

110TH CONGRESS
1ST SESSION

S. 869

To reform certain provisions of section 404 of the Sarbanes-Oxley Act of 2002, to make compliance with that section more efficient, with the goal of maintaining United States capital market global competitiveness.

IN THE SENATE OF THE UNITED STATES

MARCH 14, 2007

Mr. DEMINT (for himself and Mr. MARTINEZ) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To reform certain provisions of section 404 of the Sarbanes-Oxley Act of 2002, to make compliance with that section more efficient, with the goal of maintaining United States capital market global competitiveness.

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 “Competitive and Open
5 Markets That Protect and Enhance the Treatment of En-
6 trepreneurs Act of 2007” or the “Compete Act of 2007”.

1 **SEC. 2. DEFINITIONS.**

2 For purposes of this Act, the terms “audit”,
3 “Board”, “Commission”, “issuer”, and “public account-
4 ing firm” have the same meanings as in section 2 of the
5 Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201).

6 **SEC. 3. INTERNAL CONTROL REPORTING AND EVALUA-**
7 **TION.**

8 Section 404(b) of the Sarbanes-Oxley Act of 2002
9 (15 U.S.C. 7262(b)) is amended to read as follows:

10 “(b) INTERNAL CONTROL REPORTING AND EVALUA-
11 TION.—

12 “(1) AUDITOR ATTESTATION AND REPORT.—

13 “(A) IN GENERAL.—With respect to the
14 internal control assessment required by sub-
15 section (a), each registered public accounting
16 firm that prepares or issues the audit report for
17 the issuer shall, at the interval determined
18 under paragraph (2), attest to, and report on,
19 the assessment made by the management of the
20 issuer.

21 “(B) CONTENT.—The attestation and re-
22 port on the management assessment required
23 by this paragraph—

24 “(i) shall focus on the process and
25 system management used—

1 “(I) to identify and manage
2 risks;

3 “(II) to identify and implement
4 key controls; and

5 “(III) to come to a conclusion on
6 the effectiveness of the internal con-
7 trols over financial reporting; and

8 “(ii) shall not include a separate opin-
9 ion on the outcome of the assessment, in-
10 cluding any pass or fail opinion by the
11 auditor on the effectiveness of the internal
12 controls of management over financial re-
13 porting.

14 “(2) INTERVALS FOR ATTESTATION AND RE-
15 PORT.—The regulations of the Commission under
16 this section—

17 “(A) shall require that the attestation and
18 report required by paragraph (1) be performed
19 during an initial reporting period, and then at
20 3-year intervals; and

21 “(B) may require a shorter interval in the
22 event of a major shift in the structure or per-
23 formance of the issuer, such as a merger, a sig-
24 nificant financial restatement, evidence of

1 fraud, or other such events, as determined by
2 the Commission

3 “(3) STANDARDS FOR ATTESTATION AND RE-
4 PORT.—

5 “(A) RISK-BASED EVALUATION.—

6 “(i) IN GENERAL.—An attestation
7 made under this subsection shall be made
8 in accordance with standards for attesta-
9 tion engagements issued or adopted by the
10 Board.

11 “(ii) REQUIREMENTS.—The standards
12 issued or adopted by the Board for pur-
13 poses of this subsection shall require that
14 the audit of the management assessment of
15 the internal controls of the issuer shall—

16 “(I) be designed, on the basis of
17 the probability of risk and magnitude
18 of potential harm, to focus on those
19 controls that are critical to the accu-
20 racy of the financial statements of the
21 issuer;

22 “(II) be consistent with the ma-
23 teriality standards prescribed by the
24 Commission under paragraph (4); and

1 “(III) require that the deter-
2 mination by the auditor of the con-
3 trols that create the greatest risk to
4 the company shall be made in con-
5 sultation with management of the
6 issuer, and shall identify those great-
7 est risks in consideration of the char-
8 acteristics of the industry within
9 which the issuer operates.

10 “(B) RELIANCE ON THE WORK OF OTH-
11 ERS.—The standards issued or adopted by the
12 Board for purposes of this subsection shall
13 eliminate duplication of audits and examina-
14 tions—

15 “(i) by allowing registered public ac-
16 counting firms performing attestations and
17 reports under this subsection to rely on ex-
18 aminations and inspections conducted by
19 Federal and State regulatory agencies—

20 “(I) to the extent that such ex-
21 aminations and inspections focus on
22 the risk-based internal controls of the
23 issuer; and

24 “(II) to the extent practicable,
25 without affecting the timely comple-

1 tion of the examinations and inspec-
2 tions;

3 “(ii) where the issuer has engaged a
4 third-party accountant to test and provide
5 its management assessment of the internal
6 control systems, by permitting—

7 “(I) the third-party accountant
8 to work with registered public ac-
9 counting firms performing attesta-
10 tions and reports under this sub-
11 section on determining the controls to
12 be tested and the scope of the work;

13 “(II) the registered public ac-
14 counting firms performing attesta-
15 tions and reports under this sub-
16 section to rely heavily on the work of
17 the third-party accountant during the
18 attestation engagement to avoid repet-
19 itive testing; and

20 “(III) management of the issuer
21 to communicate openly with the reg-
22 istered public accounting firms per-
23 forming attestations and reports
24 under this subsection on all aspects of
25 its internal controls.

1 “(C) DEFINITION.—For purposes of sub-
 2 paragraph (B)(ii), the term ‘third-party ac-
 3 countant’ means a registered public accounting
 4 firm other than the registered public accounting
 5 firm that is engaged to perform the attestation
 6 and report under this subsection.

7 “(4) MATERIALITY STANDARD.—The Commis-
 8 sion shall develop a standard of materiality for the
 9 conduct of the assessment and report on an internal
 10 control under this subsection that shall be based on
 11 the relationship of the internal control to the reason-
 12 ably possible effects on the financial statements of
 13 the issuer, and its significance to the overall finan-
 14 cial status of the issuer.”.

15 **SEC. 4. SMALLER PUBLIC COMPANY OPTION REGARDING**
 16 **INTERNAL CONTROL PROVISION.**

17 Section 404 of the Sarbanes-Oxley Act of 2002 (15
 18 U.S.C. 7262) is amended by adding at the end the fol-
 19 lowing:

20 “(c) SMALLER PUBLIC COMPANY OPTION.—

21 “(1) VOLUNTARY COMPLIANCE.—A smaller
 22 issuer shall not be subject to the requirements of
 23 subsection (a), unless the smaller issuer voluntarily
 24 elects to comply with such requirements, in accord-
 25 ance with regulations prescribed by the Commission.

Any smaller issuer that does not elect to comply with subsection (a) shall state such election, together with the reasons therefor, in its annual report to the Commission under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)).

“(2) DEFINITION.—

“(A) IN GENERAL.—For purposes of this subsection, and subject to subparagraph (B), the term ‘smaller issuer’ means an issuer for which an annual report is required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), that—

“(i) has a total market capitalization at the beginning of the relevant reporting period of less than \$700,000,000;

“(ii) has total product and services revenue for that reporting period of less than \$125,000,000; or

“(iii) has, at the beginning of the relevant reporting period, fewer than 1500 record beneficial holders.

“(B) ANNUAL ADJUSTMENTS.—The amounts referred to in clauses (i) and (ii) of subparagraph (A) shall be adjusted annually to

1 account for changes in the Consumer Price
 2 Index for all urban consumers, United States
 3 city average, as published by the Bureau of
 4 Labor Statistics.”.

5 **SEC. 5. COMPETITION FOR AUDITING SERVICES.**

6 (a) STUDY REQUIRED.—The Commission and the
 7 Board shall jointly conduct a study examining the lack of,
 8 and impediments to, robust competition for the perform-
 9 ance of audits for issuers.

10 (b) SUBJECTS OF STUDY.—The study required by
 11 this section shall examine—

12 (1) the causes for, and the measures that may
 13 be taken to alleviate, the concentration of audit per-
 14 formance in only 4 large public accounting firms ca-
 15 pable of servicing the larger issuers; and

16 (2) the extent to which the Commission and the
 17 Board may, under existing law, take reasonable
 18 steps—

19 (A) to increase the number of qualified ac-
 20 counting firms; and

21 (B) to eliminate de minimis conflict of in-
 22 terest provisions.

23 (c) REPORT.—

24 (1) IN GENERAL.—Not later than 6 months
 25 after the date of enactment of this Act, the Commis-

1 sion and the Board shall submit a joint report on
2 the study required by this section to the Committee
3 on Banking, Housing, and Urban Affairs of the Sen-
4 ate and the Committee on Financial Services of the
5 House of Representatives.

6 (2) REQUIREMENTS.—The report required by
7 this subsection shall—

8 (A) contain the results of the examination
9 of each of the subjects identified in subsection
10 (b);

11 (B) make recommendations to the account-
12 ing industry of measures that may be under-
13 taken under existing provisions of law, regula-
14 tions, and standards to alleviate the concentra-
15 tion described in subsection (b)(1);

16 (C) identify the measures that the Com-
17 mission and the Board should be authorized to
18 undertake to alleviate such concentration; and

19 (D) make any recommendations to Con-
20 gress for changes in the laws administered by
21 the Commission and the Board that the Com-
22 mission or the Board consider appropriate and
23 necessary on the basis of the study.

1 **SEC. 6. PRINCIPLES-BASED GUIDANCE STUDY.**

2 (a) STUDY REQUIRED.—The Commission and the
3 Board shall jointly conduct a study comparing and con-
4 trasting the principles-based Turnbull Guidance under the
5 securities laws of Great Britain to the implementation of
6 section 404 of the Sarbanes-Oxley Act of 2002.

7 (b) REPORT.—

8 (1) IN GENERAL.—Not later than 1 year after
9 the date of enactment of this Act, the Commission
10 and the Board shall submit a joint report on the
11 study required by this section to the Committee on
12 Banking, Housing, and Urban Affairs of the Senate
13 and the Committee on Financial Services of the
14 House of Representatives.

15 (2) REQUIREMENTS.—The report required by
16 this subsection shall—

17 (A) compare the relative accounting and
18 other costs of the principles-based Turnbull
19 Guidance under the securities laws of Great
20 Britain and the implementation of section 404
21 of the Sarbanes-Oxley Act of 2002, in relation
22 to the relative reduction in the level of risk to
23 investors and increase in the level of investor
24 confidence in the financial statements of
25 issuers; and

1 (B) recommend to the Congress appro-
2 priate measures to alleviate accounting and
3 other costs in relation to the reduction of such
4 risk and the increase in such confidence.

○