



# SARBANES-OXLEY ACT OF 2002

## *SWEEPING CHANGES IN STORE FOR THE ACCOUNTING AND FINANCIAL COMMUNITY*

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act, which generally applies to all publicly listed companies and their audit firms. The Act is designed to: **improve the quality of financial reporting, improve the quality of audits performed by independent accounting firms, clarify and strengthen the independence rules required to be followed by independent accountants, and increase the responsibility of management in the financial reporting process.**

The Act specifically applies to companies that file periodic reports with the Securities and Exchange Commission (SEC) including companies that:

- (1) have securities registered under Section 12 of the Securities Exchange Act of 1934,
- (2) are required to file reports under Section 15(d) of the 1934 Act, or
- (3) file a 1933 Act registration statement.

Public accounting firms subject to the Act and to the rules of the Public Company Accounting Oversight Board include U.S. and non-U.S. public accounting firms that prepare audit reports for listed companies, and could include accounting firms (U.S. and non-U.S.) that perform audit work for a subsidiary of a listed company which is relied on by the primary audit firm.

The following is a summary of the major provisions addressed by the Act:

### **CORPORATE RESPONSIBILITY**

The Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) are required to certify as to the accuracy of their company's periodic reports. Separate certification by both the CEO and CFO are required under the provision of Section 302 and Section 906 of the Act. The certifications require, among other things, that the CEO and CFO state: (1) the periodic report has been reviewed, (2) the report

does not contain untrue statements nor are material facts omitted, (3) the financial statements and other information in the report are fairly presented, (4) they are responsible for establishing and maintaining the company's internal controls, and (5) the reports comply fully with all requirements of the Securities Exchange Act of 1934. **The certifications must follow the exact form set forth by the Act without changes.**

### **PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD**

The Act calls for the creation of an independent Public Company Accounting Oversight Board (Board). The SEC will appoint the five-member Board and will have oversight and enforcement authority over the Board. **The primary function of the Board will be to oversee accounting firms that audit financial statements of reporting companies.**

The Board will have the authority to set auditing and professional conduct standards, conduct inspections of registered accounting firms, perform investigations and institute enforcement actions.

The Board is expected to be formed and its members appointed later this year. **Accounting firms must register with the Board within 180 days of the formation of the Board.**

### **AUDITOR INDEPENDENCE STANDARDS**

The Act imposes restrictions on the nature of services accounting firms can provide to companies when serving as their auditors. Some of the prohibited services are as follows:

- Bookkeeping or other services related to the accounting records or financial statements
- Financial information system design
- Appraisal or valuation services
- Actuarial services

- Internal audit services
- Management or human resource functions
- Investment advisory services
- Legal and other non-audit expert services

Certain non-audit services, including tax services, may be provided but only if approved in advance by the company's audit committee.

## INDEPENDENT ACCOUNTING FIRMS

The Act prescribes a number of rules and requirements to be followed by auditors of public companies including:

- ✓ All accounting firms that perform audits of public companies or companies in registration will be required to register with the Board. Non U.S. accounting firms that audit either domestic or foreign reporting companies must also register with the Board.
- ✓ Non-U.S. accounting firms that audit subsidiaries of U.S. companies may be subject to the provisions of the Act and to the rules and requirements of the Board.
- ✓ In registering, accounting firms are expected to be required to consent to comply with any request of the Board or the SEC for testimony or production of documents.
- ✓ Registered accounting firms servicing more than 100 public companies will be subject to annual quality review inspections by the Board, while all other accounting firms will be reviewed no less than once every three years.
- ✓ The lead audit partner and concurring partner will be required to rotate every five years.
- ✓ A registered accounting firm may not perform audit services for a listed company if that company's CEO, CFO, Controller, Chief Accounting Officer, or any person serving in an equivalent position was employed by the accounting firm and participated in the audit during the one-year period before the initiation of the current year's audit.

## AUDIT COMMITTEES

The Act provides additional responsibilities for audit committee members. If no audit committee exists, the Company's entire Board would be considered the audit committee under the provisions of the Act. Some of the additional responsibilities and requirements of the committee include:

- Enhanced independence rules
- Financial expertise
- Appointing, compensating and overseeing independent auditors
- Addressing any internal control deficiencies and management or employee fraud

- Pre-approval of all audit and non audit services
- Resolution of disagreements between management and the auditors
- Establishing procedures for handling accounting complaints
- Engaging independent counsel and other advisors it deems necessary in order to carry out its duties.

Additionally, each member of the committee must be independent, as defined, and no member may accept any compensation from the issuer for consulting, advisory or other services (other than for services as a director).

## OTHER PROVISIONS

- ◆ The CEOs and CFOs of Foreign Private Issuers are required to sign the certification requirements of Section 302 and 906 of the Act.
- ◆ The SEC must review the annual reports of all listed companies at least once every three years.
- ◆ Personal loans made by a public company to its directors and officers are prohibited (does not apply to existing loans, but no material modifications or renewals can be made).
- ◆ Accounting firms must maintain all audit and review workpapers for at least five years and possibly as many as seven years.
- ◆ The Board will adopt standards requiring every audit report to attest to management's assessment of its internal controls.

***The Act is broad in scope and, accordingly, a number of questions relating to the interpretation of the rules and requirements have arisen. Clarification of the requirements for both public companies and their auditors under the provisions of the Act are expected once the yet-to-be established Public Company Accounting Oversight Board is formed. Some of the Act's provisions are effective on various future dates and are subject to interpretation by the Board, while other provisions require immediate adoption.***

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*Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a professional advisor. If you have any questions or would like to discuss any of these matters in more detail, please feel free to contact the director in charge of your account.*

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