

# Frequently Asked Questions About Sarbanes-Oxley

## What is the Sarbanes-Oxley Act of 2002?

Effective in 2004, all public companies will be required (for the first time) to submit an annual assessment of the effectiveness of their internal financial auditing controls to the Securities and Exchange Commission (SEC). Additionally, each company's external auditors are required to audit and report on the internal control reports of management, in addition to the company's financial statements.

## What companies need to comply with Sarbanes-Oxley?

All publicly-traded companies in the United States, including all wholly-owned subsidiaries, and all publicly-traded non-US companies doing in business in the US are effected. In addition, any private companies that are preparing for their initial public offering (IPO) may also need to comply with certain provisions of Sarbanes-Oxley.

## When did Sarbanes-Oxley compliance take effect?

All parts of the Sarbanes-Oxley Act with the exception of Section 409 are effective now. For Section 404, public companies with a market capitalization over US \$75 million needed to have their financial reporting frameworks operational for their first fiscal year-end report after November 15, 2004, then for all quarterly reports thereafter. For smaller companies, compliance is required for the first fiscal year-end financial report, then for all subsequent quarterly financial reports after July 15, 2005.

## What is the Sarbanes-Oxley Act comprised of?

The Sarbanes-Oxley Act itself is organised into eleven sections, but sections 302, and 404 are the most important in terms of systems related compliance. Section 404 seems to cause the most difficulties for compliance. More specifically, Sarbanes-Oxley established new accountability standards for corporate boards and auditors, established a Public Company Accounting Oversight Board (PCAOB) under the Security and Exchange Commission (SEC), and specified civil and criminal penalties for non-compliance.

## What does Sarbanes-Oxley compliance require?

All applicable companies must establish a financial accounting framework that can generate financial reports that are readily verifiable with traceable source data. This source data must remain intact and cannot undergo undocumented revisions. In addition, any revisions to financial or accounting software must be fully documented as to what was changed, why, by whom and when.

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## What are the penalties for non-compliance with Sarbanes-Oxley?

Besides lawsuits and negative publicity, a corporate officer who does not comply or submits an inaccurate certification is subject to a fine up to \$1 million and ten years in prison, even if done mistakenly. If a wrong certification was submitted purposely, the fine can be up to \$5 million and twenty years in prison.

## Section 302: Corporate Responsibility For Financial Reports

The CEO and CFO of each issuer shall prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." A violation of this section must be knowing and intentional to give rise to liability.

## Section 404: Management Assessment Of Internal Controls

Requires each annual report of an issuer 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 issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

The language in the report of the Committee which accompanies the bill to explain the legislative intent states, "--- the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges or fees."

Directs the SEC to require each issuer to disclose whether it has adopted a code of ethics for its senior financial officers and the contents of that code.

Directs the SEC to revise its regulations concerning prompt disclosure on Form 8-K to require immediate disclosure "of any change in, or waiver of," an issuer's code of ethics.