CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 26, 2002

H.R. 3763

Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002

As passed by the House of Representatives on April 24, 2002

SUMMARY

H.R. 3763 would establish a new board to oversee the accounting industry and would give the Securities and Exchange Commission (SEC) the authority to review the board's decisions. This new board would be known as the Public Regulatory Organization (PRO). Also, the act would require the SEC to review the financial statements of public companies no less than once every three years. H.R. 3763 would mandate that the agency receive and publicize certain filings related to insider trading in electronic format. The SEC and the General Accounting Office (GAO) also would be required to complete a number of studies and rulemakings within several months of enactment.

In addition, H.R. 3763 would allow the SEC to assess new civil penalties for violations of the act's provisions. The act also would require that any civil penalties collected by the SEC from Enron Corporation, or from Arthur Andersen L.L.C. concerning its audits of Enron, be paid directly to former Enron employees and others designated by the agency.

Based on information from the SEC, CBO estimates that implementing H.R. 3763 would cost about $150 million over the 2002-2007 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 H.R. 3763 would not change the amount of fees expected to be collected in the future. CBO also estimates that H.R. 3763 would increase revenues and direct spending. Therefore, pay-as-you-go procedures would apply. We estimate that the net change in such effects would be insignificant each year.

H.R. 3763 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

H.R. 3763 would impose several private-sector mandates, as defined by UMRA, on certain accountants, companies that issue registered securities, officers and directors of those companies, and certain owners of the securities. CBO cannot determine whether the total

direct cost of those mandates would exceed the annual threshold established by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation), as we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3763 is shown in the following table. The costs of this legislation would fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars				
	2003	2004	2005	2006	2007
CHANGES IN SPENDING SUBJECT TO APPROPRIATION [a]					
Estimated Authorization Level [b]	36	31	31	31	31
Estimated Outlays [b]	28	31	30	30	30

a. H.R. 3763 also would have negligible net effects on revenues and direct spending.

b. Subject to appropriation acts, the gross spending of the SEC is offset by fees the agency collects from securities markets. CBO estimates that the SEC collections will average about $1.6 billion a year over the next five years.

BASIS OF ESTIMATE

For the purposes of this estimate, CBO assumes that H.R. 3763 will be enacted by the end of 2002. Assuming appropriation of the necessary funds, CBO estimates that implementing H.R. 3763 would cost $150 million during the 2003-2007 period. The SEC's gross spending is offset by fees the agency collects from securities markets on transactions, registrations, and mergers of securities. The act also would affect both revenues and direct spending, but the net impact would be negligible for each year.

Spending Subject to Appropriation

H.R. 3763 would require the SEC to review financial statements from every public company at least once every three years. Currently, the SEC employs about 300 people who review about 14,000 annual financial statements submitted by publicly traded companies at a rate of once every five to seven years. Based on information from the SEC, CBO expects that shortening the time between reviews to three years would require doubling the workforce that conducts such reviews. At current pay rates, CBO estimates that salaries and expenses for the new personnel would cost about $30 million a year, assuming appropriation of the necessary funds.

In addition, implementing two provisions of H.R. 3763 would require the SEC to upgrade its computer systems. First, the act would require the agency to establish a new rating system to review the financial statements of riskier companies more frequently. Also, the agency would have to receive and publicize electronically certain filings related to insider trading. Based on information from the agency, CBO expects that the computer upgrades needed to fulfill these requirements would cost about $1 million in 2003 and less than $500,000 every year thereafter, subject to the availability of appropriated funds.

H.R. 3763 also would require the SEC to review any sanctions or rulemakings proposed by the PRO. Based on information from the SEC, CBO expects that the agency would need to hire additional workers to oversee the PRO. Assuming that these new personnel would be compensated at current pay rates, CBO estimates that implementing these provisions would cost less than $1 million a year, subject to the availability of appropriated funds.

H.R. 3763 would require SEC and GAO to complete a number of studies and rulemakings within several months of the act's enactment. Based on information from the CBO estimates that implementing these provisions would cost $4 million over the 2002-2004 period, assuming the appropriation of the necessary amounts.

Revenues and Direct Spending

H.R. 3763 would establish new civil penalties for people who mislead auditors in a way that distorts financial statements, officers who trade their companies' stock during periods when employees are not allowed to trade that stock, and other persons who violate the act's provisions. Such civil 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 act, any civil penalties collected by the SEC under current law from Enron Corporation, or from Arthur Andersen L.L.C. related to its Enron audits, would be paid directly to Enron employees and others. Because of the low probability that the SEC would both assess and be able to collect civil penalties from these two companies, we expect that any change in direct spending that would result from this provision would be negligible.

Under the act, all financial statements required to be filed with the SEC under the securities laws would have to be certified by an accountant that was deemed qualified to do so by the PRO. CBO expects this provision would give the SEC, acting through the PRO, substantial authority to regulate and control entry into the accounting industry. In addition, the SEC could control the appointment of officers to the PRO board, would approve its annual budget, and could grant the PRO board members the authority to subpoena witnesses. Because the PRO would have regulatory power over the accounting industry, thus exercising the sovereign power of the federal government, CBO would consider it a governmental entity. As a result, we believe that its collections and spending should be included in the federal budget.

H.R. 3763 would require that the board be self-funded, although the act does not specify the nature or the intended payers of any fees or charges it might assess. Based on information from the SEC, we expect the PRO would cost at least a few million dollars a year to operate. Without such details, we cannot determine whether these fees should be classified in the budget as governmental receipts or offsetting receipts. CBO estimates, however, that the net effect of the board’s collections and spending under H.R. 3763 would not be significant in any 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 H.R. 3763's net pay-as-you-go effects would be insignificant for each year.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3763 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3763 would impose several private-sector mandates, as defined by UMRA, on certain accountants, companies that issue registered securities, officers and directors of those companies, and certain owners of the securities. CBO cannot determine whether the total direct cost of those mandates would exceed the annual threshold established by UMRA for private-sector mandates ($115 million in 2002, adjusted annually for inflation), as we do not have sufficient information to estimate the cost of prohibiting insider trading during blackout periods when investment activity is restricted.

Under the bill, independent public or certified accountants would be:

- Subject to a system of review by a public regulatory organization to be established under the act;
- Prohibited from offering both audit and certain nonaudit consulting services (financial information system design or implementation services or internal audit services); and
- Required to prepare final audit work papers and maintain them and other information related to certified financial statements for at least seven years.

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

- Sponsors a private entity that reviews independent accountants;
- Has voluntarily stopped offering both audit and such nonaudit consulting services; and
- 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, if any.

H.R. 3763 would require that the public regulatory organization be self-funded. Based on information from the SEC, the annual cost of operating the public regulatory organization would be at least a few million dollars. Although the act does not specify the nature or the intended payers of any fees or charges to fund the organization, it is likely that such fees would be levied on the accounting industry and other private entities involved in investment activities. Currently, the accounting industry is self-regulated and voluntarily provides the funding.

Accelerated Financial Information Disclosure

Under sections 4 and 6 of the act, the SEC would prescribe rules that would require companies that issue securities to file and make public certain financial information on a rapid and essentially contemporaneous basis and to provide additional financial information in periodic financial reports to the SEC. The cost of providing real-time disclosure of financial information and additional financial reporting 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.

Section 4 would require officers and directors of companies that issue securities and certain owners of such securities to disclose electronically to the SEC any insider trading before the end of the next business day. 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. Under the act, the SEC is required to facilitate electronic filing and disclosure through revising forms needed for reporting. Thus, CBO estimates that the cost of providing such information on an expedited basis would be small.

Section 4 also would require a company that issues securities to provide on their corporate Web site insider trading information before the end of next business day after the day the disclosure is received by the SEC. According to the SEC, an average of 15 to 20 insider trades per company each year would need to be posted on the company's Web site. With the requirement that the SEC facilitate electronic filing and disclosure, CBO, therefore, estimates that the cost of posting insider trading information on a company's Web site would be small.

Periodic Restrictions On Insider Trading

Section 5 would prohibit certain owners and officers of a company from selling equity securities issued by that company during a period (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.

Code of Ethics Disclosures

Section 8 would require the SEC to prescribe rules that would require companies that issue securities to immediately disclose electronically any changes in, or waiver of, their code of ethics to the SEC. Based on information from the SEC, a change in a company's code of ethics occurs very infrequently; therefore, CBO estimates the direct cost to comply with this requirement would be minimal.

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