

Sarbanes/Oxley Act: Accounting/Corporate Governance Reform



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Sarbanes/Oxley Act

OVERVIEW

- ✓ Enacted July 30, 2002
- ✓ Enhances accounting and corporate governance of public companies
- ✓ SEC charged with implementing provisions of the Sarbanes-Oxley Act

Sarbanes/Oxley Act

- ✓ Title I - Public Company Accounting Oversight Board
- ✓ Title II - Auditor Independence
- ✓ Title III - Corporate Responsibility
- ✓ Title IV - Enhanced Financial Disclosure
- ✓ Title V - Analyst Conflict of Interest
- ✓ Title VI - Commission Resources and Authority
- ✓ Title VII - Studies and Reports
- ✓ Title VIII - Corporate and Criminal Fraud

Accountability

Sarbanes/Oxley Act

- ✓ Title IX - White-Collar Crime Penalty Enhancements
- ✓ Title X - Corporate Tax Returns
- ✓ Title XI- Corporate Fraud and Accountability

<http://www.law.uc.edu/CCL/sldtoc.html> -OR-

<http://news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf>

Sarbanes/Oxley Act

Who does this affect?

✓ Publicly Held Banking Organizations

- Companies that have a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (the 1934 Act), and/or are required to file periodic reports (10-Ks and 10-Qs) under 15 (d) of the 1934 Act

Sarbanes/Oxley Act

What does the Act do?

- ✓ Mandates corporate governance reforms
- ✓ Creates a new Public Company Accounting Oversight Board
- ✓ Creates new criminal laws relating to corporate conduct
- ✓ Creates new financial reporting requirements for issuers
- ✓ Enhances the role and independence of audit committees
- ✓ Creates new auditor independence of audit committees

Sarbanes/Oxley Act

Audit Committee Standards S 301

- ✓ **Prohibits national securities exchanges from listing a company that is not in compliance with the following requirements:**
 - committee members must be independent;
 - responsible for the appointment, compensation, retention and oversight of outside auditor activities;
 - establish procedures for receiving and addressing complaints about accounting, internal controls, or auditing; anonymous and confidential submission
 - authority to retain and compensate outside advisers to carry out duties

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Audit Committee Standards S 301

✓ **Independence**

- may not accept any consulting, advisory, or other compensatory fee from the company, or
- be an affiliated person of the company or any of its subsidiaries.

Sarbanes/Oxley Act

Audit Committee Standards S 301

- ✓ Pre-approval of audit and non-audit services
 - general pre-approval of categories of services based on established policies or procedures, or
 - pre-approval on an engagement-by-engagement basis
- ✓ Communications from Auditor to Audit Committee
 - all critical accounting policies and practices to be used,
 - all alternative treatments within GAAP for policies and procedures related to material items that have been discussed with management of the issuer
 - other written communications between the independent auditor and the management of the issuer that are material to the financial statements

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“*Financial Expert?*” S 407

- ✓ The rules will define “audit committee financial expert” to mean a person who has the following attributes:
 - An understanding of generally accepted accounting principles and financial statements;
 - an ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
 - Experience preparing, auditing analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant’s financial statements, or experience actively supervising one or more persons engaged in such activities;
 - an understanding of internal controls and procedures for financial reporting; and
 - An understanding of audit committee functions.

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“*Financial Expert?*” S 407

- ✓ A person can acquire such attributes through any one or more of the following means:
 - education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;
 - experience actively supervising a principal financial officer, principal accounting officer, controller, public account, auditor, or person performing similar functions, or experience overseeing and assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or
 - other relevant experience.
- ✓ Safe Harbor Rule

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Auditor Independence

✓ Partner Rotation S 203

- 5-year rotation for lead partner

✓ Cooling-off Period S 206

- 1-year for audit engagement team members to be hired in a financial reporting oversight role

✓ Pre-approval of Services Provided by the Auditor S 202

✓ Communications with Audit Committee S 204

✓ Prohibited non-audit services S 201

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Non-audit services

Prohibited Activities S 201

- ✓ Bookkeeping or other services related to accounting records or financial statements;
- ✓ financial information systems design or 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 advisor, 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.

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Provisions that were effective immediately

- ✓ Management Certifications S 906
- ✓ Personal Loans – S 402; Regulation O Exception
- ✓ Triennial SEC Review S 408
- ✓ Private Securities Litigation Statute of Limitations S 804
- ✓ Increased Fines for Willful Violations of 1934 Securities Exchange Act S 1106
- ✓ Criminal Penalties S 807, S 802, S 1102, S 903
- ✓ SEC Sanctions S 1105, S 1103
- ✓ Whistleblower Protections S 1107

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Final Rules Adopted

- ✓ Management Certification S 302 [8/27/02]
- ✓ Insider Reporting S 403 [8/27/02]
- ✓ Public Company Accounting Oversight Board [10/25/02]
- ✓ Rules on the use of Pro Forma Figures S 401 (b) [1/15/03]
- ✓ Real Time Issuer Disclosures S 409 [1/15/03]
- ✓ Insider Trading During Blackout Period S 306 [1/15/03]
- ✓ Code of Ethics for Senior Financial Officers S 406 [1/15/03]
- ✓ Disclosure of Audit Committee Financial Expert S 407 [1/15/03]

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Final Rules Adopted

- ✓ Off-Balance Sheet Transactions S 401a [1/22/03]
- ✓ Auditor Independence S 201, 202, 203, 204, 206
as amended by S 208 [1/22/03]
- ✓ Audit Records S 802 and 103 [1/22/03]
- ✓ Responsibilities of Attorneys S 307 [1/23/03]
- ✓ PCAOB Operations S 101
- ✓ Audit Committee Standards S 301 [4/9/03]
- ✓ Improper Influence of Audits S 303 [4/24/03]
- ✓ Electronic Reporting of Insiders S 403 [4/24/03]

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Other Provisions and Deadlines

July 30, 2003

✓ Principles-Based Accounting Study S 108(d)

October 23, 2003

✓ PCAOB Operations S 102

✓ Recording Audit Adjustments S 401

January 30, 2004

✓ Special Purpose Entities Study

No Deadlines

✓ Internal Controls Reports S 404 (10/22/02)

✓ Real Time Disclosures S 409

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Regulatory Guidance

- ✓ SR 03-5 “Interagency Policy Statement on the Internal Audit Function and its Outsourcing Overview”
- ✓ SR 02-20 “The Sarbanes-Oxley Act of 2002”
- ✓ FIL 17-2003 “Corporate Governance, Audits, and Reporting Requirements”
- ✓ SR 99-33 “Interagency Policy Statement on External Audit of Banks with Less Than \$500 Million in Total Assets”

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Questions ?