

Sarbanes Oxley Act Summary – via <http://www.sarbanes-oxley-101.com>

Tens of thousands of companies face the task of ensuring their accounting operations are in compliance with the Sarbanes Oxley Act. Auditing departments typically first have a comprehensive external audit by a Sarbanes-Oxley compliance specialist performed to identify areas of risk. Next, specialized software is installed that provides the "electronic paper trails" necessary to ensure Sarbanes-Oxley compliance.

The summary highlights of the most important Sarbanes-Oxley sections for compliance are listed below. Note that certification and specific public actions are required by companies to remain in SOX compliance.

SOX Section 302 - Corporate Responsibility for Financial Reports

- a) CEO and CFO must review all financial reports.
- b) Financial report does not contain any misrepresentations.
- c) Information in the financial report is "fairly presented".
- d) CEO and CFO are responsible for the internal accounting controls.
- e) CEO and CFO must report any deficiencies in internal accounting controls, or any fraud involving the management of the audit committee.
- f) CEO and CFO must indicate any material changes in internal accounting controls.

SOX Section 401: Disclosures in Periodic Reports

All financial statements and their requirement to be accurate and presented in a manner that does not contain incorrect statements or admit to state material information. Such financial statements should also include all material off-balance sheet liabilities, obligations, and transactions.

SOX Section 404: Management Assessment of Internal Controls

All annual financial reports must include an Internal Control Report stating that management is responsible for an "adequate" internal control structure, and an assessment by management of the effectiveness of the control structure. Any shortcomings in these controls must also be reported. In addition, registered external auditors must attest to the accuracy of the company management's assertion that internal accounting controls are in place, operational and effective.

SOX Section 409 - Real Time Issuer Disclosures

Companies are required to disclose on a almost real-time basis information concerning material changes in its financial condition or operations.

SOX Section 806 - Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud

This section deals with **whistleblower protection**

SOX Section 902 - Attempts & Conspiracies to Commit Fraud Offenses

It is a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding.

SOX Section 906 - Corporate Responsibility for Financial Reports

Section 906 addresses criminal penalties for certifying a misleading or fraudulent financial report. Under SOX 906, penalties can be upwards of \$5 million in fines and 20 years in prison.

Section 302:

Corporate Responsibility for Financial Reports

The essence of Section 302 of the Sarbanes-Oxley Act states that the CEO and CFO are directly responsible for the accuracy, documentation and submission of all financial reports as well as the internal control structure to the SEC. Here is the direct excerpt from the Sarbanes-Oxley Act of 2002 report:

a. Regulations Required. The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934, that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that--

1. the signing officer has reviewed the report;
2. based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
3. based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;
4. the signing officers--
 - A. are responsible for establishing and maintaining internal controls;
 - B. have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;
 - C. have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and
 - D. have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
5. the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)--
 - A. all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
 - B. any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
6. the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

b. Foreign Reincorporations Have No Effect. Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

Section 401:

Disclosures in Periodic Reports

Section 401 (listed under Title IV "Enhanced Financial Disclosures") of the Sarbanes Oxley Act deals with financial statements and their requirement to be accurate and presented in a manner that does not contain incorrect statements or admit to state material information. Such financial statements should also include all material off-balance sheet liabilities, obligations, and transactions. A direct excerpt from the Sarbanes-Oxley Act of 2002 report for Section 401:

(a) DISCLOSURES REQUIRED.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

(i) ACCURACY OF FINANCIAL REPORTS.

Each financial report that contains financial statements, and that is required to be prepared in accordance with (or reconciled to) generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

(j) OFF-BALANCE SHEET TRANSACTIONS.

Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that each annual report shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.

(b) COMMISSION RULES ON PRO FORMA FIGURES.

Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

(c) STUDY AND REPORT ON SPECIAL PURPOSE ENTITIES.

(1) STUDY REQUIRED.

The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934, as added by this section, complete a study of filings by issuers and their disclosures to determine

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

(2) REPORT AND RECOMMENDATIONS.

Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934;

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

SOX Section 404: Management Assessment of Internal Controls

Section 404 is the most complicated, most contested, and most expensive to implement of all the Sarbanes Oxley Act sections for compliance. All annual financial reports must include an Internal Control Report stating that management is responsible for an "adequate" internal control structure, and an assessment by management of the effectiveness of the control structure. Any shortcomings in these controls must also be reported. In addition, registered external auditors must attest to the accuracy of the company management assertion that internal accounting controls are in place, operational and effective.

A direct excerpt from the Sarbanes-Oxley Act of 2002 report for section 404:

(a) Rules Required. The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 to contain an internal control report, which shall--

(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 issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) Internal Control Evaluation and Reporting. With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

Section 409: Real Time Issuer Disclosures

The essence of Section 302 of the Sarbanes-Oxley Act states that companies are required to disclose on an *almost* real-time basis information concerning material changes in its financial condition or operations. Here is a direct excerpt from the Sarbanes-Oxley Act of 2002 report for section 409:

Section 13 of the Securities Exchange Act of 1934, as amended by this Act, is amended by adding at the end the following:

(I) Real Time Issuer Disclosures. Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.

SOX 806: Sarbanes Oxley Whistleblower

SEC. 806. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

Sarbanes-Oxley encourages the disclosure of corporate fraud by protecting employees of publicly traded companies or their subsidiaries who report illegal activities. **Section 806** of Sarbanes Oxley the Act authorizes the U.S. Department of Labor to protect whistleblower complaints against employers who retaliate and further authorizes the Department of Justice to criminally charge those responsible for the retaliation.

Under Section 806 of SOX, an employee engages in protected whistleblower conduct by providing information that he or she reasonably believes is a violation of:

- federal mail, wire, bank, or securities fraud
- federal law relating to fraud against shareholders
- any rule or regulation of the Securities and Exchange Commission (SEC)

Section 806 of SOX extends its protection to any whistleblower who is an officer, employee, contractor, subcontractor, or agent of:

- a publicly traded company
- a subsidiary of a publicly traded company
- a nationally recognized statistical ratings organizations (NRSROs)

Section 1107 of SOX makes it a crime for a person to knowingly retaliate against a whistleblower for disclosing truthful information to a law enforcement officer regarding an alleged federal offense.

Section 902: Attempts & Conspiracies to Commit Fraud Offenses

SOX 902 is listed under Title IX, which discusses white-collar crime penalty "enhancement". A direct excerpt from the Sarbanes-Oxley Act of 2002 report for section 902:

a. In General. Chapter 63 of title 18, United States Code, is amended by inserting after section 1348 as added by this Act the following:

Sec. 1349. Attempt and conspiracy

Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

Section 906: Corporate Responsibility for Financial Reports

Section 906 addresses criminal penalties for certifying a misleading or fraudulent financial report. Under SOX 906, penalties can be upwards of **\$5 million in fines and 20 years in prison**. A direct excerpt from the Sarbanes-Oxley Act of 2002 report for section 906:

(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS. Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

(b) CONTENT. The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

(c) CRIMINAL PENALTIES. Whoever - (1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or (2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both.