



The Sarbanes-Oxley Act

An Introduction



SOXBOOKSERIES



THE SARBANES-OXLEY ACT: AN INTRODUCTION

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An Introduction

Sanjay Anand



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INTRODUCTION:

An Introduction to the Sarbanes-Oxley Body of Knowledge (SOXBoK) from the SOX Institute

'By practitioners for practitioners'

The *Sarbanes-Oxley Body of Knowledge* (SOXBoK) has been developed by a select group of volunteers and recruits from the growing, active membership of the SOX Institute. Every member of the team is an active practitioner in at least one area of Sarbanes-Oxley compliance efforts within public companies. The SOXBoK was completed in three, distinct phases:

- Phase I of the project, involved forming several small teams to complete initial scope planning, research and content development, driven by team leads with expertise in specific Knowledge Areas to include:
 - Finance and Accounting
 - Information Technology
 - Legal and Ethical Compliance
 - Internal and External Audit
- Phase II of the project, involved a single, smaller team with cross-functional representation focused on knowledge sharing and analysis of the content, focusing on fact checking the content submitted by the Phase I activities.
- Phase III of the project, involved the same team as Phase II, with members now working directly with the SOX Institute Board of Directors to fine-tune the content, obtain and incorporate public commentary, and coordinate with the publisher to edit the book into its final format.

The Sarbanes-Oxley Act of 2002 (SOA or SOX Act) had far-reaching implications for the operations of public companies, which were greater than any other legislation to date. Large publicly traded companies are required by law to comply with the guidelines of the SOX Act; however, more and more mid-size and non-public companies are making the choice to comply with the SOX Act to instill greater stakeholder confidence in their operations and financials.

The Sarbanes-Oxley Act: An Introduction strives to align itself with the SOX Institute's objectives: The SOX Institute was created to enable individuals and enterprises to:

- freely share and exchange SOX-related information, expertise and experiences
- enable members to understand and appreciate the implications of SOX on their industry, their companies, their careers and their jobs
- Encourage the industry-wide standards of SOX competence
- take SOX compliance to a whole new level, both in the US, and around the world

The SOX Institute (now known as the Governance, Risk, Compliance (GRC) Institute) has, since its inception in 2003, organized over 100 training sessions, published four books on the Sarbanes-Oxley (SOX) Act, and trained more than 2,000 professionals and executives in SOX Act compliance, across the US, Canada, Europe, the Indian sub-continent and Asia.

The SOXBoK is intended to be a reference document for practitioners who are responsible for implementing the Sarbanes-Oxley Act of 2002 ('SOX') within their organizations. The content of the guide is written in a clear style appropriate for any level, from absolute beginners to those who want to become professionals in their audit-related fields. The SOXBoK has been developed by industry practitioners to:

- establish a consensus mechanism for delineating the knowledge and skills required to be a professional
- characterize standard practices of the profession
- guide the development of quality knowledge and skill competency assessment
- provide a background for curriculum development efforts throughout academia

The SOXBok includes each title and section of the SOX Act in its entirety. All 11 Titles and 66 sections of the SOA of 2002 were analyzed and documented in the SOXBoK. Each Title and section of the SOX Act is summarized and categorized for easy reference and comprehension, and industry best practices are discussed from the practitioner's perspective.

While developing and finalizing this Introduction, the team considered the following content and editorial assertions:

- **Completeness** – all elements in the SOX Act are addressed
- **Accuracy** – the right level of detail and instruction
- **Actionable** – how would you implement this section?
- **Single Source** – direct references within the SOX Act (eg Securities Exchange Act of 1934) are explained within the synopsis
- **Consistency** – flow, style, presentation
- **Clarity** – fully explained, clear, concise, readable
- **Relevance** – relevant to the section discussed and relevant to the audience

SOX-Specific Terminology and Abbreviations

This Introduction uses terminology that is particular to the audit, legal or accounting professions. Terms and acronyms that are consistently used throughout this publication are defined below. Additional terminology is defined in the Glossary:

- **GASP** – Generally Accepted SOX Principle is a practice that is the best response to a given section of the SOX Act
- **Issuer** – public company, which must issue financial reports according to Securities and Exchange Commission (SEC) regulations and/or the SOX Act
- **PCAOB** – Public Company Accounting Oversight Board
- **SEC** – Securities and Exchange Commission
- **SOX** – Interpretation of the Sarbanes-Oxley Act of 2002
- **Audit Partner** – accountant with primary responsibility for attesting to the adequacy of the issuer's compliance with the regulations in the SOA

SOX Processes

This section identifies key processes, domains, and Knowledge Areas associated with each SOX Title. SOX processes are the steps needed to comply with SOX requirements within multiple business functions, impacted by each section within identified domains, including:

- **Regulations for Others** – SOX requirements that apply to government agencies, independent accounting firms, or other groups that are not part of the issuing company; detailed knowledge of these regulations is not integral to Issuer compliance with the SOX Act, but practitioners should be aware of these sections and Titles to build their awareness of the whole process
- **Planning** – setting up committees, preliminary preparation work, building the underlying structure for adequately responding to SOX requirements
- **Risk Analysis** – identifying where the financial risks lie, which ultimately determines which process controls will need to be evaluated and attested to by executive management
- **Control Assessment** – identifying which controls/processes are in place and determining whether they address the financial risks
- **Control Testing** – systematically selecting samples from each control/process, and evaluating whether the process and practice is effective
- **Co-ordinating with Auditors** – co-ordinating with internal audit resources to plan, assess and report on internal controls; working effectively with external audit to expedite independent testing and evaluation of management's testing
- **Control Deficiencies and Remediation** – once a control has been deemed ineffective, this process identifies the root cause(s) of the deficiency and how to fix it; then re-testing of controls is performed to clear associated audit comments
- **Reporting and Communication** – specifies which reports are required, what formats should be used, how frequently reports should be prepared and submitted, and by whom
- **Evaluation and Control Enhancement** – determining which effective controls/processes are not operating as well as they could be, and then making improvements

- **Sustaining** – building effective controls/processes into your company's daily routine for strong, reliable reporting capabilities
- **Audit Compliance and Enforcement** – what to do if serious material findings result in a Federal investigation or court case

SOX Domains

Domains, within the context of SOX compliance, are disciplinary overlays that aid in the understanding and implementation of the intent of the SOX Act. The objective is to ensure that auditors remain *independent*; corporations and auditors are *accountable* to the public for the numbers they publish; an independent body *governs* financial reporting processes; sufficient measures are in place to *deter* fraudulent activity; financial activities are *transparent* enough to allow fraud detection to occur; and if fraud is detected, somebody is held *responsible* for it. Domains help answer the question, 'what gets accomplished or achieved as a result of this section of the SOX Act?'

Summary of Domains by Section Indexed By Topic	
Independence: an environment where auditing bodies are not affiliated with or controlled by an issuer, and therefore are more likely to issue an objective opinion	
Section 103	Independence standards and rules
Section 104	PCAOB periodically inspects and assesses registered public accounting firm work
Section 201	Registered public accounting firms prohibited from performing both auditing and other services that may present a conflict of interest
Section 202	Audit committee, independent from the company, approves and oversees all registered public accounting firm work
Section 203	Lead audit partner and reviewing partner's primary responsibility for an issuer's audit limited to 5 years
Section 204	All registered public accounting firms must submit regular reports to the company's audit committee
Section 205	Audit committee comprised of members of Board of Directors
Section 206	Limitations on former registered accounting firm or its employee acting as director/officer for issuer
Section 301	Audit committee independence

Accountability: answering to a higher level or regulating body	
Section 102	Public accounting firms must register with, and pay annual fees to, PCAOB
Section 302	Management responsibility for design, implementation, evaluation and reporting of disclosure controls to SEC
Section 401	SEC requirements for filing financial statements
Section 403	Stock transactions must be filed with SEC
Section 404	Issuer must report weaknesses of Internal Control Over Financial Reporting to registered public accounting firm; registered public accounting firm must attest to, and report on, assessment of internal controls made by management to SEC
Section 405	Exemptions from requirements of Sections 401, 402 and 404
Section 406	Failure to adopt a 'code of ethics' must be disclosed to SEC
Section 407	Issuers must include a financial expert in their audit committee
Section 501	Registered securities association or national securities exchange must modify their rules relating to securities analysts findings
Section 906	Directors/officers must certify every periodic report submitted to the SEC, or else face criminal penalties
Section 1001	CEO is individually accountable and responsible for financial reporting results
Section 1103	During cease-and-desist proceeding, SEC can issue temporary order requiring the issuer to escrow extraordinary payments
Section 1104	US Sentencing Commission must review and update sentencing guidelines applicable to securities and accounting fraud and related offences
Governance: the continuous exercise of authority over and the performance of functions for a political unit	
Section 101	PCAOB governance of internal and external auditors
Section 103	PCAOB establishes rules and requirements for auditing
Section 106	PCAOB oversees foreign accounting firms
Section 107	SEC oversees the PCAOB operations
Section 108	Accounting standards acceptable to SEC
Section 109	PCAOB funding and budgeting guidelines
Section 202	Audit committee pre-approval required for all registered public accounting firm activities
Section 203	SEC requires a mandatory auditor rotation
Section 204	All registered public accounting firms must disclose key company financial information to the audit committee
Section 205	Audit committee oversees registered public accounting firm
Section 206	SEC limits who can act as director/officer for issuer
Section 207	US Comptroller General to publish a study on mandatory auditor rotation effectiveness
Section 208	Registered public accounting firm cannot perform audit activities if engaged in activities prohibited by Securities Exchange Act of 1934
Section 209	Applicability of Title II requirements determined by appropriate state authorities
Section 307	Escalation process for attorneys reporting deficiencies

Section 404	Issuer must report weaknesses of internal control over financial reporting to registered public accounting firm; registered public accounting firm must attest to, and report on, assessment of internal controls made by management to SEC
Section 408	SEC right to review financial statements and disclosures at will
Section 601	Additional funds appropriated to SEC
Section 602	SEC authority to reject or refuse any auditor
Section 603	Prohibition of brokers, dealers, and issuers from participating in penny stock transactions
Section 604	SEC authority to censure or restrict an associated person or a broker or dealer from engaging in the business of securities, banking or insurance
Section 701	US General Accounting Office (GOA) must submit a study concerning 'Public Accounting Firms-Mandated Study on Consolidation and Competition'
Section 702	SEC must submit a report addressing each of the topics identified for Commission study in the Sarbanes-Oxley Act
Section 703	SEC must submit a report and study addressing violations by security professionals
Section 704	SEC must submit a study on enforcement actions
Section 705	Analysis by the US General Accounting Office on role of Investment Banks with respect to the corporate scandals conducted by Enron and WorldCom executives
Section 802	Criminal penalties for altering documents in the course of an investigation
Section 804	Statute of limitation for filing a fraud claim
Section 805	US Sentencing Commission to revisit and update the sentences relating to obstruction of justice and extensive criminal fraud
Section 807	Criminal penalties for defrauding shareholders of publicly traded companies
Section 1104	US Sentencing Commission must review and update sentencing guidelines applicable to securities and accounting fraud and related offenses
Deterrence: the measurements taken to prevent in appropriate behavior using fear, especially of punishment	
Section 102	Unlawful for an unregistered public accounting firm to issue audit report
Section 104	PCAOB periodically inspects and assesses registered public accounting firm work
Section 105	Disciplinary action against registered public accounting firms for non-compliance with investigatory proceedings
Section 107	SEC has the authority to remove PCAOB board members who have willfully violated the SOX Act
Section 108	Establishing accounting standards
Section 303	Employees, officers, etc. are prohibited from influencing the outcome of an audit
Section 304	If restatement filed for 'material non-compliance', directors/officers must reimburse issuer for certain types of compensation
Section 305	SEC has authority to prohibit an individual from serving as a director/officer
Section 308	Civil penalties and repayment to investors may be required when violations of the federal securities acts occur involving fraud

Section 802	Criminal penalties for altering documents in the course of an investigation
Section 902	Increased penalties for criminal fraud offenses
Section 903	Increased penalties for defrauding shareholders
Section 904	Increased penalties associated with a conviction
Section 905	US Sentencing Commission must review sentencing guidelines related to certain white collar crimes
Section 1102	Penalties for tampering with evidence and/or documents in an official proceeding
Section 1106	Maximum SEC penalty fine for individuals, corporations, entities is defined
Section 1107	Penalties for retaliation or discrimination against another person providing information to the SEC
Transparency: the state of openness or being free from pretense or deceit	
Section 102	Public accounting firms must submit reports to PCAOB, periodically and upon request
Section 301	Audit committee oversight of audit activities
Section 306	Guidelines and requirements for insider trading
Section 401	GAAP accounting principles must be used for filing financials
Section 402	Prohibition of personal loans from issuer to directors/officers
Section 403	Issuers must make stock purchase information available to the public
Section 404	Weaknesses in the effectiveness of the internal control over financial reporting must be reported by management to the registered public accounting firm
Section 409	Issuers must quickly disclose information about material changes in the financial conditions or operations to the public
Section 806	Whistleblower program must be established
Section 906	Directors/officers must certify every periodic report submitted to the SEC, or else face criminal penalties
Responsibility: the moral, legal, or mental obligation for a course of action or producing results	
Section 307	Ethical responsibilities of attorneys
Section 401	Issuer is responsible for disclosing complex transactions and pro forma figures
Section 403	Insiders must file periodic statements with the SEC
Section 406	Issuers must adopt a 'code of ethics' for directors/officers
Section 407	Issuers must disclose who is the financial expert of the audit committee to the SEC, or disclose why they have none
Section 501	Working environment for securities analysts must promote objectivity and independence
Section 803	Debts incurred as a result of criminal activity against Federal or State security laws will not be discharged
Section 805	US Sentencing Commission to revisit and update the sentences relating to obstruction of justice and extensive criminal fraud
Section 806	Whistleblower program must be established and communicated to all employees
Section 807	Criminal penalties for defrauding shareholders of publicly traded companies

Section 906	Directors/officers must certify every periodic report submitted to the SEC, or else face criminal penalties
Section 1001	CEO is individually accountable and responsible for financial reporting results
Section 1105	SEC authority to prohibit individuals from serving as directors/officers during cease-and-desist proceeding

Knowledge Areas identify the corporate resource or department that is most responsible for compliance with, or that implement, a particular SOX regulation. Areas of responsibility addressed in this Introduction include:

- **Accounting and Finance (A and F)** – Although the entire department(s) might participate in the design and implementation of specific controls, the Chief Financial Officer (CFO) or equivalent director or officer of the issuing company, would be ultimately held responsible for all actions taken by this Knowledge Area.
- **Information Technology (IT)** – The Chief Information Officer (CIO) or equivalent, and his or her staff are responsible for insuring the technological and systems security for the company.
- **Law, Ethics and Compliance (LEC)** – Activities undertaken by this Knowledge Area may actually bridge several different departments in the practitioner’s company, involving legal counsel, human resources and compliance officers.
- **Internal/External Audit (IEA)** – Internal audit refers to those functional areas which actually carry out audit testing on behalf of management, or a department which oversees the issuer’s self-audit activities. External audit is defined as the registered public accounting firm that is hired to issue an audit conclusion. These Knowledge Areas were combined for the purposes of this Introduction, to emphasize the close working relationship and overlapping responsibilities between the two.

Practitioners Perspective and Regulation Synopsis

This section provides an explanation of the Sarbanes-Oxley Act in terms meaningful to financial and business professionals faced with meeting the requirements of SOX. With the goal of being a single source of high-level SOX information, any references to other legislation, by the Security Exchange Commission and other government entities, have been summarized within the synopsis.

Generally Accepted SOX Principle [GASP]

This section explains the generally accepted SOX practice, and points out the practices or principles that translate into best practices and help a company become compliant. Since specific ways to comply with the SOX Act have not been, and are not likely to be, published by the PCAOB, the practitioner must discern the best way to attain compliance, according to the company's priorities, industry, risk factors and budget. This Introduction offers information about practices and principles that have helped many other companies comply with the SOX Act, and provides suggestions for the practitioner's consideration.

CHAPTER 1:

Public Company Accounting Oversight Board

Practitioners Perspective and Regulation Synopsis

Title 1 establishes the Public Company Accounting Oversight Board (PCAOB) as an agency of the US Government to oversee the audit of publicly traded companies.

- It is mandatory for all public accounting firms, which audit public companies, to register with the PCAOB.
- The PCAOB provides guidelines specific to auditing, quality control practices, independence standards, frequency and expected results of registered public accounting firm inspections.
- Lack of compliance with PCAOB guidelines will result in investigations and disciplinary proceedings of public accounting firms. Serious penalties can result if firms are non-complaint with the PCAOB directives and mandates.
- The Securities Exchange Commission oversees the PCAOB.
- Title 1 establishes the manner in which the PCAOB as well as the standards setting body are funded.
- The PCAOB is also referred to as the ‘Board’ in this publication.

Regulation Text

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in

the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section—

- (1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;
- (2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;
- (3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;
- (4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms, in accordance with section 105;
- (5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;
- (6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof. The Commission shall be responsible, prior to the appointment of the Board, for the planning for the establishment and administrative transition to the Board's operation.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, and subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

- (i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and
- (ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

- (1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;
- (2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

- (3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;
 - (4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);
 - (5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and
 - (6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.
- (g) RULES OF THE BOARD.—The rules of the Board shall, subject to the approval of the Commission—
- (1) Provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;
 - (2) Permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—
 - (A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;
 - (B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and
 - (C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

- (3) Establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board;
and
- (4) Provide as otherwise required by this Act.

(h) ANNUAL REPORT TO THE COMMISSION.—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

SEC. 102. REGISTRATION WITH THE BOARD.

(a) MANDATORY REGISTRATION.—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) APPLICATIONS FOR REGISTRATION.—

(1) FORM OF APPLICATION.—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) CONTENTS OF APPLICATIONS.—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) The names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year; (15 USC 7212).

(B) The annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

- (C) Such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;
 - (D) A statement of the quality control policies of the firm for its accounting and auditing practices;
 - (E) A list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;
 - (F) Information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;
 - (G) Copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and
 - (H) Such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.
- (3) CONSENTS.—Each application for registration under this subsection shall include—
- (A) a consent executed by the public accounting firm to co-operation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm.
 - (B) a statement that such firm understands and agrees that co-operation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b) (2).

(e) PUBLIC AVAILABILITY.—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) REGISTRATION AND ANNUAL FEES.—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES.

(a) AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.—

(1) **IN GENERAL.**—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) **RULE REQUIREMENTS.**—In carrying out paragraph (1), the Board—

(A) Shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and (iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present in such report or in a separate report

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such internal control structure and procedures—

(aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

- (bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
 - (III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.
- (B) Shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—
- (i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;
 - (ii) consultation within such firm on accounting and auditing questions;
 - (iii) supervision of audit work;
 - (iv) hiring, professional development, and advancement of personnel;
 - (v) the acceptance and continuation of engagements;
 - (vi) internal inspection; and
 - (vii) such other requirements as the Board may prescribe, subject to subsection (a) (1).
- (3) AUTHORITY TO ADOPT OTHER STANDARDS.—
- (A) IN GENERAL.—In carrying out this subsection, the Board—
- (i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and
 - (ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A) (i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) INDEPENDENCE STANDARDS AND RULES.—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) CO-OPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.—

(1) IN GENERAL.—The Board shall co-operate on an ongoing basis with professional groups of accountants designated under subsection (a) (3) (A) and advisory groups convened under subsection

(a)(4) In the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) BOARD RESPONSES.—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) **EVALUATION OF STANDARD SETTING PROCESS.**—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3) (A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) **IN GENERAL.**—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) **INSPECTION FREQUENCY.**—

(1) **IN GENERAL.**—Subject to paragraph (2), inspections required by this section shall be conducted:

(A) Annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) Not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) **ADJUSTMENTS TO SCHEDULES.**—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections.

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall:

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response,

appropriately reacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be:

- (1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm;
- (2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be “final agency action” for purposes of section 704 of title 5, United States Code.

(3) **TIMING.**—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS.

(a) **IN GENERAL.**—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

(b) **INVESTIGATIONS.**—

(1) **AUTHORITY.**—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) **TESTIMONY AND DOCUMENT PRODUCTION.**—In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may;

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject

to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section.

(3) NONCO-OPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise co-operate with the Board in connection with an investigation under this section, the Board may;

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) CO-ORDINATION AND REFERRAL OF INVESTIGATIONS.—

(A) CO-ORDINATION.—The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter co-ordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) REFERRAL.—The Board may refer an investigation under this section—

(i) to the Commission;

(ii) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and (iii) at the direction of the Commission, to—

- (I) the Attorney General of the United States;
- (II) the attorney general of 1 or more States; and
- (III) the appropriate State regulatory authority

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may;

- (i) be made available to the Commission; and
- (ii) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

- (I) the Attorney General of the United States;
- (II) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;
- (III) State attorneys general in connection with any criminal investigation; and
- (IV) any appropriate State regulatory authority, each of which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) Bring specific charges with respect to the firm or associated person;

(B) Notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) Keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) Each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) The specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and (C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) Temporary suspension or permanent revocation of registration under this title;

(B) Temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

- (C) Temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);
 - (D) A civil money penalty for each such violation, in an amount equal to—
 - (i) not more than \$100,000 for a natural person or \$2,000,000 for any other person; and
 - (ii) in any case to which paragraph (5) applies, not more than \$750,000 for a natural person or \$15,000,000 for any other person;
 - (E) Censure;
 - (F) Required additional professional education or training; or
 - (G) Any other appropriate sanction provided for in the rules of the Board.
- (5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D) (ii) of paragraph (4) shall only apply to—
- (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or
 - (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.
- (6) FAILURE TO SUPERVISE.—
- (A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—
 - (i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and
 - (ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if;

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.

It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to:

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

- (A) the name of the sanctioned person;
- (B) a description of the sanction and the basis for its imposition; and
- (C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm (or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented:

(A) To produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) To be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1).

(A) To have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) To have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term “foreign public accounting firm” means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD.

(a) **GENERAL OVERSIGHT RESPONSIBILITY.**—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a) (1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q (a) (1)), and of section 17(b) (1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q (b) (1)) shall apply to the Board as fully as if the Board were a “registered securities association” for purposes of those sections 17(a) (1) and 17(b) (1).

(b) **RULES OF THE BOARD.**—

(1) **DEFINITION.**—In this section, the term “proposed rule” means any proposed rule of the Board, and any modification of any such rule.

(2) **PRIOR APPROVAL REQUIRED.**—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) **APPROVAL CRITERIA.**—The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) **PROPOSED RULE PROCEDURES.**—the provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (b)) shall govern the proposed rules of the Board, as fully as if the Board were a “registered securities association” for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase “consistent with the requirements of this title and the rules and regulations there under applicable to such organization” in section 19(b) (2) of that Act shall be deemed to read “consistent with the requirements of title I of the Sarbanes-Oxley Act of 2002, and the rules and regulations issued there under applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors”; and

(B) the phrase “otherwise in furtherance of the purposes of this title” in section 19(b) (3) (C) of that Act shall be deemed to read “otherwise in furtherance of the purposes of title I of the Sarbanes-Oxley Act of 2002”.

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—

The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a “registered securities association” for purposes of that section 19(c), except that the phrase “to conform its rules to the requirements of this title and the rules and regulations there under applicable to such organization, or otherwise in furtherance of the purposes of this title” in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read “to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Sarbanes-Oxley Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations there under applicable to that Board”.

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act for non-co-operation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e) (1) to “members” of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase “consistent with the purposes of this title” in that section 19(e) (1) shall be deemed to read “consistent with the purposes of this title and title I of the Sarbanes-Oxley Act of 2002”;

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) shall not apply; and (E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board;

(A) Has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) Without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member;

(A) Has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) Has willfully abused the authority of that member; or

(C) Without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) By redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) By inserting after subsection (a) the following:

“(b) RECOGNITION OF ACCOUNTING STANDARDS.

“(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as ‘generally accepted’ for purposes of the securities laws, any accounting principles established by a standard setting body—

“(A) that—

“(i) is organized as a private entity;

“(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

“(iii) is funded as provided in section 109 of the Sarbanes-Oxley Act of 2002;

“(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and

“(v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

“(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

“(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.”

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) **STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—**

(1) **STUDY.**

(A) **IN GENERAL.—**The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) **STUDY TOPICS.—**The study required by subparagraph (A) shall include an examination of—

- (i) The extent to which principles-based accounting and financial reporting exists in the United States;
- (ii) The length of time required for change from a rules-based to a principles-based financial reporting system;
- (iii) The feasibility of and proposed methods by which a principles-based system may be implemented; and
- (iv) A thorough economic analysis of the implementation of a principles-based system.

(2) **REPORT.—**Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING.

(a) **IN GENERAL.—**The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) **ANNUAL BUDGETS.—**The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains (or at the beginning of the Board's first fiscal year, which may be a short fiscal year). The budget of the Board shall be subject to approval by the Commission. The budget for the first fiscal year of the Board shall be prepared and approved promptly following the appointment of the initial five Board members, to permit action by the Board of the organizational tasks contemplated by section 101(d).

(c) SOURCES AND USES OF FUNDS.

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e). Accounting support fees and other receipts of the Board and of such standard-setting body shall not be considered public monies of the United States.

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (i), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board. Such fee may also cover costs incurred in the Board's first fiscal year (which may be a short fiscal year), or may be levied separately with respect to such short fiscal year.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (g), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.

The annual accounting support fee for the standard setting body referred to in subsection (a).

- (1) shall be allocated in accordance with subsection (g), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and
- (2) may differentiate among different classes of issuers.

(f) LIMITATION ON FEE.— The amount of fees collected under this section for a fiscal year on behalf of the Board or the standards setting body, as the case may be, shall not exceed the recoverable budget expenses of the Board or body, respectively (which may include operating, capital, and accrued items), referred to in subsection (c)(1).

(g) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—

Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction:

- (1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and
- (2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(h) CONFORMING AMENDMENTS.—

Section 13(b) (2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m (b) (2)) is amended—

- (1) in subparagraph (A), by striking “and” at the end; and

(2) in subparagraph (B), by striking the period at the end and inserting the following: “; and “(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 109 of the Sarbanes-Oxley Act of 2002.”

(i) **RULE OF CONSTRUCTION.**—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

(j) **START-UP EXPENSES OF THE BOARD.**—From the unexpended balances of the appropriations to the Commission for fiscal year 2003, the Secretary of the Treasury is authorized to advance to the Board not to exceed the amount necessary to cover the expenses of the Board during its first fiscal year (which may be a short fiscal year).

Section 101 – Establishment; Administrative Provisions

Domain: Deterrence

Knowledge Area: Accounting and Finance, Law, Ethics and Compliance

SOX Process: Audit Compliance and Enforcement

Section 101 Synopsis

The Public Company Accounting Oversight Board (PCAOB) is a nonprofit corporation which oversees the audit of public companies, protects the interests of investors, and furthers the public interest with the preparation of informative, accurate, and independent audit reports of companies with securities that are sold to, and held by and for, public investors. Section 101 establishes the authority and responsibilities of a Board to act and support the goals of the PCAOB.

Duties of the PCAOB Board

Primary duties of the PCAOB Board include:

- registering public accounting firms that prepare audit reports for issuers
- establishing or adopting auditing, quality control, ethics, independence and standard practices in the preparation of audit reports
- conducting investigations and disciplinary proceedings of registered accounting firms
- enforcing compliance with the SOX Act
- setting PCAOB budget, and managing Board operations and staff

Board Membership

- composed of Chairperson and four other members
- two members must be, or have been, certified public accountants
- the Chairperson cannot have been a practicing certified public account for at least 5 years
- each member must serve on the board on a full-time basis
- none of the members may be receiving any profits or payments from any public accounting firm, other than retirement payments, or similar types of payments
- PCAOB duration of service are 5 year terms, and no member is allowed more than 2 terms

Powers of the PCAOB consist of the following:

- to sue, be sued, complain, or defend, with the approval of the SEC, in any federal, state or other court
- to operate and maintain offices (lease, buy) in accordance with the powers of the Act in any state
- to appoint employees (accountants, attorneys as appropriate), determine qualifications, define duties, and fix salaries and other compensation, in accordance with the Act
- to enter into operation management agreements, execute obligations, rights and powers imposed or granted by the Board in accordance with the Act

Rules of the Board (Subject to the approval of the SEC):

- provide for the operation and the administration of the board, per the exercise of its authority and responsibilities of the Act

- the Board to delegate, per its internal functions: review of any actions; including hearing, ordering, certifying, and reporting; a person may be entitled to a review by the Board, with respect to any delegated matters or decisions or appeals; if a review is declined or not sought, it will be deemed an action of the Board
- establish ethics, rules and standards of conduct, including a bar on practice for former Board members and non-Board members

Section 101 GASP

- Practitioners must ensure they comply with the statutes of the PCAOB.
- Public accounting firms must register with the PCAOB and abide by the regulatory powers of the body.

Section 102 – Registration with the Board

Domain: Accountability, Transparency, Deterrence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 102 Synopsis

- It is unlawful for any non-registered public accounting firm to prepare or issue an audit report. All unregistered public accounting firms, who wish to audit publicly traded companies, must register with the PCAOB, otherwise they are not legally permitted to prepare or issue audit reports on behalf of public companies.
- Registration applications are assessed by the PCAOB and mandatory, periodic reports are assessed in accordance with PCAOB rulings.
- Mandatory registration and annual fees apply to each public accounting firm registering with the PCAOB.
- Registration applications may only be in the form prescribed by the PCAOB.
- Each application for registration under this subsection shall include consenting compliance:
 - Action of Applications
 - Periodic Reports
 - Public Availability
 - Registration and Annual Fees

- The PCAOB may require more frequent reports, which disclose accounting disagreements between the issuers and the firm in connection with the audit report.

Section 102 GASP

- All public accounting firms, that audit publicly traded companies, must register with the PCAOB, no later than 180 days after the date of the determination of the Commission.
- In preparing annual reports submitted to the PCAOB, the accuracy and currency of information must be the highest priority. If the PCAOB feels the reports are lacking, the Board may request more frequent reports to assist in the disclosure of accounting details and settle disagreements between issuers and the public accounting firms.
- The issuer's audit committee is required to ensure the public accounting firm hired to issue their audit report has been properly registered with the PCAOB.

Section 103 – Auditing, Quality Control, and Independence Standards and Rules

Domain: Governance, Independence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 103 Synopsis

- The PCAOB shall establish the appropriate adoption of standards proposed by professional groups of accountants.
- The PCAOB shall determine appropriate standards for auditing, quality control, and ethics, in accordance with the Sarbanes-Oxley Act.
- The PCAOB closely monitors rule requirements including: the auditing standards of registered public accounting firms, the preparation and statutory retention of reports for 7 years, IT generated reports and adherence to control structures and procedures.
- The PCAOB also closely monitors procedures, professionalism, ethics, and the independence of external audit activities.

Public Accounting Firm Quality Assurance Requirements

- identifies requirements to public accounting firms for their internal quality assurance requirements, documentation and reporting:
 - prepare and maintain audit work papers for 7 years
 - employ second partner review and approval process
- specific auditor attestations related to Section 404 including testing of internal control structures and procedures of the issuer
- maintain records accurately reflecting the transaction and dispositions of assets by the issuer
- provide reasonable assurance that transactions are recorded as necessary to prepare financial statements in accordance with GAAP
- material weaknesses are described in the internal controls relating to any material non-compliance found during the testing of internal controls

Section 103 GASP

- Registered public accounting firms must adhere to the rules determined by the PCAOB regarding auditing, quality control, independence, ethics, rules, and standards.
- Public companies must be aware of the PCAOB requirements, processes, reviews, and recent issues of scrutiny to comply with their auditor's SOX requirements. SOX documentation is a requirement beyond the company's review with their auditors, as auditing firms have their own documentation and review requirements. Companies must provide robust systems for documenting key control activities, as well as establishing appropriate retention mechanisms.
 - Auditor independence, transparency and reporting of any fees or projects outside of the annual audit by the company's audit firm will be reported.
 - Management needs to carefully consider the appearance of conflict of interest when using audit firm's for company projects.

Section 104 – Inspections of Registered Public Accounting Firms

Domain: Deterrence, Independence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 104 Synopsis

- All registered public accounting firms will be subjected to a continuing program of inspections to assess adherence and compliance to PCAOB rules, professional standards, performance of audits, the issue of audit reports, and other matters related to the PCAOB jurisdiction.
- Inspection frequency can vary from 1-3 years, depending on the number of issuers. Adjustments to inspection schedules are permitted, consistent with the purposes of the Act.
- The PCAOB will inspect to the fullest extent of the Act.
- The PCAOB provides a report to the SEC of all inspections, including frequency, procedures and review details. If a registered public accounting firm does not agree with the PCAOB findings they have 30 days to seek a review from the SEC.

Section 104 GASP

- Registered public accounting firms must maintain accurate and current reporting as they can be subjected to inspection. The frequency and timing of the inspections are determined by the number of public companies they audit and considered of appropriate consistency by the PCAOB.
- Registered public accounting firms must retain audit records for 7 years. The PCAOB has the power to inspect documentation in order to determine compliance with this record retention policy. Appropriate record details are subject to report protection and confidentiality determined by the PCAOB.
- When registered public accounting firms disagree with a PCAOB judgement they may seek review from the SEC.

Section 105 – Investigations and Disciplinary Proceedings

Domain: Deterrence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 105 Synopsis

Rules for Investigations and Disciplinary Proceedings

- The PCAOB has established rules and subject requirements for investigations and disciplinary proceedings enacted against public accounting firms. These are exercised, if deemed appropriate, as a result of review findings.
- Registered public accounting firms must provide the PCAOB with all testimony, documentation and audit papers upon request.
- All parties may be subject to subpoena. The PCAOB will notify the SEC of pending investigations and disciplinary proceedings and thereafter will co-ordinate with the SEC Division of Enforcement.
- The PCAOB may refer an investigation to the SEC, other functional regulators; per Gramm-Leach-Bliley Act., Attorneys of one or more states of the US or State Regulatory Authorities.
- The documents used for an investigation (except where directed by the SEC, Attorney General of the US, or other statutory body), are confidential and will not be subject to civil discovery, or disclosure under the Freedom of Information Act.
- Documents used for an investigation may also be made available to government agencies such as the Attorney General or other investigative body, without the loss of privileged or confidential status as appropriate to accomplish the purposes of the Act.
- Employees of the PCAOB undertaking an investigation are subject to immunity protection from civil liability, arising out of an investigation as a federal employee.

Disciplinary Procedures

- In the event that a registered public accounting firm or an associated person should face disciplinary procedures, such procedures will include the following:
 - **Notification and record-keeping:** the PCAOB will bring specific charges, notify the person of the opportunity to defend against such charges and keep a record of proceedings
 - **Public hearings:** proceedings will not be made available to the public, unless determined by the PCAOB with the consent of all the parties

- **Supporting statement:** an official declaration by the PCAOB that a registered public accounting firm or an associated person has been determined by the PCAOB to be part of a sanction

- The following conduct will lead to disciplinary action:
 - **Intentional or other knowing conduct:** includes reckless conduct, violation of professional and regulatory standards, and negligent conduct
 - **Failure to supervise:** when a supervisor is negligent in the execution of his/her duties

- The following sanctions may result from disciplinary action:
 - **Sanction determinations:** require supporting statements; temporary or permanent suspension, barring from practice, and civil money penalties: \$100,000 natural person, \$2,000,000 for other person; if the penalty covers intentional, knowing or repeated conduct, by a natural person, the fine is: \$750,000, or by other person (corporation), the fine is: \$15,000,000
 - **Suspended association:** a person who has been suspended may not have a remaining association with a public accounting firm, without the consent of the PCAOB or SEC; it is also unlawful for any person who is suspended or barred to be associated with an issuer in an accountancy or financial capacity without the consent of the PCAOB or SEC
 - **Reporting sanctions:** the PCAOB must report sanctions to the SEC, State regulatory authority and the public; sanction reports contain, name description and other information as appropriate
 - **Stay of sanctions:** a person may have the possible stay of disciplinary action via application to the Commission for review; this may also be exercised after the disciplinary period has ended; hearing may consist solely on a submission of affidavits or presentation of oral arguments that no stay will continue to operate
 - **Expedited procedures:** the SEC has established appropriate cases for expedited procedure for consideration and determination of the duration of a stay pending review of any disciplinary action of the board

Section 105 GASP

- Registered public accounting firms must abide by the PCAOB rules, subject requirements, procedures, professional ethics standards and inspection program to the fullest extent.
- Non-compliance with investigation and disciplinary proceedings, procedures and outcomes, will result in the public accounting firm's suspension or barring from practice and penalties.

Section 106 - Foreign Public Accounting Firms

Domain: Governance

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 106 Synopsis

Implications for Foreign Public Accounting Firms

- Foreign accounting firms are subjected to all rules, regulations and standards of the PCAOB.
- Any foreign public accounting firm that prepares an audit report for any issuer of securities publicly traded in the United States, is to be considered by the PCAOB under the same guidelines as a public accounting firm based in the US
- Even if foreign public accounting firms do not issue reports, they may still be considered under the jurisdiction of the PCAOB.
- Depending on the specific circumstance, the SEC and the PCAOB may determine that foreign public firms may also be exempt.

Section 106 GASP

- Foreign public accounting firms must ensure their status with the PCAOB, as to whether they are exempt from requirements of the PCAOB. If they are not exempt, then they must fulfill the same roles as public accounting firms in the US, and can be subjected to the fullest extent of meeting the standards and requirements of the PCAOB.
- Any exemptions from meeting this classification are determined by the PCAOB.

Section 107 – Commission Oversight of the Board

Domain: Governance, Deterrence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 107 Synopsis

SEC Governance

- The SEC has full oversight and enforcement authority over the PCAOB.
- The PCAOB must submit all new or modified rules to the SEC for approval.
- The Securities Exchange Act of 1934 stipulates that the SEC will govern the rules of the PCAOB as if it were a ‘registered securities association’, consistent with the requirements, rules and regulations of this Title.
- The SEC is responsible, for rule amendment, if it is found that rules are to be deleted, repealed, or modified to more fairly enable the PCAOB to govern.
- The SEC will also review the final sanctions determined by the PCAOB and may enhance, modify, revoke or reduce based on review findings not in keeping with the fairness and appropriateness of the SOX Act.
- The SEC has the power of censure and removal from office PCAOB members who willfully violate any provision of the SOX Act, have willfully abused the authority of being a PCAOB member, or failed to enforce compliance to the SOX Act in keeping with the role of a PCAOB member.

Section 107 GASP

- Public accounting firms must ensure full compliance with the PCAOB rules, regulations, standards, and professional ethics, or else they will be subjected to the scrutiny of the SEC and the statutes of the Securities Exchange Act of 1934.

Section 108 – Accounting Standards

Domain: Governance, Deterrence

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 108 Synopsis

Accounting Standards Establishment

- The SEC will recognize ‘generally accepted’ accounting principles, established by a standard setting body. The standards setting body is to be a private entity and have a board of trustees serving in the public interest. The members of the board will not have practiced for a period of at least 2 years with any registered public accounting firm.
- This standard setting body is funded by the yearly fiscal budget of the SOX Act. The standard setting body is deemed to improve the accuracy and effectiveness of financial reporting and protect investors under the Securities Exchange Act of 1934. The standard setting body’s responsibilities include:
 - Compiling an annual report containing audited financial statements study and a report on adopting principle-based accounting (due July 23, 2003 to the committee of Banking, Housing and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives). The Report was delivered July 25, 2003. This report also reviews the transition time to move from a rules-based to a principal-based financial reporting system, and an economic analysis of this effort. Reports are available from the SEC on the results of this study. (See References for details.)

Section 108 GASP

- At the planning stages of the organization’s Sarbanes-Oxley project, the accounting leadership of the company, namely, the CFO and CFO-nominated Issuers Audit Committee members, should inquire with their outside auditors as to new requirements of the PCAOB or new implementation of those requirements within their firm.
- This discussion should provide the company with insight as to any required or desired modifications in the Sarbanes-Oxley program for the year.

Section 109 – Funding

Domain: Governance

Knowledge Area: Accounting and Finance, Internal and External Audit

SOX Process: Audit and Compliance Enforcement

Section 109 Synopsis

PCAOB Budgetary Practices

- The PCAOB and the standard setting body establish a budget every fiscal year. Budgets are subject to review and approval per internal procedures.
- Budget expenses are payable from annual accounting support fees and will not be considered public monies.
- Funding is supplied via PCAOB assessments, annual accounting support fees for the standard setting body and among issuers or classes of issuers. The amount of fees collected must not exceed recoverable budget expenses from the PCAOB or standards body (including operating, capital or accrued items).
- Funds generated from the collection of penalties, are used to fund a merit scholarship programs for undergraduate and graduate students enrolled in accredited accounting degree programs. This program is operated by the PCAOB or an agent nominated by the PCAOB.

Section 109 GASP

- None Noted.

CHAPTER 2:

Auditor Independence

Practitioners Perspective and Regulation Synopsis

The main focus of this Title is to amend Section 10A, subsections (g) through (l), of the Securities Exchange Act of 1934, which is concerned with auditor and audit committee requirements:

- focuses on conflict of interests stemming from close relationship between audit firms and the companies they audit
- prohibits auditors from performing certain non-audit services
- allows audit committees to pre-approve some activities for non-audit services that are not expressly forbidden by Title II of the SOX Act

Regulation Text

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES- Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1) is amended by adding at the end the following:

(g) PROHIBITED ACTIVITIES- Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the `Board`), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including--

- (1) bookkeeping or other services related to the accounting records or financial statements of the audit client;
- (2) financial information systems design and implementation;
- (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (4) actuarial services;
- (5) internal audit outsourcing services;
- (6) management functions or human resources;
- (7) broker or dealer, investment adviser, or investment banking services;
- (8) legal services and expert services unrelated to the audit; and
- (9) any other service that the Board determines, by regulation, is impermissible.

(h) **PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES-** A registered public accounting firm may engage in any non-audit service, including tax services, that is, not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).

(b) **EXEMPTION AUTHORITY-** The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107 securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(a)) applies. The Commission may, from time to time, amend or supplement the rules and regulations that it is required to promulgate under this section, after adequate notice and an opportunity for comment, in order to ensure that such rules and regulations adequately comport with the purposes of this section.

(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 10 years, or both.

(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation imposed by Federal or State law or regulation to maintain, or refrain from destroying, any document.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.

1520. Destruction of corporate audit records.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

(i) PREAPPROVAL REQUIREMENTS-

(1) IN GENERAL-

(A) AUDIT COMMITTEE ACTION- All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be pre-approved by the audit committee of the issuer.

(B) DE MINIMUS EXCEPTION- The pre-approval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if--

(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the non-audit services are provided;

(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(2) **DISCLOSURE TO INVESTORS**- Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

(3) **DELEGATION AUTHORITY**- The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant pre-approvals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to pre-approve an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

(4) **APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES**- In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been pre-approved for purposes of this subsection.’

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

(j) **AUDIT PARTNER ROTATION**- It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or co-ordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.’

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

(k) **REPORTS TO AUDIT COMMITTEES**- Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer--

(1) all critical accounting policies and practices to be used;

- (2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and
- (3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

SEC.205. CONFORMING AMENDMENTS.

(a) DEFINITIONS- Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

(58) AUDIT COMMITTEE- The term `audit committee' means--

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(59) REGISTERED PUBLIC ACCOUNTING FIRM- The term `registered public accounting firm' has the same meaning as in section 2 of the Sarbanes-Oxley Act of 2002.'

(b) AUDITOR REQUIREMENTS- Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1) is amended--

(1) by striking `an independent public accountant' each place that term appears and inserting `a registered public accounting firm';

(2) by striking `the independent public accountant' each place that term appears and inserting `the registered public accounting firm';

(3) in subsection (c), by striking `No independent public accountant' and inserting `No registered public accounting firm'; and

(4) in subsection (b)--

(A) by striking `the accountant' each place that term appears and inserting `the firm';

(B) by striking `such accountant' each place that term appears and inserting `such firm'; and

(C) in paragraph (4), by striking `the accountant's report' and inserting `the report of the firm'.

(c) OTHER REFERENCES- The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended--

- (1) in section 12(b)(1) (15 U.S.C. 78l(b)(1)), by striking `independent public accountants' each place that term appears and inserting `a registered public accounting firm'; and
- (2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking an independent public accountant' each place that term appears and inserting `a registered public accounting firm.'

(d) CONFORMING AMENDMENT- Section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(f)) is amended--

- (1) by striking `DEFINITION' and inserting `DEFINITIONS'; and
- (2) by adding at the end the following: `As used in this section, the term issuer' means an issuer (as defined in section 3), the securities of which are registered under section 12, or that is required to file reports pursuant to section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.'

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

- (1) CONFLICTS OF INTEREST- It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.'

SEC.207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS.

(a) STUDY AND REVIEW REQUIRED- The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) **REPORT REQUIRED-** Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section.

(c) **DEFINITION-** For purposes of this section, the term 'mandatory rotation' refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY.

(a) **COMMISSION REGULATIONS-** Not later than 180 days after the date of enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title.

(b) **AUDITOR INDEPENDENCE-** It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued there-under.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES.

In supervising non-registered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized non-registered public accounting firms.

Section 201 – Services Outside the Scope of Practice of Auditors

Domain: Independence

Knowledge Area: Internal and External Audit

SOX Process: Planning; Regulations for Others

Section 201 Synopsis

PROHIBITED ACTIVITIES

Unless exempted by the PCAOB, it is against the law for a registered public auditing firm (or associated person) to perform auditing work for an issuer while performing one or more of the following services for the issuer:

- bookkeeping or other services related to the accounting records or financial statements of the audit client
- financial information systems design and implementation
- appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- actuarial services
- internal audit outsourcing services
- management functions or human resources
- broker or dealer, investment adviser, or investment banking services
- legal services and expert services unrelated to the audit
- any other service that the PCAOB determines, by regulation, is impermissible

Exemptions to this rule can be granted on a case-by-case basis by the PCAOB, and subject to SEC review, in the following cases:

- necessary or appropriate in the public interest and is consistent with the protection of investors
- subject to audit review by the Commission, ensuring
 - (a) procedures provide assurance of detecting illegal acts that materially affect financial statements
 - (b) procedures identify third party transactions that materially affect financial statements
 - (c) an evaluation is made as to the issuer's ability to continue during the ensuing fiscal year
 - for example, tax return preparation would be an exempt activity, whereas tax consulting would not be permissible

PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES

A registered public auditing firm (or associated person) is allowed to perform both auditing work and additional services under certain conditions:

- The additional work must be something other than the prohibited services listed above.
- The work must be pre-approved by the issuer's audit committee.

Issuers who willfully and knowingly violate these rules and regulations can be:

- fined
- imprisoned for up to 10 years
- both fined and imprisoned for up to 10 years

Section 201 GASP

PROHIBITED ACTIVITIES

- Accounting must keep current with PCAOB regulations and identify if any additional non-audit services are prohibited for registered public auditing firms (or associated persons) to be provided while conducting an audit for the issuer.

PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES

- Department managers for Accounting, Human Resources, Investment, Actuarial, and Legal Services must consult with, and gain written approval from, the audit committee prior to contracting services with a registered public accounting firm (or associated person).
- Before any services are performed by a registered public accounting firm, or person associated with such firm, the audit committee must review and approve (ie pre-approve) the services in writing.

Section 202 – Pre-Approval Requirements

Domain: Governance; Independence

Knowledge Area: Law, Ethics and Compliance; Internal and External Audit

SOX Process: Planning; Regulations for Others

Section 202 Synopsis

All auditing activities provided by a registered public accounting firm (or associated person), must be pre-approved by the audit committee.

All non-audit activities provided by a registered public accounting firm (or associated person), must be pre-approved by the audit committee, except where:

- the aggregate cost of all such non-audit activities is less than 5% of revenues paid to the auditor during the same year
- the services were not recognized as non-audit at the time of engagement
- the services are approved by one or more members of the audit committee before the audit is completed

An audit service shall be deemed to have been pre-approved if the audit committee approves an audit service within the scope of the audit engagement and during the course of its regular duties of appointing, compensating, and overseeing the work of registered public accounting firms employed by that issuer.

Pre-approvals performed by the audit committee must be disclosed in the issuer's annual and quarterly publicly issued financial reports.

The audit committee delegate authority to grant pre-approvals to one or more designated members of the audit committee, with the following requirements:

- designees must be independent directors of the board of directors
- pre-approval decisions must be presented to the full audit committee at each of its scheduled meetings

Section 202 GASP

The audit committee is responsible for evaluating each audit and non-audit service to determine whether it must be pre-approved.

Although it is allowable for the audit committee to appoint and authorize one member of the committee to grant pre-approvals, they should require two or more approvers to avoid potential conflicts of interest.

The audit committee is responsible for appointing, compensating and overseeing the work performed by registered public accounting firms employed by the issuer.

The audit committee, along with Accounting, must disclose all pre-approvals to the public on the quarterly and annual reports to the SEC.

Section 203 – Audit Partner Rotation

Domain: Governance; Independence

Knowledge Area: Law, Ethics and Compliance; Internal and External Audit

SOX Process: Planning; Regulations for Others

Section 203 Synopsis

The same lead audit partner and reviewing partner cannot have primary responsibility for an issuer's audit for more than 5 years in a row.

Section 203 GASP

The audit committee must ensure that a new lead audit partner and reviewing partner are put in charge of the issuer's audit every sixth fiscal year, at a minimum.

Section 204 – Auditor Reports to Audit Committees

Domain: Governance; Independence

Knowledge Area: Law, Ethics and Compliance; Internal and External Audit

SOX Process: Planning; Regulations for Others

Section 204 Synopsis

Registered public accounting firms that perform audits related to the SOX Act must provide timely reports to the issuer's audit committee, including:

- all critical accounting policies and practices to be used
- disclosure and analysis of issuer's alternative accounting methods within GAAP, as revealed by issuer management, which discusses:
 - description of alternate accounting practices, which are compliant with generally accepted accounting principles, that have been discussed with officers and directors of the issuer
 - possible outcome(s) of using the alternative accounting method(s)
 - registered public auditing firm's recommended accounting methods
- written communications between the audit firm and issuer management

Section 204 GASP

The audit committee should meet with audit firm(s) regularly to ensure they receive the following reports and updates timely:

- all critical accounting policies and practices to be used
- disclosure and analysis of issuer's alternative accounting methods within GAAP, as revealed by issuer management, which discusses:

- description of alternate accounting practices, which are compliant with generally accepted accounting principles, that have been discussed with officers and directors of the issuer
- possible outcome(s) of using the alternative accounting method(s)
- registered public auditing firm's recommended accounting methods

The audit committee should evaluate reports, correspondence, analysis and recommendations received from audit firms and plan appropriate follow-up actions with issuer's officers and directors.

Section 205 – Conforming Amendments

Domain: Governance; Independence

Knowledge Area: Law, Ethics and Compliance

SOX Process: Planning; Regulations for Others

Section 205 Synopsis

The audit committee is expected to:

- oversee the accounting and financial reporting processes of the issuer
- oversee audits of the financial statements of the issuer
- be a committee (or equivalent body)
- be established by the board of directors of an issuer
- be comprised of members of the board of directors of an issuer
- if no such committee exists with respect to an issuer, the entire board of directors of the issuer comprises the audit committee

A registered public accounting firm is defined in Section 2 as:

- a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports
- registered with the Board in accordance with this Act (See Section 102.)

The term 'issuer' is modified in this section. The full definition, including the modification, appears below:

- any person who issues or proposes to issue any security, the securities of which are registered with the SEC by a member, broker or dealer, allowing them to effect any security transaction on a national securities exchange

- the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued, the securities of which are registered with the SEC by a member, broker or dealer, allowing them to effect any security transaction on a national securities exchange, with respect to:
 - certificates of deposit for securities
 - voting-trust certificates
 - collateral-trust certificates
 - certificates of interest not having a board of directors or of the fixed, restricted management, or unit type
 - shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type
- the person by whom the equipment or property is, or is to be, used, the securities of which are registered with the SEC by a member, broker or dealer, allowing them to effect any security transaction on a national securities exchange, with respect to equipment-trust certificates or like securities
- the securities of which are registered with the SEC by a member, broker or dealer, allowing them to effect any security transaction on a national securities exchange
- an issuer who files, or is required to file annual and/or quarterly reports as prescribed by the SEC, and either:
 - filed a registration statement or became operative prior to the enactment date of the Securities Acts Amendments of 1964, or
 - that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn

Section 205 GASP

The board of directors must select members and/or participate in the audit committee, which will be responsible for the financial reporting process and financial statement audits.

Qualified members of the board of directors should serve on the audit committee with rotating memberships.

Audit committee members should possess knowledge of GAAP, Financial Reporting, Auditing and SOX.

Section 206 – Conflicts of Interest

Domain: Governance; Independence

Knowledge Area: Law, Ethics and Compliance

SOX Process: Planning; Regulations for Others

Section 206 Synopsis

An individual who has provided an audit service to an issuer within the past year cannot be hired as, or serve as, an officer or director of that company.

Section 206 GASP

Human Resources management should ensure that interview candidates for officer and director positions have not been employed by the independent public accounting firm which had provided audit services to the company within the past year.

Section 207 – Study of Mandatory Rotation of Registered Public Accounting Firms

Domain: Governance

Knowledge Area: Law, Ethics and Compliance; Internal and External Audit

SOX Process: Planning; Regulations for Others

Section 207 Synopsis

The Comptroller General of the United States is required to issue a study which reviews the potential effects of the mandatory rotation of auditors.

- The report was issued November 2003 and is available to the public.
- The report findings were inconclusive on whether auditor rotation was an effective way to assure quality and auditor independence. A long-term study was recommended.
- Mandatory rotation' refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer. Currently, the mandatory audit partner rotation is set at 5 years, according to the Security Exchange Act of 1934 section 10A subsection (j).

Section 207 GASP

The audit committee should keep up-to-date with mandatory rotation standards and ensure the registered public accounting firms conduct their audits in compliance with the mandate.¹

Section 208 – Commission Authority

Domain: Governance

Knowledge Area: Law, Ethics and Compliance

SOX Process: Planning; Regulations for Others

Section 208 Synopsis

As amended by Sections 201 through 206 of the Act, the SEC has issued final regulations for carrying out the Securities Exchange Act of 1934 section 10A subsections (g) through (l). The regulations cover the Title 2 amendments in detail, including:

- discussion surrounding conflicts of interest
- detailed descriptions of the services prohibited for registered public accounting firms that are providing audit services for the issuer
- partner rotation rules, including exceptions
- audit committee responsibilities
- disclosure requirements and instructions for completing disclosure forms

In order to maintain auditor independence, a registered public accounting firm cannot issue an audit report if they engage in activities that are prohibited by the Securities Exchange Act of 1934 section 10A subsections (g) through (l), as amended by Sections 201 through 206 of the Act (as summarized above).

Section 208 GASP

- Accounting management must become familiar with SEC regulations developed to comply with section 208. At the time of this writing, final SEC regulations and associated corrections are available via the internet.²

¹ Contributors: Jeanette M. Franzel, John J. Reilly, Jr., William E. Boutboul, Cheryl E. Clark, Robert W. Gramling, Wilfred B. Holloway, Michael C. Hrapsky, Catherine M. Hurley, Charles E. Norfleet, Judy K. Pagano, Sidney H. Schwartz, Jason O. Strange, Patricia A. Summers, and Walter K. Vance (2003). *PUBLIC ACCOUNTING FIRMS Required Study on the Potential Effects of Mandatory Audit Firm Rotation*. Retrieved August 3, 2007, from the United States General Accounting Office website: <http://www.gao.gov/new.items/do4216.pdf>

² The Securities and Exchange Commission (2003). 17 CFR PARTS 210, 240, 249 and 274 [RELEASE NO. 33-8183; 34-47265; 35-27642; IC-25915; IA-2103, FR-68, File No. S7-49-02] RIN 3235-A173 Strengthening the Commission's Requirements Regarding Auditor Independence. Retrieved August 6, 2007, from the Securities and Exchange Commission website: <http://www.sec.gov/rules/final/33-8183.htm>

- Before pre-approving services provided by a registered public accounting firm, the audit committee should investigate the firm's background to make sure they have not engaged in any of the activities prohibited by the Securities Exchange Act of 1934 section 10A subsections (g) through (l), as amended by Sections 201 through 206 of the Act.

Section 209 – Considerations by Appropriate State Regulatory Authorities

Domain: Governance

Knowledge Area: Law, Ethics and Compliance; Internal and External Audit

SOX Process: Regulations for Others

Section 209 Synopsis

The requirements outlined by Title II may not be appropriate or applicable for all accounting firms. State regulatory authorities that supervise the firm should determine the appropriate requirements, depending on the size and nature of the business.

Section 209 GASP

Audit committees should be aware of the requirements that their accounting firms must comply with as determined by state regulatory authorities.

Individualized regulations may affect how auditors are appointed, managed, and compensated.