beneficiaries and participants are precluded from such activity during a “blackout period.”
- Provides that employee contributions are immediately diversifiable.
- Allows employers to provide workers with direct access to professional investment advice related to employees’ choices of retirement investments, as long as the advisers disclose any fees or potential conflicts of interest.
- Makes the fees for such investment advice exempt from excise taxes imposed by section 4975 of the Internal Revenue Code.
- Prohibits an investment adviser from actually making any investment without the express direction of the advisee.
- Requires that advisers make their best-faith efforts to provide advice that is in the best financial interest of the individual plan-participant. As evidence of compliance, advisers would be required to keep all records of such investment advice for at least six years.
- Allows employees to use pre-tax dollars to obtain their own investment advice.

For a more detailed summary of this legislation, please visit this website:  
<http://www.house.gov/burton/RSC/Lb41102.pdf>

The Senate adjourned for the year without bringing this legislation to the Senate floor.  
*(H.R. 3762)*

- **Permanent Pension Reform.** The House passed a bill to make permanent the pension and individual retirement arrangement provisions contained in last year’s Bush tax-cut package that are set to sunset on January 1, 2011. (This bill would not affect provisions set to expire before the January 1, 2011, general sunset date in the tax-cut package.) Current law is as follows:

- Increases the maximum Individual Retirement Account (IRA) contribution limits for traditional and Roth IRAs as follows:

<b>Year</b>	<b>Contribution Limit</b>
2002-2004	\$3,000
2005-2007	\$4,000
2008	\$5,000
2009 and thereafter	Indexed for Inflation

- Increases IRA catch-up contribution limits for those age 50 and over by \$500 in 2002 and \$1,000 in 2006
- Includes other pension provisions generally included in the Portman-Cardin Retirement Savings Bill (regarding such items as elective deferrals, vesting of employer matching contributions, increasing pension portability, excise taxes on pension plans, employer-provided retirement advice, etc.)

The pensions and individual retirement arrangement provisions are set to expire on January 1, 2011. If this bill is not signed into law, the pre-tax-package provisions would return literally overnight on New Year’s Eve, 2011. For example, in 2010, a person could contribute \$5000 (plus inflation adjustment) annually to his IRA, yet in 2011 without this bill, a person could only contribute \$2000 annually. Failure to pass this bill would result in a **\$6.1 billion tax increase** on Americans in just two years (2011 and 2012).

The Senate adjourned for the year without bringing this legislation to the Senate floor.  
(H.R. 4931)

- **Other House-Passed Items.** The House passed several additional bills in response to the corporate scandals. While many of the provisions of these bills were incorporated into the Sarbanes-Oxley bill summarized above, other House-passed provisions (listed below) were not included in Sarbanes-Oxley and thus have not become public law. Several of these other House-passed provisions below *were* included in Sarbanes-Oxley but in a less flexible format.
  - The U.S. Sentencing Commission would be directed to consider the promulgation of new sentencing guidelines or changes to existing guidelines regarding securities and accounting fraud and related offenses. (H.R. 5118)
  - The SEC would be authorized, during the course of a securities investigation, to petition a federal district court for a temporary freeze on payments to officers and employees of the issuer of such security under investigation. (H.R. 5118)
  - The SEC would be authorized in any cease-and-desist proceeding to prohibit persons from serving as officers or directors of any issuer as the SEC sees fit. (H.R. 5118) (H.R. 3763—original House version)
  - The 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. (H.R. 3763—original House version)
  - The PRO would be prohibited from solely depending on the accounting profession for its funding and operations. The PRO would essentially operate on a “self-funded basis.” (H.R. 3763—original House version)
  - The PRO would be charged with assuring (and reporting to the SEC violations of) auditor independence. (H.R. 3763—original House version)
  - 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. (H.R. 3763—original House version)
- **Urging Senate Action.** The House passed two resolutions urging the Senate to act on House-passed legislation that would protect small investors and pension holders:
  - The House passed a resolution urging completion of pension security legislation (H.R. 3762, described above) before the end of the 107<sup>th</sup> Congress. (H.Res. 540)
  - The House passed a resolution urging passage of legislation (H.R. 4931, described above) making permanent the pension reform provisions in the Bush tax cut package of 2001. (H.Res. 544)
  - Neither of these resolutions go to the Senate or the President for approval.

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