

# Sarbanes-Oxley Act of 2002: Outcomes, Impacts, and Influence

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# Purpose

To examine Sarbanes-Oxley (SOX) legislation impacts by identifying:

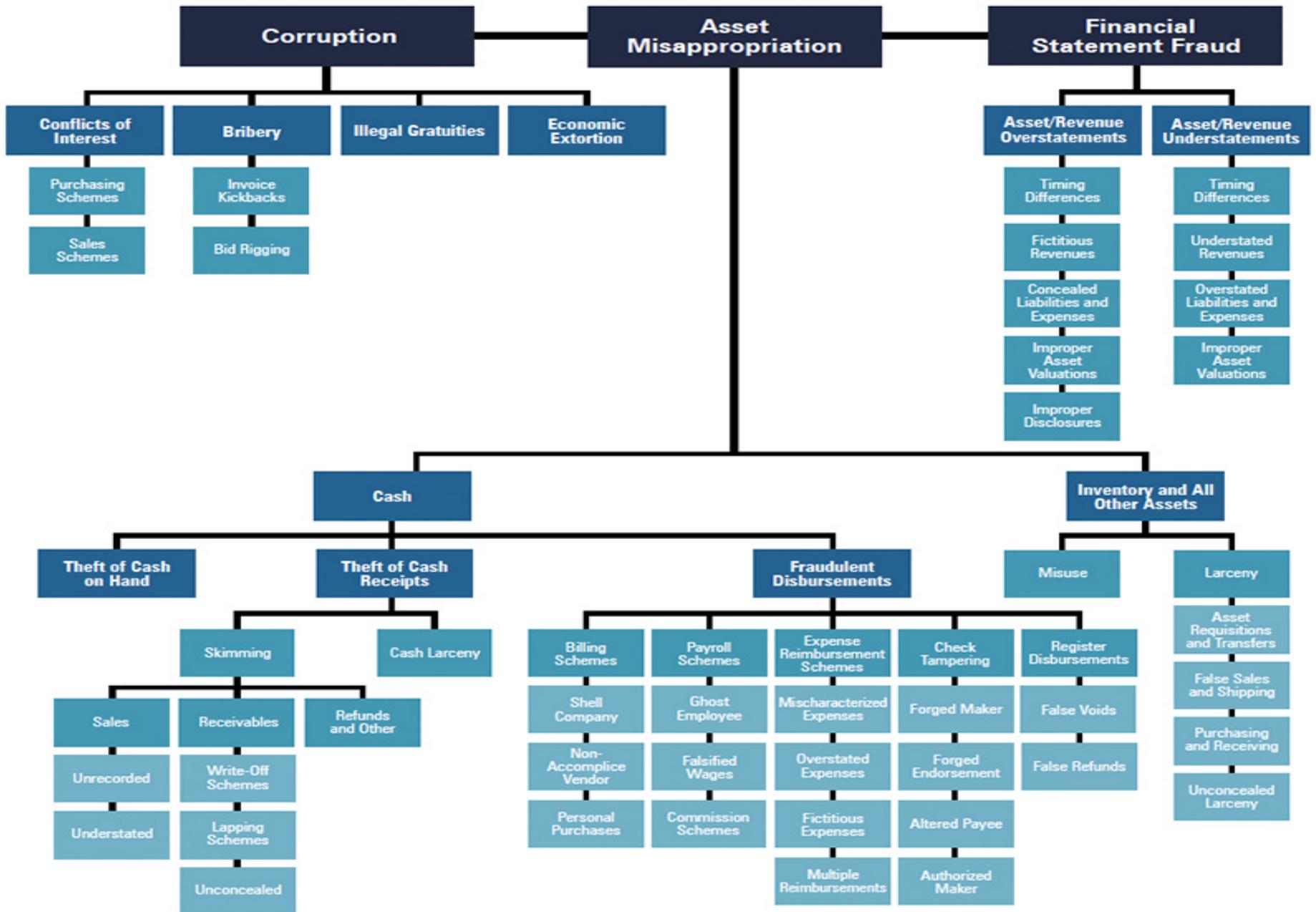
- changes to reporting infrastructures to protect financial markets from abuse
- influences on organizations not initially covered by SOX
- ripple effect within and across national borders
- extension of SOX to new federal regulation



# Definition of Abuse/Fraud

In the broadest sense, fraud can encompass “**any crime for gain that uses deception** as its principal modus operandus”.

More specifically, fraud is defined by Black’s Law Dictionary as “A **knowing misrepresentation** of the truth or concealment”.



# Rationale for Study

Society depends on individuals and organizations with financial and accounting expertise to maintain integrity in financial markets and to support sustainable markets.

Legislation has been the primary vehicle by US government for creating a floor for meeting this public expectation.

# Approach to Study of SOX

Three of SOX's eleven titles are emphasized.

Academic/ trade publications are combined with credible activist literature to explore perspectives on outcomes.

Data on actual outcomes is incorporated when available.

Extrapolation is used to develop future scenarios.

# Titles: SARBANES OXLEY ACT OF 2002

TITLE 1: PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

TITLE 2: AUDITOR INDEPENDENCE

TITLE 3: CORPORATE SOCIAL RESPONSIBILITY

TITLE 4: ENHANCED FINANCIAL DISCLOSURES

TITLE 5: ANALYST CONFLICTS OF INTEREST

TITLE 6: COMMISSION RESOURCES AND AUTHORITY

TITLE 7: STUDIES AND REPORTS

TITLE 8: CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

TITLE 9: WHITE COLLAR CRIME PENALTY ENHANCEMENTS

TITLE 10: CORPORATE TAX RETURNS

TITLE 11: CORPORATE FRAUD AND ACCOUNTABILITY

# Selected Titles for Review

**Title II amends the Securities Exchange Act of 1934 by prohibiting certain activities.**

To ensure that the firm is independent of the audit client, a registered public accounting firm and specific persons associated with that firm may be prohibited ...from providing **certain services**, including **bookkeeping** or other services related to the accounting records or financial statements of the audit client; **financial information systems design** and implementation; **appraisal or valuation** services, fairness opinions, or contribution-in-kind reports; **actuarial** services; **internal audit** outsourcing services; **management functions** or human resources; broker or dealer, investment **adviser**, or **investment banking services**; **legal** services and **expert** services unrelated to the audit; and any other service that the Board determines, by regulation, is impermissible.

# Selected Titles for Review

**Title III: amends the Securities Exchange Act of 1934 by setting standards related to audit committees.**

Places **responsibility** for the appointment, compensation, and oversight of the work of a registered public accounting firm that is employed by the issuer on the audit committee... requires that **members of the audit committee** be a member of the issuer's board of directors but "**otherwise be independent.**" It requires that the **principal executive officer(s) and financial officer(s)** **certify** that they have read reports, that the statements contains no untrue statements not omissions of a material fact, and that proper internal controls are in place. They are **prohibited** from taking actions that **fraudulently** influence, coerce, manipulate, or mislead any independent public accountant engaged in performance of a financial audit.

# Selected Titles for Review

**Title IV mandates that an issuer's published financial statements be accurate, scrutinized and transparent.**

Mandates that an issuer's published financial statements be **accurate** and that they must **include** material off-balance sheet liabilities, obligations and transactions. **Generally accepted accounting principles** and regulations must be scrutinized to ensure that they result in **transparent** reporting.

# Changes Due to SOX

The ways  
that SOX  
changed  
public  
companies

- greater **internal control** of financial reports
- increased expertise and independence among **more-focused boards**, committees and directors
- new reporting, audit, disclosure and **ethics** requirements and infrastructures
- **whistleblower** structures (upon which the **Dodd-Frank Wall Street Reform and Consumer Protection Act** has built)
- Foundation for new language on **executive compensation**

# **CHANGES TO THE ACCOUNTING PROFESSION**

# Public Company Accounting Oversight Board

- SOX Mandates the Establishment of a Not-For-Profit, Non-Governmental Public Company Accounting Oversight Board
- The protection of the interests of the public as well as investors
- Duties of the Board include
  - Registering Public Accounting Firms That Prepare Audit Reports For Issuers;
  - Establishing and/or Adopting, By Rule, Auditing, Quality Control, Ethics, Independence, and Other Standards Relating To The Preparation of Audit Reports for Issuers;
  - Conducting Investigations and Disciplinary Proceedings and Imposing Appropriate Sanctions When Justified.
- The Board is Mandated to Enforce Compliance With The Act, The Rules of The Board, Professional Standards, and The Securities Laws Relating to The Preparation and Issuance of Audit Reports.

# Public Company Accounting Oversight Board continued

- The Board Composition
- Funding of the PCAOB
- International Authority of the Board

# New Roles for Audit Committees & Auditors

- Auditors Report
- Approval of Services Performed by Auditor
- Auditor Reporting of New Information
- Offering of Specified Non-Audit Services Prohibited
- Audit Partner Rotation
- Employment Implications

# Criminal Penalties and Protection for Whistleblowers

- Failure to Maintain Working Papers
- Document Destruction
- Securities Fraud
- Fraud Discovery
- Other Provisions

# Financial Reporting and Auditing Process Additions

- Second Partner Review and Approval of Audit Reports
- Management Assessment of Internal Controls
- Audit Reports – New Content Required

# Areas For The Profession To Watch

- Consulting Services
- Implications for CPAs with Tax Practices
- Cascade Effect
- Additional Burdens for CPAs in Business and Industry



# **IMPACTS ON NOT-FOR-PROFITS AND PRIVATE COMPANIES**

# Impacts on US Not-for-profit Organizations

## Adopted SOX provisions as best practices

- Independence of directors
- Audit committee procedures
- Transparency values
- Solid organizational governance
- Accountability



# National Association of College and University Business Officers (NACUBO)

## ON ACCOUNTABILITY

Public awareness of how quickly financial wrongdoing and a lack of effective controls can devastate some of America's largest and most well-known companies is at its peak. The Sarbanes-Oxley Act of 2002 (Sarbanes), was essentially a formal response to major corporate and accounting scandals. Although Sarbanes applies to companies that register securities with the Securities and Exchange Commission (SEC), NACUBO believes that college and university business officers **should regard Sarbanes as an opportunity to further the business officer's defining core objectives, namely, the enhancement of institutional accountability and responsibility.**



## Example: SOX at DePaul University

Since DePaul is a non-profit university, not governed by the same rules as a corporation, the **Sarbanes-Oxley Act has minimal impact**. However, there are several examples of how DePaul is **taking the initiative to adopt many of the same principles outlined in Sarbanes-Oxley**, and applying them to its stewardship practices.

...(NACUBO) released ...recommendations for higher education based on the Sarbanes-Oxley Act... NACUBO says colleges and universities should consider the act "as a framework to help evaluate overall financial risks..."

At the request of the audit committee of the board of trustees, DePaul formed **the Office of Institutional Compliance** to lead such efforts. A university compliance officer was named, and in the spirit of the Sarbanes-Oxley Act, the compliance department created supporting programs...

A Comparison of The United State's Sarbanes-Oxley Act of 2002 (SOX)  
and The European Union's 8<sup>th</sup> Company Law Directive (8<sup>th</sup> Directive)

# **INFLUENCE ON EUROPEAN BUSINESS**

# Comparison of SOX and The 8<sup>th</sup> Directive

Registration of Accounting Firms, Auditors, and Audit Firms

The Audit Committee

Responsibility For Auditing, Quality Control, and Independence Standards and Rules

Rotation of Auditors

Competent Authority

	The 8 <sup>th</sup> Company Law Directive	The Sarbanes-Oxley Act of 2002
Approval, Continuing Education & Mutual Recognition of Statutory Auditors and Audit Firm	Public oversight systems approve auditors & audit firms if conditions laid down in Article 3(4) to 10	PCAOB approves auditor firms after reviewing application for registration with details the Board specify in Section 102(b)
Registration of Statutory Auditors and Audit Firms	Public oversight systems in Member States register auditors and audit firms with the information required in Articles 16 and 17	

# **SOCIETAL AND CONSUMER IMPACTS**



# The Dodd-Frank Wall Street Reform and Consumer Protection Act (2013)

Creates new regulations for companies that extend credit to consumers and a new **Consumer Financial Protection Bureau**

**Exempts small public companies** from Sarbanes-Oxley section 404(b)

Makes auditors of broker-dealers subject to **PCAOB regulation** and change registration requirements for investment advisers

Articulates new language for **whistleblowers** and **executive compensation/governance**



# BUREAU OF CONSUMER FINANCIAL PROTECTION (BCFP)

**Consolidates** most federal regulation of financial services offered to consumers

Replaces the Office of Thrift Supervision's seat on the FDIC board

**Covers most credit providers**, including mortgage lenders, providers of nonbank financial companies, and banks and credit unions (assets over \$10 billion)

Has **authority over CPAs** providing "customary and usual" accounting activities

Covers **other services** "incidental" to such usual and customary accounting activities



# Whistleblower Provisions: Section 922

- **Prohibits retaliation** against employee who complains to SEC, regardless of whether employee reasonably believes the conduct violates the law. (SOX - only if they reasonably believe the conduct is unlawful.)
- Provides for **double back-pay damages** to prevailing whistleblowers who sue alleging retaliation for participating in SEC investigation.
- Amends SOX to cover both publicly-traded companies and **any subsidiary or affiliate**.
- Doubles SOX's 90 day **statute of limitations** for filing retaliation claim to 180 days. (Statute of limitation for retaliation for participating in SEC inquiry: 6 years from the date of the violation; 3 years from the date violation is discovered.)
- Allows employee to file a retaliation complaint directly in federal court, **bypassing the current DOL administrative process**, when whistleblower participated in SEC investigation.
- Gives claimants a **right to jury trial** in federal court, i.e., does not allow mandatory arbitration agreements to whistleblower retaliation claims.
- Gives the BCFP **the authority** to investigate and commence civil actions against financial services industry employers who retaliate against whistleblower employees.



# EXECUTIVE COMPENSATION, CORPORATE GOVERNANCE

Requires a nonbinding **shareholder vote on executive pay**. Listing exchanges will enforce the compensation policies.

Requires **directors on compensation committees** to be independent of the company and its management

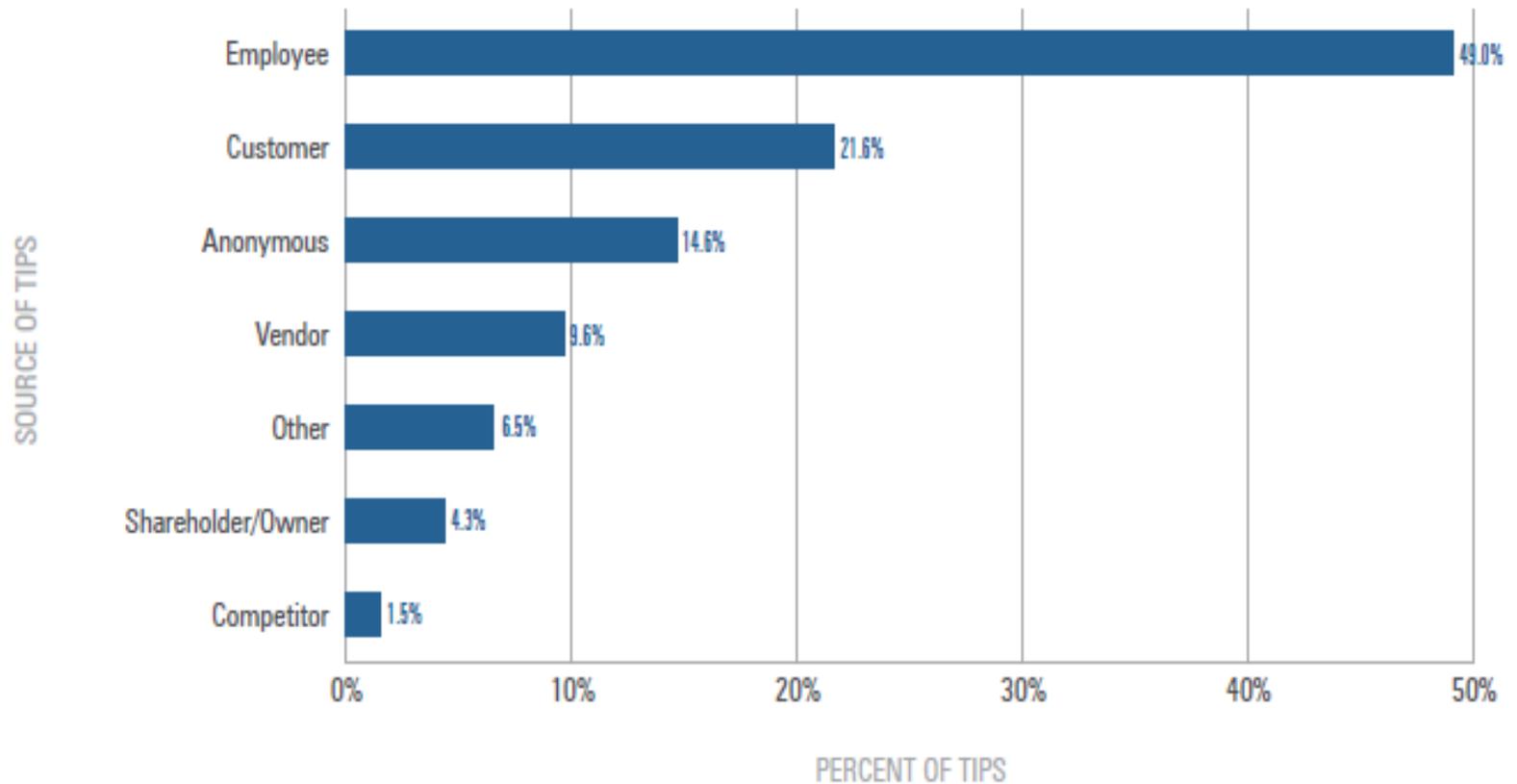
Requires **new disclosures** regarding compensation.

Requires the SEC, within 180 days after enactment, to issue rules requiring companies to disclose in the proxy statement why they have **separated, or combined, the positions of chairman and CEO**.

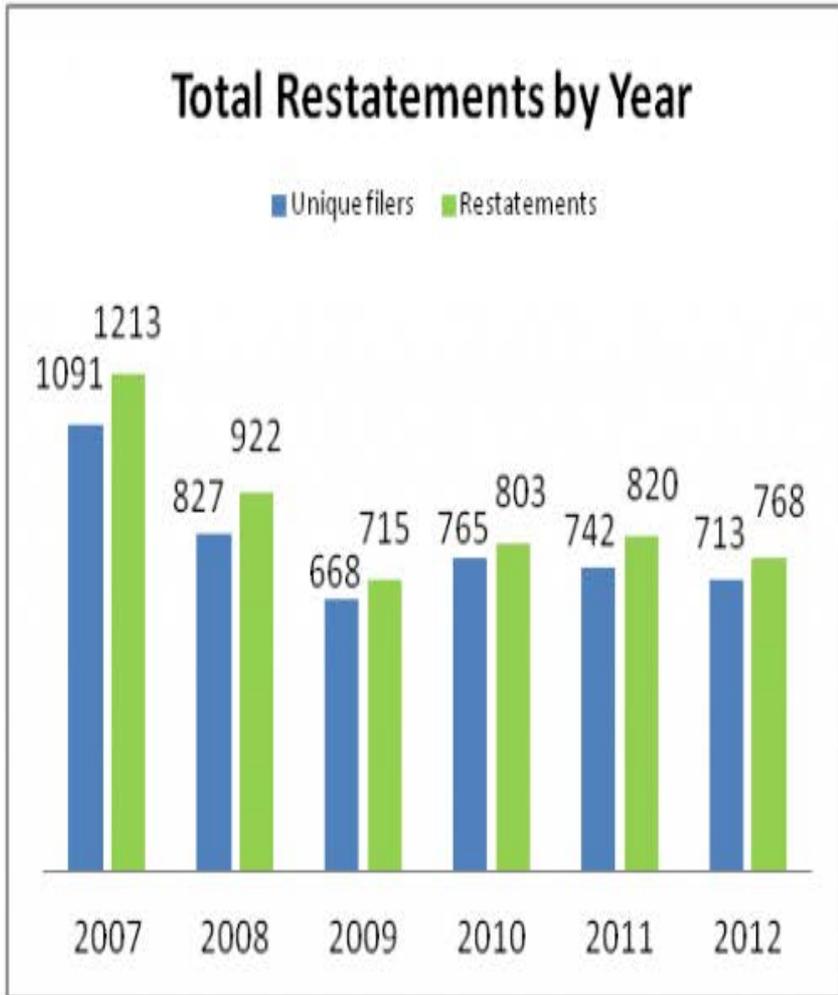
# **FINDINGS**

# FYI: Whistleblowing

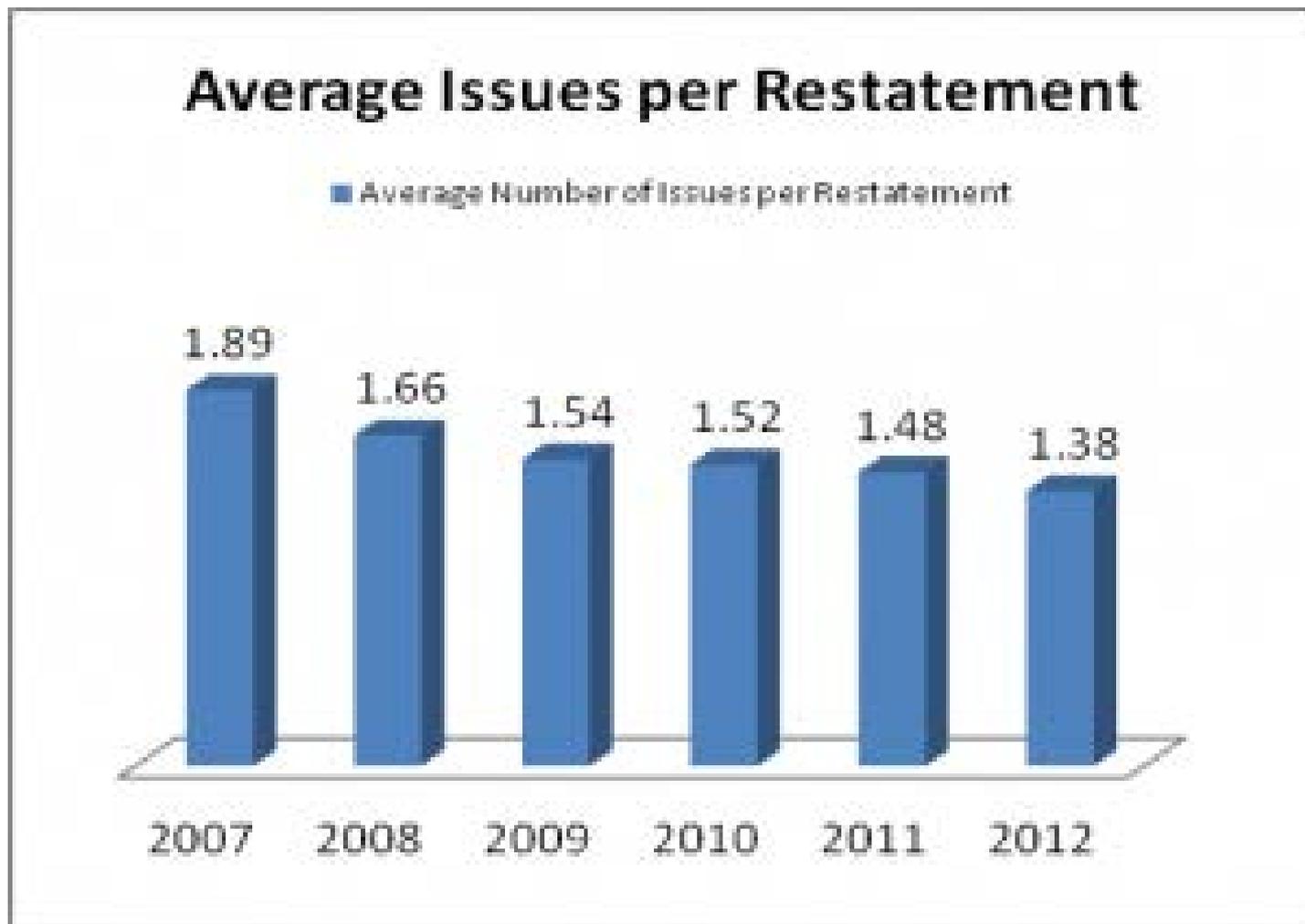
Figure 13: Source of Tips



# FYI: Restatements



# Restatements continued



# Summary: Major Impacts of SOXs and Related Legislation on Accounting

- Relationship with General counsel
- Auditor fees
- Major changes to how firms are being assessed for covered public firms
- Financial Stability Oversight Council
- Sox 404(b) exemption (See Dodd-Frank Wall Street Reform and Consumer Protection Act)

# Management/Governance

- Code of ethics
  - Encouraged and further strengthened by:
    - Federal Sentencing Guidelines
    - SOX requirement regarding senior execs and financial officers
    - Dodd-Frank Act
- Empowerment
  - Empowered board of directors
  - In-house counsel – shift in focus to organization
  - Shareholder activism – “say on pay” (being continued thru Dodd-Frank Act)
  - Empowered SEC

# Beyond the Public Company/Issuers

- US not-for-profits and private organizations are adopting the standards articulated through SOX legislation.
- It appears that the number of organizations that have statements of commitment to SOXs is trending upwards (though there is not database that provides this data).
- Awareness of fraud and abuse is increasing
  - SOX encourages the use of anti-fraud initiatives and detection and prevention tools for stopping fraud in organizations by providing for greater communication about accountability and transparency.



# Conclusions

SOX has encouraged implementation of more transparent accounting systems and new government regulatory protections.

Substantial problems with accounting-related fraud continue to exist.”

# Conclusions

Performing all tasks mandated by SOX continues to plague efforts to fully implement SOX. Unfortunately, what has been encountered is what is often termed an expectations gap (i.e., the expected impact and related outcome of SOX when it was passed in 2002 does not meet the reality of what is being seen twelve years later).