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Council of Economic Advisers

Kroszner, Randall (Randy) - Subject Files

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Folder Title:

Corporate Governance Briefing Book: Summer/Fall 2002 [1]

Withdrawn/Redacted Material

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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Table of Contents	Corporate Governance Briefing Book	2	N.D.	P5;
002	Talking Points	Corporate Governance and Accounting Reforms...	21	09/2002	P5;
003	Draft	[Letter] - To: POTUS - From: Harvey Pitt	5	06/14/2002	P5;
004	Report	SROs and Corporate Governance	2	11/01/2002	P5;

COLLECTION TITLE:

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RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

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- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

Deed of Gift Restrictions

- A. Closed by Executive Order 13526 governing access to national security information.
- B. Closed by statute or by the agency which originated the document.
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Freedom of Information Act - [5 U.S.C. 552(b)]

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**Corporate Governance and Accounting Reforms
Economic Perspective**

**Randall S. Kroszner
Member, Council of Economic Advisers
U.S. Executive Office of the President**

October 2002

Conceptual Overview

Our **macroeconomic outlook** depends on the quality of corporate governance and its reform:

- corporate governance affects how financial information is used
 - *better deployment of financial information* leads to better decisions & lower “transactions costs” within organizations -> *stronger economic growth*

Reforms are occurring at record pace through variety of channels. Some examples:

- **Legal and regulatory initiatives:**
 - SEC: implementation of Sarbanes-Oxley Act
 - NYSE/NASDAQ: proposed new listing standards
- **Market pressures toward reform:**
 - Managerial labor market
 - changes in D&O insurance
 - Equity market, large shareholders
 - management/activist initiatives
 - Market for corporate control

Reform: Three Core Principles at Work

Existing reforms tend to follow one of **three core principles of reform** underlying President's ten-point plan, announced last March:

- **Investor Access to Information**
 - timely and truthful reporting
- **Management Incentives**
 - including accountability (e.g., bearing of downside risk)
- **Auditor Independence**
 - elimination of conflicts of interest, other malincentives

Information Accuracy and Accessibility

Information-access reforms target a wide range of topics.
For example:

- Disclosure of **material off-balance sheet transactions** ... by 1/26/03
 - Disclose whether senior financial officers have **code of ethics** (and, if not, why not) ... by 1/26/03
- - —
- Reconciliation of pro-forma accounting with GAAP
 - Insider transaction Disclosure
 - Real-time disclosure
 - rather than waiting for periodic filing date (e.g., quarterly report)

Manager/Officer Incentives and Accountability

Some recent reforms that target incentives (examples under Act):

- *Legal sanctions* for fraud and other dishonesty:
 - require CEO & CFO to **certify financial reports**.
 - **tough penalties** for false certification:
 - up to \$1 million (or 10 ys), or:
 - \$5 MM (20 yrs) if “knowingly” standard met.
- *Auditor cannot be [recent] former employer* of principal financial officer (recent: 1 year or less)
- Restricting use, or requiring shareholder approval, of certain forms of executive compensation.
 - *Prohibition on loans to officers and directors*
Sarbanes-Oxley Act

Auditor Independence

A **special board** will be appointed to oversee the reform of auditor's rights and incentives.

Public Company Accounting Oversight Board, under SEC supervision

- **five members (only 2 CPAs)** appointed by 10/28/02
- up and running by 4/26/03

Also, auditors will be prohibited from from supplying certain (8) "non-audit" services, with additional prohibitions under Board discretion.

— - —

- All audit firms, foreign and domestic, must "register" with board.
 - commitment to follow rules
 - provide audit work papers
 - SEC may decide to make exemptions of foreign and other audit firms in some instances.
- Board powers include:
 - referral of misconduct to SEC, DOJ others
 - establishing auditing, attestation, quality control and ethics standards for public accounting firms to follow in preparing and issuing audit reports

Next Steps

Big legislative and regulatory steps have been taken, as well as major changes in the markets.

The SEC will implement the Act in phases, following a “clock” set by Congress. Examples, by #days from enactment:

- 30 days: rules requiring CEO/CFO certification of financial statements.
- 90 days: appoint members to oversight board (PCAOB) ... draft rules requiring disclosure of financial officer codes of ethics (final at 180 days).
- 180 days: issue final rules requiring disclosure of off-balance sheet transactions ... final rules on presentation of pro forma financial information (not misleading, reconciled with GAAP).
- 270 days: Board should be and running ... issue rule directing exchanges to amend “audit committee” aspect of listing standards.

SEC also must conduct **studies**. For example:

- Should issuers be required to switch audit firms periodically? (Act requires switching each 5 years).

SEC Record of Enforcement
FY 2002 – 2002

	FY 2000 (year)	FY 2001 (year)	FY 2002 (10 mos)
Financial fraud and issuer reporting actions filed	103	112	122
Officer and director bars sought	38	51	71
Temporary restraining orders filed	33	31	42
Asset freezes	56	43	50
Trading suspensions	11	2	10
Subpoena enforcement actions	9	13	18
Disgorgement of compensation/ bonuses/ stock options sought	N/A	18	17
Disgorgement ordered (millions)	\$463	\$530	\$632
Penalties ordered (millions)	\$43.7	\$56.1	\$46.9

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Pension and Corporate Governance Timeline

2001

December

- **12/2:** Enron files for Chapter 11 bankruptcy protection.

2002

January

- **1/10:** President convenes Task Force on Pension Security (Secretaries of Labor, Treasury, and Commerce) and Financial Markets Working Group (Treasury, SEC, Fed, and CFTC).

February

- **2/1:** President presents recommendations of the Task Force on Pension Security (better information, executive accountability during blackouts, access to investment advice, and ability to diversify).
- **2/14:** Boehner bill (H.R. 3762) on pension reform, implementing President's pension recommendations, is presented in committee.
- **2/14:** Oxley bill (H.R. 3763) on corporate governance and accounting reform is presented in committee.

March

- **3/7:** President presents Ten-Point Plan to Improve Corporate Responsibility and Protect America's Shareholders, based on recommendations of Financial Markets Working Group.

April

- **4/11:** Boehner pension bill passes House 255-163 and is referred to Senate, which is yet to act on pension reform.
- **4/24:** Oxley corporate governance bill passes House 334-90 and is referred to Senate.

June

- **6/18:** Sarbanes corporate governance bill is presented in committee.

July

- **7/9:** President delivers corporate governance speech in NYC calling for enhanced penalties and enforcement of securities fraud and related crimes.
- **7/15:** Sarbanes corporate governance bill passes Senate.
- **7/21:** Worldcom files for Chapter 11 bankruptcy protection.
- **7/25:** Sarbanes-Oxley conference report passes House and Senate.

- **7/30:** President signs Sarbanes-Oxley corporate governance bill.
- **Provisions of S-O effective immediately:**
 - CEO and CFO certification (section 906);
 - CEO and CFO disgorgement of bonuses and profits from security sales if earnings are restated due to material noncompliance with the financial reporting requirements (section 304);
 - Prohibition of personal loans made by an issuer to its directors and executive officers (section 402);
 - SEC to review the reports of all listed companies no less than once every three years (section 408);
 - Penalties for "knowingly false" officer certifications up to \$1 million and 10 years imprisonment (section 906);
 - Penalties for securities fraud include fines and maximum 25 years imprisonment (section 807);

August

- **8/16:** NYSE original listing rule proposals submitted to SEC for review.
- **8/29: (30 day mark)**
- SEC to issue final rules about CEO and CFO certification (section 302);
- Effective date of accelerated filings by officers, directors and significant owners (section 403).

September

- **9/10:** original NASDAQ listing rule proposals published (not submitted to SEC).

October

- **10/28: (90 day mark)**
- The SEC must have appointed chairperson and initial members of the Oversight Board (section 101);
- SEC must propose rules prohibiting an officer to influence the conduct of audits (section 303);
- SEC must propose rules requiring each issuer to disclose that the audit committee is comprised of at least one member who is a financial expert (section 407);
- SEC to propose rules regarding the disclosure of code of ethics for senior financial advisors (section 406)

2003

January

- **1/26: (180 day mark)**
- Audit firms must be registered with Oversight Board (section 102);
- SEC must issue final regulations to carry out requirements on auditor independence (sections 201, 202, 203, 204, 206);
- SEC must consult with Secretary of Labor to clarify regulations regarding insider trades during individual account plan blackout periods (section 306);
- SEC to issue rules regarding the professional responsibilities of attorneys (section 307);
- SEC to issue requirements that each annual and quarterly financial report must disclose all material off-balance sheet transactions (section 401);
- SEC to issue rules regarding accountant's retention of records (section 802);
- SEC to issue report about the role and functions of credit rating agencies in the operation of the securities market (section 702);
- Comptroller General to issue report whether investment banks and financial advisors assisted public companies in manipulating their earnings and obfuscating their true financial condition (section 705).

April 2003

- **4/26: (270 day mark)**
- The SEC must determine if the Oversight Board has the capacity to carry out its duties of overseeing accounting firms that audit the financial statements of public reporting companies (section 101);
- SEC to issue rules directing national securities and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the Act's audit committee standards, including the requirement that every member of the audit committee be "independent" (section 301).

July 2003

- **7/30: (One year mark)**
- SEC to adopt, or to direct a registered securities association or national securities exchange to adopt, rules to reduce conflicts of interest of securities analysts (section 501);
- Comptroller General to study the potential effects of requiring the mandatory rotation of registered public accountants (section 207); Comptroller General to conduct study on the consolidation of public accounting firms (section 701).

Directors and Auditors

	Administration	Sarbanes-Oxley	SEC	SROs
Majority Independent Directors	Requests that stock markets require that a majority of a company's directors be truly independent so that they have no material relationship with the company.			NYSE: Listed companies must have a majority of independent directors (within 24 months of SEC appr). NASDAQ: majority of independent members and independent director approval (by ad hoc committee or majority) of all director nominations.
Definition of Independent Director				NYSE: i. No material relationship (Board definition); ii. Five year cooling off period for employees, auditors, interlocking relationships, anyone with immediate family in any of these categories (effective upon SEC approval). NASDAQ: prohibit former auditors from being considered independent; 3 year cooling off period for interlocking relationships, receipt of >\$60,000 other than for Board service, former audit service.
Independent Audit, Nominating, and Compensation Cmtes.	The President also calls for all members of a company's audit committee, nominating committee, and compensation committee to be truly independent.	Audit committee members must be independent.		NYSE: Audit, nominating, and compensation committees comprised solely of independent directors (effective: audit- 6 months after SEC approval nom and comp- 24 months of SEC approval). NASDAQ: audit committee member cannot be "affiliate" of company in any way.

Audit Committees	Point 7: Investors should have complete confidence in the independence and integrity of companies' auditors. (I.e. Audit committees choose auditors)	Audit committee hires and oversees accounting firms. Companies disclose if one member of audit committee is "financial expert." Auditors disclose all critical accounting practices to audit cmte.	Drafting rules to ensure audit committees alone hire and fire auditors. Companies must disclose whether they have a "financial expert" on audit committee (required by 10/28/02)	NYSE: Audit committee alone can hire/fire auditor (effective within 6 months of SEC approval) NASDAQ: Audit cmtes alone hire and fire auditors, review and approve all related-party transactions.
Regularly scheduled meetings of non-management directors				NYSE: Board must schedule regular executive sessions without management (effective within months of SEC approval). NASDAQ: same.
Auditor Service Restrictions	Point 7: Investors should have complete confidence in the independence and integrity of companies' auditors. (I.e. No non-audit or internal audit services provided by external auditor)	Auditors may not provide any of nine specified services for audit client and must obtain prior approval from PCAOB for any services provided.	Drafting rules to ensure audit committees approve non-audit services by external auditors.	NYSE: Audit committee alone can approve non-audit relationship with auditors (effective within 6 months of SEC approval) NASDAQ: Audit committees must approve non-audit services by external auditors.
Auditor Rotation		Audit partner rotation every 5 years.		
Foreign Auditing Firms				

Disclosure

	Administration	Sarbanes-Oxley	SEC	SROs
Fuller Disclosure	Point 1: Each investor should have quarterly access to information needed to judge a firm's financial performance, conditions, and risk.	Pro forma accounting statements must be reconciled with GAAP in company reports. Material off-balance-sheet transactions must be disclosed in company reports.	Proposed rules requiring description of accounting policies in clear language and put limitations on pro-forma reporting.	
Real-time Disclosure	Point 2: Each investor should have prompt access to critical information.		Proposed rules accelerating filing deadlines. Tripled amount of information that must be reported.	NASDAQ: considering but nothing proposed yet.
Ethics Code Disclosure		Companies must disclose code of ethics for senior financial officers in company report.	Companies must issue code of ethics for senior financial officers (required by: 10/28/02)	NYSE: Code of ethics and business conduct must be published, as must any waivers. This includes suggested prohibition of loans to officers and directors (effective within 6 months of SEC approval). NASDAQ: same.
Accounting Practice Disclosure	Point 10: Firms' accounting systems should be compared with best practices, not simply against minimum standards.	Auditor report to audit committee must compare company's audit practices to auditor's preferred treatment.		
Compensation Disclosure	Describe and justify compensation packages in annual reports.			
Insider Transactions	Point 6: Corporate leaders should be required to tell the public promptly whenever they buy or sell company stock for personal gain.	Management and principal stockholders must report transactions by end of second business day.	Initiated rulemaking to require companies to promptly report specific securities transactions (required by: done).	NASDAQ considered proposal but did not include in first submission to SEC.
Executive Certification	Point 3: CEOs should personally vouch for the veracity, timeliness, and fairness of their companies' public disclosures, including their financial statements.	CEO and CFO must verify fairness and accuracy of company reports. "Knowing and willful" violations of requirement subject to 20 years in prison.	Proposed rules requiring CEO and CFO certification of quarterly and annual reports. (required by: done)	NYSE: Listed company CEOs must certify annually compliance with exchange corporate governance stds (effective within 6 months of SEC approval). NASDAQ: no proposal- considers certification of financials an SEC issue.
Going Concern Qualifications				NASDAQ: A going concern qualification in an audit opinion must be disclosed by press release.

Disclosure of material off-balance sheet transactions			Firms must disclose material off-balance sheet transactions (required by 1/26/03)	
Listed foreign companies				<p>NYSE: Listed foreign companies must disclose significant ways that their corporate governance practices differ from those practiced by domestic companies under NYSE standards (effective within 6 months of SEC approval). NASDAQ: disclosure of any exemptions (GAINED THROUGH APPLICATION PROCESS) to exchange requirements, all interim reports filed in home country be filed with exchange and SEC.</p>

Executive Compensation

	Administration	Sarbanes-Oxley	SROs
Company Loans	Compensation committees of public companies called on to prevent corporate officers from receiving loans from their companies.	Prevents personal loans to corporate officers.	NYSE: recommends corporations prohibit loans through statement of conduct. NASDAQ: Loans to officers and directors prohibited.
Shareholder Approval of Stock Option Plans	The President calls on the nation's stock markets to require listed companies to receive shareholder approval for all stock option plans.		NYSE: requires shareholders approve equity-compensation plans (effective upon SEC approval). NASDAQ: Requires shareholder approval of all stock option plans or meaningful adjustment to existing plans.
Approval of CEO Compensation			NASDAQ: Independent compensation committee or majority of independent directors must approve CEO compensation.
Independent Director Compensation			NYSE: NASDAQ: Independent directors must not receive payments exceeding \$60,000 other than for board service.
Audit Committee Compensation			NYSE: Directors' compensation must be sole payment from listed company for audit cmte members (effective within 6 months of SEC approval). NASDAQ: same.

Accounting Board

	Administration	Sarbanes-Oxley	SEC	
Membership	Point 8: An independent regulatory board should ensure that the accounting profession is held to the highest ethical standards.	Only two members can have been CPA. Chair may not have been CPA for five years prior to service.	Proposed rules for new independent accounting oversight board.	
Confidentiality		Board may compel information from member-accounting firms and their clients if the Board considers it "relevant or material." Disclosures to board remain confidential "unless and until presented in connection with a public proceeding."		
Funding		Funded by accounting support fees assessed on public companies.		
Member Appointment		SEC will appoint five full-time members in consultation with the Fed Chairman and Treasury Secretary.		SEC appoints members in consultation with _____ (implementation: by 10/28/02)
Accounting Standards		Point 9: Accounting standards must be responsive to the needs of investors.		SEC may recognize as "generally accepted" accounting principles established by the Board.

Penalties and Enforcement

	Administration	Sarbanes-Oxley	SEC
Task Force	Corporate Fraud Task Force to provide oversight and enable improved inter-agency coordination of civil and criminal investigations.		
Mail Fraud	Double the maximum prison term for mail fraud and wire fraud to ten years.	Quadruple the maximum prison term for mail fraud and wire fraud to twenty years.	
Sentencing for Fraud	Requests U.S. Sentencing Commission to enhance prison time for criminal fraud when committed by corporate officers and directors.	Imprisonment for up to 10 years.	
Document Destruction/Alteration		Up to 10 years imprisonment for destruction of documents relevant to bankruptcy or federal proceeding. Up to five year imprisonment for destruction of audit documents.	
Obstruction of Justice	Strengthening laws that criminalize document shredding and other forms of obstruction of justice.	Orders review of sentencing guidelines.	
Conspiracy		Amends conspiracy law to impose sentence equal to the greater of 5 years or maximum penalty of underlying offense. Current maximum for conspiracy is 5 years.	
SEC Temporary Freeze	New provisions to strengthen the ability of the Securities and Exchange Commission (SEC) to freeze improper payments to corporate executives while a company is under investigation.	Allows SEC to request in court a 45-day freeze on payments to executives under investigation.	

Penalties and Enforcement (cont'd)

	Administration	Sarbanes-Oxley	SEC
SEC Funding	\$20 million funding increase requested earlier this year so that the SEC can hire 100 new enforcement officers. Also request an additional \$100 million in FY 2003 to enable the SEC to hire more enforcement officers and provide them with state-of-the-art technology.	Additional \$776 million in FY03 for technology and at least 200 new enforcement officers.	
Non-dischargeable claims		Securities fraud claims non-dischargeable under Bankruptcy Code.	
Whistleblowers		Creates private right of action (if DOL does not respond within 180 days) for whistleblowers so they are shielded from retaliatory action if the disclose information to assist a "judicial proceeding."	
Disgorgement	Point 4: CEOs or other officers should not be allowed to profit from erroneous financial statements.	Following restatement of earnings, executive must forfeit bonuses, incentive-based compensation, and profits from stock sales for the previous year.	Has sought appropriate disgorgement of compensation and/or stock options from senior management.
Director and Officer Bars	Point 5: CEOs or other officers who clearly abuse their power should lose their right to serve in any corporate leadership positions.	SEC may bar officers and directors.	Under current legislative authority, seeking to bar officers and directors appropriately in a record number of federal cases.
Expansion of Plaintiff Actions		Expands actions that can be brought by plaintiffs in civil cases. Extended statute of limitations on securities fraud.	

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PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT¹
LIST OF ACTIONS EXPRESSLY MANDATED BY ACT²

ACTIONS REQUIRED WITHIN 30 DAYS (August 29, 2002)

Matter	Obligation	Act Provision	Timetable for SEC Action
CEO and CFO certification requirements	Commission to adopt rules	Section 302 – Commission “shall, by rule,” (1) require certification of financial statements by CEOs and CFOs of public companies, and (2) require CEOs and CFOs to certify to the effectiveness of internal controls and that the auditors and audit committee are aware of significant deficiencies in the controls	“The rules required by subsection (a) shall be effective not later than 30 days” after enactment

ACTIONS REQUIRED WITHIN 90 DAYS (October 28, 2002)

Matter	Obligation	Act Provision	Timetable for SEC Action
Appointment of Board members	Required appointments after consultation with the Fed and Treasury	Section 101(e)(4)(A) – Commission “shall appoint the chairperson and other initial members of the Board” and “designate a term of service for each.” Under Section 101(e)(4)(B), the SEC also fills vacancies on the Board.	Appointments made “not later than 90 days” after enactment
Rules prohibiting improper influence on audits	Commission to propose and adopt rules	Section 303(a) – Commission “shall prescribe” rules “as necessary and appropriate in the public interest or for the protection of investors” to prevent fraudulent influence for purposes of rendering financial statements materially misleading	“Commission shall (1) propose the rules or regulations required by this section, not later than 90 days” after enactment, and “(2) issue final rules . . . not later than 270 days” after enactment ³
Code of ethics for senior financial officers	Commission to propose and adopt rules	Section 406 – Commission “shall issue” rules to require disclosure of whether a company has a code of ethics for senior financial officers and, if not, the reason why it does not. Commission to also revise rules for disclosures on form 8-K, to require immediate disclosure of any changes in, or waivers to, a code of ethics	“Commission shall (1) propose rules to implement this section, not later than 90 days” after enactment, and “(2) issue final rules . . . not later than 180 days” after enactment
Disclosure of audit committee “financial experts”	Commission to propose and adopt rules	Section 407 – Commission “shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer” to disclose whether the audit committee has at least one member who is a “financial expert,” as defined by the Commission, and to give reason why not if one is not present	“Commission shall (1) propose rules to implement this section, not later than 90 days” after enactment, and “(2) issue final rules . . . not later than 180 days” after enactment

¹ Enacted on July 30, 2002 (Pub. L. No. 107-204). General rulemaking authority is included in section 3(a) of the Act.

² This chart does not include rulemakings and other actions not expressly required by the Act.

³ Items with multiple statutory deadlines are only listed once, under the earliest deadline specified.

ACTIONS REQUIRED WITHIN 180 DAYS (January 26, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
Rules to implement auditor independence	Commission must propose and adopt rules to carry out provisions of Title II	Sections 201, 202, 203, 204, 206, 208(a) – “Commission shall issue final regulations” regarding prohibited non-audit services, preapproval requirements, audit partner rotation, reports to audit committees and conflicts of interest. Commission must amend rules to require disclosure in reports under section 13(a) of approvals by the audit committee of auditor’s performance of non-audit services.	“Not later than 180 days after enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A . . . as added by this title”
Prohibition on insider trades during blackout periods	Commission shall issue rules in consultation with the Secretary of Labor	Section 306(a)(3) – “Commission shall, in consultation with the Secretary of Labor, issue rules to clarify” the prohibition on insider trades during pension fund blackout periods, and to “prevent evasion thereof”	No deadline in Act, but rules presumably need to be effective before section takes effect 180 days after enactment
Minimum standards of conduct for attorneys	Commission to propose and adopt rules	Section 307 – “Commission shall issue rules, in the public interest and for protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing” before the Commission, which shall include a rule requiring an attorney with evidence of a material violation to report it to company’s chief legal officer or CEO and, if necessary, the Board	“Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules”
Disclosure of material off-balance sheet transactions	Commission to propose and adopt rules	Section 401(a) – “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 and other relationships with unconsolidated entities having a material effect on condition, capital, liquidity, results of operations, revenues or expenses	“Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules”
Pro forma financial information	Commission to propose and adopt rules	Section 401(b) – “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 other public disclosure shall be presented in a manner that” is not misleading, and reconciles it with the financial condition and results of operations of the issuer under GAAP	“Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules”
Record retention	Commission shall propose and adopt rules	Section 802 – “Commission shall promulgate . . . such rules and regulations, as are reasonably necessary, relating to the retention of relevant” audit records	“Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary”

ACTIONS REQUIRED WITHIN 270 DAYS (April 26, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
Determination that Board is properly organized	Required planning for establishment and administrative transition to Board prior to appointment of Board, and determination that Board, once in place, has capacity to carry out its obligations.	Section 101(d) – “Commission to determine” that the Board is organized and can carry out the purposes of the Act.	“Not later than 270 days after enactment”
<i>Standards relating to audit committees</i>	<i>Commission to direct the exchanges to amend audit committee rules</i>	<i>Section 301 – “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” new standards of audit committee responsibility and independence</i>	<i>“Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct” the exchanges and associations to prohibit certain listings</i>

ACTIONS REQUIRED WITHIN ONE YEAR (July 30, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
<i>Analyst conflicts of interest</i>	<i>Commission to adopt, or have securities associations and exchanges adopt, rules on analyst conflicts of interest</i>	<i>Section 501 – “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 enactment, “rules reasonably designed” to address, and limit, securities analyst conflicts of interest, and to require public disclosure of analyst conflicts of interest</i>	<i>“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 enactment, “rules reasonably designed” to achieve goals of section</i>

ACTIONS REQUIRED WITHOUT SPECIFIC DEADLINE

Matter	Obligation	Act Provision	Timetable for SEC Action
Commission procedures for review of disputes over Board inspection reports	Commission to promulgate procedural rules	Section 104(h) – “A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate,” of certain Board determinations concerning inspections of public accounting firms	No deadline in Act, but presumably needs to be done shortly after the Board is operational
Commission procedures for determining length of stay in certain reviews of Board disciplinary actions	Commission shall establish procedures for appropriate cases	Section 105(e)(2) – “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”	No deadline in Act, but presumably needs to be done shortly after the Board is operational
Recognition of accounting standards	Commission shall propose and adopt such rules and regulations to implement new statutory provision	Section 108 – “Commission shall promulgate such rules and regulations” to implement provision for recognition of generally accepted accounting principles, “as it deems necessary or appropriate in the public interest or for the protection of investors”	No deadline in Act
Internal control report as part of annual report	Commission to propose and adopt rules	Section 404 – “Commission shall prescribe rules requiring each annual report . . . to (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 . . . of the effectiveness of the internal control structure and procedures of the issuer for financial reporting. With respect to the internal control assessment required . . . 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”	No deadline in Act

COMMISSION STUDIES – SIX MONTHS OR 180 DAYS (January 26, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
FAIR Funds for investors	Commission must conduct study and report on previous five years' civil penalty and disgorgement cases	Section 308(c) – Study and report on civil penalties and disgorgement, to determine how to maximize efficiency, including recommendations to address any concerns noted in the study	Report to Congress within 180 days of enactment
Study and report on credit rating agencies	Commission to conduct study	Section 702 – Commission is to report on study of the role and function of credit rating agencies in the operation of securities markets	Report to the President and Congress within 180 days of enactment
Study and report on aiding and abetting liability	Commission to conduct study	Section 703 – Commission must conduct a study of securities professionals who have “aided and abetted” violations of federal securities laws between 1998 and 2001, and report to Congress	Report to Congress within 6 months of enactment
Study of enforcement actions	Commission to conduct study	Section 704 – Commission shall conduct a study of all of its enforcement actions involving violations of reporting requirements and restatements, within the previous five years, to identify areas most susceptible to fraud or manipulation	Report to Congress within 180 days of enactment

COMMISSION STUDIES – ONE YEAR OR MORE (July 30, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
Study and report on principles- based accounting	Commission to conduct study and report	Section 108(d) – Commission to conduct a study of principles-based accounting	Report to Congress within one year of enactment
Study and report on special purpose entities	Commission must conduct study and report on off-balance sheet transactions and special purpose entities	Section 401(c)(1) -- Commission to complete a study and report on off-balance sheet transactions and special purpose entities to ascertain the extent of their use and whether the accounting treatment afforded them results in transparency	Study to be completed within one year after the adoption of the off-balance sheet disclosure rules. Report and recommendations to the President and Congress based on the Commission's findings must be made within six months of the completion of the study

GAO STUDIES – 180 DAYS (January 26, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
Study of investment banks	None	Section 705 – GAO to conduct a study on whether investment banks and financial advisers assisted public company earnings manipulation, especially with regard to Enron and Global Crossing	GAO to report to Congress within 180 days of enactment

GAO STUDIES – ONE YEAR (July 30, 2003)

Matter	Obligation	Act Provision	Timetable for SEC Action
Report on potential effects of mandatory rotation of public accounting firms	None	Section 207 – GAO to report on audit firm rotation	GAO to report within one year of enactment
Study and report of consolidation of accounting firms	Commission to be consulted on study	Section 701 – GAO to report on study of consolidation of accounting firms	Report to Congress required within one year of enactment

SEC Funding

- The President is committed to ensuring that the SEC has the resources it needs to crack down on corporate wrongdoing and restore corporate accountability.
- During the summer, the President asked SEC Chairman Harvey Pitt what additional resources were necessary to get the job done. Chairman Pitt informed the President that he needed supplemental funding to hire an additional 100 personnel immediately. Chairman Pitt also requested an additional \$100 million on top of the President's original '03 budget to aggressively fulfill the SEC's mission.
- The President delivered. The President asked for a supplemental appropriation for the SEC and amended his 2003 budget request to reflect Chairman Pitt's request. We stand by our commitment to ensure that the SEC has the fund necessary to get tough on corporate crime and increase corporate responsibility.
- If approved by Congress, the President's request would raise the SEC's funding for FY 03 to \$567 million (this represents more than a 25 percent increase over FY02 levels).
- In addition, Chairman Pitt has said that, at his request, McKinsey and Co. is conducting a comprehensive study to review the efficiency and needs of the Commission, which is expected to be completed soon. If, at that time, Chairman Pitt determines that additional resources are necessary to conduct the SEC's business, the White House will review that request.
- Congress has failed to pass all but two of the appropriations bills for 2003. The President is hopeful that when the Congress returns for the Lame Duck session that it will quickly and responsibly pass his budget requests so that all agencies, including the SEC, can operate at the funding levels necessary to fully execute their missions.

Withdrawal Marker

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FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
Report	SROs and Corporate Governance	2	11/01/2002	P5;

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COLLECTION:

Council of Economic Advisers

SERIES:

Kroszner, Randall (Randy) - Subject Files

FOLDER TITLE:

Corporate Governance Briefing Book: Summer/Fall 2002 [1]

FRC ID:

5789

OA Num.:

2841

NARA Num.:

2740

FOIA IDs and Segments:

2014-0373-F

RESTRICTION CODES**Presidential Records Act - [44 U.S.C. 2204(a)]**

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P3 Release would violate a Federal statute [(a)(3) of the PRA]
- P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [(a)(5) of the PRA]
- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

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- A. Closed by Executive Order 13526 governing access to national security information.
- B. Closed by statute or by the agency which originated the document.
- C. Closed in accordance with restrictions contained in donor's deed of gift.

Freedom of Information Act - [5 U.S.C. 552(b)]

- b(1) National security classified information [(b)(1) of the FOIA]
- b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
- b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Records Not Subject to FOIA

Court Sealed - The document is withheld under a court seal and is not subject to the Freedom of Information Act.

Summary of NYSE Proposals Made August 1, 2002 and submitted to SEC on August 16, 2002.

PROPOSAL RECOMMENDATIONS	CURRENT RULES	IMPLEMENTATION TIMETABLE
Require corporate boards to have a majority of independent directors. Companies with a controlling shareholder are exempt.	Audit committee must be composed of at least three independent directors.	Within 24 months of the date that the standard is approved by SEC (except majority owned).
Require listed companies to have audit, compensation and nominating committees composed entirely of independent directors. Companies with a controlling shareholder are exempt but must have a minimum three-person audit committee composed entirely of independent directors.	Require audit committee to be composed of at least three independent directors. No existing rules requiring compensation and nominating committees.	Effective within 6 months of SEC approval for audit committee; effective within 24 months of SEC approval for nominating and compensation committees.
Require non-management directors to meet at regularly scheduled executive sessions without management.	No existing requirement.	Effective within 6 months of SEC approval
For a director to be deemed independent, the board must affirmatively determine that the director has no material relationship with the listed company.	Existing definition precludes any relationship with the company that may interfere with the exercise of director's independence from management and the company.	Effective upon SEC approval.
Former employees of the company or the independent auditor of the company—and their family members—may not be considered independent until five years after their employment ends.	Three-year "cooling-off" period for former employees and business relationships.	Effective upon SEC approval.
Director's compensation must be the sole remuneration from the listed company for audit-committee members.	No existing restrictions.	Effective within 6 months of SEC approval
Require listed companies to have an internal audit function.	No existing requirement.	Effective within 6 months of SEC approval
Require shareholder approval of all stock-option plans, except employment-inducement options, option plans acquired through mergers, and tax-qualified plans such as 401(k)s.	Require shareholder approval of equity-compensation plans for directors and officers, but broad-based plans and one-time employment inducements are exempt.	Effective upon SEC approval.
Require companies to adopt and disclose governance guidelines, codes of business conduct, and charters for their audit, compensation and nominating committees.	Require board to adopt and approve a written charter for the audit committee, which must be reviewed annually. No existing rules requiring compensation and nominating committees, governance guidelines, or codes of business conduct.	Effective within 6 months of SEC approval
Require foreign private issuers to disclose significant ways in which their governance practices differ from NYSE rules. A brief, general summary of significant differences is sufficient to meet this requirement.	No existing requirement.	Effective within 6 months of SEC approval
Allow the NYSE to issue a public reprimand letter to listed companies in violation of a corporate-governance	No current provision.	Effective upon SEC approval.