

**Sarbanes - Oxley Act: Coming to a firm near you.**

Professor Michael J. O'Hara, J.D., Ph.D.  
University of Nebraska at Omaha  
<http://cba.unomaha.edu/faculty/mohara/web/ohara.htm>

NACM - North Central  
**National Agri-Business Credit Group Meeting**  
June 16, 2004  
Hilton Omaha, Nebraska

ABSTRACT: Bursting stock market bubbles often generate substantial changes in law that seek to increase transparency in the market. The 2002 Sarbanes - Oxley Act (SOXA) requires substantial new disclosures and certifications. Some of its changes are simple to state and to do; for example, CEO and CFO certification. (Simple for the CEO and CFO, but not everybody else doing the lead up tasks.) As with any major change, the real change is in the detail, and the detail often generates far more than a few surprises. Creditors will need to pay particular attention to their own disclosures, as well as seeking profit by mining the disclosures of their debtors.

---

---

---

---

---

---

---

---

**buzzkill**

technology bubble burst  
demand evaporated

accounting bubble burst  
smoothing had become boosting

law reacts  
SOxA by Congress, and the  
related regulations by SEC, FASB, PCAOB,  
AICPA, NYSE, NASDAQ

2

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

**kitchen sink**

independence      transparency

auditing the auditor      document retention

name on the line      identical blackouts

code of ethics      whistleblower

3

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## credit has a special role

off-balance sheet  
contractual obligations

loans to officers and directors

grants, awards, *bona fide* gifts, & inheritance

4

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## *Et tu, Brutus?*

The principal-agent problem is alive and well.

Officers and directors, accountants, and attorneys  
all had at least one finger in this pie, and  
each drew its own rebuke.

5

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Step up to the plate.

The Board of Directors must do **corporate governance**.

majority must be *independent*

meetings of independents

independents control management compensation

shareholders influence compensation

Board monitor and report compliance

clarity in the Board nomination process

*audit committee* role strengthened greatly

*financial expert member*

6

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## A thumb on the scale.

Management is prohibited from taking any action which would *improperly influence an auditor* and result in a materially misleading financial statement.

If *restatement* of financials is required because of misconduct by the CEO or CFO, then they must *reimburse* any bonuses.

No company *loans* to officers or directors.

7

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## I felt so conflicted.

**Auditor independence** is the linchpin of this reform.

Firms may buy what ever service the firm desires: but, not all from the same accountant.

An auditor may *not audit own work* and may *not perform management functions*.

Report: Audit Fees, Audit-Related Fees, Tax Fees, and All Other Fees.

8

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## If it looks, acts, walks, OR sounds like a duck, it is a duck.

bookkeeping	information services
employment relations	human resources
valuation service	actuarial services
legal services	expert witness
management functions	tax services
investment services	banking services
internal audit	

**partner rotation required:** max of 5 years

9

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## asleep at the switch

The Board of Directors' **audit committee** must become more involved.

**communication before, during, and after the audit.**

For example, audit committee must approve the auditor or the **hiring** process, create pre-approval processes for minor work, (e.g., >5% of fees), *de minimis* exception, no auditor earns a commission.

10

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## A watched pot overflows less often.

**audit committee financial expert**

understanding of **GAAP** and financial statements  
**ability to assess** general application of GAAP  
**experience** with comparable breadth and complexity  
**understanding** of internal controls and procedures  
understanding of audit committee functions

Board classifies at least one, preferably independent

**safe harbor: not really an expert**

11

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Keep an eye on the ball.

Auditor must report to the audit committee:

**critical accounting polices,**  
**alternative accounting treatments**  
discussed with management  
(including ramifications), and  
**other material communications**  
between the auditor and management.

12

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Speak no evil

Management is not the **client** of the attorney;  
the **Board of Directors** is the client.

All agents, but especially attorneys have a **duty to report** once the attorney has **credible evidence** (i.e., unreasonable for a prudent and competent attorney not to conclude that a material violation is reasonably likely).

Continue reporting up the chain of command until perceive an **appropriate response within a reasonable time**.

13

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Can you hear me knocking?

Firm may use a **qualified legal compliance committee** to capture and manage SOx'A reports.

The **proposed** SEC rules required attorney's **noisy withdrawal** (i.e., preempt State created privilege) if attorney had credible evidence of flawed SEC filing by the firm. This proposed rule is **on hold**.

Just recently, the FTC backed off requiring attorneys to comply with Graham-Leach-Bliley Act's privacy rules when providing "financial services".

14

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## filing the GAAP

### non-GAAP financial measures

exclude the included  
include the excluded  
*especially cash*

neither GAAP nor non-GAAP  
statistical measures  
otherwise required disclosures

15

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Is it clear yet?

**disclose** all non-GAAP financial measures  
*furnishing* versus *filing* an 8-K  
post to web if inadvertent oral disclosure

when choose to use a  
non-GAAP financial measure  
then also must present  
**most directly comparable GAAP financial measure**

*may not use confusingly similar names for non-GAAP*

16

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## three shell monte

### **off balance sheet**

with unconsolidated entity providing  
financing, liquidity,  
market risk or credit risk support  
via leasing, hedging, or R&D services

For example,

guarantee contract  
contingent interests (e.g., royalty streams)  
derivative equity

17

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## three card monte

The Management Discussion and Analysis (MD&A) also  
must disclose **contractual obligations**.

Must disclose in multiple **tables**.

### TOPICS

long-term debt  
capital lease obligations  
operating leases  
purchase obligations  
other long-term obligations

### DURATIONS

less than 1 year  
between 1 and 3 years  
between 3 and 5 years  
more than 5 years

***all footnotes necessary***

18

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Deal the cards face up.

Disclose all material arrangements if **current or future material effect**.  
Disclose to **extent necessary** to understand business purpose, importance; revenues, expenses, and cash flows; other indebtedness; other **known events** reasonably likely to terminate or materially reduce arrangement.  
Forward looking **safe harbor**.

19

SOx/A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## miles and miles of files, pretty files

**Document retention** for audits expanded:  
seven years of **workpapers**  
but, two years of Statute of Limitations  
documents materially **supporting** accounting conclusions  
**contradicting** accounting conclusions

Public Company Accountability Oversight Board (PCAOB)

20

SOx/A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## You talking to me?

Organizational commitment  
is sought via CEO and CFO **certification**.

What do you **know**?

disclosure controls and procedures  
active versus passive  
internal and external  
fair representation

21

SOx/A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## I'm late, I'm late, for a very important date!

accelerated reporting by statutory insiders

**two business days:** was 10 days after end of month  
but, employee benefit plans

equity securities transactions (e.g., derivatives)  
but not stock splits

22

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## What's good for the goose ...

Executive officers and directors  
subject to **same** pension plan trading **blackout**  
as the rest of pension plan members.  
temporary suspension affecting 50% or more  
but not including  
regularly scheduled  
M & A, or D  
grant or award  
*bona fide* gift

23

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## One size fits all?

**code of ethics**

must bind CEO, CFO, & senior accounting

must require comply with the law  
ethics requires more

Use the same code of all within corporation?  
*any lawful purpose?*

24

SOx'A: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## In the eye of the beholder.

code of ethics

conflicts of interest

waiver

Who grants a Board member's waiver?

disclosure

accountability

report changes in code of ethics

25

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---

## Mirror, mirror on the wall ...

whistle blowing

both *civil* and *criminal* liability for *retaliation*

see: <http://www.law.com/jsp/article.jsp?id=1086705997094>

26

SOxA: Coming to a firm near you.

O'Hara © 2004

---

---

---

---

---

---

---

---



---

---

---

---

---

---

---

---