



Consumer Federation of America



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August 9, 2002

Harvey L. Pitt  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Chairman Pitt:

When Congress passed the Sarbanes-Oxley bill, it entrusted key decisions that will determine the legislation's effectiveness to you and your fellow commissioners at the SEC. None is more important than the responsibility for naming members to the new auditor oversight board. Who is selected will determine whether this new board emerges as a rigorous and independent regulator committed to raising the quality of audits of public companies or as a protector of the status quo. Nothing less than the public's ability to trust in the accuracy of corporate disclosures hangs in the balance.

The first oversight board will be more important than any of its successors, because it will be responsible for creating the overall structure upon which the board will be built, putting together a strong team of employees to carry its mission forward, defining the agenda for raising the quality of audits of public companies, and setting up the inspection and enforcement programs that are essential to effective deterrence. Because of the central role the auditor oversight board will play in improving the quality of corporate disclosures, getting the board off to a strong start is key to restoring investor confidence. A board made up of outspoken advocates for reform -- individuals who are unlikely to back down in the face of any political pressure the accounting firms are able to exert -- is essential to that process.

By opening up the process of recommending board candidates, you have taken an important first step toward assuring public confidence in the outcome. Industry groups' access to decision-makers has often allowed them to play a role in suggesting (or vetoing) candidates for key positions that members of the public have largely been denied. While we recognize that the selection process is not, and should not be, a popular election, we also believe that public trust in the board is essential to restoring investor confidence. The approach you have adopted should help to provide an initial barometer for measuring which candidates will be viewed by the investing public as representing their interests and be trusted as true proponents of reform. These are important factors that must be taken into account in any final selections.

While some of our organizations may write again later to suggest specific candidates for the board, the purpose of this letter is to define the principles that we believe should guide your selections. The legislation lays down some general guidelines in this regard, which are reflected in your request for recommendations and which provide a good starting point for this discussion. Specifically, the new law states that board members must be:

**1) Prominent Individuals of Integrity and Reputation**

As a key to inspiring public trust in the board, the new law specifies that board members are to be selected from among prominent individuals with a reputation for integrity. This provision should not be viewed as requiring that all board members be household names, or even that they be well recognized by the investing public. The key is not how well known they are, but for what they are known. Thus, appropriate candidates will be those who have achieved a level of recognition within the regulatory and investor advocacy communities and who are respected within those communities as knowledgeable individuals of utmost probity and as strong, determined advocates for reform.

**2) Individuals with a Demonstrated Commitment to the Interests of Investors and the Public**

It is the clear intention of Congress that the new auditor oversight board not become a mouthpiece for the accounting profession it is supposed to regulate. One way the drafters of the legislation have attempted to prevent that outcome is through the requirement that board members have a meaningful record as advocates for investors and the public interest. It is important to note that this requirement applies not just to "public" members, but also to those members of the board who are current or past accountants. In other words, the requirement that two members of the board be accountants is most definitely not a requirement that two board members serve as *representatives* of the accounting profession. Instead, this provision is designed to ensure both that accounting expertise is represented on the board, and that this expertise is wedded to a pro-investor, public-interest outlook. Put another way, the legislation is written to ensure that all board members, whether accountants or not, will be independent "public" members in the truest sense of the word. The Commission should make a special effort to seek out accountant members of the board who will not be viewed as mouthpieces for the profession but who instead have a strong record of public service and a commitment to reform.

**3) Individuals with a Demonstrated Understanding of the Responsibilities for and Nature of the Financial Disclosures Required of Issuers under the Securities Laws and the Obligations of Accountants with Respect to the Preparation and Issuance of Audit Reports with Respect to such Disclosures.**

For the board to be effective, board members also must have an in-depth understanding of the role of corporate disclosures in ensuring the integrity of the financial markets and the role of auditors in ensuring the integrity of corporate disclosures. In other words, board members' commitment to the public interest must be informed by knowledge of the issues that the board will be called on to address. This requirement should not be viewed as requiring, for example, that all board members come to the position with a detailed knowledge of current audit standards. In fact, too much immersion in or identification with the current system of regulation could serve as an impediment to examining issues with the fresh viewpoint that is a prerequisite to upgrading the quality of audits and auditor oversight. Rather, this requirement should be relied on to ensure that all board members have both the framework of financial expertise necessary to knowledgeably evaluate issues that come before the board and the commitment to raising the quality of public audits that will make the new board a success.

**4) Other Considerations**

If the Commission faithfully applies these three principles for selecting board members, it will go a long way toward appointing a board with independence, expertise, and credibility. However, the current crisis in investor confidence demands that the Commission go beyond the minimal requirements of law in several areas to ensure that board members are of the highest caliber.

A Cooling-Off Period for Board Members

The new law would allow an accountant fresh from a major accounting firm to serve on the oversight board, so long as that individual was not named as chairman of the board. To enhance public trust in the independence of the board, we urge the Commission to apply to all accountant board members the sort of cooling-off period that the new law requires only for an accountant who serves as chairman. While it may not be necessary to restrict board candidates to those who have been out of the profession for a full five years, some significant time away from the profession -- at least two or three years -- would be beneficial. Such a cooling-off period, in addition to enhancing the perception of independence, would offer an excellent opportunity for accountants to demonstrate the public interest and investor protection commitment that the new law imposes on board members.

Public Members Who Are Independent of the Accounting Industry

The new law places no further restrictions on who can serve in the three non-accountant slots on the board, other than that they not be past or current accountants. In order for these members to have legitimacy with the investing public, we urge you to eliminate from consideration individuals who have had significant past association with the accounting

profession, either as a non-accountant employee of an accounting firm, as a non-accountant employee of the professional association, or as a consultant, attorney or lobbyist to an audit firm or professional association, for example. It is essential that the board not appear to be stacked with accounting industry insiders. While there may be individuals with such a background who would be technically qualified to serve on the board, their presence would create a serious credibility problem. If these board members have had a past association with the accounting industry, it should represent a relatively minor portion of their overall career. Furthermore, where such an association exists, the candidate in question must have unquestioned credentials as someone committed to raising standards and reforming the industry.

#### A Chairman Who Inspires Public Confidence

The new law also would permit an accountant to serve as chairman of the board. While there undoubtedly are accountants who would qualify for the position of board chairman, we believe public confidence in the board would be enhanced if the chairman were a non-accountant. We supported your inclusion of this requirement in the SEC's proposal for a new oversight board. We urge you to adopt this restriction voluntarily in naming the new board chairman. Furthermore, to get the board off to the best possible start, we urge you to seek out and if possible appoint a chairman with the prominent public profile that will provide real credibility to the board. Finally, the chairman should be someone who has been an outspoken champion of the strongest possible oversight board. In short, all the characteristics that are important for board members should be most conspicuously displayed by the board chairman.

#### **5) Conclusion**

The series of congressional hearings that laid the foundation for passage of this legislation, and the public debate that has accompanied its congressional consideration, have brought to light a number of prominent, public-spirited, financially expert individuals whose recommendations have formed the basis for the board's creation. These individuals, who outlined a vision of what an effective, independent regulator might look like, should be at the top of any list of board candidates. Their high profile advocacy for reform gives them credibility with the public, and their expertise gives them an understanding of what needs to be done.

Some members of the accounting profession have reportedly singled out three such individuals -- Charles Bowsher, Arthur Levitt, and Lynn Turner -- as unacceptable candidates for the board. It would seem that the very qualities that make these three such strong candidates -- a record of ardent advocacy on behalf of raising industry standards and a refusal to back down in the face of industry pressure -- have earned them the industry's opposition. This offers a clear demonstration of why the industry must not be allowed to exercise veto power over board appointments. The purpose of the board is to shake things up, raise standards, and force reform. If it is to achieve this goal, and have credibility with the public, the best candidates will be those very individuals who are feared by the accounting industry because they will not settle for incremental change or for the appearance of reform instead of the real thing.

By soliciting suggestions for board members, you have encouraged public involvement in the process and trust in its outcome. We encourage you to continue in this vein by conducting the selection process in as open a manner as possible. This should include releasing all letters received by the Commission on the subject, consistent with Commission policy on publishing comment letters on rule proposals, as well as providing summaries of meetings and other less formal communications from interested parties. Such an approach would go a long way toward assuring the investing public that the accounting profession was not being allowed to exert undue influence over the selection process. As the congressional debate on this legislation made clear, opponents of reform are far less willing to pursue in public the same ends that they aggressively promote behind closed doors.

Once again, we commend you for getting this process off to a good start. We look forward to working with you to put together the strongest possible board. Thank you for taking the time to consider our views. Please feel free to contact any of us if we can be of further assistance or if you have any questions about our position.

Respectfully submitted,

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