

White Paper

## **Sarbanes Oxley Act of 2002**

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“Free markets are not a jungle in which only the unscrupulous survive, or a financial free-for-all guided only by greed. The fundamentals of a free market – buying and selling, saving and investing – require clear rules and confidence in basic fairness.” George Bush said this during the signing of an Act Senator Paul S. Sarbanes and Congressman Mike Oxley wrote. The act was written with the intent to produce financial, ethical standards for corporate America.

There are eleven parts to this act that was signed into law on July 30, 2002. Although the majority of the act is specific to accounting practices, there are some direct implications for compensation and benefit professionals. Here are very brief summaries of each title.

### Title 1 – Public Company Accounting Oversight Board

- Responsibilities of board members for overseeing the audit of public companies

### Title 2 – Auditor Independence

- Do’s and Don’ts of an auditor

### Title 3 – Corporate Responsibility

- Standards for audit committees
- Guidelines for Pension fund black out periods

### Title 4 – Enhanced Financial Disclosures

- Accuracy of financial reports
- Senior financial officer code of ethics
- Enhanced conflict of interest provisions
  - Executives can’t receive loans from their company with the exceptions of loans that are no more generous than what’s commonly offered to the public
  - Directors, Officers and principal shareholders must disclose their stock purchases and sales

#### Title 5 – Analyst Conflicts of Interest

- Guidelines for Brokers writing information that could be used to base an investment decision
- Limiting supervisors and performance evaluators to those not active in investment and banking activities

#### Title 6 – Commission Resources and Authority

- Funds available to the commission and guidelines when members violate provisions of the laws

#### Title 7 – Studies and Reports

- The US General Accounting Office will examine the consolidation of public accounting firms while the commission examines credit rating agencies. GAO will also examine investment banks to assess manipulation of earnings.
- Commission will assess violations of security professionals and analyze enforcement actions to reassess rules and regulations

#### Title 8 – Corporate and Criminal Fraud Accountability

- Penalties for altering financial documents
- Protection for employees of publicly traded companies who provide evidence of fraud
- Penalties for defrauding shareholders of publicly traded companies

#### Title 9 – White-collar crime penalty enhancements

- Penalties for conspiring to commit fraud
- Penalties for violating ERISA

#### Title 10 – Corporate Tax Returns

- Should be signed by the CEO

#### Title 11 – Corporate Fraud and Accountability

- Commission has authority to keep violators from serving as officers or directors
- Fines for retaliating against informants

#### **What does this mean to me?**

- You may need to explain when employees ask you why executives used to receive loans.
  - Explain to the employee the type of borrowing programs that are available to all employees? Such as a paycheck advance, 401K loans, emergency relief funds, etc.
- What about the loans executives currently have?
  - Title 4 Section 402 explains that current loans if left alone, are ok. Any changes to the terms on or after July 30<sup>th</sup>, is illegal.
- How will the elimination of a perk effect the executive's total rewards package?
  - "It shall be unlawful for any issuer directly or indirectly, including through any subsidiary to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer of that issuer." (Title 4, Section 402)
  - This basically means no personal loans to executives from their company. The only loans that can be extended to them are those with terms no more favorable than those offered to the general public. If the company wants their officers to possess a certain level of stock ownership to exhibit commitment or accountability, the compensation mix may need to be adjusted. A simple fix could be more stock options but a more effective solution would be a change in their performance-based pay.
- How will the guidelines for pension fund blackouts effect you?
  - Directors, executives and officers cannot trade company stock during a blackout period. The company will revoke profits made by trading during blackout. The company is also required to provide 30 days notice of a blackout period to plan participants unless it conflicts with ERISA or if an unforeseeable event prevents such notice. (Title 3, Section 306)
- Job descriptions will change.

## **Securities Associations and Exchanges Title 5, Section 501**

By July 30<sup>th</sup> 2003, registered securities associations or national securities exchanges will have adopted rules designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances. It will be their responsibility to provide investors with more objective and reliable information.

Safeguards will be designed and managed to protect securities analysts from pressure or oversight of those whose involvement in investment banking might bias their judgment.

Securities associations and exchanges will foster greater public confidence in securities research and to protect the objectivity and independence of securities analysts

Research reports will be written, approved and published by analysts but never by persons employed by a broker or dealer, investment banker or someone not directly responsible for investment research.

Supervision and evaluation of analysts can only be performed by employees with no investment banking activities.

### **Sr. Financial Officer**

#### **Title 4, Section 406**

Ethical handling of actual or apparent conflicts of interest between personal and professional relationships

Full, Fair, accurate, timely and understandable disclosure in the periodic reports required to be filed by the issuer

Compliance with applicable governmental rules and regulations

### **Finance Staff**

Title 3, Section 301

Each company will disclose every equity transaction of anyone with 10% ownership. The disclosures include:

- Stating the amount of the company's total equity securities
- Ownership of person making equity transaction at the time of the act
- Purchases and sales of equity since the most recent filing.

By July 30<sup>th</sup> 2003 the transaction will be disclosed on the Internet by the commission or the company's Web site no later than the end of the business day following that filing.

### **Audit Committee of a corporation's Board of Directors**

Title III, section 301 2

Directly responsible for the appointment, compensation and oversight of the work of any registered public accounting firm employed by a public corporation.

- Are you prepared for an employee coming to you with knowledge of accounting fraud or being retaliated against for revealing knowledge?
  - A company can in no way retaliate against any employee that comes forward with information regarding fraud. If an employee feels they've been retaliated against they can file a complaint with the Secretary of Labor. Penalties can include: reinstatement with the same seniority status had the employee not been discriminated against, back pay with interest, compensation for any damages for litigation costs, expert witness fees and reasonable attorney fees. Depending on the severity of retaliation, jail time of up to 10 years for the violator.

For more information:

Full text on act.

[http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107\\_cong\\_bills&docid=f:h3763enr.tst.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:h3763enr.tst.pdf)

Aon Consulting wrote an eALERT on august 2, 2002 "Accounting Oversight and Corporate Responsibility Reform Also Amends ERISA

<http://www.aon.com/about/publications/pdf/alert/al020802.pdf>

White House info on new act

[www.whitehouse.gov/infocus/corporateresponsibility](http://www.whitehouse.gov/infocus/corporateresponsibility)

The American Institute of Certified Public Accounts has a summary sheet

[http://www.aicpa.org/info/sarbanes\\_oxley\\_summary.htm](http://www.aicpa.org/info/sarbanes_oxley_summary.htm)

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