

103D CONGRESS  
1ST SESSION

# H. R. 574

To amend the Securities Exchange Act of 1934 to impose additional fraud detection and disclosure obligations on auditors of public companies.

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## IN THE HOUSE OF REPRESENTATIVES

JANUARY 26, 1993

Mr. WYDEN (for himself, Mr. MARKEY, and Mr. DINGELL) introduced the following bill; which was referred to the Committee on Energy and Commerce

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## A BILL

To amend the Securities Exchange Act of 1934 to impose additional fraud detection and disclosure obligations on auditors of public companies.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Financial Fraud De-  
5 tection and Disclosure Act”.

6 **SEC. 2. AMENDMENT TO SECURITIES EXCHANGE ACT OF**  
7 **1934.**

8 (a) AMENDMENTS TO THE SECURITIES EXCHANGE  
9 ACT OF 1934.—The Securities Exchange Act of 1934 is

1 amended by inserting after section 10 (15 U.S.C. 78j) the  
2 following new section:

3 “FRAUD DETECTION AND DISCLOSURE

4 “SEC. 10A. (a) AUDIT REQUIREMENTS.—Each audit  
5 required pursuant to this title of an issuer’s financial  
6 statements by an independent public accountant shall in-  
7 clude, in accordance with methods prescribed by the Com-  
8 mission, the following:

9 “(1) procedures designed to provide reasonable  
10 assurance of detecting illegal acts that would have a  
11 direct and material effect on the determination of fi-  
12 nancial statement amounts;

13 “(2) procedures designed to identify related  
14 party transactions which are material to the finan-  
15 cial statements or otherwise require disclosure there-  
16 in; and

17 “(3) an evaluation of whether there is substan-  
18 tial doubt about the issuer’s ability to continue as a  
19 going concern over the ensuing fiscal year.

20 “(b) REQUIRED RESPONSE TO AUDIT DISCOV-  
21 ERIES.—

22 “(1) INVESTIGATION AND REPORT TO MANAGE-  
23 MENT.—If, in the course of conducting any audit  
24 pursuant to this title to which subsection (a) applies,  
25 the independent public accountant detects or other-  
26 wise becomes aware of information indicating that

1 an illegal act (whether or not perceived to have a  
2 material effect on the issuer's financial statements)  
3 has or may have occurred, the accountant shall, in  
4 accordance with methods prescribed by the Commis-  
5 sion—

6 “(A)(i) determine whether it is likely that  
7 an illegal act has occurred, and (ii) if so, deter-  
8 mine and consider the possible effect of the ille-  
9 gal act on the financial statements of the is-  
10 suer, including any contingent monetary effects,  
11 such as fines, penalties, and damages; and

12 “(B) as soon as practicable inform the ap-  
13 propriate level of the issuer's management and  
14 assure that the issuer's audit committee, or the  
15 issuer's board of directors in the absence of  
16 such a committee, is adequately informed with  
17 respect to illegal acts that have been detected or  
18 otherwise come to the attention of such ac-  
19 countant in the course of the audit, unless the  
20 illegal act is clearly inconsequential.

21 “(2) RESPONSE TO FAILURE TO TAKE REME-  
22 DIAL ACTION.—If, having first assured itself that  
23 the audit committee of the board of directors of the  
24 issuer or the board (in the absence of an audit com-  
25 mittee) is adequately informed with respect to illegal

1 acts that have been detected or otherwise come to  
2 the accountant's attention in the course of such ac-  
3 countant's audit, the independent public accountant  
4 concludes that—

5 “(A) any such illegal act has a material ef-  
6 fect on the financial statements of the issuer,

7 “(B) senior management has not taken,  
8 and the board of directors has not caused sen-  
9 ior management to take, timely and appropriate  
10 remedial actions with respect to such illegal act,  
11 and

12 “(C) the failure to take remedial action is  
13 reasonably expected to warrant departure from  
14 a standard auditor's report, when made, or  
15 warrant resignation from the audit engagement,  
16 the independent public accountant shall, as soon as  
17 practicable, directly report its conclusions to the  
18 board of directors.

19 “(3) NOTICE TO COMMISSION; RESPONSE TO  
20 FAILURE TO NOTIFY.—An issuer whose board of di-  
21 rectors has received a report pursuant to paragraph  
22 (2) shall inform the Commission by notice within  
23 one business day of receipt of such report and shall  
24 furnish the independent public accountant making  
25 such report with a copy of the notice furnished the

1 Commission. If the independent public accountant  
2 making such report shall fail to receive a copy of  
3 such notice within the required one-business-day pe-  
4 riod, the independent public accountant shall—

5 “(A) resign from the engagement; or

6 “(B) furnish to the Commission a copy of  
7 its report (or the documentation of any oral re-  
8 port given) within the next business day follow-  
9 ing such failure to receive notice.

10 “(4) REPORT AFTER RESIGNATION.—An inde-  
11 pendent public accountant electing resignation shall,  
12 within the one business day following a failure by an  
13 issuer to notify the Commission under paragraph  
14 (3), furnish to the Commission a copy of the ac-  
15 countant’s report (or the documentation of any oral  
16 report given).

17 “(c) AUDITOR LIABILITY LIMITATION.—No inde-  
18 pendent public accountant shall be liable in a private ac-  
19 tion for any finding, conclusion, or statement expressed  
20 in a report made pursuant to paragraph (3) or (4) of sub-  
21 section (b), including any rules promulgated pursuant  
22 thereto.

23 “(d) CIVIL PENALTIES IN CEASE-AND-DESIST PRO-  
24 CEEDINGS.—If the Commission finds, after notice and op-  
25 portunity for hearing in a proceeding instituted pursuant

1 to section 21C of this title, that an independent public  
2 accountant has willfully violated paragraph (3) or (4) of  
3 subsection (b) of this section, then the Commission may,  
4 in addition to entering an order under section 21C, impose  
5 a civil penalty against the independent public accountant  
6 and any other person that the Commission finds was a  
7 cause of such violation. The determination whether to im-  
8 pose a civil penalty, and the amount of any such penalty,  
9 shall be governed by the standards set forth in section 21B  
10 of this title.

11 “(e) PRESERVATION OF EXISTING AUTHORITY.—Ex-  
12 cept for subsection (d), nothing in this section limits or  
13 otherwise affects the authority of the Commission under  
14 this title.

15 “(f) DEFINITIONS.—As used in this section, the term  
16 ‘illegal act’ means any action or omission to act that vio-  
17 lates any law, or any rule or regulation having the force  
18 of law.”.

19 (b) EFFECTIVE DATES.—As to any registrant that  
20 is required to file selected quarterly financial data pursu-  
21 ant to item 302(a) of Regulation S-K (17 CFR  
22 229.302(a)) of the Securities and Exchange Commission,  
23 the amendments made by subsection (a) of this section  
24 shall apply to any annual report for any period beginning  
25 on or after January 1, 1994. As to any other registrant,

1 such amendment shall apply for any period beginning on  
2 or after January 1, 1995.

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