FOSTERING AN INTERNATIONAL REGULATORY CONSENSUS

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More than 1,200 foreign companies file reports with the U.S. Securities and Exchange Commission and are thus affected by changes to U.S. law, including the Sarbanes-Oxley Act of 2002. To ease the path to compliance for those and other firms, U.S. regulators have been working with their foreign counterparts and the business community to remove barriers and reconcile differences in national standards and practices.

Photo above: President Bush speaks to business leaders on Wall Street outlining his agenda for coroprate reform. (*©AP/WWP Photo/Kathy Willens)*

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The Sarbanes-Oxley Act is the most comprehensive and important U.S. securities legislation affecting public companies and independent accountants since the Securities and Exchange Commission (SEC) was created in 1934. The broad reforms in the act address disclosure and financial reporting by public companies, corporate governance, and auditor oversight. But what is especially striking is the interest, concern, and debate that the act has generated outside the United States. When the SEC was created, no one could have imagined that revisions to the U.S. securities laws could have such an impact abroad. Today, the more than 1,200 foreign companies that file reports with the SEC represent nearly 10 percent of all SEC reporting companies. Some of these companies' shares are among the most actively traded on U.S. markets.

More than ever, capital markets around the world are interdependent, and changes to national laws can have repercussions outside of borders.

Rep. Michael Oxley, left, and Sen. Paul Sarbanes, co-sponsors of the United States' corporate governance overhaul, speak to reporters outside the White House. (*©AP/WWP Photo/Ron Edmonds*)

The Sarbanes-Oxley Reforms

The principal reforms contained in Sarbanes-Oxley generally can be grouped into three categories. First, the act includes important reforms aimed at improving the performance of and restoring confidence in the accounting profession. It ends self-regulation of the accounting profession where the audit of public companies' financial statements is concerned. In its place, it creates the Public Company Accounting Oversight Board, an independent private sector body that, in turn, is subject to SEC oversight.

Second, the act provides new tools to enforce the securities laws. The Securities and Exchange Commission has been using those tools to broaden the scope of its enforcement program. Over the past two fiscal years, the commission has filed more than 1,300 enforcement actions, more than 370 of which involved financial reporting and accounting frauds. We have obtained orders for penalties and repayment of ill-gotten gains totaling nearly $5 billion, and have sought to bar more than 330 executives from serving again as officers or directors of public companies.

Third, the act mandates new requirements designed to improve public companies' disclosure and financial reporting practices. The provisions concerning chief executive officer (CEO) and chief financial officer (CFO) certifications of reports containing financial statements, including the adequacy of disclosure controls and procedures, are intended to leave no doubt as to senior management's responsibilities for financial reporting. Also in this category are the provisions that are currently receiving the most attention from companies and auditors—the requirements for an annual management report on and audit of companies' internal control over financial reporting.

National Boundaries and Concerns Over Sovereignty

While Sarbanes-Oxley represents a U.S. legislative response to the financial failures of U.S. companies such as Enron and WorldCom, the financial problems that have come to light in non-U.S. companies, such as Ahold, Parmalat, Royal Dutch Shell, and Vivendi, confirm that the issues that the act was intended to address transcend national boundaries.

Today, lawmakers and regulators around the world are actively working to improve corporate governance, auditor oversight, and other aspects of the financial reporting process. There is a fast-developing international consensus on many critical goals, as illustrated in statements by the International Organization of Securities Commissions on the reporting of price sensitive information, management's discussion and analysis of financial statements, auditor independence, and auditor oversight. Many jurisdictions, including some European Union (EU) member states, are undertaking efforts to reform their auditor oversight systems, and the EU has announced Priorities for Improving the Quality of Statutory Audits in its member states. Additionally, the 2004 amendments to the Organization for Economic Cooperation and Development's Principles of Corporate Governance place increased emphasis on the role of independent directors and audit committees in the financial reporting process.

Although the SEC shares the above regulatory goals with our foreign counterparts, we have recognized from the outset that certain aspects of the Sarbanes-Oxley Act raise potential conflict of laws and sovereignty concerns for some non-U.S. regulators and market participants. The U.S. Congress was clear that the act generally should make no distinction between domestic and foreign companies. Certainly, U.S. investors transacting on U.S. markets are entitled to the same protections regardless of whether the issuer of a security is foreign or domestic.

Securities and Exchange Commission Chairman William Donaldson testifies before the Senate Banking Committee on Capitol Hill. (©AP/WWP Photo/Dennis Cook)

At the same time, the SEC recognizes that its rules applicable to non-U.S. market participants must be implemented in a reasonable and measured way that fosters cooperation and consensus building. One of the greatest challenges that the commission has faced in implementing Sarbanes-Oxley is to fulfill our congressional mandate while respecting potential conflicts with foreign laws and regulations. Our willingness to address foreign concerns is a testament to the importance that we place on open dialogue and to the strong relationships we have with our non-U.S. counterparts.

Accommodating Non-U.S. Firms

Among the most important of the Sarbanes-Oxley reforms are those that address the role of the audit committee of the board of directors in overseeing accounting, auditing, and financial reporting. The SEC's approach toward implementation of the audit committee requirement for listed companies is an example of our efforts to address potential conflicts and to accommodate different, non-U.S. regulatory requirements.

The act required the commission to adopt a rule directing the national securities exchanges and the National Association of Securities Dealers to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements mandated by the act. All members of the audit committees of listed companies must be independent directors, and audit committees must be directly responsible for the appointment, compensation, and oversight of the issuer's independent accountants.

Based on a consideration of potentially conflicting non-U.S. legal requirements raised by foreign commenters, the SEC's rule includes certain accommodations for foreign private issuers that take into account foreign corporate governance schemes, while preserving the intention of the act to ensure that those responsible for overseeing a company's outside auditors are independent of management. These accommodations:

- allow nonmanagement employees to serve as audit committee members, consistent with some countries' requirements for employee representation on the board of directors;
- allow shareholders to select or ratify the selection of auditors, also consistent with requirements in many countries;
- allow alternative structures, such as statutory auditors or boards of auditors, to perform auditor oversight functions where they are authorized by home country requirements, they are not elected by management of the issuer, and no executive officer of the issuer is a member;
- allow for foreign government representation and controlling shareholder nonvoting representation on audit committees, provided the representatives are not members of management.

Some observers do not believe that the Securities and Exchange Commission has gone far enough in accommodating non-U.S. market participants, and they have called for exemptions based on principles of mutual recognition. Of course, we respect those views, but we believe that the SEC, as well as any other national regulator, has the sovereign right to determine the terms and conditions under which companies and their representatives may access investors in its jurisdiction. The real challenge is to do so in a reasonable manner and on an equitable basis that fosters international acceptance.

Challenges Facing Foreign Firms

Though the Sarbanes-Oxley Act does not provide an exemption for foreign private issuers, the SEC will continue to be sensitive to the need to accommodate unique foreign structures and requirements. Many non-U.S. companies and their auditors are currently working hard and are well on their way to completing the processes necessary to report on internal controls. We recognize that the internal control disclosure provisions of the act are the most difficult and expensive to implement. However, of all the reforms contained in the act, getting these processes right may have the greatest long-term impact on improving the accuracy and reliability of financial reporting. But for non-U.S. companies, in some cases, these reforms require significant rethinking of the control environment. This is one of the reasons that the commission extended the compliance date for non-U.S. companies to fiscal years ending on or after July 15, 2005.

Subsequently, the commission has taken steps to provide additional time for certain U.S. companies with less than $700 million of unaffiliated market capitalization to comply, and we intend to be sensible in addressing the requirements for non-U.S. issuers as well. Perhaps most important, many companies abroad, especially in Europe, face additional challenges in the near term that go above and beyond those faced by U.S. companies as they adopt international financial reporting standards for the first time in 2005. To address these burdens, the commission has proposed amendments to our reporting requirements that would facilitate foreign private issuers' conversion to International Financial Reporting Standards (IFRS). We will continue to monitor progress in these areas. We are prepared to reach out and engage in an open dialogue to address concerns regarding both internal controls and IFRS implementation.

EXPANDING THE SHAREHOLDER SOCIETY

Our regulation of U.S. markets and our foreign counterparts' regulation of their markets is part and parcel of a broader issue: the movement of millions of people throughout the world into what has been called "the shareholder society." Today, more than 13 million households in India are directly invested in debt or equity shares. There are believed to be approximately 60 million active equity investors in China. Share ownership creates new opportunities to accumulate savings and wealth and to put capital to use in entrepreneurial ventures that are the lifeblood of growing economies.

The fundamental issue for everyone involved in financial markets, regardless of company or country, must be to maintain high standards that foster trust and confidence. Investors can—and do—move capital around the globe with a few keystrokes on a computer. Capital will flee environments that are unstable or unpredictable—whether that's a function of lax corporate governance, ineffective accounting standards, or a lack of transparency. Investors must be able to see for themselves that companies are living up to their obligations and embracing the spirit of all securities and governance requirements.

One of the highest priorities for the United States and for the SEC is helping to foster the growth of capital markets and the multiple benefits that flow from dynamic markets and enlightened corporate governance. These benefits help to reduce the cost of capital and provide a more stable platform for long-term economic growth. These conditions, in turn, spark prosperity and create opportunities for investors to achieve higher returns. Only with the widespread acceptance of these values will our capital markets maintain their rightful place as an engine of prosperity in the United States and throughout the world. ■