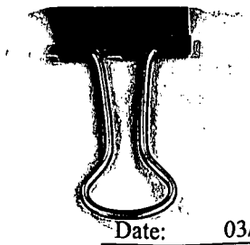

PRIVILEGED & CONFIDENTIA

REQUEST FOR COMMISSION ACTION

Date: 03/19/2002 Control No.: S-02-172-OLA

SUBJECT/S: Testimony before the House Committee on Financial Services concerning "the Corporate and Auditing Accountability, Responsibility, and Transparency Act."

REQUESTED: That the Commission approve the testimony in substantially the form attached hereto.

(X) SERIATIM CONSIDERATION - Joint deliberation by the members of the Commission on this matter is unnecessary, impracticable, or contrary to the requirements of agency business, pursuant to the provisions of 17 CFR 200.42(a).

( ) DUTY OFFICER CONSIDERATION - Pursuant to the provisions of 17 CFR 200.43(b).

( ) EMERGENCY CALENDAR CONSIDERATION FOR:

Action Requested By: ASAP, March 19, 2002.

TIMING ISSUES (Complete only if applicable)

(X) REASON EXPEDITED ACTION IS REQUESTED: The testimony is being given tomorrow morning, March 20.

( ) EXTERNAL DEADLINE:

Casey M Cartier
Requesting Division Director

Suzanne Dans 0118
Staff Contact: Ext.#

Margaret H McFarland
Deputy Secretary 3-19-02

Cynthia A. Glassman
Duty Officer Commissioner

Date: 3/19/02

	Seriatim Commission Action			Duty Officer Action		Deferred for Regular Calendar
	Apprd	Date	Disapprd	Affirmed	Date	
Chairman Pitt	[signature] *	3/19/02				
Commissioner Hunt	[signature] *	3/19/02				
Commissioner Glassman	CAG *	3/19/02				

Date of Action: 3-19-02

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Draft as of 3/19/2002 2:33 PM

TESTIMONY OF
HARVEY L. PITT, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING THE CORPORATE AND AUDITING ACCOUNTABILITY, RESPONSIBILITY, AND TRANSPARENCY ACT

BEFORE THE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

March 20, 2002

Chairman Oxley, Ranking Member LaFalce, and Members of the Committee:

I am pleased to appear before the House of Financial Services Committee today on behalf of the Securities and Exchange Commission regarding H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002. On February 4th of this year, I was privileged to testify before Subcommittee Chairman Baker and Congressman Kanjorski on "Legislative Solutions to Problems Raised by Events Relating to Enron." I know that all Members of this Committee have worked diligently to explore the substantive issues at stake and to develop reform proposals that will help restore confidence in the integrity of our financial markets, and I want to commend the leadership shown by you, Mr. Chairman, and Ranking Member LaFalce, as well as Congressmen Baker and Kanjorski, and all of the Members of this Committee, in this effort. The SEC has appreciated the opportunity to work with you and your staffs on many ideas in your legislative proposals, and we look forward to continuing that cooperation. Whether by legislation, regulation, or some combination of legislation and regulation, we will work together to make our nation's federal securities laws more responsive to the current-day needs of investors.

Mr. Chairman, I would also be remiss if I did not take this opportunity to say how very much the entire Commission and its Staff appreciate your support, Congressman Lafalce's support, and the support of the entire Committee for funding pay parity for our Staff and your concern for our agency's resources at this especially critical time.

INTRODUCTION

The past seven months have tested the mettle and resiliency of our country, our markets, and the investing public's confidence. With the events of September 11th, the bankruptcy of Enron and, just last week, the indictment of Arthur Andersen, we have witnessed how critical our appropriately vaunted capital markets are to the strength, security and spirit of our Country and our economy. All Americans have felt, and continue to feel, the consequences of these events. From the perspective of the federal securities laws, all three crises have much in common. In each, the continuity and

integrity of our capital markets was, or is, put in play. The response to the tragic loss of lives, and the sudden shutdown of our capital markets after the terrorist attacks of September 11th, presented a model for all of us, and the rest of the watching World, on how to address and respond to a crisis. From the President's unstinting and fearless leadership, to bipartisan cooperation in Congress, we responded quickly and forcefully to an unthinkable crisis. With the implosion of Enron, and the indictment of Arthur Andersen, my hope is that we will follow the model set last September, and work constructively together to restore vital confidence in our capital markets.

With Enron's disintegration, innocent investors, employees and retirees, who made life-altering decisions based upon a stock's perceived value, found themselves locked-in to a rapidly sinking investment that ate up the fruits of years of their hard work. It is these Americans, whose faith fuels our markets, whose interests are, and must be, paramount. America's investors are entitled to the best regulatory system possible. The Commission as an institution, and I both as its Chairman and personally, are committed to doing everything in our power not only to prevent other abuses of our system, but also to improve and modernize our existing system.

In the aftermath of Enron's meltdown, our agency currently is conducting an enforcement investigation to identify violations of the federal securities laws that may have occurred, and those who perpetrated them. Until the investigation is complete, the Commission cannot address the specific conduct of Enron Corporation and those involved with it, or the activities currently under investigation. The public can have full confidence, however, that our Division of Enforcement is conducting a thorough investigation and that the Commission will redress any and all wrongdoing and wrongdoers swiftly and completely.

Nothing that has occurred in recent months should undermine, or be allowed to undermine, investor confidence that our markets, and the regulatory system governing them, are still the best in the world. Our capital markets are still the world's most honest and efficient. Our current disclosure, financial reporting and regulatory systems also are still the best developed, the most transparent, and the best monitored by market participants and regulators. No other system yet matches the depth, breadth and honesty of our markets, and it is important that we not lose sight of that critical fact. While some foreign regulators have publicly claimed that Enron would not have collapsed under their systems, I tell you unequivocally that any such claim, whatever the source, is unsupportable.

But, even though our system is the best at present, we can, and must, do better. As more and more individuals become direct participants in our markets, and face increasingly difficult investment decisions that affect their lives, savings goals and retirement security, we need to maximize the utility of our existing system for individual investors. At the same time, we must find a way to facilitate and promote the ability of American businesses to raise capital efficiently and expeditiously.

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OVERVIEW OF NEEDED REFORMS

Our system requires that corporate leaders be faithful to the interests of investors and to act both with ability and integrity. Complete and accurate disclosure and financial reporting to investors and markets are important parts of this duty. The most important challenge to corporate governance today is to restore the preeminence of that duty. This is as much a moral imperative as a legal one.

In recent years, corporate leaders have been under increasing pressure from the investment community, including individual investors, to meet elevated expectations. They also have been operating under a system that can misalign the incentives of investors and those of management. Our culture over the past decade has fostered a short-term perspective of corporate performance. Corporate leaders and directors have been rewarded for short-term performance, sometimes at the expense of long-term fundamental value. Investors have purchased stock not because they believed in the business or its strategy as an investment over the long-term, but simply under the assumption that stock prices would only go up.

But, after a most incredible bull market, we have had to witness the truth of the timeless axiom that, aside from age, whatever goes up can also come down, and not only because of a reversal in business outlook for fundamentals. Corporate leaders, under pressure to meet elevated expectations in the bull market, in too many instances were drawn to accounting devices whose principal effect was to obscure potentially adverse results. Moreover, the effectiveness of a number of the checks and balances intended to ensure that we achieve appropriate corporate governance and financial reporting and disclosure also declined. These include reviews of financial reporting by outside auditors and the activities of audit committees. The moral imperative on those intended to provide the checks and balances has eroded and must be restored. Out of the ashes of the Enron debacle, corporate reputation is reemerging as a significant economic value. Corporate governance appears to be improving as a result of this greater market discipline in the wake of the Enron debacle. But much more needs to be done.

Confidence in our capital markets begins with the quality of the financial information available to help investors decide whether, when and where to invest their hard-earned dollars. Comprehensible information is the lifeblood of strong and vibrant markets. Our system and the global markets supporting that system require accurate, complete and timely disclosure of financial and other information. The current system of federal securities regulation is premised on full and fair disclosure of this information. Companies choosing to access the public capital markets must provide material information about their financial results and condition, businesses, securities, and risks associated with investment in those securities.

Congress wisely engrafted on the federal securities laws the philosophy that full disclosure is the best way to permit markets to allocate capital. Congress rejected a "merit-based" system of regulation, which could have been construed as government's approval or guarantee of securities issued by public companies and that could unduly

interfere with efficient market allocation of capital. Optimal capital allocation requires that there not be limits on entrepreneurship or companies failing, or on permitting people to invest in companies that will fail. There must, however, be complete, clear, and timely disclosure to support the market's allocation decisions. We believe it is important to maintain a disclosure-based regulatory system that relies on capital allocation decisions made by market participants.

The success of our markets has not been due just to their depth and breadth, but also to their quality and integrity. In the wake of the Great Depression, when world economic forces caused precipitous and calamitous declines in equity market values, this Country learned that investors are willing to commit their capital to markets *only* if they have confidence that those markets are fairly and honestly run, are fully transparent, and affirmatively minimize the risk of loss from fraud and manipulation. Existing statutory and regulatory provisions require that the public statements by or on behalf of publicly traded companies in the United States contain no misstatements of material fact and no omissions that make the statements that are made materially misleading. These protections are supported by a detailed structure of accounting and disclosure requirements intended to ensure financial reporting and other disclosures that meet the mandated standards of accuracy, completeness and comparability. Current law prohibits wrongful activity, including, but very definitely not limited to, fraud in making materially defective or incomplete disclosure.

As the complexity of our financial markets continues to grow unabated, and the number of Americans who participate in them increases steadily, the Commission must ensure that our system's traditional high standards are not compromised. The goal of the SEC is to ensure that our financial markets are transparent and fair to all investors, and to do so, we must make certain that the public is adequately informed about investing and that corporate America provides the disclosure investors need to make fully informed decisions based on sound and reliable information. In addition to our extensive investor education programs, an integral part of our investor protection efforts is the SEC's aggressive law enforcement program, which protects investors from fraudulent and unfair practices.

Of course, no one should believe that we could create a foolproof system; those with intent and creativity can override any system of checks or restraints. Fraud aside, however, both the quality and timeliness of financial reporting and other disclosures can, and must, be enhanced. Financial reporting and disclosure standards can and should be amended to address the evident deficiencies, and the standard-setting process can and should be made more responsive to changing circumstances. As I discuss in more detail below, we believe we can achieve needed improvements by improving standards and our regulations in three principal areas.

- ***First, disclosure by public companies must be truly informative and timely.*** Companies must be subject to an affirmative obligation to provide reliable information that is informative, relevant, comprehensible, and timely. Investors should have all the information they need to make valuation and investment

decisions. We want investors to have an accurate and current view of the posture of their company, as seen "through the eyes of management." This has long been the SEC's disclosure standard, but "through the eyes of management" must be viewed by all of us, and most importantly by companies' top officials, as a broad and fluid obligation, not merely an obligation to disclose specified categories of information at specified times. And, meaningful disclosure is more than a single number. There has been far too heavy an emphasis by all market participants on quarterly and year-end earnings per share, and too little emphasis on a concise, yet totally lucid, presentation of financial information. We recommend additional substantive disclosure requirements that permit fuller understanding of financial statements and thereby improve overall financial disclosure. We also recommend improving other disclosure requirements to provide disclosure of higher quality, while avoiding greater quantity for quantity's sake. Finally, we are seeking to modernize our disclosure system to seek more timely disclosure of the most significant information, while protecting companies from premature disclosure, disclosure of sensitive information and second-guessing over when and how disclosures were made.

- ***Second, oversight of accountants and the accounting profession must be strengthened and accounting principles that underlie financial disclosure must be made more relevant.*** Outside auditors have an important role in ensuring that the companies they audit present an accurate, complete and current picture of their financial condition. Critical regulatory functions, including quality control and discipline, should be moved from the profession to an independent regulatory body that is completely or substantially free from influence or funding by the profession, and is subject to comprehensive and vigorous SEC oversight. Standards of independence should be revisited and strengthened to prevent conflicts of interest that might cause auditors to compromise the performance of their auditing functions. The standard-setting process for accounting and financial disclosure must be more timely and responsive to market changes and independent from undue influence. Present-day accounting standards are cumbersome and offer far too detailed prescriptive requirements for companies and their accountants to follow. That approach encourages accountants to "check the boxes" — to ascertain whether there is technical compliance with applicable accounting principles. We seek to move toward a principles-based set of accounting standards, where mere compliance with technical prescriptions is neither sufficient nor the objective. We support the wisdom of having accounting standards set by the private sector, but subject to our vigorous oversight. That standard-setting authority today resides in the Financial Accounting Standards Board, whose pronouncements govern financial statements because, but only because, the Commission has chosen to accept those standards as authoritative. The SEC should exercise its authority to ensure that FASB's agenda is responsive to issues facing investors and accountants and is completed on a timely basis.

- ***Third, corporate governance needs to be improved.*** Recent events also underscore the need to craft responsible guidance for directors and senior officers to follow. There are a number of ways current corporate governance standards can be improved to strengthen the resolve of honest managers and the directors who oversee

management's actions and make them more responsive to the public's expectations and interests. We think the best way to do that is a two-fold approach: first, make certain that officers and directors have a clear understanding of what their roles are, and second, apply serious consequences to those who do not live up to their fiduciary obligations. The role of audit committees and outside directors also must be strengthened.

In his State of the Union Address in January, the President appropriately demanded "stricter accounting standards and tougher disclosure requirements." He called for corporate America to "be made more accountable to employees and shareholders and held to the highest standard of conduct." Just two weeks ago, the President outlined a substantive, serious and thoughtful program to move toward implementation of these goals. The SEC shares and embraces these principles, and is firmly committed to making them a reality.

The President's Plan specifically calls on the SEC to implement the President's program. We believe we already have statutory authority to adopt rules to implement the President's program, as well as other improvements necessary to address the problems in our system brought to light so vividly by the collapse of Enron. We intend to work closely with you to ensure that the regulatory framework we ultimately propose meets your view of what is appropriate and in the interests of the public. We also plan to work cooperatively with others who are so vital to our capital markets — the investing public, the securities industry, the accounting profession, the self-regulatory bodies, and corporate management.

It is Congress, however, that must make the final judgment whether legislation is necessary or appropriate. We will work, and indeed are already working, with Members on both sides of the aisle, in both the House and the Senate, regarding legislation Congress may consider. We will continue in these efforts and are committed to implementing any legislative changes Congress ultimately believes are necessary.

H.R. 3763: CORPORATE AND AUDITING ACCOUNTABILITY, RESPONSIBILITY, AND TRANSPARENCY ACT OF 2002

Last month, Chairman Oxley and Capital Markets Subcommittee Chairman Baker introduced H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 (CARTA). The proposed CARTA addresses many of the key issues facing our capital markets today, most notably, creating a statutory "public regulatory organization" to oversee the public accounting profession. The bill would also call on the Commission to improve and modernize, through rulemaking, our disclosure process in a number of key respects. Finally, CARTA requires the Commission and others to study a number of other issues about which questions have been raised in the aftermath of Enron's collapse. The Commission has had an opportunity to examine this legislation, and we believe that, given the Commission's existing authority, as well as Section 12 of this bill, we would have adequate authority to enforce the bill as written. We commend Chairman Oxley, Subcommittee Chairman Baker, and the bill's other co-

sponsors, for this effort to improve and modernize our system of financial reporting and regulation of the accounting profession in a comprehensive and deliberate fashion. In my testimony today, I will address the key aspects of this proposed legislation.

A. Creation, Authority and Funding of Accounting "PRO"

CARTA would establish a public regulatory organization (PRO) to perform certain review and disciplinary functions with respect to accountants who certify financial statements and other documents filed with the Commission.

We are proposing "private sector" regulation, not "self" regulation. Self-regulation implies that the accounting profession would regulate itself. We are suggesting regulation by the private sector, but not by the profession. Rather than a body that functions under the aegis of the American Institute of Certified Public Accountants, which represents the accounting profession, as we announced on January 17th, the Commission believes that it is necessary to create a new, private sector, independent body that can direct periodic reviews of accounting firms' quality controls for their accounting and auditing practices and discipline auditors for incompetent and unethical conduct. We believe there is substantial consensus on this approach. This private sector body would supplement our enforcement efforts, by adding a layer, or tier, or new regulation.

The proposed PRO in the CARTA legislation shares many characteristics that the Commission believes are necessary for effective private-sector regulation of the accounting profession. It is critical to separate discussion of the regulatory model from the issue of whether there is a need for legislation. While legislation is not required to establish private sector regulation with SEC oversight, if Congress determines that legislation is desirable, we are committed to assisting that process and appreciate the opportunity to work with this Committee in doing so. But regardless of whether Congress acts, I believe it is incumbent that the SEC move forward with the most responsible proposal it can.

Our approach and the CARTA legislation share many key elements. The board of the PRO would include some members of the accounting profession, but the overwhelming majority of members would be unaffiliated with the profession, providing a level of independence that the Commission considers critical for effective oversight. Further assuring the PRO's independence, CARTA requires that the PRO function on a self-funded basis, and not rely solely on fees from the accounting profession. We believe these structural measures will go a long way to addressing concerns with the accounting profession's previous self-regulatory scheme.

The PRO would have the authority to perform reviews of accountants and accounting firms who certify financial statements of public companies, and the power to deem them unqualified if necessary. The PRO would also have the authority to conduct disciplinary proceedings and impose sanctions, including determining that an accountant is not qualified to certify a financial statement required by the securities laws.

The PRO established by CARTA would be a positive step toward establishing an effective, independent private-sector regulator of the accounting profession. One aspect of the bill's PRO that could be enhanced, we believe, is the bill's provisions on SEC oversight of the PRO. If such a body is established by legislation, in addition to mandating that the Commission pre-approve the PRO's rules and granting the Commission the authority to amend those rules, several other oversight features could be added. For instance, the PRO and all of its records should be subject to examination by Commission staff, at the Commission's discretion. The Commission should also have the authority to direct the PRO to conduct special projects, such as a special review of a particular firm's quality control system, or a special review of a particular aspect of every firm's quality control systems. In addition, the Commission should have the authority to approve the PRO's budget and to approve the selection of individuals to the PRO.

B. Auditor Independence

CARTA would address concerns about maintaining auditor independence by stipulating that a public accountant not be considered independent of its audit client if it provides that client with financial information system design or implementation, or internal audit services. Specifically, the bill directs the Commission to revise its auditor independence regulations as they relate to these two non-audit service.

There has been considerable debate concerning what, if any, changes to the Commission's current auditor independence rules are necessary to restore investors' confidence in the integrity of the audit process. The Commission's rules on auditor independence were adopted less than 18 months ago, and were targeted to address problems about which there had been considerable study, discussion and debate. The Commission's approach at that time should be tested by practical application, over a reasonable period of time. If problems are empirically shown to exist in this area, any needed reforms can be tailored to address the precise problems uncovered. Some of the restrictions on non-audit services adopted in those auditor independence rules have not yet even taken effect, due to the rules' phase in provisions. With this in mind, we are considering these matters carefully, in light of the rules adopted previously by the Commission, the additional evidence before us, and legislative proposals that have already been made.

We believe that limiting those services that create an inherent conflict with auditing, barring inappropriate compensation mechanisms (such as compensation for cross-selling services) and penalizing firms whose aggregate and individual audit performance is substandard (most likely by limiting the ability to take on new clients for significant periods of time and compelling termination of client relationships) are more likely to prevent audit failures than the suggestion that we increase the reliance of all audit firms on their audit clients

C. Improper Influence on Conduct of Audits

The sponsors of CARTA also recognize that an auditor cannot do his or her job if misled or improperly coerced in the course of conducting the audit. The bill therefore includes a provision that would make it unlawful for any officer, director, or affiliated person of an issuer to unduly or improperly 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 bill grants the Commission exclusive civil enforcement authority over this provision.

We agree with the proposition that issuers have to be forthcoming with their auditors. Anyone who obstructs an auditor is doing something wrong. The Commission has long recognized that the auditor must not be misled or improperly coerced in the course of an audit. We already have the authority to sanction any such improper conduct, and do so. In addition to the general anti-fraud sections of the federal securities laws, which could apply based upon the specific facts and circumstances, Section 13(b)2 of the Exchange Act, and Rule 13b2-2 thereunder, prohibit making materially false or misleading statements to auditors, and Section 20(c) of the Exchange Act prohibits obstruction of the making or filing of any required report with the Commission.

D. Real-Time Disclosure of Financial Information

CARTA would require issuers with securities registered under section 12 of the Securities Exchange Act of 1934 to make "real time" disclosures of information concerning the issuer's financial condition and operations. The Commission strongly supports this initiative. As a first step toward achieving this objective, we announced on February 13th that we will engage in rulemaking to require accelerated filing by companies of their quarterly and annual reports, and to expand the list of significant events requiring current disclosure on existing Form 8-K.

In addition, CARTA would require any disclosure concerning any sale of securities by an officer, director, or affiliated person of the issuer of those securities would have to be made electronically to the Commission before the end of the following business day, and would subsequently have to be made available to the public, electronically, by the Commission. The Commission recognizes the need to require corporate insiders to make public their trading activities more quickly than current law requires. Under current law, which dates back to 1934, the principal provision covering reporting by insiders calls for filing by the tenth day of the month after the month when the trading occurred. While that may have been good enough in 1934, it is not nearly good enough today.

E. Insider Trades During Pension Fund Blackout Periods

Recent events have demonstrated the loss of investor confidence that can result when officers or directors of public companies have the right to trade in the company's stock during periods in which the company's employees may not make trades through

their retirement plans. CARTA would address this concern by restricting insider trading during such a blackout period, with appropriate sanctions for those who violate the restrictions. Early last month, the President proposed safeguards to pension laws, including that when a company's employees are blocked from trading the company's stock in their 401K plans (including during a change in administrators of the plan), company executives also should be blocked from trading the company's stock.[1] We agree with this proposal.

F. Improved Transparency of Corporate Disclosures

No factor is more critical for maintaining the investing public's confidence in our markets than corporate transparency. CARTA seeks to improve the disclosures in public companies' registration statements and periodic reports, so that they provide adequate and appropriate disclosure of certain off-balance sheet transactions and relationships and material transactions. As the Commission has recognized, the quality of information public companies currently disclose on these issues should be improved. Moreover, since an issuer's choice of critical accounting principles may play a significant role in its reported financial condition and results of operation, CARTA would require the Commission to consider requiring the identification of, and additional disclosure about the effect of, the key accounting principles that are most important to the issuer's reported financial condition and results of operation. We strongly support these provisions and are already actively working on them using our regulatory authority.

G. Oversight of Financial Disclosures

CARTA would require the Commission to set minimum periodic review requirements to ensure that the periodic reports of the largest issuers will be subject to a regular and thorough review. The SEC would report annually to Congress on its compliance with this requirement.

We agree with the concept that the Commission, through its Staff, must significantly expand its review of financial and non-financial disclosures. In the wake of Enron, we announced that our Division of Corporation Finance would monitor the annual reports submitted by all Fortune 500 companies that file periodic reports with the Commission in 2002.[2] Through this process, the Division will focus on disclosure that appears to be critical to an understanding of each company's financial position and results, but which, at least on its face, seems to conflict significantly with generally accepted accounting principles or Commission rules, or to be materially deficient in explanation or clarity. Where problems are identified, the Division will select the filing for expedited review. We are encouraging all companies to consult with our Staff if they have questions concerning disclosure issues *before* they file their reports. We are

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[1] President George W. Bush, Radio Address to the Nation on Pension Protection Plan (Feb. 2, 2002).

[2] "Program to Monitor Annual Reports of Fortune 500 Companies," *SEC News Digest*, Issue 2001-245 (Dec. 21, 2001).

committed to providing that assistance in a timely fashion; our goal is to address problems before they happen.

We think, however, that circumscribing these periodic reviews through legislation could be impractical or counterproductive. The Commission should have the flexibility to focus on areas we believe require in-depth scrutiny immediately when we identify these areas. For example, announcing the timing and criteria of our reviews through legislation would be troublesome. Issuers would be on notice regarding the timing and scope of our reviews and could adapt accordingly. Also, regular, thorough reviews of all public companies would require significant resources, since the Commission oversees over 17,000 reporting companies.

H. Studies

CARTA also requires the Commission to perform or participate in several studies that may shed light on the need for additional reforms. The Commission supports each of these initiatives and, without waiting on the passage of CARTA, is focusing attention on each of these areas.

1. Analyst Conflicts

CARTA mandates that the Commission review any SRO final rules on matters involving equity research analyst conflicts of interest, for effectiveness in addressing matters of objectivity and integrity of equity research analyst reports and recommendations. As the Committee is aware, the Commission has been working with the SROs to improve and more diligently enforce the disclosure of conflicts of interest, and has made repeated efforts to educate investors about analyst risk. We believe that we have made significant progress in addressing this issue, and will continue to move forward in our efforts.

2. Corporate Governance

Another study, conducted by the President's Working Group, would review ~~of~~ corporate governance standards and practices, to ensure that they are serving the best interests of shareholders.

3. Identifying reporting areas prone to fraud

The Commission would be required to analyze certain Commission enforcement actions and restatements of financial statements during the last five years to identify the areas of reporting most susceptible to fraud, inappropriate manipulation or inappropriate earnings management.

4. Credit Rating Agencies

CARTA also requires the Commission to study the role and function of credit rating agencies in the operation of the securities markets.

SEC RESOURCE NEEDS

Let me conclude with a point that may be last but is certainly not least. Mr. Chairman, I want to thank you and Congressman LaFalce – indeed all of the Members of this Committee – for your support for pay parity and additional resources for the Commission. I know that separate legislation has been introduced to authorize substantially increased resources for the SEC, and that Members on both sides of the aisle have expressed their strong support for funding pay parity for the agency in Fiscal Year 2003. The entire Commission appreciates your help and support for these resources.

We need legislative assistance in increasing our funding for both this and subsequent fiscal years. The SEC regulates industries and markets that have grown enormously, in both size and complexity. The Commission currently oversees an estimated 8,000 brokerage firms employing nearly 700,000 brokers; 7,500 investment advisers with approximately $20 trillion in assets under management; 34,000 investment company portfolios; and over 17,000 reporting companies.

The President's budget for fiscal 2003 requested an appropriation of $466.9 million for the Commission, an appropriation that made sense when it was first formulated, and that I supported. But since the time that appropriation was formulated, pay parity legislation has passed, and the Commission has had to respond to three crises. As a result of those recent events, we critically need additional funds to enable us to phase-in a modest pay parity plan. We also need authorization to add new staff to address pressing immediate needs. We have discussed our interim personnel and resource needs with OMB, and they have indicated that they are receptive to our request for an additional $15 million to fund 100 new lawyers and accountants.

Given the enormous surge in our enforcement activities, the desire to do a better job than has been done previously at reviewing public company filings, and overseeing a restructured accounting profession, even before looking for efficiencies, the SEC must seek a staffing increase of 100 positions in fiscal 2003:

- 35 accountants and lawyers in the Division of Enforcement to deal with the increasing workload from financial fraud and reporting cases;

- 30 professional staff, including accountants and lawyers, in the Division of Corporation Finance to expand, improve and expedite our review of periodic filings; and

- 35 accountants, lawyers, and other professionals in the other divisions — including the Office of Chief Accountant — to deal with new programmatic needs and policy.

These are the minimum staffing levels required to deal with our *immediate* post-Enron needs. Under a pay parity system, this increased staffing level will require an additional $15 million. The Commission has not received a staffing increase in the last two years, despite the additional responsibilities we have received as a result of the Commodity Futures Modernization Act and the Gramm-Leach-Bliley financial services modernization act. A staffing increase is even more critical in light of recent events.

CONCLUSION

I take quite seriously my stewardship responsibilities and the Oath of Office I took when I became Chairman of the Commission. I look forward to continuing to work with you to work closely with you regarding legislation you are considering. We are committed to implementing any legislative changes Congress ultimately believes are necessary. In our view, any such changes should include provisions broadly reaffirming and enabling the SEC to improve the current disclosure and accounting system and to discharge our obligations prudently, generously and in the spirit with which the federal securities laws were adopted: to protect investors and maintain the integrity of the securities markets.

Our system must be improved and modernized. We are up to the task, but only if we are able to tap our best minds to produce our most creative solutions, and only if we are able to discuss these issues openly, honestly, and as constructively as possible. The SEC is committed to that end, and we seek participation by everyone with an interest in our capital markets. Together, we can, we must and we will make a difference. That is our vision and our unalterable mission.

On behalf of the Commission, thank you for the opportunity to testify today. I am pleased to respond to any questions the Committee may have.