



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 17, 2002

The Honorable George W. Bush
President of the United States
The White House
Washington, DC 20500

Dear Mr. President:

On March 7th you announced your Plan to Improve Corporate Responsibility and Protect America's Shareholders. Your plan addressed issues within the jurisdiction of the Securities and Exchange Commission and requested that we begin promptly to implement those specific proposals. We are pleased to respond to your request for an update of our significant progress since your call to action.

As we have previously indicated, we believe that we have the authority to implement all of the ten initiatives you have outlined, although as you noted in your Plan one of the initiatives would be enhanced by additional legislative action. And I am happy to report that we are 10 for 10, just three months after you announced your Plan.

We are confident that these initiatives will result in some of the most dramatic and far-reaching changes in corporate behavior in decades. In fact, while many of these reforms require formal rulemaking, and therefore will not be legal requirements immediately, we believe that public companies already are moving to improve their corporate governance and disclosure in anticipation of these reforms.

1. Each investor should have quarterly access to the information needed to judge a firm's financial performance, condition, and risks.

The Commission has proposed disclosure regarding the application of a company's critical accounting policies in clear and understandable language in a company's annual and quarterly reports. In addition, the Commission has issued cautionary advice on the appropriate use of, and limitations on, pro forma financial information in earnings press releases, as well as an investor alert regarding the appropriate use of such financial statements. We also issued cautionary advice regarding the need for issuers to disclose in their 2001 financial reports off-balance sheet financing arrangements.

Our enforcement program also has focused on the quality of disclosure and corporate behavior. This sends an important message that technical compliance with Generally Accepted Accounting Principles (GAAP) may not reveal the entire story of a company's financial activities and supplemental disclosure may be necessary. An illustration is provided

by the settled enforcement action against Edison Schools, where the Commission took enforcement action even though the company's financial statements arguably complied with GAAP.

We have taken additional steps to effect dramatic improvements in the corporate governance standards applicable to US companies. In that effort, we have been assisted greatly by our partnership with the New York Stock Exchange and Nasdaq, both of which have shown a determination to improve the standards to give vitality and meaning to the concept of shareholder ownership of America's corporations. These will be the most extensive changes in corporate governance in many decades.

2. Each investor should have prompt access to critical information.

The Commission has proposed accelerating the filing deadlines of public company annual reports from 90 to 60 days after the close of the fiscal year, and quarterly reports from 45 to 30 days after the end of the quarter.

On June 12th, we proposed a significant expansion of the types of information companies must report currently and an acceleration of the timing of those required disclosures. This proposal would more than triple the items corporations must disclose in the time between the filing of annual and quarterly reports. Not only is the scope of the information that must be reported markedly expanded, companies also would have to file reports of these events no later than the second business day following their occurrence. With these rules, investors will receive information about significant events as they occur.

3. CEOs should personally vouch for the veracity, timeliness, and fairness of their companies' public disclosures, including their financial statements.

On June 12th, we proposed a rule that would require CEOs and CFOs to certify that quarterly and annual reports include all information of which they are aware that they believe to be important to a reasonable investor. This requirement will enhance the accountability of these officers to their shareholders so that no CEO or CFO could even contemplate saying that he or she was not focused on the details of what was, and was not, disclosed to investors. We also proposed rules that would require companies to have in place systems designed to cause compliance with disclosure requirements. These systems would bring all significant information to the attention of senior corporate managers, including the CEO and CFO.

4. CEOs or other officers should not be allowed to profit from erroneous financial statements.

We have implemented your proposal to prevent corporate officers from profiting from erroneous financial statements by seeking, in our enforcement actions, disgorgement of compensation and/or stock options from senior management of public companies. Since March 7, we have been targeting this type of disgorgement in our current cases — seeking it in four cases (equal to the number sought all of last fiscal year) and adding a new focus on

stock options. We are ensuring that this initiative is woven into our ongoing and new enforcement investigations.

5. CEOs or other officers who clearly abuse their power should lose their right to serve in any corporate leadership positions.

As you noted in your Plan, currently the Commission can seek to bar officers and directors only by going through the federal court system. Legislation would be required to give us the power to bar officers and directors administratively, which we support. Even in the absence of this power, however, we are seeking such bars, in appropriate cases and in record numbers, through the federal courts. In the first eight months of this fiscal year, we have sought 54 officer and director bars — 30 of those since March 7th. This is more than were sought all of last fiscal year, and 40% more than were sought in fiscal year 2000.

6. Corporate leaders should be required to tell the public promptly whenever they buy or sell company stock for personal gain.

Pursuant to your directive, the Commission initiated rulemaking to require companies to report promptly a wide variety of transactions by executive officers and directors. This rule would impose obligations on companies to report within 2 days to 10 days any transactions in the company's securities by corporate insiders, including transactions with the company and loans between the company and its officers and directors. Currently, corporate insiders need not file reports of their activities in their company's stock for periods up to 410 days.

7. Investors should have complete confidence in the independence and integrity of companies' auditors.

Commission rules require that public companies disclose in their proxy statements fees paid to their auditors for audit services, information technology services, and all other services, as well as the audit committee's consideration of the compatibility of the provision of non-audit services by the auditor with the auditor's independence. To further strengthen auditor independence, we have asked our Staff to draft and recommend this summer rules that would require all companies registered with us to have independent audit committees, and to vest in those audit committees of the board (i) *sole* responsibility for hiring, firing and retaining independent auditors, and (ii) *sole* responsibility to approve in advance the provision of any and all non-audit services by independent auditors. In addition, we expect to recommend enhancements to the required fee disclosures by companies of amounts paid to their auditors. We will seek comment on whether the Commission should prohibit certain non-audit services by auditors to their audit clients, a prohibition that could go well beyond those Commission rules adopted in 2000, which become effective on August 5, 2002.

8. An independent regulatory board should ensure that the accounting profession is held to the highest ethical standards.

On Thursday, June 20, we intend to propose an unprecedented and comprehensive series of rules to create a new independent oversight board to govern and regulate the public

accounting profession. To strengthen investor confidence, we believe such a board must be in place by the end of this calendar year. Naturally, if legislation should be enacted and become effective, we will implement any legislative mandates we receive.

In developing our rules for such a board, which we have termed a "Public Accountability Board" or "PAB," we have been guided by the following principles:

- It should be mandatory for auditors of SEC registrants' financial statements
- It should be funded, involuntarily, by those who benefit from the audits of public companies' financial statements, not solely by the accounting profession
- It should be run by a board dominated by public members
- It should operate under close and rigorous SEC supervision
- It should be separate from, and not under the control or influence of, the American Institute of Certified Public Accountants
- It should set or oversee the establishment of professional audit, quality control and ethics standards
- It should direct reviews, including annual reviews for larger accounting firms, of firms' quality controls over their accounting and auditing practices
- It should have the ability to discipline firms and individuals for deficiencies that are noted during quality control reviews or that otherwise come to its attention
- It should issue public reports of its activities

9. The authors of accounting standards must be responsive to the needs of investors.

While the Commission has the statutory authority to set accounting principles itself, we have looked to the private sector — since 1972 primarily to the Financial Accounting Standards Board — to assume the initiative in establishing accounting principles. We continue to support private sector standard setting, but are taking a more active role than in past years to ensure that standards are implemented that benefit markets and investors. In recent months, we have been implementing procedures to: broaden funding sources for the FASB and make funding non-discretionary; meaningfully participate in setting the FASB's agenda; exercise our authority to review adopted standards; and promote the idea that the FASB should promulgate principle-based standards, which adapt faster to changing business environments and emphasize overall accuracy and completeness.

Following consultation with us, a new FASB Chairman has been appointed, effective July 1, 2002, and has been instructed to conduct a review before the end of the year to recommend to improve the FASB's efficiency and speed.

10. Firms' accounting systems should be compared with best practices, not simply against minimum standards.

The Commission has proposed rules requiring meaningful disclosure of the application of a company's most critical accounting policies. Among other things, these rules would require a company to state whether or not senior management discussed the development, selection and disclosure of those estimates with the company's audit committee.

Further, we are soliciting comment on disclosures when a company's accounting policies diverge from those used by other industry members, and we encourage audit committees of boards of directors to consider the disclosures of other peer companies in the course of their own disclosure process.

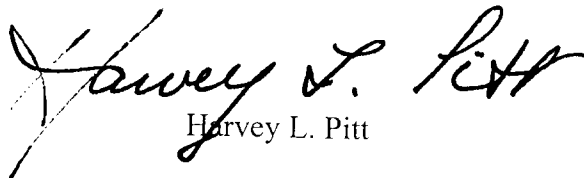
As discussed above, we are strengthening the function and performance of audit committees, both through improvements to our own rules (such as those discussed under item 7, above) and by working with the NYSE and Nasdaq on listing standards.

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The above initiatives represent only a portion of our extensive efforts to further our goal of ensuring that investors have access to timely and correct information necessary to make investment decisions. For example, after conducting a review of research analysts practices and issuing an investor education warning about their reports last summer, we recently approved wide-ranging reforms that were developed by the NYSE and NASD over a number of months to address research analyst conflicts. We continue to review this issue as we proceed on a joint inquiry regarding research analyst practices. We also are considering ways to improve the quality of information investors receive directly from issuers, including further reforms to our disclosure rules, such as requiring disclosure of current trend and evaluative data upon which corporate executives and bankers base critical decisions, and which would assist investors in assessing a company's evolving financial posture. At the same time, we have instituted a dynamic program of "real time enforcement," by which we are seeking to protect investors from scam artists before funds are dissipated, and the scammers flee the jurisdiction. We are having unparalleled success in these efforts, and the best is yet to come.

Our capital markets are the deepest and most liquid in the world. As your call to action on March 7th makes clear, however, certain aspects of the system have long needed, and must now receive, significant improvement. Investors expect our system to be the finest in the world, and we are embarked upon an unparalleled reform crusade designed to ensure that it remains the finest. I hope this update on our efforts proves useful to you. If there is any further information you would find helpful, please do not hesitate to call upon us. And please be assured that we are committed to being fully responsive to your leadership.

Yours truly,



Harvey L. Pitt