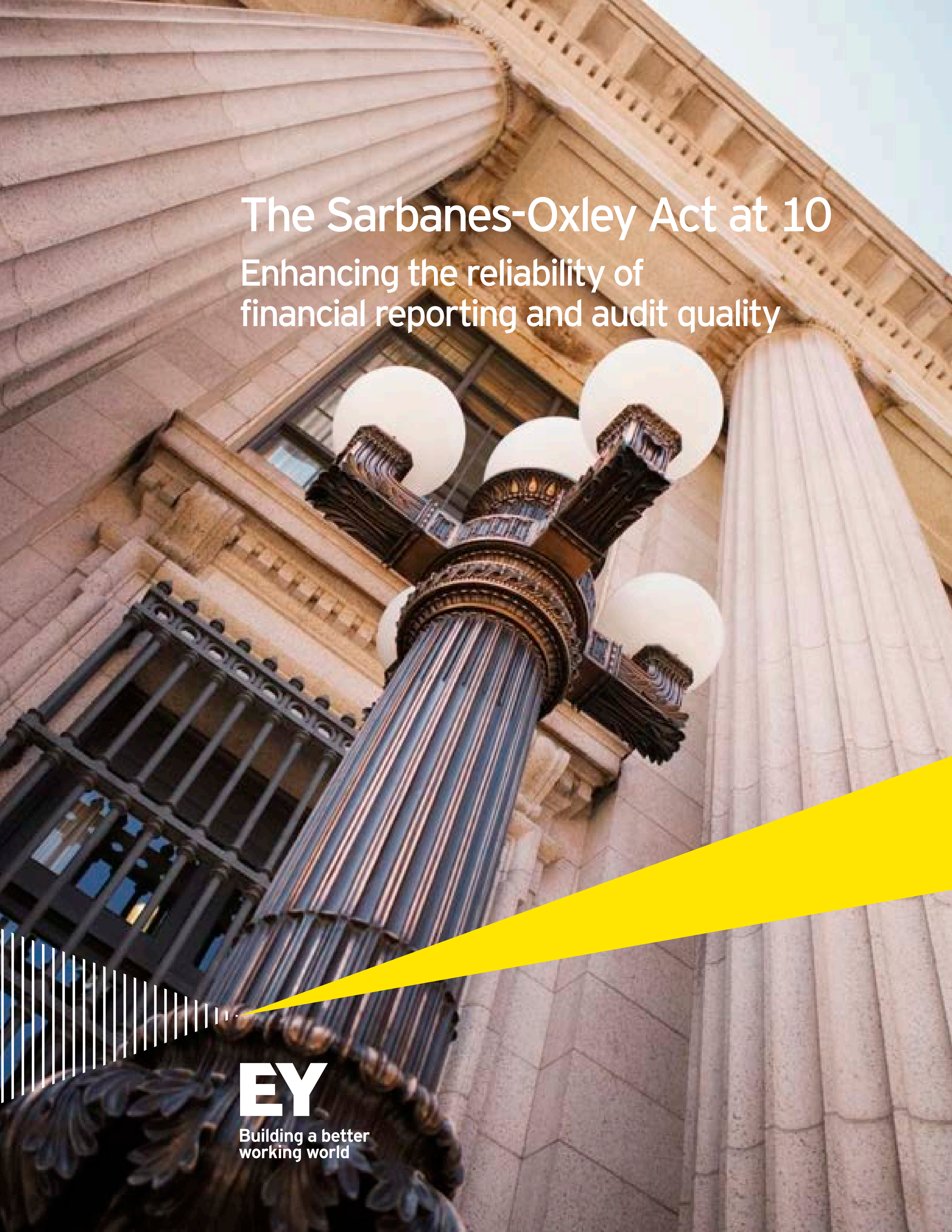
The Sarbanes-Oxley Act at 10

Enhancing the reliability of financial reporting and audit quality



Building a better working world

Twelve years ago, the US capital markets were roiled by revelations of financial wrongdoing at numerous major companies. The damage to investors, pensioners, communities and markets was historic. Corporate executives were jailed. One of the nation's largest companies and one of the largest audit firms went out of business. After hundreds of corporate earnings restatements, confidence in financial markets was shaken to the core.

To restore public confidence in the reliability of financial reporting, the US Senate and House of Representatives passed the Sarbanes-Oxley Act of 2002, by votes of 99-0 and 423-3, respectively, sending it to President George W. Bush, who signed the reform measure into law on July 30, 2002. Since its enactment, the Sarbanes-Oxley Act, or SOX as it is often called, has been both heralded and maligned. EY believes it is important to consider what the Act was actually designed to do and to revisit the significance of its impact.

SOX was designed to enhance the reliability of financial reporting and to improve audit quality. At EY, we believe it has done both; although, more work surely remains. SOX forged a new era for the US audit profession by ending over 100 years of self-regulation and establishing independent oversight of public company audits by the Public Company Accounting Oversight Board (PCAOB). SOX strengthened corporate governance, shifting responsibility for the external auditor relationship away from corporate management to independent audit committees. It instituted whistleblower programs, CEO and CFO certification requirements and stricter criminal penalties for wrongdoing, including lying to the auditor. These measures and others were geared toward improving the reliability of corporate financial reporting.

Over the last 12 years, key elements of the Act have been replicated around the world, perhaps the purest form of flattery. Today, as we turn the corner on the global financial crisis, many jurisdictions are looking anew at policy improvements similar to those instituted by SOX.

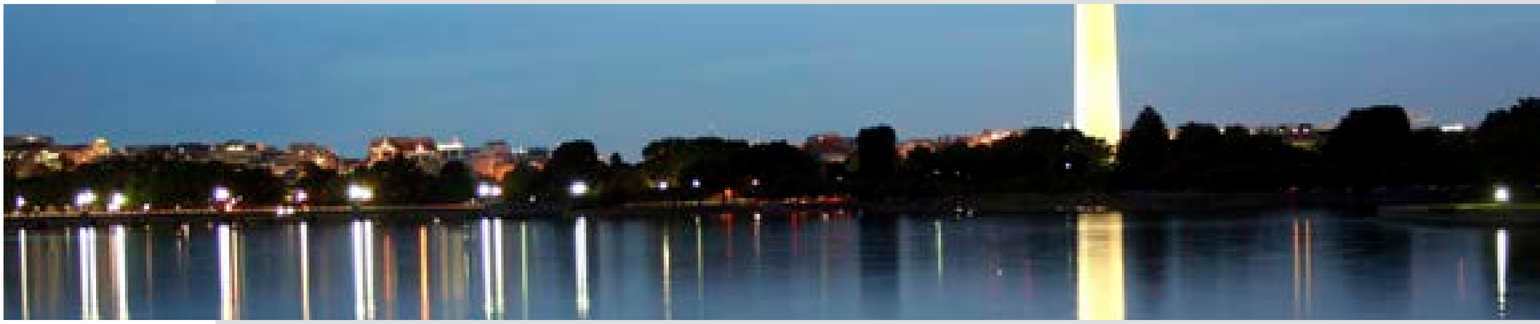
To be sure, Sarbanes-Oxley has received its share of criticism over the years, the bulk of which has focused on Section 404 relating to internal controls over financial reporting. Such concerns have been addressed since the passage of SOX through a series of regulatory and legislative actions, including changes enacted in 2012.

At EY, we believe history has shown, and will continue to show, that the Sarbanes-Oxley Act as a whole has afforded a substantial benefit to investors and US capital markets. We believe that one of the greatest successes of the Sarbanes-Oxley Act was to align the interests of auditors, independent audit committees and audit oversight authorities with those of shareholders. In our view, as the 10th anniversary of the Sarbanes-Oxley Act approaches, the Act continues to provide a solid foundation from which to further this alignment.

This document reviews the Act's key provisions, perspectives on some improvements engendered by SOX and opportunities for further enhancements to the financial reporting system.

James S. Turley
Former Global Chairman and CEO,
2001-2013

Steve Howe
Americas Managing Partner and Managing
Partner of the US Firm



Principal components of the Sarbanes-Oxley Act of 2002

I. Established independent oversight of public company audits

- Established the PCAOB, which ended more than 100 years of self-regulation by the public company audit profession
- Provided the PCAOB with inspection, enforcement and standard-setting authority

II. Strengthened audit committees and corporate governance

- Required audit committees, independent of management, for all listed companies
- Required the independent audit committee, rather than management, to be directly responsible for the appointment, compensation and oversight of the external auditor
- Required disclosure of whether at least one "financial expert" is on the audit committee

III. Enhanced transparency, executive accountability and investor protection

- Required audit firms to disclose certain information about their operations for the first time, including names of clients, fees and quality control procedures
- Required the CEO and CFO to certify financial reports
- Prohibited corporate officers and directors from fraudulently misleading auditors
- Instituted clawback provisions for CEO and CFO pay after financial restatements
- Established protection for whistleblowers employed by public companies who report accounting, auditing and internal control irregularities
- Required management to assess the effectiveness of internal controls over financial reporting (404(a)) and auditors to attest to management's representations (404(b))
- Established the "Fair Funds" program at the U.S. Securities and Exchange Commission (SEC) to augment the funds available to compensate victims of securities fraud

IV. Enhanced auditor independence

- Prohibited audit firms from providing certain non-audit services to audited companies
- Required audit committee pre-approval of all audit and non-audit services
- Required lead audit partner rotation every five years rather than every seven years

Established independent oversight of public company audits

Sarbanes-Oxley's establishment of the PCAOB, which ended more than 100 years of self-regulation at the federal level by the public company audit profession, is perhaps the most fundamental change made by SOX. Today, it is the PCAOB, not the profession, which regulates audit firms, establishes auditing and ethics standards, conducts audit quality inspections for the purpose of identifying issues related to audit quality, investigates allegations and disciplines auditors of public companies and broker-dealers.[1]

As of December 31, 2011, over 2,000 audit firms from more than 80 countries were registered with the PCAOB. In 2011, it conducted inspections of 213 registered audit firms, and initiated an interim inspection program for broker-dealers.[2] The PCAOB's standardsetting initiatives and inspections have contributed significantly to improvements in audit quality and auditor independence — affording investors significant benefits.

Standard setting

The PCAOB has the authority to set standards governing how auditors conduct audits of public companies and broker-dealers; auditor ethics and independence; and an audit firm's system of quality control. From time to time, the PCAOB identifies potential areas to be addressed via standard setting, including review and analysis of information obtained from inspections as well as input received from its Standing Advisory Group, which includes representatives from investor groups, the audit profession and public company board members.[3] The PCAOB also seeks comment from and publicly engages with a variety of stakeholders throughout the year via the public comment process, roundtables and other means. Recent and current standard-setting projects include those related to the auditor's risk assessment process, auditor communications with audit committees and the nature and content of the auditor's report.

In addition to standard setting, PCAOB staff issue practice alerts to draw auditors' attention to emerging issues or risks. Recent alerts have highlighted audit risks associated with the current economic environment and certain emerging markets. EY believes the PCAOB's current standard-setting agenda has the potential to make significant additional contributions to audit quality.

1 Under Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the PCAOB now has authority over the auditors of broker-dealers. This publication focuses on the PCAOB's regulation of public company auditors.

2 Data obtained from the PCAOB Annual Report 2011, available at *www.pcaobus.org*.

3 See *http://pcaobus.org/Standards/SAG/Pages/default.aspx*.

> "While nobody likes to be inspected by their regulator, I truly believe that EY and the entire profession will be better for it."

James S. Turley
Former Global Chairman & CEO, EY
Testimony before the US Senate Committee on Banking,
September 9, 2004

Inspections

The PCAOB's inspection process is a significant element of its efforts to drive audit quality. EY views the annual inspections as opportunities to further improve audit quality. The PCAOB inspects registered audit firms at intervals based on the number of public companies that the firm audits. Firms that perform annual audits of more than 100 issuers are inspected annually, while other firms are inspected at least every third year. The PCAOB uses a variety of factors to select the audits that it looks at for each audit firm it inspects, including its assessment of the risk that a public company's financial statements may contain a material misstatement.

These inspections provide an independent review of audit quality that highlight opportunities for improvement within audit firms, both at the individual audit level and with respect to a firm's system of quality control. Inspection results are used to identify areas in which additional audit guidance, training, practice reminders or enhanced skills may be needed, all of which enable audit professionals to improve their performance.

As part of each inspection, the PCAOB prepares a report, part of which is made publicly available. The public portion of the report cites audits where the PCAOB believes the firm failed to obtain sufficient evidence to support its opinion. The non-public portion of the inspection report includes concerns raised during inspections related to a firm's system of quality control. If an audit firm does not address those concerns to the PCAOB's satisfaction within a one-year period, the PCAOB's concerns are publicly reported.[4]

Enforcement

The PCAOB's enforcement staff actively investigates and sanctions individual auditors and audit firms for violations of laws, regulations and professional standards. The PCAOB's disciplinary powers include the authority to impose fines on individual auditors or the audit firm, revoke an audit firm's registration with the PCAOB (which would prevent it from performing audits of public companies and/or broker-dealers) and bar an individual auditor from association with registered audit firms. It also can punish firms and auditors that do not cooperate with PCAOB investigations and inspections and may refer matters to the SEC and other relevant authorities. The PCAOB publishes its settled and adjudicated disciplinary orders on its website to alert the public about the actions it has taken and against whom they have been taken.

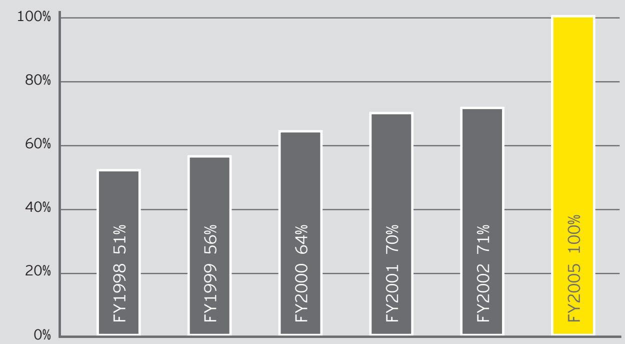
4 The Sarbanes-Oxley Act of 2002, §104(g)(2).

Strengthened audit committees and corporate governance

In a move that significantly strengthened corporate governance, Sarbanes-Oxley greatly expanded the responsibilities of audit committees.[5] SOX required the boards of companies listed on US stock exchanges to establish audit committees made up solely of board members independent from management. Because of SOX, audit committees, not management, are directly responsible for the appointment, compensation and oversight of the work of external auditors, who are charged with evaluating whether the financial statements prepared by management are fairly presented in accordance with the relevant financial reporting framework.

With respect to the composition of the audit committee, SOX enhanced and codified changes the SEC and US stock exchanges had begun making in the late 1990s. In 1998, only about half of all public companies had fully independent audit committees (see table). Many audit committees were reconstituted in order to meet the new independence requirements outlined by the SEC and US stock exchanges in late 1999.[6] SOX went further and enhanced independence requirements to require for the first time that all listed company audit committee members be independent, meaning they could not be affiliated with the company or any subsidiaries, and did not directly or indirectly receive any compensation from the company other than in their capacity as members of the board.

Evolving audit committee independence — S&P 1500 companies[7]



While the exchanges and the SEC began to make improvements at the end of the 1990s, SOX transformed the composition of audit committees. The new SOX audit committee independence rules became effective at companies' first annual shareholders meetings after January 15, 2004.

SOX also encouraged audit committees to have at least one member who is a "financial expert"[8] to serve as a resource to help the audit committee carry out its duties. This puts the audit committee in a stronger position to review and challenge financial statements, determine whether internal controls are appropriate and sufficient and, if necessary, perform certain accounting actions to protect shareholder interests. Companies that do not have an audit committee member with financial expertise must disclose this in the annual proxy statement and explain the rationale for not having one. In 2003, only a small number of audit committee members were financial experts. Today, almost one-half of all audit committee members are identified through proxy statement disclosure as meeting the definition of a financial expert.[9]

5 Audit committees are made up of members of the board of directors and oversee the companies' accounting and financial reporting process. Securities Exchange Act §3(a)(58).

6 In 1999, the New York Stock Exchange, American Exchange and NASDAQ approved rules to require that their listed companies have audit committees composed of directors independent of management, unless the board made a special determination that it was in the best interests of the company to have one audit committee member that was not independent. Each exchange had its own definition of "independent." In addition, the SEC issued a rule to require disclosure of whether the audit committee members of public companies were independent, as well as certain information about any non-independent members.

7 Source: 2005 through present, EY's corporate governance database; prior year data Investor Responsibility Research Center, Board Practices/Board Pay.

8 Generally, a financial expert is a person who, through education and experience, has an understanding of and experience in applying generally accepted accounting principles and preparing financial statements, experience with internal controls and procedures for financial reporting, and an understanding of audit committee functions. SOX §407, 17cfr229.407(d)(5)(ii).

9 Source: EY's corporate governance database, which is based on SEC filings.

> "Prior to SOX, the process for the selection and assessment of the independent auditor typically was controlled by management … . Audit committees now play an essential role in our corporate governance framework by overseeing the quality and integrity of the company's financial statements."

National Association of Corporate Directors
December 14, 2011

To facilitate its oversight of a company's financial reporting, SOX required companies to provide audit committees with the resources and authority to engage independent counsel and advisers to help them carry out their duties. SOX also required audit committees to establish procedures for receiving whistleblower complaints regarding accounting, auditing and internal control irregularities and to provide for the confidential and anonymous treatment of employee concerns regarding such matters. In addition, SOX enhanced the external auditor's required communications with the audit committee to include the following:

- A discussion of all critical accounting policies and practices used by the company
- All alternative accounting treatments that have been discussed with management, the ramifications of the use of alternative disclosures and accounting treatments and the accounting treatment preferred by the audit firm
- Other material written communications between the auditor and management

These reforms significantly empowered audit committees and they began to take a more active role to carry out their increased responsibilities. For example, audit committees for the S&P 500 companies met on average five times a year in 2001.[10] The average number of annual meetings has nearly doubled to nine today.[11] Audit committees also are exercising ownership of the relationship with the auditor.

In a 2008 audit committee survey reported by the Center for Audit Quality, 90% of audit committee members surveyed said that "they work more closely with the independent auditor" post-SOX.[12] As part of this increased focus, interaction and oversight, audit committees are asking the external auditor more probing questions and meeting with the audit firm's subject matter experts and senior leadership throughout the year, not just during formal meetings. Collectively, these reforms have contributed to significant enhancements in audit quality.

To learn more about audit committee leading practices, please visit ey.com/auditcommittee.

EY and the Tapestry Networks: enhancing audit committee leadership and influence

Through the active support and engagement of EY, Tapestry Networks organizes and leads nine audit committee networks across North America that collectively consist of 150 individuals, who chair more than 200 audit committees and sit on over 380 boards at some of the world's leading companies.

These audit committee chairs work together and with key stakeholders to improve committee performance and raise the bar on governance practices. Network members share emerging leading practices and insights into issues that dominate the audit committee environment. The networks also provide an opportunity for dialogue with stakeholders such as regulators, standard-setters and the investor community.

After each meeting, Tapestry publishes its *ViewPoints* and *VantagePoints*, which are made publicly available to stimulate board discussions about the choices confronting audit committee members, management and their advisers as they fulfill their respective responsibilities to the investing public.

10 Source: 2005 through present, EY's corporate governance database; prior year data, Investor Responsibility Research Center, Board Practices/Board Pay. 2001 and 2002: The Structure and Compensation of Boards of Directors at S&P Super 1500 Companies.

11 Source: Spencer Stuart 2011 Board Index, *http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI2011.small022212.pdf*

12 Source: Center for Audit Quality, "Report on the Survey of Audit Committee Members," March 2008, *http://www.thecaq.org/newsroom/pdfs/auditsurvey.pdf*

Enhanced transparency, executive accountability and investor protection

One of the core elements of Sarbanes-Oxley was to clearly define and place responsibility for a company's financial statements with its cchief executive officer (CEO) and chief financial officer (CFO), SOX mandated that these executives certify the following items (among others) for each annual and quarterly report:

- They have reviewed the report
- Based on their knowledge, the financial information included in the report is fairly presented
- Based on their knowledge, the report does not contain any untrue statement of material fact or omit a material fact that would make the financial statements misleading
- They acknowledge their responsibility for establishing and maintaining internal controls over financial reporting and other disclosures
- They have evaluated the effectiveness of these controls, presented their conclusion as to effectiveness and disclosed any material changes in the company's controls

By making management executives fully accountable for their companies' financial statements, Sarbanes-Oxley set a clear tone for corporate responsibility and helped restore investors' confidence in financial statements. To enhance the significance of these certifications, SOX mandated stiff penalties for executive officers who certify that financial reports comply with the various regulatory requirements while knowing that they do not. Such penalties include potential SEC enforcement action, forfeiture of bonuses and profits, or criminal penalties such as fines or imprisonment.[13] As a further step to help restore investor confidence in corporate financial statements, SOX required companies to have an auditor attest to the effectiveness of the company's internal controls over financial reporting.

To supplement the financial relief available to victims of securities fraud, SOX also established the "Fair Funds" program at the SEC. This program allows the SEC to add monetary penalties paid by those who commit securities fraud to the funds available for distribution to wronged investors.[14]

In addition to requiring the chief executive and chief financial officers to certify that the financial statements are fairly presented in accordance with the relevant financial reporting framework, Sarbanes-Oxley established a number of important additional investor protections:

- Public companies are now required to provide enhanced disclosures in annual and quarterly reports regarding material off-balance sheet transactions, arrangements and obligations
- Public companies are required to report material changes in the financial condition or operations of the company on a rapid and current basis
- Board members of public companies, officers and investors who own more than 10% of the shares of a public company must file reports specifying the number of shares bought or sold within two days of the transaction
- Board members and executive officers of public companies are prohibited from trading shares during a specific blackout period before and after earnings reports or when other material results are disclosed

13 SOX §304 requires CEOs and CFOs to reimburse issuers for bonuses and profits on the sale of the issuer's shares over the preceding 12 months if the issuer restates its financial statements due to misconduct. Section 954 of the Dodd-Frank Act of 2010 requires companies to establish policies to recover incentive-based pay of any current or former executives awarded over the three years prior to a restatement, regardless of whether there was misconduct. The SEC has not yet issued a rule to carry out this requirement.

14 Prior to SOX, these funds were paid to the US Treasury.

A November 2009 study published by Audit Analytics found the rate of financial restatements was 46% higher for companies that did not comply with all of the Sarbanes-Oxley internal control provisions.

Internal controls over financial reporting

Sarbanes-Oxley requires public companies to assess how effective their internal controls over financial reporting are at preventing misstatements that could be material to the financial statements. While public companies have long been required to maintain effective systems of internal controls, pursuant to the Foreign Corrupt Practices Act of 1977, SOX requires them to annually evaluate their financial internal controls and to disclose the results of that assessment. This includes whether there were any weaknesses that may not prevent or detect a material misstatement in the financial statements.

SOX Section 404(a) requires management to report on the e ffectiveness of the company's internal controls over financial reporting, and Section 404(b) requires the auditor's attestation regarding their effectiveness. SEC rulemaking and legislation subsequent to SOX (e.g., the Dodd-Frank Act and the JOBS Act) have delayed or eliminated the requirement for certain companies to comply with Section 404(b). These include non-accelerated filers and emerging growth companies.

Internal controls over financial reporting are processes that provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. These include policies and procedures that:

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer
2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the registrant
3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements

The requirements to conduct the assessment and provide the related disclosures have widely been credited with improving public companies' systems of internal control and have also given investors additional insights and confidence with respect to a company's financial reporting.

Enhanced auditor independence

Sarbanes-Oxley strengthened auditor independence and established certain types of non-audit services as off-limits to audit firms that provide auditing services to a public company. In addition, the company's independent audit committee must pre-approve any of the permissible non-audit services performed by the external auditor.

To further enhance independence, SOX calls for the mandatory rotation of the lead engagement partner every five years, rather than seven years as had been required under prior professional standards. SOX also extended the five-year rotation requirement to the concurring audit partner.[15] During the rulemaking process following passage of Sarbanes-Oxley, the SEC further enhanced auditor independence by extending rotation requirements to other audit partners who have significant responsibilities on audits. These other audit partners are required to rotate off an engagement every seven years.

SOX prohibits audit firms from providing certain services to public companies they audit:

- Bookkeeping
- Financial information systems design and implementation
- Appraisal or valuation services or fairness opinions
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker, dealer, investment adviser or investment banking services
- Legal and expert services unrelated to the audit

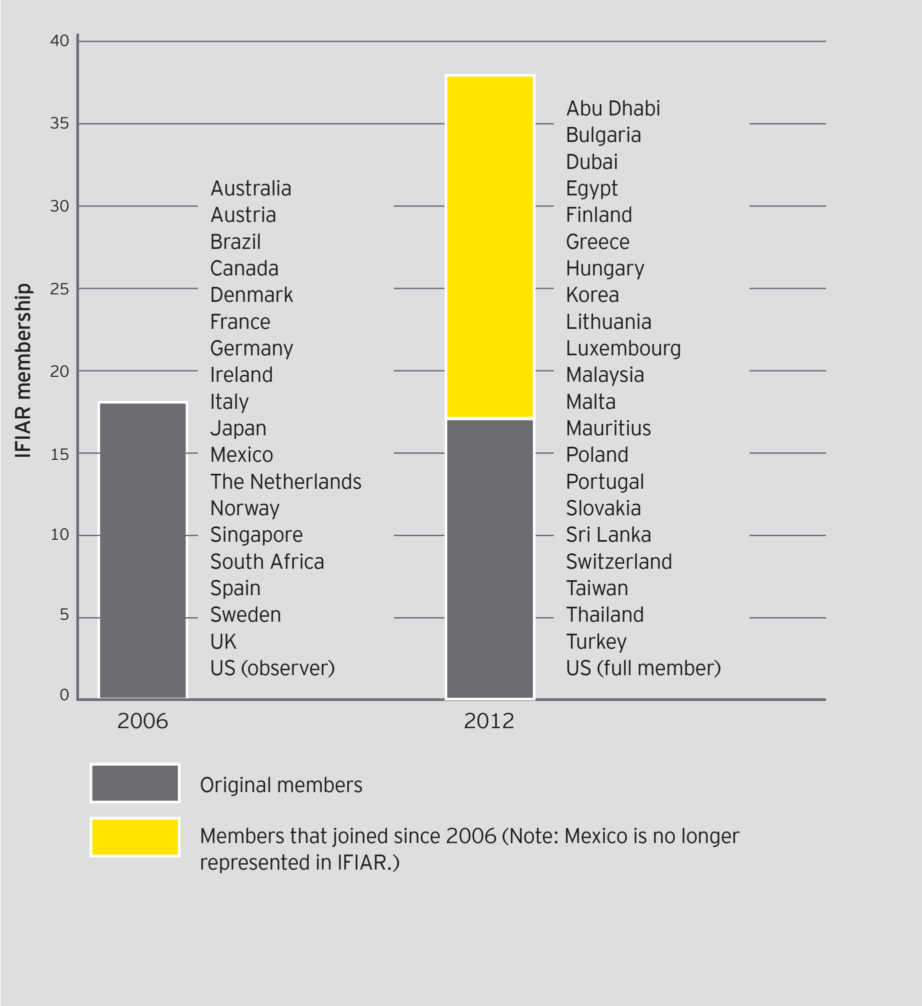
15 "Concurring audit partner" (or "engagement quality reviewer" as defined in PCAOB standards) is a partner, independent of the audit team, whose role is to perform an objective review of the significant judgments made by the audit team and the related conclusions reached in forming an opinion on the financial statements. Engagement quality reviewers must provide their approval prior to issuance of an audit report.

Looking ahead: the next 10 years

As companies continue to operate in more volatile, dynamic and global market conditions, audits will become increasingly complex — and even more critical to investor confidence. For this reason, EY strongly supports a broad spectrum of efforts to improve audit quality and strengthen corporate governance.

For example, EY supports enhancements to existing professional standards to strengthen the relevance, reliability and transparency of the audit process to investors. Some of the more significant recent efforts include the recently adopted standards related to the auditor's identification, assessment and response to the risks of material misstatement and engagement quality review. In addition, the PCAOB has a number of current initiatives that are intended to have a positive impact on audit quality, such as enhancements to the standards related to auditor communications with the audit committee, the auditor's reporting model, the auditor's consideration of related parties and the evaluation of fair value measurements.

At the global level, EY expects to see increasing cooperation among audit regulators, many of which have been created since the passage of SOX. The International Forum of Independent Audit Regulators (IFIAR) was established in 2006 and has a steadily growing membership roster (see graph to the right).[16] The PCAOB is a member of IFIAR, which provides a forum for discussion of common concerns about and practices in audit firms. EY supports measures to improve regulatory coordination across borders.



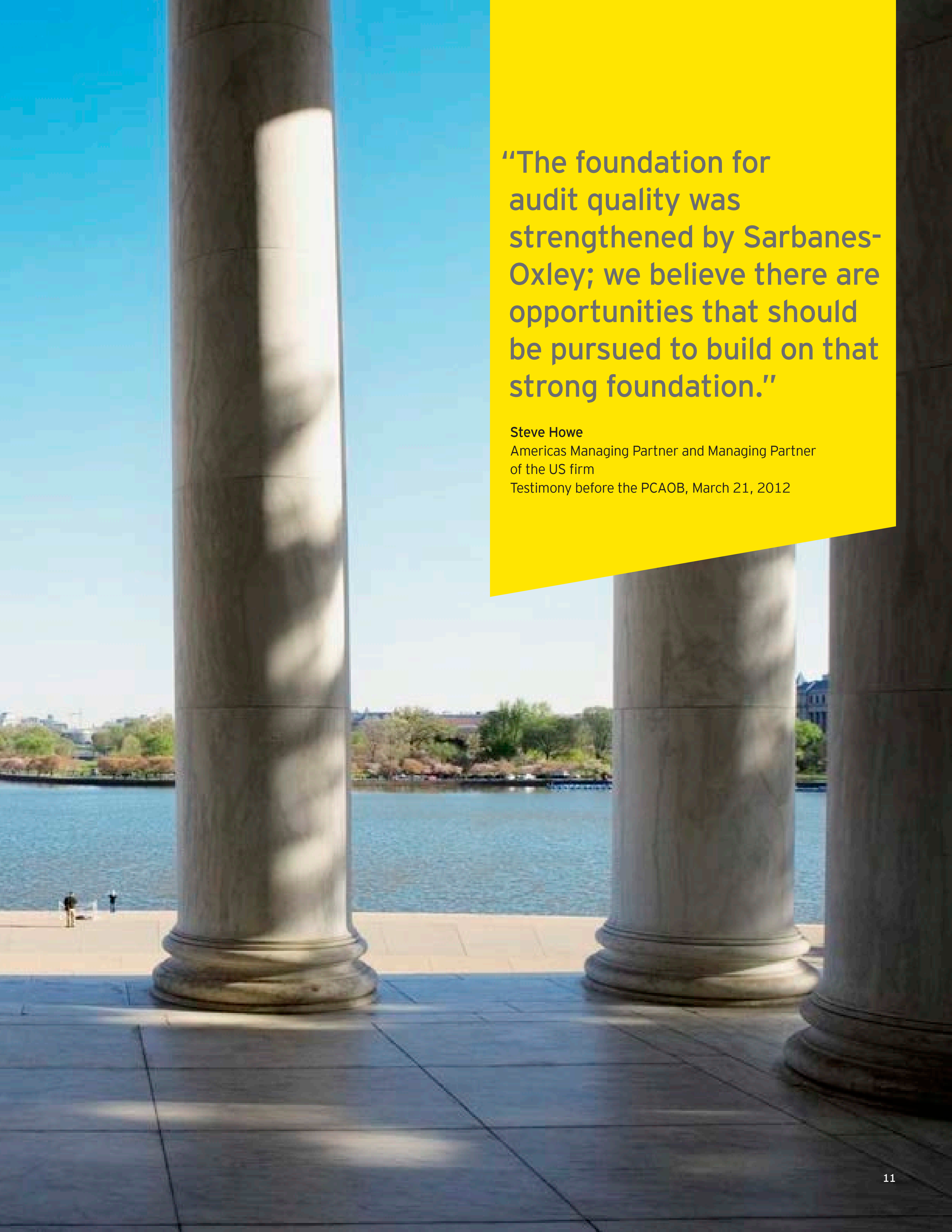
16 See ifiar.org/aboutus/index.cfm.

Withstanding the test of time

While SOX put in place numerous improvements with respect to auditor oversight and independence, EY believes that achieving and maintaining audit quality requires a process of continuous improvement. Auditors must always seek to improve in their work, given the dynamism and complexity of companies, global markets, financial products and the business environment. Fostering alignment through increased communication and transparency among auditors, audit committees and shareholders, as well as between audit committees and the PCAOB, is critical to improving audit quality and maintaining investor confidence in the financial reporting system. For that reason, EY has outlined support for a number of policy initiatives with regulators around the world, including the PCAOB, related to these topics, and has contributed suggestions to further their study.[17]

Moving forward, EY reaffirms its commitment to build upon the foundation established by SOX by working with the PCAOB, independent audit committees and shareholders. As the 10th anniversary of the Sarbanes-Oxley Act of 2002 approaches, we encourage a closer look at its provisions and impact, which we believe will stand the test of time.

17 For more information on the policy initiatives that Ernst & Young supports, please see *http://pcaobus.org/Rules/Rulemaking/Docket037/063_EY.pdf and http://pcaobus.org/Rules/Rulemaking/Docket037/ps_Howe.pdf*



"The foundation for audit quality was strengthened by Sarbanes-Oxley; we believe there are opportunities that should be pursued to build on that strong foundation."

Steve Howe
Americas Managing Partner and Managing Partner of the US firm
Testimony before the PCAOB, March 21, 2012

Key features of The Sarbanes-Oxley Act of 2002

On July 25, 2002, Congress passed the Sarbanes-Oxley Act of 2002 by a vote of 423-3 in the House, and 99-0 in the Senate. On July 30, 2002, President George W. Bush signed the measure into law (PL 107-204).

The following is an outline of the major requirements of the Act, broken into five sections: (1) consequences for issuers; (2) audit committee requirements; (3) board and corporate officer requirements; (4) audit firm requirements; and (5) the major amendments to SOX since its enactment.

I. Issuers

The Act has the following consequences for issuers:

1. Issuers are subject to the Act: The Act defines "issuer" as any company whose securities are registered, whether the issuer is domiciled in the United States or elsewhere, and any company required to file reports under §15(d) of the Securities Exchange Act of 1934 (§2).
2. Issuers must establish audit committees: The Act effectively requires all listed companies, whether US or non-US, to have fully independent audit committees (Title II generally).
3. The PCAOB can compel testimony and audit work papers related to an issuer: The PCAOB may require testimony or the production of documents or information in the possession of any registered audit firm or "associated person" of the firm relevant to an investigation. The PCAOB may also "request" documents and testimony from other persons, including issuers. If necessary, the PCAOB may request that the SEC issue a subpoena to assist it in its investigation (§105).
4. Issuers will be held responsible for associating with suspended or barred auditors: The Act prohibits an issuer from employing a person who has been suspended or barred from associating with any audit firm (§105).
5. Issuers are required to fund the PCAOB's and FASB's operations: The Act authorizes the PCAOB to fund itself by requiring issuers to pay an "annual accounting support fee." Issuers also are responsible for funding FASB (§108 and §109).
6. An issuer may not engage its auditor for nine specifically listed categories of non-audit services: The Act statutorily prohibits specifically listed categories of non-audit services from being offered by audit firms to their public audit clients (§201).
7. An issuer's audit committee must pre-approve all audit and non-audit services: Before an auditor can provide audit services or any non-audit service to a public audit client, the audit committee of the client must approve (§202).
8. Issuers must disclose approvals of non-audit services: Audit committee approvals of non-audit services must be disclosed in SEC periodic reports (§202).
9. Issuers must wait one year before hiring an audit engagement team member to be CEO, CFO, CAO or equivalent: The Act provides that an audit firm may not provide audit services for a public company if that company's chief executive officer, controller, chief financial officer, chief accounting officer, or other individual serving in an equivalent position, was employed by the audit firm and worked on the company's audit during the one year before the start of the audit services (§206).
10. Issuers must provide audit committees with adequate funding: Issuers must provide appropriate funding, as determined by the audit committee, for payment of compensation to the auditor and any advisers employed by the audit committee (§301).
11. Issuers must disclose off-balance sheet transactions: The SEC issued rules requiring that annual and quarterly financial reports disclose all material off-balance sheet transactions, arrangements, obligations, and other relationships of the issuer that may have a material current or future effect on the financial condition of the issuer (§401).
12. Issuers must reconcile pro forma information with GAAP and not omit information that otherwise makes financial disclosures misleading: The SEC issued rules providing that pro forma financial information disclosures must reconcile with GAAP and not be misleading (§401).
13. Issuers may not extend loans to board members or corporate officers: The Act makes it unlawful for an issuer to extend a loan to a board member or executive officer that is not made in the ordinary course of business of the issuer, and is not of a type generally made available to the public and on market terms (§402).
14. Issuers must disclose transactions involving management and principal stockholders: Section 16 of the Securities Exchange Act of 1934 was amended to require that changes in equity ownership by board members, officers and 10% stockholders must be reported within two business days after the day of the transaction. These "Section 16 filings" must be filed electronically and posted on the company's website (§403).

15. Issuers must make annual internal control reports: Issuers must make reports that (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and (2) contain an assessment as of the end of the most recent fiscal year of the effectiveness of the internal control structure procedures of the issuer for financial reporting. The auditor must attest to, and report on, management's assertion (§404).
16. Issuers must disclose whether they have adopted codes of ethics for their senior officers: The SEC issued rules requiring companies to disclose whether they have adopted codes of ethics for senior officers. If not, issuers must explain their rationale for failing to do so (§406).
17. Issuers must disclose the existence of a "financial expert" on the audit committee: The SEC issued rules requiring issuers to disclose whether or not (and if not, reasons therefore) the audit committee has at least one member who is a "financial expert" (§407).
18. Issuers must disclose information about "material changes" on a real time basis: Public companies must disclose in plain English and "on a rapid and current basis" additional information regarding material changes in their financial conditions or operations (§409).
19. The Act creates criminal penalties for obstruction of justice by destruction of documents: The Act creates criminal penalties for obstruction of federal agency or other official proceedings by destruction of records. The Act provides for up to 20 years in jail for knowingly destroying or creating evidence with intent to obstruct a federal investigation or matter in bankruptcy (§802 and §1102).
20. The Act changes bankruptcy law regarding obligations incurred in violation of securities laws: The Act amends the federal bankruptcy code so that obligations arising from securities law violations cannot be discharged in bankruptcy (§803).
21. The Act creates longer statutes of limitations for securities fraud cases: The Act lengthens the statute of limitations for private federal securities fraud lawsuits from one year after the date of discovery of the facts constituting the violation and three years after the fraud to two years from discovery and five years after the fraud (§804).
22. The Act creates "whistleblower" protections for employees of issuers: The Act provides whistleblower protection to employees of publicly traded companies when they disclose information or assist in detecting and stopping fraud (§806 and §1107).
23. The Act creates criminal penalties for defrauding shareholders of publicly traded companies: The Act provides that anyone who "knowingly" defrauds shareholders of publicly traded companies may be subject to fines and imprisonment of up to 25 years (§807).
24. The Act enhances penalties for white collar crime: The Act increases jail time for conspiracy, mail and wire fraud, violations of ERISA, Exchange Act violations and retaliation against informants (§902, §903, §904, §1106 and §1107).

II. Audit Committees

The Act requires that audit committees:

25. Pre-approve all audit and non-audit services: The Act provides that both auditing and non-audit services must be pre-approved by the audit committee. The Act makes it "unlawful" for audit firms to perform nine specifically listed categories of non-audit services for their public audit clients. The Act specifically indicates that the performance of any other non-audit service by an audit firm for a public audit client is not prohibited, provided such services are "pre-approved" by the client's audit committee (§201, §202).
26. Have the ability to delegate pre-approval authority: The pre-approval of non-audit services may be delegated to a member of the audit committee. The decisions of any audit committee member to whom pre-approval authority is delegated must be presented to the full audit committee at its next scheduled meeting (§202).
27. Receive regular reports from the auditor on accounting treatments: An auditor must report to the audit committee on the critical accounting policies and practices to be used, all alternative treatments of financial information within GAAP that have been discussed with management, including the ramifications of the use of such alternative treatments, and the treatment preferred by the auditor; any accounting disagreements between the auditor and management; and other material written communications between the auditor and management (such as any management letter and schedule of unadjusted differences) (§204).
28. Be responsible for oversight of the auditor: The Act provides that auditors shall report to and be overseen by the audit committee of a client, not management. The audit committee is "directly responsible for the appointment, compensation, and oversight" of the auditor's work (§301).

29. Be independent of the issuer: Audit committee members must be independent. In order to be considered "independent," an audit committee member may not accept any consulting, advisory or other compensatory fees from the issuer or be an "affiliated person" of the issuer or a subsidiary thereof (§301).
30. Establish complaint procedures: Audit committees must establish procedures for receiving and treating complaints regarding accounting and auditing matters, including complaints from those who wish to remain anonymous (§301).
31. Be given authority to engage advisers: Audit committees must "have the authority to engage independent counsel and other advisers, as it determines necessary, to carry out its duties" (§301).
32. Receive corporate attorneys' reports of evidence of a material violation of securities laws or breaches of fiduciary duty: The SEC established rules for attorneys appearing before it that require them to report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the company to the chief legal counsel or the CEO. If management does not appropriately respond to the evidence, the attorney must report the evidence to the audit committee (§307).

III. Boards of directors and corporate officers

The Act imposes the following requirements on boards of directors and corporate officers:

33. The board of directors must either form an audit committee or take on such responsibilities: The Act requires boards of directors to either form an audit committee or otherwise take on the responsibilities of one (§2).
34. CEO and CFO must certify financial reports: An issuer's CEO and CFO must certify that periodic reports filed with the SEC are materially correct; that financial statements and disclosures "fairly present" the company's operations and financial condition in all material respects; and that they are responsible for evaluating and maintaining internal controls, have designed such controls to ensure that material information related to the issuer and its consolidated subsidiaries is made known to such officials and others within such entities, have evaluated the effectiveness as of a date within 90 days prior to the report, and have presented in their report their conclusions bout the effectiveness of their internal controls. Further, they shall certify that they have disclosed to the auditor and audit committee all "significant deficiencies" in the design or operation of internal controls, including any material weaknesses, and any fraud, whether or not material, that involved management or other employees who have a significant role in the issuer's internal controls (§302).

    A separate criminal provision requires the signing officer to certify that each periodic report containing financial statements complies with securities laws and that the information in such report fairly presents, in all material respects, the financial condition and results of operations of the company. Failure to do so is a criminal felony, punishable by up to 10 years in jail. A willful violation is punishable by a fine up to US$5 million and/or imprisonment of up to 20 years (§906).
35. Officers, directors and others are prohibited from fraudulently misleading their auditors: The Act prohibits "any officer or director of an issuer" and persons "acting under the direction thereof" from taking any action to fraudulently influence, coerce, manipulate or mislead any accountant engaged in preparing an audit report, for the purpose of rendering the audit report misleading (§303).
36. CEO/CFO must disgorge bonuses and profits after restatements due to misconduct: CEOs and CFOs must forfeit bonuses, incentive-based compensation and profits on stock sales if the issuer is required to issue a restatement due to misconduct (§304).
37. The SEC can bar "unfit" officers and directors: The Act gives the SEC authority to bring administrative proceedings to bar persons who are found to be "unfit" from serving as officers or directors of publicly traded companies. (Note: Under prior law, the SEC had to go to court to obtain such a bar, and the standard was "substantial unfitness.") (§305 and §1105).
38. Officers and directors are prohibited from trading during pension "blackout" periods: The Act prohibits corporate officers and directors from trading company securities during a pension fund "blackout" period (§306).
39. The CEO and chief legal counsel must receive corporate attorneys' reports of evidence of a material violation of securities laws or breaches of fiduciary duty: The SEC established rules for attorneys appearing before it that require them to report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the company to the chief legal counsel or the CEO. If management does not appropriately respond to the evidence, the attorney must report the evidence to the audit committee (§307).

40. The Act gives the SEC authority to temporarily freeze the pay of corporate officers: The Act gives the SEC authority to temporarily freeze the pay of corporate officers pending an investigation of securities fraud (§1103).

IV. Audit firms

The Act's regulatory board provisions require audit firms to:

41. Be subject to oversight by a new accounting oversight board: The Act established the PCAOB, which has broad powers over the profession. The PCAOB has five full-time members, appointed for staggered five-year terms. Two (and no more than two) of the members must be or have been CPAs. The SEC appoints PCAOB members (after consultation with other agencies) (§101).
42. Register with the PCAOB: Audit firms that perform audits of public companies must register with the PCAOB. The registration form requires firms to disclose: the names of audit clients; annual fees received from each issuer for "audit services, other accounting services, and non-audit services;" a statement of the firm's quality control policies; a list of all the firm's auditors, and licensing information; information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or associated persons in connection with any audit report; copies of any SEC reports disclosing accounting disagreements between the firm and an issuer in connection with an audit report; any additional information the PCAOB specifies as necessary or appropriate in the public interest or for the protection of investors; consent to cooperate in and comply with any testimony or document production request made by the PCAOB; and an agreement to secure and enforce similar consents from "associated persons" of the firm (§102).
43. Submit periodic reports: Audit firms must submit annual updates of their registration to the PCAOB (more frequently if the PCAOB determines it necessary) (§102).
44. Pay fees to the PCAOB: Audit firms must pay registration fees and annual fees to the PCAOB to cover the costs of processing applications and annual reports (§102).
45. Comply with auditing and other professional standards: The Act requires the PCAOB to establish, or adopt by rule, "auditing and related attestation standards," as well as "ethics standards" to be used by audit firms in the preparation and issuance of audit reports.

The Act indicates that the PCAOB may adopt standards proposed by "professional groups of accountants" (§103).

46. Comply with quality control standards: The Act requires the PCAOB to issue standards for audit firms' quality controls, including: monitoring of ethics and independence, internal and external consulting on audit issues, audit supervision, hiring, development and advancement of audit personnel, client acceptance and continuance, and internal inspections (§103).
47. Submit to quality control inspections: The PCAOB must regularly inspect audit firms' audit operations (annually for large firms) to assess the degree of compliance by those firms with the Act, the rules of the PCAOB, the firm's own quality control policies, and professional standards relating to audits of public companies (§104).
48. Subject foreign firms to PCAOB regulation: Foreign audit firms that "prepare or furnish" an audit report with respect to US registrants must register with the PCAOB and are treated the same as US audit firms for purposes of the Act (§106).
49. Secure the consent of foreign firms to PCAOB requests for documents if a domestic firm relies on its opinion: A domestic audit firm that relies upon the opinion of a foreign audit firm must "secure" the foreign firm's agreement to supply audit work papers to the PCAOB (§106).

The Act's legal and disciplinary provisions have the following consequences for audit firms:

50. Investigations and disciplinary actions: The PCAOB investigates potential violations of the Act, its rules, related provisions of the securities laws (and the rules), and professional accounting and conduct standards (§105).
51. Testimony and document production requests: The PCAOB may require testimony or the production of documents or information in the possession of any audit firm, "associated person," or any other person (including any client of an audit firm) if relevant to an investigation. All confidential information received by the PCAOB under the authority provided in §105 may be furnished to the SEC and appropriate federal functional regulators (§105).
52. PCAOB sanctions, including suspension: The PCAOB may impose sanctions for non-cooperation or violations, including revocation or suspension of an audit firm's registration, suspension from auditing public companies, and imposition of civil penalties (§105).

53. State and federal prosecution after referral from the PCAOB: The PCAOB may refer investigations to the SEC, or with the SEC's approval to the Department of Justice, state attorneys general, or state boards of accountancy, if such disclosure is "necessary to accomplish the purposes of the Act or to protect investors" (§105).
54. Sanctions for failure to supervise: The PCAOB may also impose sanctions upon an audit firm or its supervisory personnel for failure reasonably to supervise a partner or employee (§105).
55. Members of the audit engagement team must wait one year before accepting employment as an audit client's CEO, CFO, CAO or equivalent: The Act provides that an audit firm may not provide audit services for a public company if that company's chief executive officer, controller, chief financial officer, chief accounting officer, or other individual serving in an equivalent position, was employed by the audit firm and worked on the company's audit during the one year before the start of the audit services (§206).
56. Criminal penalties for destruction of corporate audit records: The Act creates a felony for the willful failure to maintain "all audit or review work papers" for five years. Pursuant to SOX, the SEC promulgated a rule on the retention of other audit records (paper and electronic) in addition to actual work papers (§802).
57. Longer statutes of limitations for securities fraud cases: The Act lengthens the statute of limitations for securities fraud from one year after the date of discovery of the facts constituting the violation and three years after the fraud to two years from discovery and five years after the fraud (§804).

The Act's internal procedure provisions require audit firms to:

58. Retain documents: Pursuant to SOX, the PCAOB issued standards compelling audit firms to maintain for seven years "audit work papers, and other information related to an audit report, in sufficient detail to support the conclusions reached in such a report" (§103).
59. Submit audits to second partner reviews: The PCAOB issued standards requiring audit firms to have second partner review and approval of each public company audit report (§103).
60. Rotate audit partners every five years: An audit firm must rotate its lead partner and its review partner on audits so that neither role is performed by the same accountant for more than five consecutive years (§203).

With respect to their public clients, the Act requires audit firms to:

61. Comply with PCAOB issued internal controls testing standards: The PCAOB issued standards requiring an auditor's report on its "findings" with respect to the audit client's internal control structure and the auditor's "evaluation" of whether the internal control structure and procedures "include a maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuers" (§103).
62. Attest to management's representations on internal controls: The Act requires management to assess and make representations regarding the quality of internal controls and requires audit firms to attest to and report on management's assessment (§404).
63. Cease offering certain non-audit services to public audit clients: The Act statutorily prohibits a number of non-audit services from being offered to public audit clients (§201).
64. Obtain audit committee preapproval for services: Before an audit firm can provide audit or non-audit services to a public audit client, the audit committee of the client must approve (§202).
65. Regularly report to audit committees on accounting treatments: Audit firms must report to the audit committee on the critical accounting policies and practices to be used, all alternative treatments of financial information within GAAP that have been discussed with management officials, the ramifications of the use of such alternative treatments, and the treatment preferred by the auditor; any accounting disagreements between the audit firm and management and other material written communications between the audit firm and management (§204).
66. Be responsible to the audit committee, not management: The Act provides that audit firms shall report to and be overseen by the audit committee of a company being audited, not management (§301).

V. Amendments to the Sarbanes-Oxley Act

Housing and Economic Recovery Act of 2008:

67. All confidential information received by the PCAOB under the authority provided in §105 may be furnished to the Director of the Federal Housing Finance Agency, at the discretion of the SEC (§1161).

Dodd-Frank Act of 2010:

68. Exempted all public companies classified as "non-accelerated filers" by the SEC from complying with §404(b) of the Sarbanes-Oxley Act (§989G).
69. Expanded the requirement of domestic audit firms to secure a foreign firm's audit work papers. Also required appointment of an agent for service of process in the US (§929J).
70. Authorized monetary awards to whistleblowers providing the SEC with information that leads to a successful enforcement action.

    Confidential information supplied to the SEC by a whistleblower may be furnished to the appropriate regulatory authority, the Attorney General of the United States, the PCAOB and others, at the discretion of the SEC (§922).
71. Expanded the authority of the PCAOB to oversee the audits of registered brokers and dealers, as defined by the Securities Exchange Act of 1934 (§982).
72. Civil money penalties for securities laws violations may be used to benefit victims without obtaining disgorgement from the defendant, as was previously required under the Sarbanes-Oxley Act (§929B).
73. Expanded the definition of "person associated with an [audit] firm" to include persons "formerly associated with an [audit] firm" for purposes of investigative and enforcement authority (§929F).
74. Authorized the PCAOB to provide foreign auditor oversight authorities with all confidential information received by an audit firm under the PCAOB's §104 inspection or §105 investigation authority, at the discretion of the PCAOB and pursuant to certain qualifications (§981).

JOBS Act of 2012:

75. Exempted all companies defined within the Act as Emerging Growth Companies from complying with §404(b) of the Sarbanes-Oxley Act (§103).
76. Exempted all companies defined in the Act as Emerging Growth Companies from complying with any new accounting standard until such date that private companies must comply, if such standard applies to private companies at all (§102).
77. Exempted all companies defined within the Act as Emerging Growth Companies from complying with any PCAOB rules requiring mandatory firm rotation or auditor discussion and analysis (§104).
78. Exempted all companies defined within the Act as Emerging Growth Companies from complying with other new auditing standards unless the SEC determines that the application of such standard is "necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation" (§104).

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