

Recommendations to Other Institutions

Reforms implemented by the NYSE alone will not be enough to repair the damage done to investor confidence by recent instances of illegal and unethical behavior. As a step toward coordinating our efforts with those of other institutions, we believe that the NYSE Board of Directors should make the following recommendations.

- 1. The SEC should require public accountants to be regulated by a new private-sector organization governed and funded independently of the accounting industry.**

The SEC has proposed (as have several bills in Congress) a system of “private sector” regulation to oversee the quality of the audits of public companies. This private, independent body would review the quality controls of accounting firms and discipline auditors for incompetent or unethical conduct. The SEC would oversee the organization’s membership, rules and activities to ensure that it is independent of the accounting industry. We support the creation of this new organization.

- 2. The SEC should require CEOs to certify to shareholders that, to their best knowledge and belief, their companies’ financial statements and disclosures fairly present the information that reasonable investors should have to make informed investment decisions.**

We agree with the President and the SEC that it is unacceptable for the CEO of a company to disclaim responsibility for company disclosures. To avoid potentially pernicious private litigation based on this certification, the SEC should have exclusive authority to enforce the requirement of a CEO certification.

- 3. The SEC should require companies, in all public or shareholder communications, to report complete GAAP-based financial information before any reference to “pro forma” or “adjusted” financial information. Any pro forma information should be reconciled to the GAAP information.**

Companies increasingly (and in a non-uniform way) use “pro forma” or “adjusted” financial information in their press releases and other public statements. While such information can give investors important operating information, this non-uniform, “adjusted”

information can be presented in such a way that makes it difficult for investors to evaluate the company's performance. The SEC should require each company to report its GAAP-based financial information before any pro forma information, and more prominently than the latter information, in all its public releases. Companies should also be required clearly and concisely to reconcile pro forma information to GAAP results, so that investors can see and understand the effects of "adjusting" the information.

4. The SEC should prohibit relationships between independent auditors and audit clients that may impair the effectiveness of audits.

There is a careful balance to be struck between an auditor's familiarity with its client, which will help the auditor do its job, and unhealthy entanglements, which may interfere with a fair and objective audit. The SEC should pursue its review of its basic guidelines for permitted and prohibited relationships between auditors and audit clients.

5. The SEC should exercise more active oversight of the FASB to improve the quality of GAAP and the speed of FASB actions.

In general, the SEC looks to the FASB, of which it has oversight, to establish and improve accounting principles. Unfortunately, the FASB's process for reviewing and setting new standards has, at times, been impeded by a desire to address the particular issues of too many constituencies. This has resulted in an often slow standard-setting process that produces overly specific and complex accounting standards. This process is often lengthy, inefficient and overly political. The SEC should focus on improving the overall quality of GAAP (to reduce "check the box" accounting) and on ensuring that the FASB promptly responds to investor needs.

6. The SEC should improve Management's Discussion and Analysis (MD&A) disclosure.

The SEC has proposed rules requiring companies to discuss, in the MD&A section of annual reports, registration statements and proxy and information statements, accounting estimates resulting from the application of critical accounting policies and the initial adoption of

accounting policies that have a material impact on the company's financial presentation. Companies would also be required to disclose in the MD&A in their quarterly reports any new critical accounting estimates or material changes to the prior disclosure. We support the SEC's proposal requiring clear and understandable disclosure of the critical accounting alternatives and assumptions that shape the bottom line.

7. The SEC should require prompt disclosure of insider transactions.

President Bush has stated that companies should be required to disclose the purchase and sale of company stock by officers and directors within two business days, and the SEC has proposed a rule requiring companies to promptly disclose insider transactions. Currently, corporate leaders can delay for as long as a year or more disclosing personal transactions with the company, and as long as 40 days for open-market transactions. We support the SEC's proposal; accelerating disclosure will discourage the potential for abusive trades, encourage fair dealing by insiders and provide important information to shareholders. We further recommend that the SEC consider requiring companies to promptly disclose loans or similar accommodations made to officers and directors, as well as the forgiveness of such loans.

8. The SEC should evaluate the impact of Regulation F-D on corporate behavior and the capital markets in general, including potentially unintended pressures to provide regular public earnings guidance.

Although the disclosure of regular earnings guidance adds, near-term, to the store of available investor information, this practice may work against the ultimate goal of full and fair disclosure by creating pressure on management to "manage" reported earnings in order to meet or exceed market expectations formed as the result of such "expected earnings" previews. The SEC should evaluate the effects of Regulation F-D on the provision of earnings guidance and consider whether reforms are warranted.

9. Congress should allocate additional resources to the SEC as necessary to enable it to increase its monitoring and enforcement activities.

Additional funding is necessary to enable the SEC to fulfill its watchdog role, and we encourage Congress to provide increased resources to the SEC. In particular, we strongly encourage funding “pay parity.” At this critical time for the nation’s financial markets, the SEC must be able to attract good people and retain its most experienced, talented, valuable and productive employees. The only way it can do that is to provide staff with pay at levels comparable to those at the other federal financial regulatory agencies.

10. Congress should give the SEC the authority to bar officers and directors of public companies from holding these positions after they have failed to fulfill their responsibilities.

Once an officer or director of a public company has failed the public trust, he or she should not have the opportunity to do so again. Congress should give the SEC the authority to bar officers and directors who violate their duties to shareholders through an administrative process rather than going through the lengthy judicial process that is currently required.

11. Congress should create a public/private panel to review stock concentration in 401(k) plans.

Some in Congress and elsewhere have proposed addressing diversification of stock holdings in 401(k) plans. To ensure that investors receive proper protection, we support the creation of a public/private panel, appointed at the highest levels of national government, to review concentration in 401(k) plans.²¹

²¹ This proposed panel should be as comprehensive as the “Greenspan Social Security Commission,” formed in December 1981, with five members appointed by the President, five by the Senate Majority Leader (in consultation with the Minority Leader) and five by the Speaker of the House (in consultation with the Minority Leader). The Greenspan Social Security Commission presented its report “The National Commission on Social Security Reform” in January 1983.