

Executive Summary of the Sarbanes-Oxley Act of 2002 P.L.107-204

On July 30, 2002 President Bush signed into law the Sarbanes-Oxley Act of 2002. The law was intended to bolster public confidence in our nation's capital markets and imposes new duties and significant penalties for non compliance on public companies and their executives, directors, auditors, attorneys and securities analysts. The full implications of the legislation will come after further actions by the Securities and Exchange Commission and the newly created Public Company Accounting Oversight Board. Most of the provisions of this new law only apply to public companies that file a form 10-K with the Securities and Exchange Commission their auditors and securities analysts. This summary is intended to give a broad overview of the new legislation and is not intended to constitute legal advice on the implications of this legislation.

Title I: Public Company Accounting Oversight Board

- Establishes a five member Public Company Accounting Oversight Board (with general oversight by the SEC) to:
 - Oversee the audit of public companies
 - Establish audit report standards and rules
 - Inspect, investigate and enforce compliance on the part of registered public accounting firms and those associated with the firms
- Requires public accounting firms that participate in any audit report with respect to any issuer to register with the Board (this act also applies to foreign public accounting firms that prepare or furnish an audit report for an issuer)
- Directs the Board to establish (or modify) the auditing and related attestation standards, quality control and the ethics standards used by registered public accounting firms to prepare and issue audit reports.
- Requires auditing standards to include (among other things):
 - Seven year retention period for audit work papers
 - Second partner review and approval
 - Evaluation of whether internal control structure and procedures include records that accurately reflect transactions and disposition of assets
 - Receipts and expenditures are made only with authorization of senior management and directors
 - Description of both material weaknesses in internal controls and of material noncompliance
- Mandates continuing inspections of public accounting firms for compliance
 - annually for firms that provide audit reports for more than 100 issuers
 - at least every three years for firms that provide audit reports for 100 or fewer issuers
- Empowers the Board to impose disciplinary or remedial sanctions upon registered firms and their associates for intentional conduct or repeated instances of negligent conduct.
- Directs the SEC to report to Congress on adoption of a principles-based accounting system by the

U.S. financial reporting system.

- Funds the Board through fees collected from issuers.

Title II: Auditor Independence

- Prohibits an auditor from performing specified non-audit services contemporaneously with an audit. Allows the audit committee to approve some activities for non-audit services that are not expressly forbidden by the Act.
- Prohibits an audit partner from being the lead or reviewing auditor for more than five consecutive years (auditor rotation).
- Requires that auditors report to the audit committee:
 - Critical accounting policies and practices used in the audit
 - Alternative treatments and their ramifications within GAAP
 - Material written communications between the auditor and senior management of the issuer
- Places a one year prohibition on auditor performing audit services if the issuer's senior executives had been employed by that auditor and had participated in the audit of the issuer during the one year period preceding the audit initiation date.
- Encourages State regulatory authorities to make independent determinations on the standards for supervising non-registered public accounting firms and consider the size and nature of their clients' businesses audit.

Title III: Corporate Responsibility

- Requires each member of the audit committee to be a member of the board of directors, but otherwise independent (no other compensatory fees or affiliations with the issuer). Confers upon the audit committee responsibility for appointment, compensation and oversight of any registered public accounting firm employed to perform audit services. Gives audit committee authority to hire independent counsel and other advisors and requires issuer to fund them.
- Instructs the SEC to promulgate rules requiring the CEO and CFO to certify in periodic financial reports:
 - The report does not contain untrue statements or material omissions
 - The financial statements fairly present, in all material respects the financial conditions and results of operations
 - Such officers are responsible for internal controls designed to ensure that they receive material information regarding the issuer and consolidated subsidiaries
 - That the internal controls have been reviewed for their effectiveness within 90 days prior to the report
 - Any significant changes to the internal controls
- Reincorporation or transfer of corporate domicile or offices from inside the US does not impact the reach of the rules in the filing of these reports
- Deems it to be unlawful for corporate personnel to exert improper influence upon an audit for the

purpose of rendering financial statements materially misleading

- The CEO and CFO must forfeit certain bonuses and compensation received if the company is required to make an accounting restatement due to the material non compliance of an issuer. (bonuses and compensation one year from the original issuance or filing that needed restating)
- Amends the Securities and Exchange Act of 1933 to authorize a violator of certain SEC rules from serving as an officer or director if the person's conduct demonstrates unfitness to serve...the previous rule required "substantial unfitness"
- Provides a ban on trading by directors and executive officers in a public company's stock during pension fund blackout periods
- Imposes obligations on attorneys appearing before the SEC to report violations of securities laws and breaches of fiduciary duty by a public company or its agents to the chief legal counsel or CEO of the company.
- Allows civil penalties to be added to a disgorgement fund for the benefit of victims of securities violations.

Title IV: Enhanced Financial Disclosures

- Requires financial reports filed with the SEC to reflect all material correcting adjustments that have been identified. Requires disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issue
- Prohibits personal loans extended by a corporation to its executives and directors with some exceptions including loans made by an insured depository institution if they are subject to the insider lending restrictions of the Federal Reserve Act (Reg. O).
- Requires senior management, directors, and principal stockholders to disclose changes in securities ownership or securities based swap agreements within two business days (formerly ten days after the close of the calendar month). Mandates electronic filing and availability of such disclosures one year after the date of enactment.
- Annual reports are to include an internal control report which states that the management is responsible for the internal control structure and procedures for financial reporting and assesses the effectiveness of the internal controls for the previous fiscal year
- Requires issuer to disclose whether it has adopted a code of ethics for its senior financial officers and whether its audit committee consists of at least one member who is a financial expert
- Mandates regular, systematic SEC review of periodic disclosures by issuers, including review of an issuer's financial statement

Title V: Analyst Conflicts of Interest

- Restricts the ability of investment bankers to pre-approve research reports
- Ensures research analysts are not supervised by persons involved in investment banking activities

- Prevents retaliation against analysts by employers in return for writing negative reports
- Establishes blackout periods for brokers or dealers participating in a public offering during which they may not distribute reports related to such offering
- Enhances structural separation in registered brokers or dealers between analyst and investment banking activities
- Requires specific conflict of interest disclosures by research analysts making public appearances and by brokers or dealers in research reports including:
 - Whether the analyst holds securities in the public company that is the subject of the appearance or report
 - Whether any compensation was received by the analyst, or broker or dealer, from the company that was the subject of the appearance or report
 - Whether a public company that is the subject of an appearance or report is, or during the prior one year period was, a client of the broker or dealer
 - Whether the analyst received compensation with respect to a research report, based upon banking revenues of the registered broker or dealer.

Title VI: Commission Resources and Authority

- Authorizes a 77.21% increase over the appropriations for FY 2002 including money for pay parity, information and technology, security enhancements, and recovery and mitigation activities related to the September 11th terrorist attacks.
- \$98 million is included to hire no less than 200 additional qualified professionals to provide improved oversight of auditors and audit services.
- Authorizes the SEC to censure persons appearing or practicing before the Commission if it finds, among other things, a person to have engaged in unethical or improper professional conduct
- Authorizes Federal courts to prohibit persons from participating in penny stock offerings if the persons are subject proceedings instituted for alleged violations of securities laws.
- Expands the scope of the SEC's disciplinary authority by allowing it to consider orders of state securities commissions when deciding whether to limit the activities, functions, or operations of brokers or dealers

Title VII: Studies and Reports

- Sets up various reports and studies including
 - Factors leading to the consolidation of public accounting firms and its impact on capital formation and securities markets
 - The role of credit rating agencies in the securities markets
 - The number of securities professionals practicing before the Commission who have aided an abetted Federal securities violations but have not been penalized as a primary violator

- SEC enforcement actions it has taken regarding violations of reporting requirements and restatements of financial statements
- GAO report on whether investment banks and financial advisors assisted public companies in earnings manipulation and obfuscation of financial conditions

Title VIII: Corporate and Criminal Fraud Accountability

- Imposes criminal penalties for knowingly destroying, altering, concealing, or falsifying records with intent to obstruct or influence either a Federal investigation or a matter in bankruptcy and for failure of an auditor to maintain for a five year period all audit or review work papers pertaining to an issuer of securities (ten years in prison)
- Makes non-dischargeable in bankruptcy certain debts incurred in violation of securities fraud laws
- Extends the statute of limitations to permit a private right of action for a securities fraud violation to not later than two years after its discovery or five years after the date of the violation
- Provides whistleblower protection to prohibit a publicly traded company from retaliating against an employee because of any lawful act by the employee to assist in an investigation of fraud or other conduct by Federal regulators, Congress or supervisors, or to file or participate in a proceeding relating to fraud against shareholders.
- Subjects to fine or imprisonment (up to 25 years) any person who knowingly defrauds shareholders of publicly traded companies

Title IX: White Collar Crime Penalty Enhancements

- Increases penalties for mail and wire fraud from five to twenty years in prison
- Increases penalties for violations of the Employee Retirement Income Security Act of 1974 (up to \$500,000 and 10 years in prison)
- Establishes criminal liability for failure of corporate officers to certify financial reports, including maximum imprisonment of ten years for knowing that the periodic report does not comply with the act or for twenty years for willfully certifying a statement knowing it does not comply with this act.

Title X: Corporate Tax Returns

- Expresses the sense of the Senate that the Federal income tax return of a corporation should be signed by its chief executive officer

Title XI: Corporate Fraud Accountability

- Amends Federal criminal law to establish a maximum 20 year prison term for tampering with a record or otherwise impeding an official proceeding
- Authorizes the SEC to seek a temporary injunction to freeze extraordinary payments earmarked for designated persons or corporate staff under investigation for possible violations of Federal securities law

- Authorizes the SEC to prohibit a violator of rules governing manipulative, deceptive devices, and fraudulent interstate transactions, from serving as officer or director of a publicly traded corporation if the persons conduct demonstrates unfitness to serve
- Increases penalties for violations of the Securities Exchange Act of 1934 to up to \$25 million dollars and up to 20 years in prison