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Dear Senator:

We understand that the Senate Banking Committee may be marking up accounting reform legislation tomorrow. Our organizations consider accounting reform to be the single most important issue Congress must address in the wake of the Enron collapse to restore investor confidence in the integrity of our markets. We are writing to urge you to adopt the Sarbanes draft bill without weakening amendments.

Had Arthur Andersen taken a tough line with Enron when it first started down the path of inflating earnings and hiding debt, Enron might never have reached the number seven spot on the Fortune 500, but it would probably still be a going concern. Investors would not have lost an estimated $93 billion. And Enron employees would still have their jobs and their pensions. It is hard to imagine a more graphic illustration of the central importance of the independent audit to our system of investor protections.

Unfortunately, accounting firms and their audit clients have ignored their responsibility to maintain the independence of the audit, leaving the audit with little more credibility today than if companies were allowed to certify their own numbers. At the same time, auditors are subject to virtually no meaningful regulatory oversight. It is hardly surprising that as a result we have experienced a dramatic surge in recent years in the number of companies forced to restate their earnings because of errors. Under the circumstances, the fact that investors today don't trust financial disclosures just shows they are paying attention.

The Sarbanes bill offers the kind of comprehensive reform that is needed to restore investor confidence. First, it would dramatically improve the quality of regulatory oversight for accountants that audit public companies. Second, it offers real progress toward restoring the independence of the audit. Finally, it supplements those auditor independence provisions with important provisions to increase corporate board responsibility for and improve board oversight of the audit. Taken together, these reforms should dramatically improve the quality of audits and the reliability of public companies' financial disclosures.

As such, the Sarbanes bill stands in sharp contrast to the phony reform bill passed by the House last month. The House bill, like the Enzi draft being circulated in the Senate, would all but guarantee industry dominance of the new regulator. That, combined with its limited authority, would ensure the new regulator's ineffectiveness and lack of credibility. Congress has tried that approach in the past, which is what helped to land us in the mess we find ourselves in today. It is unlikely that investors will be fooled again.

The Senate has the opportunity to show it can stand up to accounting industry special interests and adopt effective reform by passing the Sarbanes bill. We urge you to do so. If you have any questions about our position on the bill, please feel free to call Barbara Roper, CFA's director of investor protection, at 719-543-9468.

Sincerely,

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Key Audit Reform Provisions of the Sarbanes Bill

1. The bill would create a strong new regulator to oversee the audits of public companies.

In analyzing what it would take to create an effective regulator for auditors of public companies, our organizations have emphasized five characteristics: independent governance, adequate and independent funding, broad standard-setting authority, extensive investigatory powers, and strong enforcement authority, including the authority to impose meaningful sanctions. The Sarbanes bill meets all these standards.

- Its five-member board would have to be made up of prominent individuals with a demonstrated commitment to investor protection and the public interest, serving on a full-time basis and receiving no compensation from an accounting firm while on the board except fixed payments under a standard retirement plan. Members could include up to two present or past CPAs. While we would prefer an approach focused on the individual's current or past ties to the industry rather than his or her status as a licensed accountant, we believe the bill's other requirements for members should help to ensure the board's credibility as an independent body.

- Funding would be provided through a combination of fees imposed on accounting firms and fees imposed on issuers. Accounting firms that failed to pay required fees would have their registration suspended and, as a result, would lose their ability to audit public companies. This should provide a guaranteed source of adequate funding that is not subject to the type of threat the industry has used to cow the Public Oversight Board.

- The bill would give the new body responsibility to set audit, quality control, ethics, and independence standards. A regulator that can only enforce standards set by the industry it regulates is doomed to ineffectiveness. Having this standard-setting authority would allow the regulator not just to clean up problems after they occur, but to prevent them by imposing and enforcing high standards for how audits of public companies are conducted.

- In addition to charging the new regulatory board with responsibility to inspect audit firms on a regular cycle, the bill would give the board the necessary powers to investigate suspected wrong-doing. This includes the power to compel testimony and documents, authority that is backed up by the potential suspension of registration for failure to cooperate.

- Where violations of laws, rules, or standards are found, the board would have authority to impose a wide range of sanctions. These include censure, retraining, limitations on activities, significant civil money penalties, and suspension or revocation of registration, which carries with it the right to audit public companies. As a result, the board would have needed flexibility to respond at an appropriate level to different types or degrees of wrong-doing. The threat of meaningful sanctions would serve as an effective deterrent to abusive practices.

Given the central importance of the outside audit to our system of investor protections and our history of repeated accounting scandals, it defies belief that we have continued to allow the accounting firms to stave off effective regulation. The House bill would maintain this tradition of allowing the major accounting firms, whose lack of ethical conduct is the source of the problem, to determine the limits of reform. The Sarbanes bill would finally impose a credible system of regulation.

2. Although it stops short of the comprehensive reform we believe is needed, the bill would enhance the independence of the audit.

Restoring real independence to the audit will require a multi-faceted approach that lessens the financial sway audit clients hold over their auditors and closes the revolving door that all too often exists between auditors and their audit clients. To that end, our organizations support requiring periodic rotation of auditor firms, prohibiting all non-audit services that cannot be shown to improve the quality of the audit without creating significant conflicts of interest, and imposing a cooling off period before partners or employees of the audit firm could be employed with the audit client without forcing a change of auditors. We are disappointed that the Sarbanes bill does not require mandatory rotation of audit firms, settling instead for a study of the issue and audit partner rotation, and that its cooling off period is both too narrow and too short. However, the bill does include two provisions that should provide real progress toward enhancing auditor independence.

- The bill would require the Securities and Exchange Commission to restore the stronger independence protections contained in the initial SEC rule proposal limiting non-audit services. These protections were whittled away in the final rule. We believe the Enron-Andersen debacle and others like it make the case for an even broader ban, but we support this as an important step in the right direction.

- The bill supplements its limited ban on non-audit services with a provision that would make board audit committees responsible for decisions about hiring the auditor to perform non-audit services. This should help to reduce the conflict that arises when management controls these decisions, and auditors with significant consulting services at stake fear that challenging management aggressively on the audit puts not just the audit itself but also that consulting business at risk.

3. The bill would enhance the audit committee's responsibility for overseeing the audit and its ability to do so effectively.

Audit committees are supposed to oversee the audit to ensure its integrity. Too often, however, they abdicate those responsibilities, relying instead on the assurances of management.

The bill would force audit committees to take responsibility for overseeing the audit and would give them the tools they need to do so.

- The bill would make audit committees directly responsible for the appointment, compensation, and oversight of the auditor. This includes responsibility for resolving disputes between management and the auditor over financial reporting.

- The bill also would improve the information audit committees have available to them in fulfilling their responsibilities. The auditor would be required to provide a report to the audit committee that describes: the critical accounting and policies and practices to be used; all alternative treatments under generally accepted accounting principles that have been discussed with management, the ramifications of the use of those alternatives, and the treatment preferred by the auditor; and any other written communications between the auditor and management, such as a management letter or a schedule of unadjusted differences.

- The bill would authorize audit committees to engage counsel or other outside advisors to assist them in fulfilling their responsibilities and would require companies to comply promptly with requests for funding for this purpose.

- The bill supplements these protections with new provisions to help ensure the independence of the audit committee. It would do so by imposing limits on the financial ties that audit committee members could have to the issuer.

4. The bill would reduce incentives for management to make misleading disclosures and provide greater accountability when they do.

Company management often faces enormous pressure to keep the company's stock price on a steady upward trajectory. Their personal financial well-being is also often at stake. The Sarbanes bill would help to counteract those forces by imposing greater accountability on management for ensuring the integrity of the audit and by imposing heavier sanctions when they fail to do so.

- Chief executive officers and chief financial officers would be required to certify that the audit report fairly and accurately presents the financial condition and operations of the issuer.

- The bill would make it a crime for an officer, director, or affiliated person of the issuer to fraudulently influence, coerce, manipulate, or mislead the auditor for the purposes of rendering the audit report materially misleading.

- CEOs and CFOs would be required to reimburse the issuer for any bonus or other incentive-based or equity-based pay or any profits realized from the sale of the issuer's securities received during the 12-month period before an accounting restatement that is required because of misconduct that resulted in material noncompliance with financial reporting requirements under the securities laws.

- In actions involving violations of the securities laws, the bill would authorize the SEC to seek, and courts to grant, any equitable relief, including disgorgement of any or all benefits received from any source in connection with the conduct giving rise to the action, including salary, commissions, fees, bonuses, options, profits from securities transactions, and losses avoided through securities transactions.

5. The bill would substantially increase SEC funding.

The Enron collapse has helped draw attention to a long-festering problem -- the gross underfunding of the Securities and Exchange Commission. The call for greater scrutiny of corporate financial disclosures and the growing enforcement caseload that have followed have put new strains on that budget. The Sarbanes bill would provide a dramatic increase in funding from $437.9 million in FY 2002 to $776 million in FY 2003. Of that, $98 million would fund the hiring of at least 200 professionals, $102.7 million would be made available to fund a pay increase for SEC staff, and $108.4 million would go toward information technology, security enhancements, and the costs of recovery from the September 11 attack.