The Sarbanes- Oxley Act 2002 (USA)

The Sarbanes-Oxley Act of 2002 is a federal law that established sweeping auditing and financial regulations for public companies. Lawmakers created the legislation to help protect shareholders, employees and the public from accounting errors and fraudulent financial practices. The legislation, commonly referred to as SOX, sought to both improve the reliability of the public companies' financial reporting as well as restore investor confidence in the wake of high-profile cases of corporate crime. SOX primarily sought to regulate financial reporting and other business practices at publicly traded companies. However, some provisions apply to all enterprises, including private companies and not-for-profit organizations. Additionally, SOX established penalties for noncompliance with its provisions. The Securities and Exchange Commission (SEC) enforces SOX. The act was named for its sponsors: U.S. Sen. Paul Sarbanes, D-Md., and U.S. Rep. Michael Oxley, R-Ohio.

History

Federal lawmakers enacted SOX in large part due to corporate scandals at the start of the 21st century. One such scandal involved energy firm Enron Corp. Enron, considered one of the largest, most successful and innovative companies in the United States around 2000, unraveled in less than two years as both the company's fraudulent practices and its executives' criminal activities came to light. Similarly, the telecommunications giant WorldCom became embroiled in scandal as its own fraudulent accounting practices made the news. After filing for bankruptcy in 2002, the company was hit with a $750 million SEC fine. Its chief executive officer (CEO) was sentenced to 25 years in prison, and the chief financial officer (CFO) received a five-year jail sentence as a result of criminal charges in the case. The financial scandal at Tyco International also preceded SOX. In this case, the company's former CEO and CFO were convicted of stealing hundreds of millions of dollars from the company, falsifying business records and violating other business laws.

Key provisions of SOX Act

The Sarbanes-Oxley Act is arranged into 11 sections, or titles. Two sections of particular note are Section 302 and Section 404. Section 302 pertains to ‘Corporate Responsibility for Financial Reports.’ It established, in part, that CEOs and CFOs must review all financial reports and that the reports are "fairly presented" and don't contain misrepresentations. This section also established that CEOs and CFOs are responsible for the internal accounting controls. Section 404 deals with ‘Management Assessment of Internal Controls’ and requires companies to publish details about their internal accounting controls and their procedures for financial reporting as part of their annual financial reports. Section 404 requires corporate executives to personally certify the accuracy of their company's financial statements and makes them individually liable if the SEC finds violations. The main provision of SOX Act are explained below:

1. **Auditing under SOX:** SOX created new requirements for corporate auditing practices. It requires public corporations to hire independent auditors to review their accounting practices. SOX also created rules for separation of duties by detailing a number of non-audit services that a company's auditor cannot perform during audits. These rules are designed to further guard against fraudulent financial practices. Furthermore, SOX led to the creation of the **Public Company Accounting Oversight Board (PCAOB),**

which sets standards and rules for audit reports. Under SOX, all accounting firms that audit public companies are required to register with the PCAOB. The PCAOB investigates and enforces compliance at the registered accounting firms.

2. Disclosure of transactions and relationships that are off-balance sheet that could impact financial status was made mandatory.
3. Prohibition of personal loans from a corporation to executives.
4. Establishment of fines and terms of imprisonment for tampering or destroying documents in events of investigations or court action; and
5. Requirements for attorneys who represent public companies before the SEC to report security violations to the CEO.

Whistle-blower Protection Act

Protection for whistle blowers is another significant provision in the Sarbanes-Oxley Act. SOX states that employees (and even contractors) who report fraud and/or testify about fraud committed by their employers are protected against retaliation, including dismissal and discrimination.

OECD /G20 Principles of Corporate Governance

One of the most influential guidelines has been the 1999 OECD Principles of Corporate Governance. This was revised in 2004. The OECD remains a proponent of corporate governance principles throughout the world. Building on the work of the OECD, other international organisations, private sector associations and more than 20 national corporate governance codes, the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has produced voluntary Guidance on Good Practices in Corporate Governance Disclosure.

The Organisation for Economic Cooperation and Development (OECD) deals with the following important issues:
i. Protection of minority interest,

ii. Impediments to cross border voting should be removed,

iii. Insider trading and abusive self-dealing should be prohibited,

iv. Board members and Key Managerial Personnels (KMPs) to disclose their interest in material contracts.

Principles of OECD code on corporate governance 2005
i. The corporate governance system should promote transparent and efficient markets; should be consistent with rule of law and should lay down clear roles of various regulatory and enforcement authorities,

ii. Corporate governance system should protect and facilitate shareholder rights,

iii. The system should facilitate equitable treatment to all shareholders, including minority and foreign shareholder,

iv. Corporate governance should recognize the rights of stakeholders established by law or mutual contract; should encourage cooperation between the corporate and the stakeholders to create value,

v. Disclosure and transparency: System should ensure timely and accurate information about financial situation, performance, ownership and governance,

vi. Board management structure.

OECD principles on shareholders' rights:
i. Basic shareholder rights – registration and transfer of shares, right to vote at meetings, obtain relevant information, appoint and remove directors and share in the profits,

ii. Fundamental corporate structure changes to require shareholder participation,

iii. Shareholders to vote on directors' and KMP's remuneration and equity options,

iv. Voting in absentia,

v. Market for transfer of control to be transparent,

vi. In practice, shareholders' rights have largely been a myth,

vii. Widespread shareholding, including cross-border holding,

viii. Role of the institutional investors.

OECD principles on stakeholders' interests:
i. Employees participation in management; performance enhancing mechanisms to be promoted,

ii. Whistle-blowers' interest to be protected,

iii. Creditors' rights,

iv. Through security interest enforcement and bankruptcy laws,

OECD principles on Board composition and structure:
i. Some key functions should be fulfilled by Board,

ii. Strategy formulation, budgets, business plans, etc.

iii. Monitoring the effectiveness of the company's governance practices,

iv. Selecting, compensating, monitoring key executives and overseeing succession planning,

v. Executive and board remuneration,

vi. Ensuring a formal and transparent board nomination and election process,

vii. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions,

viii. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, ensuring control systems for risk management, financial and operational control, and compliance,

ix. Overseeing the process of disclosure and communications.

Sources for the E-Content

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Disclaimer:

1. These notes are only for the students.

2. These notes are prepared after referring various books and websites.