

**Federal Regulations  
Sarbanes Oxley Act (SOX)  
Federal Sentencing Guidelines  
and Current Developments  
Enhanced Accountability**

..... *impacting the Accounting Profession*

November 5, 2008

# Regulatory Requirements

## Shared Goals

- Federal Sentencing Guidelines and Sarbanes Oxley
  - Accountability, integrity, transparency, compliance
  - Assurances against misstatement and/or misconduct
  - Ethics as integral part of organizational culture
  - Standards and internal controls
  - Risk-based approach

# Federal Sentencing Guidelines

## Purpose

- Fair sentencing system that applies to all organizations convicted of crime
  - Reasonably uniform and narrow disparity
- Organizations - guilty of criminal conduct
  - Liability attaches when an employee or agent acts in actual or apparent scope of employment if intent, in part, is to benefit organization – even if contrary to organization policy
- Importance of the Guidelines
  - Incentives
  - Elements of a compliance program

# Federal Sentencing Guidelines

## History

- Development
  - U.S. Sentencing Commission established (independent agency in judicial branch) - 1984
  - Federal Sentencing Guidelines for Individuals - 1987
  - Federal Sentencing Guidelines for Organizations - 1991
  - Federal Sentencing Guidelines for Organizations amended (synchronize with SOX) - 2004
  - Supreme Court decision - advisory not mandatory - 2005
  - Amendments 11/1/08 - more flexible
    - Consideration when sentencing

# Federal Sentencing Guidelines

## Activities - Sanctions

- Common Offenses
  - Fraud
  - Environmental pollution
  - Money Laundering
  - Antitrust,
  - Food and drug violation
- Organization Sentencing
  - Fines
  - Probation
  - Restitution
  - Compliance Programs

# Federal Sentencing Guidelines

## Provisions

- Range of sentences set for different offenses
- Sentence set within range based on seriousness of violation and culpability of organization
  
- Aggravating factors
  - Top executive involvement or tolerance of criminal activity
  - Prior violations
  - Court order violations
  - Obstruction of justice
- Mitigating factors
  - Compliance Program
  - Self-reporting
  - Cooperation, or acceptance of responsibility

# Federal Sentencing Guidelines

## Seven Elements of an Effective Program

1. Established standards and procedures
2. Appointment of high-level personnel for oversight
3. Careful delegation of authority
4. On-going training of personnel at all levels
5. Monitor, audit, and evaluate program effectiveness, and also develop a system to report misconduct or seek guidance without fear of retaliation
6. Consistently enforce standards through discipline and provide incentives for compliance
7. Respond appropriately to detected misconduct and take steps to prevent similar misconduct

# Federal Sentencing Guidelines

## Amendments 2004 — Synchronize with SOX

- “Organizational culture that encourages ethical conduct and a commitment to compliance with the law”
  - Greater responsibility for Leaders
    - Governing authority (Board of Directors)
      - Knowledgeable of program and exercise oversight
    - Organization leadership (Executive Management)
      - Gain information about compliance and pursue improvement
    - Individuals responsible for program operation
      - Authority, access
      - Report on significant issues and program effectiveness

# Federal Sentencing Guidelines

## Amendments - Changes (Continued)

- Goes beyond preventing and detecting misconduct
- Culture Change – integrates ethical conduct into organization
  - Expectation of ethical conduct and compliance
  - Engage in compliance training at all levels
- Adequate resources for “due diligence”

# Federal Sentencing Guidelines

## Amendments - Changes (Continued)

- Expanded monitoring and auditing
  - Expressly requires regular compliance evaluations through auditing and monitoring for adherence of activities to applicable laws and requirements
  - “Evaluate periodically the effectiveness of the compliance program to prevent and detect violations of the law”

# Federal Sentencing Guidelines

## Amendments - Changes (Continued)

- Required reporting system
  - “have a system whereby employees or agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms to allow for anonymous reporting”
- Required risk assessments
  - “conduct ongoing risk assessment and take appropriate steps to design, implement, or modify each [program element] to reduce the risk of violations of the law identified by the risk assessment.”

# SOX

## Major Regulatory Response

- Sarbanes Oxley Act (SOX) enacted in 2002 in response to unprecedented corporate scandals
  - protect investors, restore public confidence
  - accuracy/reliability of financial statements
  - Applies legally only to Security and Exchange Commission (SEC) registrants or publicly traded companies

# SOX

## Impacts

- Objectives
  - Enhance accountability and transparency
  - Span expectations gap
    - Auditor beliefs as to required performance
    - Public's expectations of auditor performance
- Changes
  - New SEC Oversight Board
  - Auditor independence
  - Corporate responsibility
  - Criminal penalties

# Sox Title I:

## Public Company Accounting Oversight Board (PCAOB)

- **Oversee audit of public companies subject to securities laws**
  - **Protect**
    - Interest of investors and further public interest through informative, accurate, and independent audit reports
  - **Registration of public accounting firms**
  - **Rules – auditing, quality control, ethics, independence and other standards**
  - **Inspections of registered public acct firms**
  - **Investigations and disciplinary actions**

# Sox Title II:

## Auditor Independence

- Prohibition of non-audit services for financial statement audit clients including
  - Bookkeeping or service related to accounting records or financial statements
  - Financial system design and implementation
  - Appraisals, valuations, contribution, actuarial
  - Internal auditing outsourcing services
  - Management or HR functions
  - Broker/dealer, investment advisor/banker
  - Legal, expert service unrelated to audit
  - Other service PCAOB deems impermissible

# Sox Title II:

## Auditor Independence (continued)

- A registered public accounting firm may perform other service, including tax, for an audit client, but only if the audit committee approves the activity in advance
- Audit committee must pre-approve all services provided by the auditor
- Rotation of lead audit partner and reviewing audit partner every 5 years

# Sox Title II

## Auditor Independence (continued)

- Public accounting firm reports to audit committee
  - All critical accounting policies and practices to be used
  - All alternative treatments of financial information and ramifications of use
  - Other material written communication between public accounting firm and management
    - Management letter
    - Schedule of unadjusted differences

# Sox Title II

## Auditor Independence (continued)

- Conflicts of interest
  - Public accounting firm cannot have employed the CEO, controller, CFO, chief accounting officer, or other equivalent position during one-year period preceding audit

# Sox Title III

## Corporate Responsibility

- Audit committee responsibility
  - Directly responsible for appointment, compensation, and oversight of public accounting firm
  - Each member of audit committee shall be member of Board of Directors and otherwise independent
  - Establish procedures for
    - complaints received by company issuer regarding accounting, internal controls, and auditing matters
    - Confidential, autonomous employee complaints

# Sox Title III

## Corporate Responsibility (continued)

- CEO and CFO certification responsibilities
  - Signing officer reviewed the financial statements
  - Based on signing officer's knowledge
    - No untrue statement of material fact or omission of material fact that makes the statement misleading
    - Materially correct financial statements

# Sox Title III

## Corporate Responsibility (continued)

- The signing officers responsibilities (continued)
  - Establish and maintain internal controls (IC)
  - Design IC so that material information relating to the issuer and consolidated subsidiaries is made know to such officers by others within those entities
  - Evaluate effectiveness of IC within 90 days prior to the report
  - Present a report of their conclusions about the effectiveness of IC based on their evaluation

# Sox Title III

## Corporate Responsibility (continued)

- The signing officers responsibilities (continued)
  - Disclose to outside auditor
    - Significant deficiencies in design and operation of IC that would adversely affect issuers ability to record, process, summarize, and report financial data
    - Fraud whether or not material involving management/employee with significant role in IC
  - Indicate in report significant changes in IC or other factors after evaluation and corrective actions regarding significant deficiencies and material weaknesses

# Sox Title III

## Corporate Responsibility (continued)

- Unlawful for officer or director to fraudulently influence, coerce, manipulate, or mislead outside auditor
- If accounting restatement necessary due to material non-compliance of issuer as result of misconduct, CEO and CFO
  - Reimburse bonuses and incentive-based or equity-based pay 12 months following first public issuance or filing
  - Reimburse profits realized from sale of securities of the company during the 12 month period

# SOX Title IV

## Enhance Financial Disclosures

- Disclosures of off-balance sheet transactions
- In general, organization cannot extend personal loans to or for any director or executive officer
- Directors, officers, and principal stockholders owning more than 10% designated equity security transaction required to report transactions to SEC

# SOX Title IV

## Enhance Financial Disclosures (Continued)

- Management Assessment of IC (Sec 404)
  - Annual report contains IC report
    - States management’s responsibility to establish and maintain adequate IC structure and procedures for financial reporting
    - Contains an assessment of effectiveness of IC and procedures of issuer for financial reporting
  - **Independent auditor attests to (and reports on) I/C assessment made by management**
- Code of ethics for senior financial officers
- Issuer disclose whether or not there is at least one “financial expert” on audit committee

# SOX - Title V, VI, VII, VIII

## Analyst, Commission, Studies

- Titles V, VI, VII
  - Conflicts of interest for security analysts
  - Commission resources and authority
  - Studies and reports
- Title VIII – Fraud accountability
  - Criminal penalties for destruction, alteration, or falsification of records in federal investigation or bankruptcy
  - Destruction of audit records- retain 5 years
  - Review Federal Sentencing Guidelines
  - Whistleblower protection for employees

# Title IX

## White Collar Crime – Penalty Enhancements

- Strengthening criminal penalties
  - Conspiracy same penalty as offense
- Amendment to Sentencing Guideline
- Certifying periodic reports containing financial statements
  - Criminal penalties
    - Certifies yet knows that report does not comport with requirements: fine not more than \$1M and imprisoned not more than 10 years, or both
    - Willfully certifies yet knows that report does not comport with requirements : fine not more than \$5M or imprisonment not more than 20 years, or both

# SOX – Title X, XI

## Corporate Tax Return, Fraud, and Accountability

- Title X – Corporate Tax Return
  - CEO signs corporate federal income tax return
- Title XI – Corporate Fraud Accountability
  - Anyone who corruptly alters, destroys, mutilates, or conceals a record or otherwise obstructs or impedes official proceeding shall be fined or imprisoned not more than 20 years, or both
  - Amendment to Federal Sentencing Guidelines
  - Authority of Commission to prohibit persons from serving as officers or directors

# Standards - Overlap

- Accounting Standards
  - Financial Accounting Foundation
    - Financial Accounting Standards Board (FASB)
    - Governmental Accounting Standards Board (GASB)
- Auditing Standards
  - Auditing Standards Board
    - Auditing Standards Executive Committee— GAAS
  - Comptroller General
    - GAGAS – Yellow Book
- PCAOB
  - Auditing standards for entities registered with SEC and SEC accounting for public entities

# SOX

## New Direction

- Advantages

- Increase focus on corporate governance and controls
- higher quality financial reporting

- Disadvantages

- Cost greater than expected
- Related effort greater than necessary

### **Audit Standard No. 5**

- Refocus resources on what matters to FS integrity
- Scaling the audit to fit size and complexity of company
- More top-down risk based approach
- Principles-base approach for relying on work of others
- External auditor reports on effectiveness of IC but does not evaluate managements' assessment process of IC

# SOX

## AS5 - applied and future focus

- Applied
  - Identify and focus on entity level controls
  - Consolidate controls covering single risk
  - Standardize processes across locations where feasible
  - Use controls embedded in automated software
- Future
  - Strengthening testing of entity level controls
  - More integration of SOX and financial operations audits
  - Computer assisted audit techniques
  - Control self assessments or peer to peer testing

# Good Practices and Critical Factors

## Financial Statement Integrity

- Good Practices
  - Code of ethics
  - Audit Committee independence, financial expertise
  - Whistle blower provision
  - Management's responsibility for IC and financial reporting
  - CEO and CFO certification of financial statements
  
- Critical Factors
  - Effective Oversight
  - Management Integrity
  - Audit Quality

# Ethics

- Focus on ethics and accountability
  - Federal Sentencing Guideline amendments strengthened focus on ethics for compliance programs
  - SOX expanded ethics into an industry
  - Integral relationship - ethics and compliance
- Texas State Board Public Accountancy
  - CPA license requirement
    - CPE in ethics increased to 4 hours every 2 years
  - CPA candidates (beginning 2005)
    - Complete 3 semester hours in TSBPA –approved ethics education as part of their college curriculum

# Globalization on the Horizon

- International Financial Reporting Standards (IFRS)
  - Single model - investors (100 countries - EU, Australia, Canada, etc.)
  - SEC proposed 2014 roadmap (110 companies - IFRS in 2010)
  - FASB's electronic GAAP codification mirrors IFRS
  - Public versus private companies and not-for profits
- US standard setters working toward convergence of their standards with International Accounting Standards Board and International Assurance Auditing Board
- Global standards for professional ethics

# Resources

- Sarbanes Oxley Act Public Law 107-204 July 30, 2002
- US Sentencing Guidelines Amendments, 2004 and 2008
- Internal Auditor, February 2007: “Streamlining Sarbanes-Oxley”
- Public Company Accounting Oversight Board: Auditing Standard No. 5 – SEC release 2007-144, May 27, 2007
- Journal of Accountancy, February 2008: “Change Agent”
- Journal of Accountancy, May 2008: “A Global Standard for Professional Ethics”
- Journal of Accountancy, October 2008: “Profession Reacts to IFRS Plan”
- Journal of Accountancy, November 2008: “Shaking Up Financial Statement Presentation”