



U.S. Securities and Exchange Commission

Commission Formally Proposes Framework of a Public Accountability Board

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Washington, D.C., June 20, 2002 — The Securities and Exchange Commission voted unanimously today to [propose rules](#) to reform oversight and improve accountability of auditors of public companies, thereby enhancing the reliability and integrity of the financial reporting process.

The proposed rules establish the framework for a Public Accountability Board — a system of "private sector" (but not "self") regulation that would not be under the control of the accounting profession. The structure is intended to supplement the SEC's oversight and enforcement efforts by expanding the opportunities to detect and remedy ethical lapses or deficiencies in competence, thereby complementing the Commission's enforcement efforts.

"Investor confidence is the bedrock of our markets," said SEC Chairman Harvey L. Pitt. "Ineffective oversight of public company audits damages that confidence. Our proposal will help restore investor faith by ensuring strong and effective regulation of the accounting profession. In putting forth this proposal, we begin a process that ensures real change before year's end."

The proposed rules are based on months of extensive public input, including comments received during a series of SEC-sponsored Roundtables and the SEC's first Investor Summit. Additional public input on the rule proposals is critical. [The rule will be open to comment](#) until September 3, 2002.

Key provisions of the proposed rules include:

- **Membership.** To assure that the benefits of the new regulatory regime extend to investors in all public companies, the financial statements of SEC-registered companies would not be deemed to comply with Commission requirements unless the company's outside auditors were members of a PAB. To ensure that a PAB has access to diverse, non-discretionary, funding and full information about audits, an SEC-registered company's financial statements also would not comply with Commission requirements unless the company was an adjunct member of, and thereby bound to cooperate in any review or proceeding commenced by, the same PAB as its accountants.

- **SEC Oversight.** The Commission would recognize a PAB after reviewing, and being satisfied with, among other things, the entity's proposed structure, charter, by-laws, rules, stated practices, proposed budget, proposed board members, membership requirements, systems, and procedures. The SEC would also oversee selection or termination of PAB board members, and the authority to review, alter, modify or abrogate any PAB rule or disciplinary sanction.
- **Independent PAB Board.** To ensure independence from the accounting profession, a PAB would be dominated by persons not associated with the accounting profession. This requirement likely would be met by a board with nine members - no fewer than six of whom are independent public members, and no more than three of whom are practicing or retired members of the public accounting profession. The latter members would provide needed current expertise, but possible accounting profession members would expressly not have any vote in, or say about, a PAB's determinations regarding disciplinary actions or findings about, and sanctions to be imposed on, members.
- **Independent PAB Funding.** A PAB will have a dependable, uninterrupted, non-discretionary funding source, from both its accounting firm members and public company adjunct members, to ensure that its funding is not based on discretionary payments or on funding exclusively by the accounting profession.
- **Strong Oversight by PAB.** Accounting firms, individual accountants, public companies and their management would be required and obligated to cooperate with PAB quality control reviews and disciplinary proceedings, and a PAB would determine appropriate document retention guidelines for its member firms. Failure to cooperate could result in suspension of the right to conduct public audits. A PAB's efforts would be directed at enforcing ethical and competency standards respecting accounting firms and individual accountants. A PAB would not conduct any roving investigations of public companies.
- **PAB Quality Control Reviews.** A PAB will directly perform quality control reviews of audit procedures and practices, at least annually for large firms (those that audit approximately 80% of SEC-registered U.S. public companies) and at least triennially for all other firms. Such reviews will be designed to ensure that audit firms have quality control policies and procedures regarding, among other things: (i) independence, integrity and objectivity of audits; (ii) personnel management; (iii) acceptance and continuation of audit clients; (iv) audit performance; (v) audit methodology; and (vi) consultation and resolution of differences of professional opinion during audits.

In addition to the above items, quality control reviews would address, among other things: (i) rotation of audit personnel; (ii) independent partner reviews of audits; (iii) consulting services; (iv) reporting termination of auditor engagements to the Commission; (v) assisting in audits by foreign associated firms; (vi) reporting litigation alleging

violations of the securities laws; and (vii) partners and employees of auditors joining clients.

- **PAB Disciplinary Powers.** A PAB will be responsible for conducting public disciplinary proceedings and imposing a broad range of disciplinary sanctions against its accounting firm and individual accountant members, including fines, censures, removal from client engagements, limitations on activities and suspension from auditing either specific SEC clients, or all SEC clients for a time certain, or an unlimited time. A PAB may discipline individual accountants for unethical or incompetent conduct or other violations of professional standards. A PAB may discipline accounting firms for not having quality control systems that meet the highest professional standards or for not complying with such systems in a way that provides reasonable assurance that the firm meets or exceeds professional standards in its audit, review or attest engagements.
- **Audit Standard Setting.** A PAB will have the responsibility for assuring high ethics, auditing, and quality control standards, either by setting them directly or by relying on and overseeing designated private sector bodies as authoritative sources of such standards. (A PAB will not, however, establish GAAP, which would continue to be established by the FASB, subject to revitalized and revamped SEC oversight).

Archives of the [audio and video webcasts](#) of the Open Commission Meeting are available on the SEC website.

<http://www.sec.gov/news/press/2002-91.htm>

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