

ensures compliance with standards of audit independence.

#### *Audit committees*

The collapse of Enron also highlights the

lack of effectiveness and independence of some audit committees. Under New York Stock Exchange rules, audit committees must comprise directors who possess financial literacy.

While the audit committee of Enron included a retired Stanford University accounting professor and an economist, market analysts have questioned whether these individuals possessed the

## SUMMARY OF SARBANES-OXLEY ACT

US President George Bush acted quickly to allay market concerns following recent corporate collapses. The result was the passing of the Sarbanes-Oxley Act of 2002 by Congress. The following is a summary with particular attention to the provisions most likely to be of interest to issuers, management and directors.

1 Disclosures. The Act requires new or more expeditious disclosures and directs the SEC to issue rules requiring other disclosures.

- Quarterly CEO/CFO certification of periodic reports.
- Quarterly CEO/CFO certification and report on internal controls.
- Annual management reports on internal controls.
- Financial statements must reflect auditors' material adjustments.
- Quarterly disclosure of off-balance sheet transactions.
- Other quarterly disclosures regarding finance-related procedures: senior finance code of ethics, Audit Committee financial expert, non-audit services provided by auditors.
- Disclosure of changes to or waivers of the senior financial officer ethics code.
- Section 16(a) stock transaction reports within two business days, with next-business-day Internet posting by issuer and SEC.
- Regular SEC review of disclosures.
- Rules coming for "real time disclosures" and pro forma financials.

2 Audit Committees. The Act establishes new rules for the composition and duties of Audit Committees. Audit Committees also will be affected by regulations applicable to auditors, and some of the disclosure rules noted above.

- Independence (under a new definition of the term).
- Inclusion of a "financial expert" as a member.
- Auditor appointment and oversight.
- Restrictions on non-audit services.
- Financial statements must reflect auditors' adjustments, with auditors protected from improper influence.
- Reports by CEO and CFO to Audit Committee of significant control deficiencies and any management fraud.
- Timely reports to the Audit Committee by auditors of critical accounting policies and discussions with management.
- Complaint/whistleblower procedures.
- Legal and other advisers.

3 Other corporate governance provisions. The Act also establishes new rules affecting other areas of corporate governance. In particular, several provisions affect officer and director compensation and stock trading.

- CEO and CFO disgorgement of bonuses and stock profits upon a restatement.
- No loans to directors or executive officers.
- No trading during individual account plan blackout periods.
- Disclosure duties for attorneys.
- New crimes and enhanced penalties. The Act establishes new crimes and increases the maximum penalties for certain existing crimes.
- False certification of periodic reports.
- Securities fraud.
- Destruction of corporate audit records.
- Destruction or alteration of records to impede a federal investigation or bankruptcy case.

- Tampering with records or otherwise impeding an official proceeding.
- Retaliation against informants.
- Penalty enhancements.

4 Provisions affecting securities or other civil litigation and SEC administrative enforcement. The Act contains a few provisions that will or may affect private securities litigation. It also creates two new private civil actions, and expands the SEC's remedies in administrative and civil actions.

- Statute of limitation for private securities fraud actions lengthened.
- Individual debts from securities judgments, orders, or settlements non-dischargeable in bankruptcy
- Administrative complaint and civil lawsuit for informants.
- Shareholder action for disgorgement of profits for trading during blackout periods.
- SEC temporary freeze order against "extraordinary payments".
- Lower standard for SEC officer and director bar.

5 Federal regulation of auditing firms. A new entity called the Public Company Accounting Oversight Board will regulate and oversee auditing firms.

- Registration.
- Auditing and professional standards.
- Inspection.
- Investigation, discipline, and sanctions.
- GAAP largely unaffected.

7 Analyst conflicts of interest. The Act requires the SEC or SROs to adopt rules addressing conflicts of interest involving securities analysts.