

MEMO# 3097

September 16, 1991

"FINANCIAL FRAUD DETECTION AND DISCLOSURE ACT"; ACCOUNTING PROVISIONS IN HOUSE ENERGY AND COMMERCE COMMITTEE FINANCIAL SERVICES RESTRUCTURING BILL

September 16, 1991 TO: SEC RULES COMMITTEE NO. 56-91 RE: "FINANCIAL FRAUD DETECTION AND DISCLOSURE ACT"; ACCOUNTING PROVISIONS IN HOUSE ENERGY AND COMMERCE COMMITTEE FINANCIAL SERVICES RESTRUCTURING BILL

On August 1, 1991, Congressmen Wyden and Markey introduced H.R. 3159, the "Financial Fraud Detection and Disclosure Act". The provisions of this bill are described below. A copy of the bill is attached. The first section of H.R. 3159 specifies certain procedures that an independent public accountant would be required to follow in performing an annual audit of an issuer covered by the legislation. These would include (1) procedures designed to detect illegal acts and identify related party transactions that are material to the financial statements and (2) an evaluation of whether there is substantial doubt about an issuer's ability to continue as a going concern. The bill provides that these procedures are to be included in an audit "in accordance with methods prescribed by the [Securities and Exchange] Commission." The next section of H.R. 3159 concerns the responsibilities of an independent accountant, who becomes aware that an illegal act has occurred, to (1) determine the possible effect of the illegal act on the issuer's financial statements and (2) promptly inform the issuer's management and audit committee (or board in the absence of an audit committee) of the illegal act. As with the audit requirements described above, these actions are to be taken "in accordance with methods prescribed by the Commission." The next section of the bill authorizes the Commission to require reports from public accountants under certain circumstances, "upon reasonable belief that material illegal acts may have been or are being committed by a registrant or employees of a registrant." This provision specifies that the registrant must pay the expense of providing any such report. The following section of H.R. 3159 directs the SEC to furnish to Congress, within six months of enactment of the legislation, a study evaluating (1) the extent of compliance with the requirements described above regarding disclosure of illegal acts and (2) the extent to which a requirement for annual reports by management and a registrant's independent public accountant on the adequacy of the registrant's internal control structure would improve such compliance and the reliability of the registrant's financial statements. Finally, the bill provides that, with respect to fiscal years beginning before January 1, 1996, an independent public accountant shall not be liable to any person for findings, conclusions, reports and statements made in

good faith in complying with the requirements of the bill regarding detection and disclosure of illegal acts. * * * * Provisions similar to those described above are included in the House Energy and Commerce Committee's substitute for H.R. 6 (the House Banking Committee's financial services restructuring bill) and are also attached. However, there are certain significant differences. Most notably, the Energy and Commerce provisions contain a section limiting their applicability to insured depository institutions or affiliates of insured depository institutions only. In addition, the Energy and Commerce legislation does not contain (1) the section of H.R. 3159 described above permitting the SEC to require reports from auditors upon reasonable belief that material illegal acts may have been committed, (2) the provision for an SEC study on internal control structures or (3) the section limiting the liability of an independent public accountant for findings, conclusions, reports or statements made in good faith in connection with complying with the legislation. If you have any comments or concerns about the potential impact of H.R. 3159 or the accounting provisions in the Energy and Commerce Committee's substitute for H.R. 6 on your firm, please contact the undersigned at 202/955-3514 or in my absence Craig Tyle at 202/955-3522. Frances M. Stadler Assistant General Counsel Attachment

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