CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 27, 2002

Public Company Accounting Reform and Investor Protection Act of 2002

As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 18, 2002

SUMMARY

The bill would establish two new organizations—the Public Company Accounting Oversight Board (Oversight Board) to regulate the accounting industry and the Standard-Setting Body to write national standards for accounting practices. The activities of these organizations would be overseen by the Securities and Exchange Commission (SEC). In addition, the bill would authorize the appropriation of $776 million in 2003 for the SEC's activities. Under the bill, both the SEC and the Oversight Board could assess civil penalties for violations of the bill's provisions. Any civil penalties collected by the Oversight Board would be spent on a scholarship program for accounting students. The bill also would require the General Accounting Office (GAO) to complete two studies of the accounting industry within one year of enactment.

Based on information from the SEC, CBO estimates that implementing this bill would cost about $787 million over the 2003-2007 period, assuming the appropriation of the necessary amounts. Under current law, the SEC's discretionary costs are offset by fees the agency collects from securities markets. Enactment of the bill would not change the amount of fees expected to be collected in the future. Assuming the continued collection of the regulatory fees assessed by the SEC, the commission would collect $1.3 billion in fees in 2003, and its net outlays would be -$621 million in that year. The two GAO studies also would cost an estimated $1 million in 2003, subject to the availability of appropriated funds. CBO estimates that the bill would have effects on revenues and direct spending, but that the net effect of those changes would be negligible each year. Because the bill would affect revenues and direct spending, pay-as-you-go procedures would apply.

The bill contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that complying with that mandate would result in no costs to state, local, or tribal governments. Therefore, the threshold established by UMRA ($58 million in 2002, adjusted annually for inflation) would not be exceeded.

The bill would impose several private-sector mandates, as defined by UMRA, on certain accounting firms, companies that issue registered securities, officers and directors of those companies, investment banking firms, and securities analysts. CBO cannot determine whether the direct cost of those mandates would exceed the annual threshold set by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation). The mandate costs are difficult to estimate because (1) we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted; (2) the cost to comply with several of the mandates would depend on rules soon to be prescribed by the SEC under current authority; and (3) the cost to comply with several of the mandates would depend on rules that would be prescribed by the SEC under the bill.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the bill is shown in the following table. The costs of this legislation would fall within budget functions 370 (commerce and housing credit—for the SEC) and 800 (general government—for GAO).

	By Fiscal Year, in Millions of Dollars					
	2002	2003	2004	2005	2006	2007
SEC SPENDING—SUBJECT TO APPROPRIATION [a]						
Gross SEC Spending Under Current Law						
Budget Authority	409	0	0	0	0	0
Estimated Outlays	408	90	0	0	0	0
Proposed Changes						
Authorization Level	0	776	5	5	5	5
Estimated Outlays	0	592	180	5	5	5
Gross SEC Spending Under the Bill						
Authorization Level	409	776	5	5	5	5
Estimated Outlays	408	682	180	5	5	5
CHANGES IN GAO SPENDING—SUBJECT TO APPROPRIATION						
Estimated Authorization Level	0	1	0	0	0	0
Estimated Outlays	0	1	0	0	0	0
Memorandum:						
Estimated SEC Offsetting Collections [b]	-1,135	-1,303	n.a.	n.a.	n.a.	n.a.

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NOTE: n.a. - not applicable.

a. Enactment of this legislation also would affect direct spending and revenues, but CBO estimates that the net amount of the effects would be negligible for each year.

b. The SEC collects fees to the extent provided in advance in appropriation acts. The amount of fees collected is not dependent on the amount appropriated. (The authority to collect such fees in 2002 has been triggered by the 2002 appropriation, but there is no appropriation yet for 2003 or future years.)

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted by the end of fiscal year 2002. Assuming appropriation of the necessary funds, CBO estimates that implementing the bill would cost the SEC about $787 million and GAO about $1 million during the 2003-2007 period. We estimate that the bill also would affect both revenues and direct spending, but that the net impact of those effects would be negligible for each year.

The SEC is typically funded through fees the agency collects for registrations, transactions, and mergers of securities. Under current law, the fee rates are determined periodically by the SEC, and they are collected only to the extent provided in advance in appropriations acts. These fees are classified in the budget as offsets to the SEC's discretionary spending.

Spending Subject to Appropriation

The bill would authorize the appropriation of $776 million for all SEC activities in 2003. Of this amount, the bill would earmark $103 million for higher salaries for SEC employees, $108 million for security and information technology enhancements needed by the agency after the September 11th attacks, and $98 million for additional staff to monitor audit services. Based on the agency's historical spending patterns, CBO estimates that implementing this provision would result in gross outlays of about $592 million in 2003 and $768 million over the 2003-2004 period, assuming the appropriation of the necessary amounts. Adding these amounts to CBO's projections for fee collections in 2003, we estimate that the SEC's net spending would be -$621 million in that year.

The bill also would require the SEC to review any sanctions or rules proposed by the Oversight Board. CBO expects that the cost of these activities would be roughly comparable to the SEC's oversight of national securities exchanges and associations. Based on information from the SEC about the cost of such oversight, CBO estimates that the SEC would require about 40 staff members, at a cost of about $5 million a year, to review the rules and sanctions proposed by the new Oversight Board. Any amounts the SEC would spend to oversee accounting practices under the bill would be subject to the availability of appropriated funds.

Under the bill, GAO would complete two reports to the Congress on the accounting industry within one year of enactment. Based on information from GAO, CBO estimates that conducting these two studies would cost the agency about $1 million in 2003, subject to the availability of appropriated funds.

Revenues and Direct Spending

CBO estimates that implementing this bill also would affect direct spending and revenues. The effects would result from the bill's provisions creating an Oversight Board and a Standard-Setting Body to oversee the accounting industry and from provisions relating to civil penalties.

Costs of Creating the Oversight Board and Standard-Setting Body. The bill would require that annual financial reports filed by public companies under the securities laws must be audited by an accountant who is deemed qualified to do so by a new organization called the Public Company Accounting Oversight Board. CBO expects this provision would give the Oversight Board substantial authority to regulate and control entry into the accounting industry, thus exercising the sovereign power of the federal government. The fact that the board's rules, sanctions, funding sources, and annual budget would be approved by the SEC indicate a significant level of federal control over the board's operations and funding. For these reasons, CBO would consider the board's spending and the fees it would collect under the bill from public companies and accounting firms as part of the federal budget (even though the bill states it would not be part of the government).

The bill also would require the SEC to designate an organization called the Standard-Setting Body to write national standards for accounting practices. Under current law, all annual financial statements filed by public companies must comply with such standards. The bill also would mandate that the Standard-Setting Body assess fees on public companies using a formula that would be approved by the SEC, thereby giving the federal government control over the Standard-Setting Body's funding. Therefore, CBO also would consider this body's collections and spending a part of the federal budget (even though the bill states it would be organized as a private entity).

CBO expects that operating the Oversight Board, when fully implemented, would cost at least as much as similar activities that are now performed by the Public Oversight Board (POB) and the Independence Standards Board, and through peer reviews administered by the American Institute of Certified Public Accountants (AICPA). Before they recently disbanded, the POB and the Independence Standards Board spent about $8 million a year. The peer reviews administered by AICPA are conducted by other accounting firms. Based on information from AICPA, CBO estimates that these reviews could cost the Oversight Board at least $50 million a year. Similarly, CBO expects that the annual costs of the Standard-Setting Board would approach the $20 million spent each year by the Federal Accounting Standards Board (FASB), which performs standard-setting duties today.

Under the bill, the Oversight Board and the Standard-Setting Body would assess fees on the public to cover their costs. CBO expects that the net effect of the two organizations' collections and spending under this bill would not be significant in any year. Whether such collections would be categorized in the budget as revenues or offsetting receipts is uncertain because we do not know how the organizations would assess those fees.

Civil Penalties. The bill also would authorize the SEC and the Oversight Board to enforce the bill's provisions with civil penalties. Such penalties are recorded in the budget as governmental receipts (revenues). Based on information from the SEC, CBO estimates that these provisions would increase revenues by less than $500,000 a year.

Under the bill, any civil penalties collected by the Oversight Board would be spent on scholarships for accounting students in undergraduate or graduate programs. Because the amounts spent would equal the penalties collected by the accounting board, CBO estimates that the increase in direct spending also would be less than $500,000 per year.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. CBO estimates that the net pay-as-you-go effects of this bill would be insignificant for each year.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

Because it would preempt state authority to license or regulate the Public Company Accounting Oversight Board as a nonprofit corporation, the bill contains an intergovernmental mandate as defined in UMRA. CBO estimates that this preemption would not affect state budgets because, while it would limit the application of state law towards the board, it would not impose a duty on states that would result in additional spending. Therefore, the threshold established by UMRA ($58 million, in 2002, adjusted annually for inflation) would not be exceeded. The remaining provisions of the bill contain no intergovernmental mandates and would impose no costs on state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

The bill would impose private-sector mandates, as defined by UMRA, on certain accounting firms, companies that issue registered securities, officers and directors of those companies, investment banking firms, and securities analysts. CBO cannot determine whether the direct cost of those mandates would exceed the annual threshold set by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation). The mandate costs are difficult to estimate because (1) we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted; (2) the cost to comply with several of the mandates would depend on rules soon to be prescribed by the SEC under current authority; and (3) the cost to comply with several of the mandates would depend on rules that would be prescribed by the SEC under the bill.

Regulation of Accounting Firms

Under the bill, a registered public accounting firm would be:

- Subject to a system of review by the Public Company Accounting Oversight Board to be established under the bill;
- Prohibited from offering both audit and certain non-audit consulting services (designing or implementing financial information systems or providing internal audit services);
- Required to retain all audit work papers for at least seven years.

According to the American Institute of Certified Public Accountants (AICPA) and other industry representatives, the accounting industry currently:

- Sponsors a transitional private entity that reviews independent accountants;
- Has voluntarily stopped offering both audit and such non-audit consulting services;
- Retains financial statement working papers and records for seven years.

Therefore, CBO estimates that the direct cost to comply with those new mandates would be small.

The bill would require an accounting firm to obtain a second review of audit reports from another auditor within the firm, and test and express an opinion on certain internal controls of public companies. The cost to obtain a second review and provide an opinion on compliance by a company would depend on rules to be prescribed by the SEC. Since the regulations have not been established, CBO cannot estimate the cost to comply with those mandates.

Registration and Accounting Support Fees

The bill would require that the new Oversight Board and a designated Standard-Setting Body be independently funded by public companies. Based on information from the SEC, CBO estimates the annual cost of operating the oversight board and the standard-setting body would be approximately $80 million. The bill would require those organizations to levy fees on registered public accounting firms and an annual accounting support fee on issuers of securities. Currently, the accounting industry is self-regulated and voluntarily provides the funding for the regulatory organization, including peer reviews. According to the SEC and the industry, the cost of oversight and review required by the bill are similar to the costs now voluntarily incurred by the industry. Therefore the incremental cost to the private sector would be small.

Auditor Independence

Section 203 of the bill would prohibit the lead and review partners of an accounting firm from providing audit services for the same company for more than five consecutive years. Based on information from the AICPA, CBO estimates that the direct cost to rotate lead and review partners would be minimal.

Section 206 would prohibit an accounting firm from providing audit services for a public company if that company's chief executive officer, financial officer, controller, or other equivalent position was employed by the accounting firm during the year before the start of the audit services. Based on information from the AICPA, CBO anticipates that some firms would lose business that other accounting firms would gain. Therefore, CBO estimates that total direct cost to the accounting industry would be negligible.

Corporate Responsibility

The bill contains provisions that would require greater corporate responsibility for financial reports. The cost of complying with those requirements would depend on rules that the SEC has agreed to propose, but not yet promulgated. Therefore, CBO cannot estimate the direct costs of complying with the following mandates:

- Section 301 would require the audit committee of a corporate board to be responsible for the appointment, compensation, and oversight of the work of their auditors. This section also would prohibit national securities exchanges and associations from listing companies that do not comply with certain audit committee standards.

- Section 302 would require chief executive officers and chief financial officers of public companies to certify the appropriateness of their company's periodic reports and to ascertain that the financial reports fairly reflect the operations and conditions of their companies.

Periodic Restrictions On Insider Trading

Section 306 would prohibit certain owners and officers of a company from selling equity securities issued by that company during periods (called "blackout" periods) when participants in the retirement plan are restricted in their ability to direct investments. Such periods may occur for administrative reasons—for example, when a plan changes recordkeepers. This restriction would increase the financial exposure of affected owners and officers and, thus, could impose a cost on them. CBO does not have sufficient information to estimate the amount of that cost.

Enhanced Financial Information Disclosure

Section 403 would require officers and directors of companies that issue securities and certain owners of such securities to disclose to the SEC any insider trading by a certain time. According to the SEC, insider trading disclosure is currently required to be reported to the SEC by the tenth day of the month following the month in which the trade occurred. Thus, CBO estimates that the cost of providing such information on an expedited basis would be small.

The bill also contains provisions that require increased disclosure of financial information. The cost of complying with those requirements would depend on rules that the SEC has agreed to propose, but not yet promulgated. Therefore, CBO cannot estimate the direct costs of complying with the following mandates:

- Under Title IV, the SEC would prescribe rules that would require companies that issue securities to report loans to insiders within a certain time period, to disclose material off-balance sheet transactions and conflicts, and present pro forma data in a manner that is not misleading in periodic financial reports to the SEC.

- Section 404 would require a company and the company's auditor to attest to the company's internal control procedures in their annual reports. Public companies also would be required to disclose whether they have adopted a code of ethics for senior financial officers, and whether their audit committee has among its members a "financial expert."

Analyst Conflicts of Interest

Section 501 would require the SEC or a registered securities association or exchange to adopt rules to prohibit certain conflicts within investment banking firms that could compromise securities analysts' independence and to require security analysts to disclose other potential conflicts. The cost of prohibiting certain conflicts and disclosing additional information would depend on rules to be prescribed by the SEC or the directed authority. CBO does not have sufficient information to estimate the cost to comply with those mandates.

PREVIOUS CBO ESTIMATE

On April 26, 2002, CBO transmitted a cost estimate for H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, as passed by the

House of Representatives on April 24, 2002. H.R. 3763 would require the SEC to oversee a new board that would regulate the accounting industry and to accelerate its review of annual reports filed by public companies. CBO estimated that implementing H.R. 3763 would cost about $150 million over the 2003-2007 period, assuming the appropriation of the necessary amounts. Because of provisions that would create new civil penalties and a new accounting board that CBO considered part of the federal budget, CBO estimated that H.R. 3763 also would cause revenues and direct spending to rise by insignificant net amounts for each year.

For H.R. 3763, CBO identified similar private-sector mandates on accountants, companies that issue registered securities, officers and directors of those companies, and certain owners of the securities. CBO could not determine whether the total direct cost of those mandates would exceed the annual threshold established by UMRA for private-sector mandates as we did not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted.

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