

Federal Regulations

Sarbanes Oxley Act (SOX)

Federal Sentencing Guidelines

Enhanced Accountability

..... *impacting the Accounting Profession*

November 28, 2007

Regulatory Requirements

Shared Goals

- Federal Sentencing Guidelines and Sarbanes Oxley
 - Accountability, integrity, and 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

- Sets uniform standards that apply to all organizations convicted of crime
- 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
 - Ethics, values
 - 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

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
 - Effective compliance and ethics programs
 - 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 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 - Changes

- Promotes an “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 compliance program
 - Exercise reasonable oversight
 - Organization leadership (Executive Management)
 - Gain information about program on regular basis
 - Act on information to pursue improvement
 - Individuals responsible for program operation
 - Authority and resources, access to senior management
 - Report on program effectiveness

Federal Sentencing Guidelines

Amendments - Changes (Continued)

- Goes beyond preventing and detecting violations to integrating ethics into organizational culture
- Impact of organizational culture in preventing misconduct
 - Emphasis on ethics and values
 - 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

Texas State Board of Public Accountancy (TSBPA)

SOX- type legislation - 2004 Report to Governor Public interest entities and other non-publicly held entities

● General Conclusions:

- Caution against state-by-state implementation of SOX – need uniformity
- Existing regulatory bodies review and adopt SOX provisions where applicable
- State agencies address and report on its review of SOX provisions
- Make illegal for officer or upper management to fraudulently influence or mislead the auditors of independent accounting firm
- TSBPA authority to refer to appropriate authorities information on activities of potential criminal conduct by individuals other than CPAs

Ethics

- Focus on ethics and accountability
 - 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

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

Streamlining the Number of Key Controls

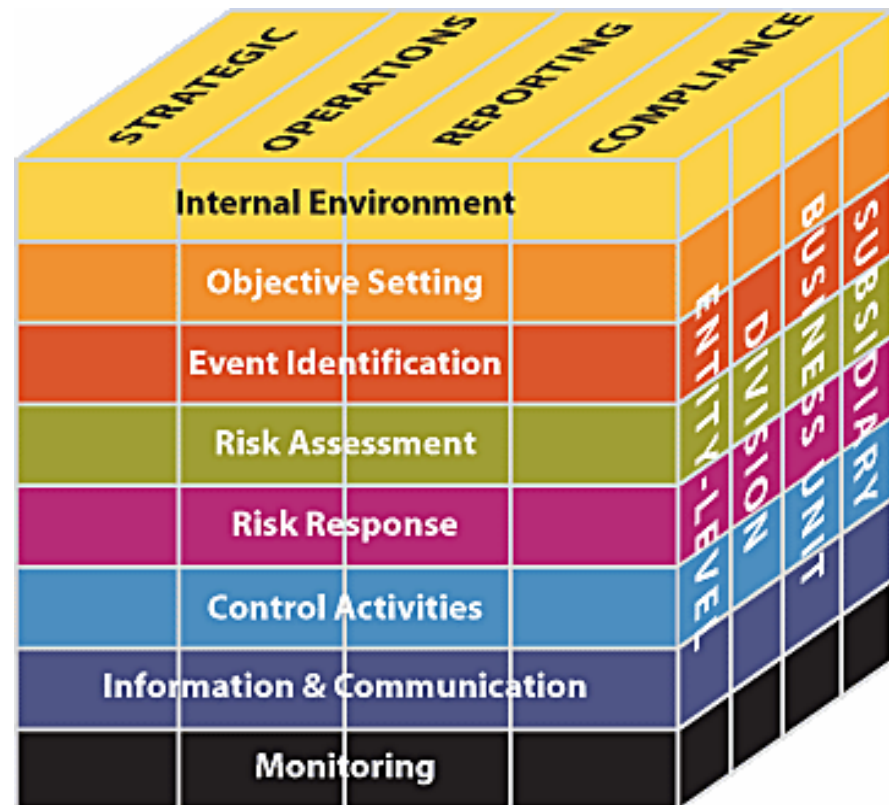
- Consolidate controls covering single risk
- Standardize processes across locations where feasible
- Use controls embedded in automated software
- Watch for changes in significant accounts
- Leverage management monitoring
- Outsource certain activities

Transition

Key 404 Activities

COSO ERM Model

- Establish and maintain IC Environment
- Assess risks to achieving financial statement assertions
- Evaluate design/operation of internal controls
- Compile and report results
- On-going monitoring



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

Resources

- Sarbanes Oxley Act
- US Sentencing Guidelines Amendments
- National Association of College and University Business Officers – Advisory Report 2003-3 “SOX: Recommendations for Higher Education”
- Texas State Board of Public Accountancy report to the Governor – Implementation of SOX in Texas - 2004
- Internal Auditor, February 2007: “Streamlining Sarbanes-Oxley”
- Today’s CPA, TSCPA November/December 2007: “SOX - It Fits More than Just Publicly-Traded Feet!”
- Public Company Accounting Oversight Board: Auditing Standard No. 5 – SEC release 2007-144