A Measured Response?
The Sarbanes-Oxley Act Of 2002 As a Case Study of
Public Outrage Inspiring Financial Legislation

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ROBERT COLBY: Good afternoon and welcome to A Measured Response? -- The Sarbanes-Oxley Act of 2002 as a Case Study for Public Outrage Inspiring Financial Legislation, broadcast from the Jack Morton Auditorium at The George Washington University, Washington, D.C., and on www.sechistorical.org. I am Robert Colby, Historian at History Associates, Incorporated, and the moderator of today's panel. I am also the curator of a permanent Gallery that will open in the virtual museum and archive of the history of financial regulation in May, on financial scandals and the legislation they inspired. Today's program is presented as one of the materials that will be part of the Gallery.

As you may know, the virtual museum and archive is built and administered by the SEC Historical Society. This year, the museum is celebrating its 10th anniversary, and in that time has welcomed more than 1 million visitors. Both it and the Society are independent of and separate from the U.S. Securities and Exchange Commission and receive no public funding.

Last summer, on this very stage - broadcast on www.sechistorical.org and now preserved in the virtual museum and archive - former Senator Paul Sarbanes and former Representative Michael Oxley shared their perspectives on the Sarbanes-Oxley Act of 2002 in a program made possible through the support of the Center for Audit Quality. As they noted, the Act emerged from what some have called the "perfect storm:" two of the largest bankruptcies in American history, the resulting media frenzy, impending Congressional elections, and a stock-market plunge, as well as the memory of previous debates on corporate governance and accounting reform. After months of debate and negotiation, Congress passed the Sarbanes-Oxley Act with near unanimity and it was signed into law on July 30, 2002. Since that time, SOX, as it is popularly called, has not been without controversy. Some have argued that the tumult surrounding the legislation produced over-hasty results. Others have argued that the scandal-filled environment provided unusual clarity and allowed for the usual legislative impediments to be swept aside.

Over the next hour, we will discuss the circumstances that led to the Sarbanes-Oxley Act, with a panel of distinguished individuals who were there at the creation, or, in the words of Representative Oxley, who were crafting the legislation over pizza at 3:00 in the morning. Joining me are Daniel Goelzer, former board member of the Public Company Accounting Oversight Board and a founding trustee of the SEC Historical Society; Peggy Peterson, a former deputy chief of staff at the U.S. House of Representatives Financial Services Committee, currently with Baker Hostetler LLP; Dean Shahinian, Senior Counsel and Chief Securities Policy Advisor, Senate Committee on Banking, Housing and Urban Affairs; and Linda Chatman Thomsen, a former director of enforcement at the SEC, now with Davis Polk & Wardwell LLP and serving on the Society's Board of Trustees. Thank you all for being with us today.

During our discussion, we will look at the critical points in the passage of the Sarbanes-Oxley Act and evaluate decisions within the context in which they were made. We will draw comparisons between the experience of passing SOX and that of other financial legislation to see what lessons we can learn. Before we begin, I would like to add that the views of the presenters are their own and do not reflect those of the SEC Historical Society. I have worked with the presenters to determine beforehand the topics and questions that will guide the content of our discussion.

So let's begin. The beginning of the Sarbanes-Oxley Act was the Enron scandal. Linda Thomsen headed the SEC's investigation of Enron. Linda, I was wondering if you would give us some background on the scandal, and specifically when did its magnitude become clear and what were your expectations as to the response?

LINDA CHATMAN THOMSEN: Sure. Going back, I think the point where it really got started was on October 16, 2001, when Enron announced it had a very big problem in its third quarter. You had some signs before that. For example, in August, Jeffrey Skilling had resigned relatively abruptly from a newly obtained chairmanship, so people asked what was going wrong with that? But by October, with that announcement, you knew you had a problem. The magnitude of the problem was not immediately clear, although I think everyone suspected it was a big problem. And then it sort of rolled forward over the next couple of months and of course, all of this is on the heels of September 11. For many people, 2001 is defined by September 11 and will be forever. A month later, for those in the securities world, this was a relatively thunderous event. I do not think it was quite as a notable exactly on October 16 but it certainly was by the beginning of December when Enron had filed for bankruptcy. There was scurrying around in November when Ken Lay was busily knocking on the doors all around this town trying to get help. Dynegy was going to acquire Enron until it became clear that their problems were greater than they had announced. So that I think in very short order, everyone knew it was a big problem. The depth of the sort of lack of controls and the shenanigans, if you will, that were going on, I do not think were fully known for more months, but it was known to be a significant problem pretty early on in the process.

ROBERT COLBY: From an enforcement perspective, what sort of expectations at that point did you have for the response?

LINDA CHATMAN THOMSEN: I think we all knew it was going to be complicated, because we knew the transactions at issue were complicated. And we knew that pretty quickly. There were all kinds of people willing to tell you that these are very, very complicated transactions and very difficult to unravel. There were very complicated ways to disguise the fact that there was nothing actually underlying it. It still takes a while to unravel all of that. So we knew we had our work cut out for us. And in no time at all, it was one of those events that was full employment for lawyers. There were people representing the auditors, people representing the company, people representing the board, in really quite large numbers. And at the time it created tremendous media frenzy. If I remember it correctly, within a matter of months, the New York Times had an index on the front page of Enron stories. They had a regular Enron index and they had a little index with the stories about Enron. It was that significant at that time. One of our struggles was everyone wanted a piece of it. So you had multiple U.S. Attorney offices until the Justice Department established the Enron Task Force. You had Energy, you had IRS, you had the SEC, everyone. Everyone had an interest because it touched so many areas and so much of the financial system.

ROBERT COLBY: But the issues that were raised by Enron were not really new. Accounting and corporate governance reform had been debated extensively. Dan, I wonder if you could give us some background about the debates over accounting and corporate governance reform?

DANIEL GOELZER: As you suggested, from my perspective, even before Enron hit the headlines, the pieces were already in place for a breakdown in confidence in auditor oversight. I would point to three things.

First, looking all the way back to the 1970s and the foreign payments investigations and crisis, Congress had an interest in the accounting profession and in how it was regulated. Senator Metcalf in particular held a series of hearings on the profession in the mid-1970s. And at that time, largely with the urging of Harold Williams as the chairman of the SEC, an independent oversight system for auditors was put in place. The AICPA had always been an organization of individual accountant members, but it created a division of firms. And within that division, the SEC Practice Section was created for firms that practiced before the SEC. The SEC Practice Section administered a system of peer review whereby one firm would review another's work and issue a report. This was all overseen by a board called the POB, the Public Oversight Board, comprised of individuals from outside the accounting profession. Over the years, some really top-flight people served on the POB. Former Defense Secretary Melvin Laird was a member for a long time. Chuck Bowsher, who had been Comptroller General, was the last chair of the POB. Aulana Peters, a former SEC Commissioner, was a member. I think the POB and the SEC Practice Section structure made a positive difference in the quality of auditing.

But by the time Enron came around, some real weaknesses in the POB structure were also apparent. The peer reviews did not look at audits that were in litigation or in controversy. The POB was dependent on the profession for funding. In fact, there had been an incident, I believe in 2000, where the SEC asked the POB to look at independence practices at the firms, and the AICPA essentially said that it was not going to fund that, so it is not going to happen because you are not going to have the money to do it. We were at a point where I think many people felt that the SEC Practice Section and the POB peer review system had to change.

The second thing I would point to is the growth in audit firm consulting. During the '90s, consulting became a much more important business for the auditing firms. What was originally called MAS, Management Advisory Services, became a key part of the revenues of the large firms. In some cases, firms were earning more from providing consulting services to audit clients then they were earning in audit fees. It was sometimes suggested that the audit was turning into a commodity and becoming just a door-opener for so more lucrative consulting services. SEC Chairman Arthur Levitt took this on as an issue in the late 1990s, and eventually, the SEC adopted rules limiting the consulting services that auditors could provide to an audit client. But those rules provoked a bitter fight between the SEC and the profession. I think there were even some suggestions that Congress should limit the SEC's funding so it could not enforce these kinds of rules. The status of auditor consulting services was therefore still left as a hanging issue when Enron occurred.

And, the third thing I would point to as evidence that auditor oversight was ripe for reform, the thing that I think of as the beginning of the Sarbanes-Oxley process, was a speech that Chairman Levitt gave at NYU in 1998 called “The Numbers Game.” He pointed to the pressures that public companies were under to meet analysts' expectations, market expectations, as to their earnings. He described the games, as he called them, that those pressures produced on public company accounting in order to report results that met those earnings expectations. He also discussed how troubling it was that auditors were going along with those sorts of games.

So, to me, even before Enron became a household name, those three things suggested that something needed to happen to strengthen auditor oversight.

ROBERT COLBY: So with that as a background and with the Enron scandal putting a great deal of pressure on the SEC and on all the enforcement agencies, Congress had to address the issue. I would like to ask first Peggy and then Dean to discuss the major issues as you saw them from the House and the Senate side. What were the sticking points and what were the turning points as you moved forward in this?

PEGGY PETERSON: I think we knew quite early on that there was going to have to be a major legislative response to this whole crisis. And there were two big problems. One was, how big was the problem? We did not know how many companies would ultimately be involved. So there had been accounting problems at other companies before Enron. And as we went through 2002, other companies started to fall as well. So there was no way to know how large the problem was. And the second problem, which Dean will recall very well, is you had to connect the dots between all those companies. All these companies had unique situations and every company was different as to the accounting and corporate governance problems that they faced. So we were operating with imperfect knowledge. Those were the big challenges we faced. But I think that the themes of the legislation were evident early on, as I went back and reviewed some of the early hearings and some of the early public statements about it. And some of the turning points are obvious. But two, I would point to that may not be as obvious would be the Powers Report. I think that had a hand in shaping the legislation, and they did an excellent job investigating Enron. That was released in February of 2002. Also Mr. Paulson's speech in early June of 2002, I think had a great impact on the course of the legislation.

ROBERT COLBY: What do you think, Dean?

DEAN SHAHINIAN: On the other side of the Hill, one of the major questions that came up was, “Is Enron one bad apple?” Is Arthur Andersen one bad accounting firm or one bad office in an accounting firm? Or is there a systemic problem affecting accountants, public companies, stock analysts, and others in the securities world? That was a major question, because if it is one bad apple, then the issue is, should there be stronger enforcement of the existing laws, stiffer penalties or more funding for the regulators to deal with it? If there is a systemic problem, then we may need to reform regulation or the law in those areas. That was a threshold question affecting how we were going to go forward. We also saw, which Peggy alluded, other problems, such as the large numbers of companies that were having accounting restatements; an increasing number of accounting restatements; the celebrated incident where Ken Lay told his employees that Enron stock was a wonderful buy, while, in fact, he was selling it, but the rules did not require disclosure of that for an extended period of time; analyst recommendations for a strong buy for stock in companies that coincidently were being underwritten by their affiliated broker-dealer and in fact, by their bosses, who were setting their salaries. There were a number of issues that were problematic and that appeared to be eroding public confidence in the markets and in the participants. Those were areas that the Senate Banking Committee looked at. I think the House Financial Services had a hearing December 11. The Senate Banking Committee, I think, was the last of about a dozen committees to hold hearings, because there was the question as to what is the situation here. I recall just before Christmas time, there was a meeting in Chairman Sarbanes' office, at which the staff said there had been many committees which were announcing hearings, should we have a hearing? He stroked his chin and said, “I think we will need more than one hearing.” And he envisioned ten hearings. In terms of turning points, one of them was on May 14, when the first Senate Banking Committee print was dropped on a Tuesday and 123 proposed amendments were submitted. Now that is a large number, even for Congressional staff. What that indicated was at that point in time, there did not appear to be consensus. It led to an additional negotiation and ultimately, in the next month, the bill passed the Banking Committee by a vote of 17-4, a bipartisan majority. So those were a couple of the turning points.

ROBERT COLBY: That is part of the interesting question. You have roots in accounting reform that had been previously proposed and defeated, and with that in mind, you also have to build a consensus towards legislation. What sort of steps do you take to build that consensus? How do you get from these ideas that are out there and the scandal and get to a compromise that people can work with? You mentioned former chairman Paulson's speech, for example. Can you tell a little more about what effect that had?

PEGGY PETERSON: I think that was an indication that changed the debate; he was considered a titan of industry. And the recommendations that he had at that time were much stronger than what the House legislation was at that time. A lot of people forget that the House acted quite early. We had hearings throughout, ever since December of 2001. Hearings throughout the winter, spring, and the full House passed the first version of what became Sarbanes-Oxley on April 24. I think when Mr. Paulson came out and recommended a stronger version of that, it really had an impact. But when you talk about building consensus, a lot of this was investor-driven. So many people owned Enron stock either outright or through mutual funds, and so this was demanded by the new investor class. So that was an important component of what happened.

LINDA CHATMAN THOMSEN: To state the obvious, WorldCom was an external event that I think coalesced and built consensus. Because that was in June and the legislation ultimately passed the next month and passed unanimously, or close to. There was bipartisan support, and I think external events also helped drive consensus at that particular time.

ROBERT COLBY: Between Enron and WorldCom, the SEC announced numerous investigations into different companies that had accounting restatements of various size. You have a rolling scandal that eventually peaked in WorldCom, which was at that point the largest bankruptcy in American history.

DEAN SHAHINIAN: We used to call that “the drum beat,” because at least once a week, there would be some company, about which there would be public disclosure of some accounting problems that vindicated the concerns that some folks had about the way things worked.

ROBERT COLBY: This day-to-day sort of steady accumulation has an effect on how you view legislation.

DANIEL GOELZER: I think it was pointed out at the Senate hearings that in the three years leading up to the first Senate hearing, there were more restatements than there had been in the prior decade. And the surge in restatements was a big issue in the press. There was a Fortune article about the time the hearings started, called "Dirty Numbers" or something like that, discussing the pattern of restatements.

DEAN SHAHINIAN: Professor Jack Coffee, who was one of the witnesses, did some research documenting that and the GAO published a report. It was very alarming. Also there was the impact on the stock value. When there was a restatement, the stock value was impacted negatively. And all of this was happening during a sudden and severe recession that was triggered by 9/11. And you look at the market capitalization that just evaporated during that time. It was an alarming time.

DANIEL GOELZER: I don't want to jump ahead of the story, but if we're still talking about the turning points, I think we should mention the SEC's rule proposals. In January 2002, Chairman Pitt came out with a proposal at the conceptual level to create a new oversight body - or perhaps more than one new oversight body - for the accounting profession, doing this through the SEC's rulemaking authority, without legislation. The basic idea would have been that, that unless an auditor was a member of one of these new oversight organizations, called Public Accounting Boards, PABs, it would not have been eligible to sign audit opinions that were filed with the SEC. Public companies would have had to be contributors in some fashion to the finances of these PABs. If a public company did not contribute, it would not have been able to have its financial statements certified by an auditor.

In my view, whatever one might think of the specifics of that kind of proposal or of the ability of the SEC to do it by rule, once you had something like that on the table, it seemed to be clear that there was going to be a change in the way the auditors were overseen and that the oversight model would probably involve the creation of a new organization. And just to put a finer point on that, the day after Chairman Pitt announced this idea of a new oversight body, the POB voted to disband. The POB members felt they had not been consulted about the proposal and that it had not been negotiated with the profession. Chairman Pitt, in his later testimony, responded to those charges. But, whatever the merits of that debate were, the fact was the one element that had provided some independent oversight of auditors was gone, once the POB said that it was not going to perform that role anymore. So I think it was just crystal clear that something new had to come in its place.

ROBERT COLBY: What would take its place eventually made it into all the proposals. The Senate had a version, the House had a version. And the SEC put forth its own proposals; each had a version of an accounting oversight board, but there were questions about what powers it would have and whether it would have SEC oversight or be independent. It was something that needed to happen and it quickly became essentially a consensus. We jumped ahead to the main tipping point in WorldCom, but right before WorldCom broke, the Senate bill made it out of committee. I would be interested to hear your thoughts on what made it possible for the Senate bill to move out of the committee?

DEAN SHAHINIAN: A meeting on June 17 between Senator Mike Enzi and Senator Paul Sarbanes. That oversimplifies it but as I mentioned there had been a Committee Print of legislation to improve investor protection and accounting practices that had drawn 123 amendments a month earlier. During the intervening time, Chairman Sarbanes and his staff - Steve Harris as staff director orchestrated this magnificent effort - were trying to understand what differences of opinion existed, and where there was a potential for consensus that would achieve the objectives of the legislation while addressing the concerns or reservations of people who opposed. So there was a tremendous amount of back and forth. That having been said, as of mid-June, June 11, a new Committee Print was put forth. At that point, it was not certain what the vote would be. There would be a majority of the 21 members on the committee - 11 in the majority, 10 in the minority. An 11-10 vote on legislation gets you out of committee. But it is a partisan vote, it is not likely to get you out of the Senate floor. So Chairman Sarbanes was discussing the issue, as were others who were concerned about the issues, and the night before the expected mark-up, he met with Senator Enzi and they reached an agreement which ultimately led to changing a potential 11-10 vote to a 17-4 vote, which is a bipartisan majority. What that means is that the committee of jurisdiction, you have a majority of members of both parties who were supporting the legislation, which was a remarkable development, and gave a significant momentum to the bill. That evening, the staff went to work on some administrative details of the agreement. It was about midnight and the door of the Banking Committee hearing room opened. And in walks Senator Enzi with a platter of food for the staff so that we would have full strength for going forward. Senator Sarbanes was masterful in negotiating and addressing the concerns.

DANIEL GOELZER: I think when Senator Sarbanes and Congressmen Oxley were on this stage, Senator Sarbanes pointed out that Senator Enzi was the only accountant in the Senate. I guess that would still be true today. In any case, he took quite an interest in these issues.

ROBERT COLBY: As Congress wrestled with these issues, the SEC's enforcement actions were obviously ongoing. Linda, I wonder if you could comment a little on where the SEC was as these developments were unfolding?

LINDA CHATMAN THOMSEN: This legislation was, to my mind remarkably Congressionally driven. I think the Congress on both sides was very focused on the legislation, and really held the pen, if you will. That being said, as Dan suggested, most of the issues had been longstanding issues. The issue of the credibility of numbers had been around for years. Concerns about the boards, particularly the audit committees, and whether or not they were doing their jobs had been around for years. Concerns about, for example, people on dozens of boards, worrying that you cannot do your job if you're on x number of boards. So, a lot of the issues were out there and the issues that had been at the SEC for some time. The SEC was obviously consulted along the way. The legislation that ultimately passed, I think, was sort of roundly supported by the SEC and provided great tools. We have not talked about is fair funds, which made its way in, and was also a direct result. I think of the environment at the time, the circumstances, the image of Enron employees walking out with no jobs with a cardboard box of stuff that was on their desk. And then adding insult to injury, if you will, most of their pension money was bound up in Enron stocks. So most of the seeds of the components of the legislation had been around for a while, and those were things that people worried about. Now at the same time, everybody wanted to have a piece of it. Everybody wanted to say they had done something. So we drafted some things that came in late on procedural stuff. I think the Department of Justice probably had a hand in some of the penalty issues. It was somewhat synergistic, in part because it was measured and responsive.

ROBERT COLBY: Peggy, Linda and Dean all mentioned the WorldCom scandal as the tipping point. What did it change? You had a bill that had gone out of committee with a majority but was still facing a tough fight on the Senate floor. And you have the Oxley bill that passed with a heavy majority but you still have to get them together. So what did WorldCom change?

DEAN SHAHINIAN: WorldCom came after the Senate Banking Committee bill had already passed. So you had already established that there would be a bipartisan majority for some legislation and it was out there. I think when it hit, USA Today had a headline, something to effect that here is yet another scandal [to shake investor faith]. Which meant that people were beginning to feel that there were a large number of improprieties that were out there. I think that made it more difficult for people to defend not doing anything. The people felt that there were things that needed to be done. That, combined with the declining value of the Dow Jones Industrial Average because people were losing money after a number of years of market increase, was a cause of concern. So, I think, it prevented people from arguing strenuously that nothing needed to be done. Also, as Peggy mentioned, there was the Paulson speech, when he said there was a crisis in confidence. Probably in some quarters, there was a sense of, “Well, we need to do something to restore confidence.” There were concerns, maybe even divorced from their analysis of the severity of the problem, so I think it gave some additional momentum.

DANIEL GOELZER: I do not want to divert the conversation from WorldCom, but it seems to me that there was one other important event that happened during this period that we have not directly touched on. That event was that Arthur Andersen was indicted in March 2002 and then convicted June 15. As a result of the indictment, it quite rapidly became clear that the firm was going to disappear. Paul Volcker had been brought in before the indictment to explore whether the firm could be restructured in some fashion and saved. But once they were indicted, I think he felt that that was impossible, and he dropped out of the picture. Many of us in those days, we were still used to thinking of the accounting profession as consisting of the Big 8, which, of course, in fact had declined to the Big 5 through mergers by 2002. And then overnight they were the Big 4.

LINDA CHATMAN THOMSEN: Which some call the final four.

DANIEL GOELZER: When Andersen collapsed, people began to wonder whether that shrinkage process could go further and whether there could be another decline in the number of large, global accounting firms. If there were fewer than four large firms, the business community could have problems in terms of access to auditors. There is nothing in the legislation that is aimed at preserving accounting firms, so I suppose you could say there was not direct connection between the reduction to the Big 4 and the passage of Sarbanes-Oxley. But, when I think back on those days, the demise of Andersen was one of the big shocks that occurred along the way.

PEGGY PETERSON: And also just the shock of WorldCom, it was several times the size of Enron. Enron, of course was the largest bankruptcy in history at that time and then just six or seven months later, WorldCom exceeded that by several times over. Sarbanes-Oxley was about accounting, auditing, it was about corporate governance, but in a larger sense it was about restoring confidence to investors in the marketplace.

ROBERT COLBY: One of the other results of the Enron scandal was it severely compressed the time-frame for legislation. At some point the President asked for legislation to sign before the August recess. There are a lot of steps you have to go through before that's possible. Can you describe that process?

DEAN SHAHINIAN: The Senate bill was on the floor July 8 to July 15, Monday to Monday. There were predictions that there would be a sizable majority for the Senate to pass the bill, but we were concerned about how the negotiation would be [in the Conference Committee] because people had various views and it was just a few months until the end of the session. But as we were walking onto the Senate floor, a representative from the White House was there, and he said, "I just wanted you to know that the President has said he wants a bill on his desk before the August recess and he does not care if it is the Senate bill." So, immediately, the issue did not appear that the Conference Committee could run out the clock without legislation. There was a mandate for legislation. That had to promote a fairly quick process. There was only from then until the end of the August recess, a short period of time. In fact, the conference met on a Friday afternoon. The staffs met on Friday evening. Then Chairman Oxley and Chairman Sarbanes met the following Monday night. The staffs met the day after, Tuesday night for about an hour-and-a-half. And on Wednesday, the conferees voted and approved it. It was a remarkably short period of time if you are going to have a conference.

DANIEL GOELZER: Was that the first explicit statement from the Administration that they wanted legislation of any sort? I think in March 2002, the Bush Administration put out a 10- point plan of ways to address the crisis.

DEAN SHAHINIAN: The President gave a speech while we were actually on the floor, advocating stronger penalties and some other measures. It was, to my knowledge, the first time that he had said that he would accept the Sarbanes legislation and wanted it within that shorter period of time.

DANIEL GOELZER: Watching from the outside, it seemed as if most of what the Administration was pushing for could have been implemented by the SEC, or perhaps other bodies, without any legislation. So it was not clear to me that the Administration was really asking for Congress to do anything. They thought there was a problem that needed to be addressed, but that it did not need to be addressed legislatively.

PEGGY PETERSON: I think because it was a process, it was mentioned in the State of the Union Address in January 2002. The President's working group spent quite a bit of time on it. And the 10-point plan was set forth as principals, I believe. So I think it was a process within the Administration.

ROBERT COLBY: The House passed its bill much earlier than the Senate. And so as you're watching the Senate go through the process of producing its legislation and passing its bill, you then have a completely unexpected event. There would have been a conference committee either way, but how did WorldCom change the goals for the conference?

PEGGY PETERSON: It just compressed the time-frame immensely, both, I think, for the Senate process to play out and also the conference. The conference was over a long weekend. So you had to pick and choose what was most important. Some of what was happening on the Senate floor was very concerning to our side. And so, we had to choose the most important things. The time frame compressed everything down.

LINDA CHATMAN THOMSEN: Absent WorldCom, I am not sure it happened as quickly as it did. It was very much a focusing event. And had it not happened when it happened, well, then if it was not done in July, we're then in the August recess, it is an election year. Who knows what else can spin out when you're on that kind of a timeline? And then you are a year away, Andersen has been indicted and others have been indicted. You know those who might be inclined to say, look, this is a law enforcement issue and they have got the tools to do it. Certainly by the end of the summer, there were some significant pleas that were starting. So it might have changed certain what was in the legislation, the timing of the legislation, and ultimately it may have been a very different piece of legislation and it would not been such a defining moment.

ROBERT COLBY: I think that is a very interesting hypothetical. I mean, if there is no WorldCom, what type of legislation comes out of Congress and does it pass?

PEGGY PETERSON: I think ultimately people were looking to the White House for their signal as to the way they wanted this to go. That was an important part of the process, obviously. So, it is hard to speculate on what that decision making process would have been otherwise. It is kind of tough to say.

DANIEL GOELZER: I was the farthest away from the process and had the least inside knowledge, but I will take a contrarian view. I think there would, at least ultimately, have been legislation creating something like the PCAOB and addressing the auditor oversight issues. The SEC had a proposal to do that administratively through rulemaking as we already discussed. In June, the Commission proposed specific rules that would have created these oversight boards. But, I think there are a couple of things that suggest it would have been difficult to actually implement the idea without legislation.

First, the resistance that the profession put up with respect to limitations on consulting suggested that there would also have been attacks on an oversight system that did not have a legislative foundation. And since the SEC Commissioners change over time as different Presidents appoint them, an oversight system based solely on SEC rules could have been changed or even been completely abolished.

Certainly, while I think the Commission had the authority to do what they were proposing to do by rule, there would have been some collateral legal issues. For example, would the members of these boards have had immunity from liability? If they could have been sued, it would have been something of a deterrent to serving on one of these groups. And could the records of these oversight boards have been subpoenaed by plaintiffs in private litigation? That was one of the things that I think concerned the POB and deterred it from looking at audits that were in litigation.

So, when you look broadly at the state of auditor oversight in those days, my belief is that sooner or later there would have been legislation to lay the foundation for a new auditor oversight system.

PEGGY PETERSON: Congress is a reactive body. If we need to get a piece of legislation through, somebody has to want it. Somebody has to be pushing it, and there has to be a reason behind it. So it is perhaps not surprising that things turned out the way they did.

ROBERT COLBY: In the way that they turned out, you have a piece of legislation that was nearly unanimously passed in the House and unanimously passed in the Senate.

PEGGY PETERSON: Although people always talk about how controversial Sarbanes-Oxley was, but it really was not. There were three votes against it in the House and no votes against it in the Senate. However, earlier in the process, I think the House Financial Services Committee voted 49-12 to pass it through Committee, and the first floor vote in April was 334-90, if I remember right. I think we did strive to get a majority of the minority party. I would have to go back and count the votes to see if we achieved that. I know we were certainly working towards that. But once things started to coalesce, it was not controversial. There was really nobody speaking out against it, or nobody was saying that you're all wrong and you should not go down that road.

LINDA CHATMAN THOMSEN: Well, they sure said it afterwards.

PEGGY PETERSON: They did. Things changed dramatically once the President's pen hit that piece of paper.

DEAN SHAHINIAN: There were differences in the legislation.

DANIEL GOELZER: One factor that I think lead to the fact that the legislation was not very controversial until after it was passed is that most of the hearings were not focused on any specific piece of legislation. The hearings were on the need for financial reporting reform. Witnesses did not have a tangible piece of legislation to look at. I just wonder whether, if Section 404 for example, had been out there as draft legislation at the time of the hearings, people would have had something to say about what the costs might have been, particularly on what the costs and benefits would be of auditor attestation of internal controls. Certainly, after the bill was signed and that provision began to be put into effect, we heard a tremendous amount about that subject.

PEGGY PETERSON: We did have legislative hearings on the House side. We did not have a 404 provision in the House bill. But there were also legislative hearings on the Senate side as well.

DEAN SHAHINIAN: In the Banking Committee, Senator Dodd who was Chairman of the Securities Subcommittee at that point and then later became Chairman of the full Committee had introduced legislation which mentioned an oversight board and had disclosure provisions. So there was that legislation that witnesses could react to. But you are right that the scope was very broad. The Senate Banking Committee had 10 hearings with 39 experts who included accountants, academics, stock analysts, former and current SEC Chairmen and many others who were speaking about a number of issues. Former Chairman Richard Breeden submitted testimony that had several dozen recommendations identified to address a variety of issues that had come up.

DANIEL GOELZER: I wonder whether, if WorldCom had not come along, the process would have been more of a traditional process. That it, first there would have been hearings laying out the problem. Then, comprehensive legislation would have been introduced, and then perhaps further hearings held on specific legislative language. And then enactment of a bill. WorldCom drove the whole thing rapidly forward.

DEAN SHAHINIAN: One thing you raise a very good point there. It was WorldCom, also the market was declining rather precipitously. The day the legislation passed, the Dow Jones went up about 6.3%, but that was to the 8,000 level. So it had gone down a good deal. And in addition to WorldCom, there was this general concern – "When will it stop? "

PEGGY PETERSON: I had seen estimates of the market decline, and valuations of market losses between $8 trillion and $10 trillion. There are a lot of estimates out there. But something had to arrest it.

ROBERT COLBY: The fact that it did pass with such overwhelming majority speaks to both the efforts made to produce a bill that people could vote for as well as the direness of the situation. There needed to be something to restore investor confidence. And what you ended up with is, as Linda said, a bill that passed very heavily but has since drawn some criticism. As we stated at the beginning, this program is supporting a broader Gallery on financial scandals and the legislation they inspired. So I want to pull back a little further. All of you have worked on legislation or have been involved in legislation that responded to other scandals. In looking at Sarbanes-Oxley, what is typical and what is unique about the process?

DANIEL GOELZER: I think Linda has already put her finger on one thing. The other situations that I was involved in, such as the Foreign Corrupt Practices Act, the Insider Trading Sanctions Act, and the Insider Trading Securities Fraud Enforcement Act, began with an SEC enforcement effort that identified a problem. Then the Commission drafted legislation that it thought was necessary to address the problem. The Commission is not allowed to lobby, but it proceeded to educate Congress about why the legislation should be enacted. Sarbanes-Oxley was very much a Congressionally-driven and originated process. I don't think much, maybe none, of the legislation was written at the SEC. It was written on the Hill. At least to my perception, while the Commission certainly was not opposed to the legislation, it seemed to feel that there was a lot that it could accomplish without legislation being passed. So the SEC was not actively pushing for it. That is what I would say is the big difference.

PEGGY PETERSON: There was a great deal accomplished when you look back. We did achieve a bipartisan consensus on legislation. There was robust enforcement activity going on at the SEC. There was robust prosecutorial agenda. Hundreds of people employed in dozens of different companies were convicted, certainly under the laws that were in effect at the time, not Sarbanes-Oxley. There were no government bailouts for anybody, and there were a lot of tragic circumstances of people who were harmed by all of the losses. But there was a lot that came together in Sarbanes-Oxley that resolved the situation in the public's mind.

DEAN SHAHINIAN: Some distinctive things that occur to me from the Senate perspective include the timing involved. The issue came up in the first session of the Congress, which meant there was going to be time to do legislation. If it had come up in the second session, there might not have been time to hold the hearings and consider legislation. Then there was the issue of the chairmanship of the committee. The 107th Congress began with a different Chairman and who had a different view in terms of the appropriate response to the Enron situation. But in the middle of the first session, a Senator from Vermont decided he was going to leave his party and that shifted the majority in the Senate. So Senator Sarbanes became the Chairman. I think his approach to the Enron situation was different than it would have been under Chairman Gramm. And it is not just in terms of the approach to one company, but it is Chairman Sarbanes' approach to a subject of national concern. When he became Chairman, he announced his agenda, and investor protection was not a major part of it. He had concerns for housing and various other issues. Investor protection was not a big issue at that point. Then he went through the 9/11 situation with terrorism risk insurance, addressing that. But when his judgment was that this was a systemic problem, he went forward with a methodical series of hearings, bringing experts from different viewpoints so that afterwards, even the critics said we have a very good set of hearings, a basis on which to legislate. So his character was significant and influenced the outcome in terms of the legislation. One of the other things, I think, might have been the industry response. There was a lot of contentiousness in terms of what the solution would be, in terms of Enron and the accounting industry and so forth. Compare that with, a short time later, a problem in the mutual fund industry with late trading and market timing. But there the industry was supportive of SEC enforcement efforts, and opposed the practices that were at issue. Although there were 10 hearings, there was no legislation. It was a very different approach where there was cooperation. There was a lot of communication with the Congress. As a result, things were worked out through SEC rulemaking and enforcement actions but not legislation. There were some very distinct things.

PEGGY PETERSON: On the House side, on the mutual fund issue, we did pass legislation in 2003 through the full House. That was unique because it was not a crisis, but there was a lot of concern for investors given some of the practices that were happening. Mr. Oxley did well with passing something in a non-crisis atmosphere, which is not that easy to do. Usually, you need something driving a piece of legislation to finish it up.

ROBERT COLBY: If you look at the Enron scandal and the responding legislation, are there lessons that you think that can be drawn from the experience of passing Sarbanes-Oxley that are applicable or is it a unique situation? Is each scandal-driven piece of legislation unique?

PEGGY PETERSON: I think every one is unique. Every one is a very different situation. But we had a good partner. The people make a difference as Dean was saying, and I think Chairman Oxley and Chairman Sarbanes really did not know each other all that well prior to this legislation coming to the floor, even as we were going through the process. But I think both of them acquitted themselves well. They were both equal partners who were skilled legislators, and that made a difference.

DEAN SHAHINIAN: Indeed, I think they worked very closely, very well together.

LINDA CHATMAN THOMSEN: We have obviously identified some external factors that no one could control, but the internal ones that people could control I think worked very well here. The legislation, when you step back, is measured. It was digestible. It is comparatively speaking short. It was 60 pages compared to some other legislation that we could talk about. And despite the fact that 404 caused a great flap after the fact, it was probably the most, and largely the only, truly controversial part of the legislation. And to a certain extent, it demonstrates that there was a profound problem out there because companies having systems of internal accounting controls had been required by the securities laws with the passage of the Foreign Corrupt Practices Act in the 1970's. So the fact that it was a big deal to have someone come in and say you have got an adequate system of internal accounting controls suggests that people were just ignoring a requirement that had been on the books for years. So to a certain extent, it really is a remarkable piece of restraint, in addition to everything else.

PEGGY PETERSON: It was targeted. I think we were able to identify the problem, which was that, alarmingly, a few people at the top of the publicly-traded company or even one person could perform criminal activity and take a public company down from the inside. It was a targeted response that I think addressed the problem at hand.

DEAN SHAHINIAN: One of the other elements I think too was that there was a lot of vetting that went on with people who would be affected. So the approach was you may oppose this legislation, but what are the consequences here that you think are unintended and would be harmful? So I think there was a significant vetting process which led to the result that Peggy was talking about.

ROBERT COLBY: Which is remarkable given how compressed the time frame was. Or maybe it is not remarkable?

DEAN SHAHINIAN: Many of the ideas that are in there had been discussed and examined over a number of years.

PEGGY PETERSON: As we went through that almost but not quite a year, I think there was a moving consensus among a lot of the stakeholders and the parties. And when Chairman Pitt first came out with this idea of a private oversight board, it was determined that this was not the way to go. And then the House bill came out and was passed by the House and ultimately it was decided that that was not going to be enough. That it needed to be stronger and there needed to be more mandatory actions taken. So when the Senate Bill came out and then at the Senate floor people thought that maybe that might be going too far with some of the amendments that were passing so quickly on the floor. And through the conference, we were able to pull back on some of those and address some of the issues. So, it really was a moving consensus throughout the whole process.

ROBERT COLBY: I wonder, is that typical? That a consensus forms and moves or is this something that was driven purely by the circumstances?

DEAN SHAHINIAN: It can happen in different ways. I think what Linda was saying about if the time line had been longer, one does not know what other things might occur. I think there is an element in which it is difficult to predict the future.

ROBERT COLBY: Thank you all. That is all the time we have for our discussion this afternoon. Linda, Peggy, Dean and Dan, thank you for joining us and for sharing your insights and experiences in this complex, and obviously continuing topic.

The broadcast this afternoon will soon be available in video/mp3 format in the museum. An edited transcript will be added later.

If you want to learn more about the Sarbanes-Oxley Act, I encourage you to watch the July 30th broadcast of "The Sarbanes-Oxley Act: The First Decade," featuring Senator Sarbanes and Representative Oxley, made possible through the support of the Center for Audit Quality. You will also want to listen to the more recent October 16th "Deloitte Fireside Chat: The Profession Looks at Sarbanes-Oxley," sponsored by Deloitte LLP, for insights into how the legal, accounting and auditing professions viewed the passage of the act, as well as for insights into the continuing regulatory developments.

As stated at the start of the program, our Gallery on financial scandals and the legislation they inspired will permanently open in the virtual museum and archive of the history of finance regulation on May 1. In addition to WorldCom and Sarbanes-Oxley, the gallery will also look at the Burr Brothers scandal and the Kansas Blue Sky Law, the Riccardi scandal and the Arizona Securities Act, illegal corporate payments and the Foreign Corrupt Practices Act - which we mentioned several times this afternoon - and Ivan Boesky, Michael Milken and the Insider Trading and Securities Fraud Enforcement Act. I encourage you to visit the Gallery when it opens in the spring. Thank you for joining us today, and good evening.