

MEMO# 14106

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SEC REPORT OF INVESTIGATION AND STATEMENT ON THE RELATIONSHIP OF CORPORATE COOPERATION TO AGENCY ENFORCEMENT DECISIONS

[14106] November 2, 2001 TO: ACCOUNTING/TREASURERS MEMBERS No. 30-01 COMPLIANCE ADVISORY COMMITTEE No. 53-01 INTERNAL AUDIT ADVISORY COMMITTEE No. 8-01 SEC RULES MEMBERS No. 72-01 RE: SEC REPORT OF INVESTIGATION AND STATEMENT ON THE RELATIONSHIP OF CORPORATE COOPERATION TO AGENCY ENFORCEMENT DECISIONS The Securities and Exchange Commission has issued a Report of Investigation and Statement explaining its decision not to take enforcement action against a company it had investigated for financial statement irregularities. In so doing, the Commission articulated a framework for evaluating cooperation in determining whether and how to charge violations of the federal securities laws.¹ The Commission's report is available from the SEC's website at <http://www.sec.gov/news/headlines/prosdiscretion.htm>. and it is summarized below. The Report discusses an administrative proceeding the Commission settled with a former controller of a public company's subsidiary.² In its order, the Commission found that the controller engaged in certain accounting irregularities that caused the parent company's books and records to be inaccurate and its periodic reports misstated.³ The Commission determined, however, not to take action against the parent company. Their decision was based on a series of steps the company took once it learned of the accounting irregularities. First, the company's internal auditors conducted a review of the situation and reported promptly to management, who, in turn, advised the Board's audit committee. Second, the controller and two of her supervisors were subsequently dismissed. Third, the company disclosed publicly and to the Commission that its financial statements would be restated. Fourth, the company pledged and gave complete cooperation to Commission staff, providing them with all relevant

1 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, SEC Release No. 34-44969 (Oct. 23, 2001), and Accounting and Auditing Enforcement Release No. 1470 (Oct. 23, 2001)(the "Report"). 2 In re Gisela de Leon-Meredith, SEC Release No. 34-44970, Accounting and Auditing Enforcement Release No. 1471 (Oct. 23, 2001). 3 Specifically, the Commission found that the controller materially misstated, over a five-year period, certain line items in the company's financial statements and failed to disclose such errors to her supervisors and to the parent company. Such irregularities resulted in the parent company's failure to comply with generally accepted accounting principles and satisfy its books and records requirements imposed under the federal securities laws. 2 information as to the underlying violations. Finally, the company strengthened its financial

reporting processes to address the controller's conduct. The Report explains that the Commission's decision to credit the parent company's behavior and not take enforcement action in this situation, as well as generally, benefits both investors and the Commission's enforcement program, as it avoids large expenditures of government and shareholder resources. The Report adds that any Commission decision to credit a company's behavior and not bring an enforcement action would be based on four broad measures of a company's cooperation. -- Self-policing prior to the discovery of the misconduct - including establishing effective compliance procedures and an appropriate tone at the top. -- Self-reporting of misconduct when it is discovered - including conducting a thorough review of the nature, extent, origins and consequences of the misconduct, and promptly, completely, and effectively disclosing the misconduct to the public, to regulators, and to self-regulators. -- Remediation - including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected. -- Cooperation with law enforcement authorities - including providing the Commission staff with all information relevant to the underlying violations and the company's remedial efforts. The Report sets forth in greater detail certain criteria the Commission will consider in determining whether, and how much, to credit these measures. This includes, among other things, the nature, location, and duration of the misconduct, the level of harm inflicted upon investors and other corporate constituents, and the reaction of the company upon learning of the misconduct, including any steps it took to remedy the situation. The Report adds that credit for cooperative behavior may range from the extraordinary step of taking no enforcement action at all to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents the Commission uses to announce and resolve enforcement actions. The Report also contains several important caveats that should be considered. First, it notes that there may be circumstances where conduct is so egregious, and harm so great, that no amount of cooperation or other mitigating conduct can justify a decision not to bring any enforcement action at all. Second, the Commission makes clear that it is not adopting any rule or making any commitment or promise about any specific case; it seeks only to convey an understanding of the factors that may influence its decisions. Finally, the Commission is not limiting itself to the above-stated criteria. The fact that a company satisfies all the criteria listed will not foreclose the Commission from bringing enforcement proceedings that it believes are necessary or appropriate, for the benefit of investors. Barry E. Simmons Associate Counsel