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The Current State of Play under the Sarbanes-Oxley Act of 2002

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The Background

Since it became the law on July 30, 2002, Sarbanes-Oxley Act[1] (as it is now commonly known) has been the subject of an endless stream of panel discussions, seminars, speeches, articles, and media interpretations. It may or may not be a tsunami in the financial markets comparable to the changes brought about by the regulatory scheme developed in the 1930s. But the statute and the corollary changes by stock exchanges to their listing requirements will alter the relationships between participants in financial markets in significant and long-term ways.

While the run-up in stock market valuations in the late 1990s is now, in hindsight, viewed as a "bubble" or a "bomb," the warning signals were in place early. Undoubtedly, the development and dissemination of information technology contributed both to the opportunity to distort results and to the mood of the market participants. The Internet expanded the speed and extent of communication. Things could be measured and compared within a time frame not previously possible. For example, only with the advanced computer technology of the 1990s was it possible to collect data about a disparate group of real estate assets from widely dispersed geographic areas on one page, which also reflected their performance, analyzed financial results, and compared that data to data about similar clusters. All this allowed for the securitization of the cash flow streams of these asset clusters, and the development of primary and secondary markets for these securities. The productivity long promised by information technology advances finally arrived. It was possible

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1 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 29 U.S.C.) (2002).

to develop internal reporting systems that were quick and thorough. It was also possible to monitor progress more rapidly.

This was a new economy. Certainly the continued improvements in productivity and profitability, without the same kind of interruptions from Cold War politics, allowed for an extended expansion of the economy that seemed, in fact, to portend a long boom. Why wouldn't underdeveloped countries rapidly enter the global economy when digital telephony could be installed without incurring the enormous cost and lengthy construction period involved in constructing a hard wire infrastructure? And with an entire world that would benefit from advances in such products, how could any step forward not be economically advantageous?

There were, however, signals to the contrary. Any number of ideas became the "core business" of "companies" with no assets, no experienced management, no customers, no defined markets, and no distribution system. Applications, which at best represented an enhancement to existing ones, became the core business of separate enterprises, which then proceeded to obtain financing with no regard to future profitability. Amazon.com and Webvan continued to expand while operating unprofitably; the new economy gurus brayed about new measures of value, while seeming to have forgotten Sears Roebuck catalogs and corner grocery stores that had once delivered telephone orders. Information technology allowed the creation of financial products—often euphemistically called "derivative products"—that simply could not exist without the ability of computers to both model and project. They were sometimes, in fact, products only because computers could identify differentials in data and place a value on them. The cultural change induced by deregulation of previously heavily regulated industries encouraged reinterpretations of products, values, and accounting concepts.

The Internet was used early to sell securities without registration. The Securities and Exchange Commission (SEC) responded by requiring registration.[2] The internet sellers

[2] *See, e.g.*, Securities and Exchange Commission v. Pleasure Time, Inc., SEC Litigation Release No. 15178, 63 S.E.C. Docket 1006 (Dec. 6, 1996) (violation of Section 5(a) of the Securities Act of 1933); SEC Creates Office of Internet Enforcement to Battle Online Securities Fraud, SEC Press Release, *available at* http://www.sec.gov/news/press/pressarchive/1998/98-69.txt (July 28, 1998) (forming the

responded by giving the stock away so long as parties who came to their website left behind personal information. The SEC responded by indicating that such a transaction included consideration and was still a sale.[3] "Eyeballs to a site" and "hits per hour" became measures of value although no economic transactions occurred.

As the market settled after March, 2000, and then dropped, then settled further, what became increasingly apparent was that financial statements for some companies had gone awry, and that the discipline of full and adequate disclosure had given way to carefully constructed footnotes where there should, perhaps, have been line items; or an absence of text altogether where there should have been ample footnotes.

There had been efforts to catch up before 2000. Audit committees with non-management directors became a standard requirement in the late 1990s.[4] Codes of ethics became, while not required, a best practice. And then came Enron, quickly followed by Global Crossing, WorldCom, Adelphia, and Xerox. For this discussion, the common elements of these companies' problems are what are important because they presage the changes mandated and under way in the new Sarbanes-Oxley world. All had financial statements that had used not just aggressive accounting techniques, but accounting techniques that were unacceptable. All had boards of directors that were apparently inadequately informed and not in control. All had managements who also appeared insufficiently well informed to execute their tasks or determined to execute them improperly. That their auditors had not been able to find the misstatements or had been unwilling to do so seemed incomprehensible. And right behind the auditors it seemed hard to believe that investment bankers and lawyers who acted as their advisors had not seen this conduct for what it was.

The Sarbanes-Oxley changes—which include those being

Office of Internet Enforcement to administer the Enforcement Division's Internet Program) (on file with the North Carolina Journal of International Law and Commercial Regulation).

[3] *See, e.g.*, Vanderkam & Sanders, SEC No-Action Letter, 1999 WL 38281 (Jan. 27, 1999); Simplystocks.com, SEC No-Action Letter, 1999 WL 51836 (Feb. 4, 1999); Andrew Jones & James Rutten, SEC No-Action Letter, 1999 WL 377873 (June 8, 1999).

[4] Exchange Act Release No. 42231 (Dec.14, 1999) [64 FR 71523] (NASDAQ Rules); Exchange Act Release No. 42233 (Dec. 14, 1999) [64 FR 71529] (NYSE Rules).

imposed by the stock exchanges—can be organized around a few central principles. Financial statements must become more reliable and more informative. Auditors must stand more independent from their clients. Boards must have committees, and these committees must take governance responsibility, including holding management accountable. Management must insist upon full and accurate disclosure and must take responsibility for the process as well as the disclosures.

Reformation of the Accounting Industry

The accounting industry itself is the subject matter of a major portion of Sarbanes-Oxley. The statute mandates the creation of the Public Company Accounting Oversight Board.[5] Only audit firms registered with the Oversight Board may audit public companies, from and after approximately November 2003.[6] The Oversight Board has been appointed, and the SEC recently selected Federal Reserve Board executive William J. McDonough to head the Oversight Board.[7] Nevertheless, it is not presently clear how close the Oversight Board is to being fully operational.

There are, however, significant features to the Oversight Board that underscore the demand for the accounting industry's increased independence from its clients. First, the Oversight Board itself is not to be comprised of a majority of persons with an accounting background.[8] Second, the Oversight Board will have ultimate authority over standards of internal conduct of auditors as well as the development of auditing standards.[9] The Oversight Board will undertake investigations of audit firms[10] and require that audit firms regularly (that is, annually) report on their own internal activities.[11] The substance of these requirements has yet to be developed, but in any event, audit firms will be under more continuous review of their own internal procedures and

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5 Sarbanes-Oxley Act § 101(a).

6 *See id.* §§ 101(d), 102(a).

7 Carrie Johnson, *Fed Officer to Head Audit Panel*, WASH. POST, Apr. 16, 2003, at E1.

8 *Id.* § 101(e)(2).

9 *Id.* § 103.

10 *Id.* § 104.

11 *Id.* § 102(d).

compliance than was previously the case.

Audit Firms Relationships With Public Companies

Sarbanes-Oxley has fundamentally altered the relationship public companies will have with their auditors. First, the statute demands that the engaging authority from the company is the audit committee rather than management.[12] Auditors are required to regularly interface with audit committees.[13] Indeed, technically the audit firm reports not to management but to the audit committee.[14] In these meetings, audit firms must inform the audit committee of those aspects of the audit that represent critical accounting policies, aggressive accounting positions, and alternative treatments, along with the substance of the audit findings.[15]

The statute took direct aim at the menu of non-audit services which audit firms had become accustomed to delivering. Now prohibited are internal accounting services, systems design and implementation, appraisal services, actuarial services, internal audit outsourcing services, legal services and expert services unrelated to audit, broker dealer services, investment advisor or investment banking services, human resources, and management functions.[16] A company's board of directors is also empowered to make other non-audit services impermissible.[17] In addition, non-audit services that are permissible must be pre-approved.[18]

To further establish the independence of auditors, the statute mandates limits on employment opportunities from audit firms to companies.[19] Audit partners must be rotated after five years of service to the account.[20] Other audit personnel are required to be

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12 *Id.* § 202 (noting that all auditing services minus a de minimus exception shall be preapproved by the audit committee of the issuer).

13 *Id.* § 204.

14 *Id.*

15 *Id.*

16 *Id.* § 201(g).

17 *Id.*

18 *Id.* § 201(h).

19 *Id.* § 206.

20 *Id.* § 203.

rotated every seven years.[21] As interpreted by the regulations, even an audit firm's recommendation to the client of an individual for employment carries with it the possibility of a loss of independence, whatever that individuals' prior relationship to the audit firm or the audit.[22] This loss of independence of course means the loss of the audit engagement.

Audit Committees

The statute focuses on audit committees and creates in the audit committee a committee of directors with substantial authority,[23] perhaps too much authority and too much responsibility for the time available. Nevertheless, the audit committee has become the gatekeeper. The audit committee engages the audit firm. The audit committee holds the audit firm accountable and meets regularly with the audit firm.[24] The audit committee meets with the CEO and CFO at least quarterly.[25] The audit committee interfaces with internal audit.[26] The audit committee is in charge of the whistleblower provisions to protect employees who bring accounting questions to the attention of the audit committee or to attend to such questions brought by persons outside the company.[27] Finally, of course, the audit committee is responsible to the board of directors for the condition of the financial statements and other financial reporting of the company.[28]

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21 Strengthening the Commission's Requirements Regarding Auditor Independence, Exchange Act Release No. 34-47265, *available at* http://www.sec.gov/rules/final/33-8183.htm (as amended Mar. 26, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

22 *Id.*

23 Sarbanes-Oxley Act § 301.

24 *Id.*

25 This occurs as a result of the requirements in §302 of Sarbanes-Oxley and the corresponding certifications required by Rules 13a-13 and 15d-13 under the Exchange Act. *See* 17 C.F.R. § 240.13a-13 (2002); 17 C.F.R. § 240.15d-13 (2002).

26 *See* New York Stock Exchange Proposals - proposed Section 303A(7) (Aug. 15, 2002), *available* at http://www.nyse.com/pdfs/corp_gov_pro_b.pdf (last visited on May 3, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

27 Sarbanes-Oxley Act § 301.

28 *Id.* at § 2(a)(3).

Though the media has suggested from time to time that the membership of audit committees will change, that will probably not be the case. To date, audit committees, as mandated by the stock exchanges and, through its regulations, by the SEC,[29] have operated under standards of relative independence. Those standards have been slightly increased, so that the only compensation of any kind that can be received by a member of an audit committee is compensation for service as a board member and as a committee member. In addition, independence requirements have been extended to eliminate contamination through affiliation (such as a relationship to an employee).[30] The committee must also have a member who is a financial expert.[31] The SEC's proposed rule with respect to this requirement was very narrow and limited financial experts to those who more or less had an accounting background.[32] The final regulation has stepped back from this definition. The universe of financial experts now includes persons whose prior occupation–especially including employment as chief executive officers–required them to understand and interpret financial statements.[33]

Changes in Disclosures and Reporting

The Sabarnes-Oxley Act and the SEC have moved to install several significant changes in financial reporting. The statute and the interpretive regulations directly attack the use of non-GAAP reporting. This practice led to the creation of pro formas and other financial measures that were not GAAP concepts. Put simply, it will no longer be possible to use non-GAAP financial measures

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29 Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78(f)); Rule 4350(d), NASDAQ Qualitative Listing Requirements for NASDAQ National Market and NASDAQ SmallCap Market Issuers Except for Limited Partnerships, *available at* http://cchwallstreet.com/nasd/nasdviewer.asp?SelectedNode=4&FileName=/nasd/nasd_rules/RulesoftheAssociation_mg.xml#chp_1_4 (last visited on May 3, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation); Rule 303.01, Audit Committee - New York Stock Exchange Listed Company Manual.

30 Sarbanes-Oxley Act § 301.

31 *Id.* § 407(a).

32 Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Exchange Act Release No. 34-47235, *available at* http://www.sec.gov/rules/final/33-8177.htm (Jan. 24, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

33 Sarbanes-Oxley Act § 407(b).

without presenting them in the context of GAAP financial measures for the same subject matter. In some industries, this may require some adjustment. For example, the Real Estate Investment Trust (REIT) industry has long used a non-GAAP concept, funds from operations (FFO), in an effort to create a measurement of performance that would allow comparison of one REIT to another.[34] While stand-alone use apparently will no longer be permitted, REITs for many years have been presenting the GAAP measure in the immediate context of the non-GAAP measure.[35]

The most powerful change will undoubtedly result from the statute's insistence on improved disclosure with respect to off-balance sheet transactions. Of particular focus, of course, were the special purpose entities whose very existence was not often adequately disclosed, let alone described and reported. Certainly, the relationships of companies to special purpose entities were often only sketchily described. Moreover, the direct or contingent liability exposure of the company to results of operations of the special purpose entity was often ignored. These off-balance sheet transactions will be required to be separately described and presented in financial statements as well as in management's discussion and analysis in the periodic reports of companies. [36]

Perhaps more significant, however, will be the provisions of the final SEC rules concerning contractual obligations. Certainly all of us would recognize that contracts not yet fully performed are "off the balance sheet" and entail some measure of liability on the part of companies. Under the final rules, companies will be obliged on an annual basis to describe and summarize the extent of these contractual obligations and the extent of the exposure, in tabular format.[37] At present, both lawyers and accountants are

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34 *See* National Association of Real Estate Investment Trusts, White Paper on Funds from Operations (NAREIT, Apr. 5, 2002), *available at* http://www.nareit.com/accountingissues/whitepaper.cfm. (on file with the North Carolina Journal of International Law and Commercial Regulation).

35 *See id.*

36 Sarbanes-Oxley Act § 401; Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Exchange Act Release No. 34-47264, *available at* http://www.sec.gov/rules/final/33-8182.htm (last visited Apr. 10, 2003) (on file with North Carolina Journal of International Law and Commercial Regulation).

37 Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Exchange Act Release No. 34-

struggling to determine just how big a burden this will become.

In addition, the SEC has signaled that management's discussion and analysis (MD&A) will continue to expand.[38] It now will include a full explanation of critical accounting policies.[39] We can expect that it is in MD&A that the SEC will continue to stress the mandate that companies continue to expand their disclosure of their operations and their operating results. As a result of the statute, the SEC will now review the financial reports of each public company at least every three years.[40] For some companies, that review may become more frequent depending upon such things as volatility of stock and size of market capitalization.

Impact on Managers and Operations

There are a series of demands on management imposed by Sarbanes-Oxley, and we can expect, by the stock exchanges. Most of these have been defined and are already in place. Extensions of credit in general have been eliminated. In fact, these have not had the extensive negative impact that was initially expected. Certainly, the manner of operating for ordinary and necessary business expenses incurred by employees has not required a change for most companies. On the other hand, the open extension of credit to officers and directors has come to a stop.

Sarbanes-Oxley imposes a quarterly certification requirement on the CEO and the CFO with respect to each periodic report filed by public companies.[41] In general terms, these officers must certify:

47264, *available at* http://www.sec.gov/rules/final/33-8182.htm (last visited on Apr. 10, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

38 Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies, Exchange Act Release No. 34-45907, *available at* http://www.sec.gov/rules/proposed/33-8098.htm (last visited on Apr. 10, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

39 *Id.*

40 Sarbanes-Oxley Act § 408(c).

41 *Id.* § 302.

- that the report meets the standards of material disclosure in general as required by Rule 10b-5;[42]
- that the financial statements fairly present the financial condition and results of operations;[43]
- that the signing officers are responsible for establishing and maintaining both disclosure controls and internal controls and that those controls are effective and ensure that material information is reported to those officers;[44]
- that those officers have disclosed to the issuer's auditors and the audit committee deficiencies in the design or operation of internal controls and material weaknesses in those controls, and any fraud involving employees with a significant role in internal controls;[45] and
- whether there were any significant changes in internal controls.[46]

At the present time, the full certification with respect to internal controls is not in place, although much of it is. The full extent of what the statute and the SEC will require as a system of internal controls is not yet clear. In addition to this quarterly report, there is also an annual certification of internal controls. This certification requires an assessment of effectiveness of the internal control structure and also requires an attestation with respect to the internal control environment by auditors. The proposed rule with respect to this requirement describes an internal control environment well beyond that presently in use in most U.S. companies or contemplated in most financial reporting systems. It appears to be based principally upon the American Institute of Certified Public Accountant's (AICPA) publication AU319[47] that provides a broad-reaching description of a control environment including such items as risk management and pathways of communication. There is some prior history in the

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42 17 C.F.R. § 240.10b-5 (2002); *see* Sarbanes-Oxley Act § 302(a)(2).

43 Sarbanes-Oxley Act § 302(a)(3).

44 *Id.* § 302(a)(4).

45 *Id.* § 302(a)(5).

46 *Id.* § 302(a)(6).

47 The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit, Statement on Auditing Standards No. 94, § 319 (American Inst. of Certified Pub. Accountants 2001).

banking industry in the United States with respect to implementation of such a broad gauge system of controls. Until the final rule is published, however, we will not know what will be required nor will we be able to evaluate the extent of change, disruption, or cost that these systems of control will impose.

One of the oddities of the statute is a further certification of each periodic report in the criminal section of the statute.[48] Each CFO and CEO must also certify (it is not clear to whom the certification must be made although the certification will be an exhibit to periodic reports) the "fair presentation" portion of the certification to the SEC.[49] This particular certification, while it carries with it the onus of a crime for filing a false certification, seems to add nothing to the overall structure of the statute or even to the crimes and penalties established within the statute.

Companies who are not presently operating with codes of ethics will surely adopt them in the near future. The statute mandates a code of ethics for senior financial officers.[50] The proposed stock exchange rules mandate a code of ethics across entire companies.[51] Many companies have already installed such codes of ethics so that this requirement will not impose a burden on them. For those who have not yet done so, putting one in place may require some time and expense but not on the order of magnitude of other requirements. In addition, management transactions in their companies' securities are now being reported within forty-eight hours instead of on a monthly basis.[52]

Impact Beyond U.S. Boundaries

For foreign companies with securities being traded in the U.S.

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48 Sarbanes-Oxley Act § 906.

49 *Id.*

50 *See id.* § 302

51 *See* NASDAQ Proposed Rule Change – (affecting Marketplace Rules 4350(m) and IM-4350-7) (Oct. 9, 2002, Amendment 1 – Jan. 15, 2003), *available at* http://www.nasdaq.com/about/ProposedRules.stm#codes (last visited on May 3, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation); New York Stock Exchange Proposals – proposed Section 303A(10) (Aug. 15, 2002), *available at* http://www.nyse.com/pdfs/corp_gov_pro_b.pdf (last visited on May 3, 2003) (on file with the North Carolina Journal of International Law and Commercial Regulation).

52 *Id.* § 403.

capital markets, there is very little leeway. In most situations, these companies and their foreign audit firms are treated like their U.S. counterparts. Corporate governance requirements remain similar. Reporting requirements and certification requirements are similar.

This has already proved problematic and may be increasingly so in the future. Of particular concern is the problem of reconciliation with GAAP financial reporting. So-called principles-based accounting and other accounting standards that are non-U.S. GAAP have been the subject of dialogue with the SEC for many years. During this period, a set of standards has developed and methods of reconciliation and presentation of that reconciliation exist. Sarbanes-Oxley requires the SEC to study this topic. It appears, then, that some of this may now be subject to re-definition, but, at the present time, information has not extended beyond speeches and position papers.

Expanded Crimes; Expanded Civil Liability; Expanded Penalties

Expanded Civil Liability

Surely, one of the sections of the statute that will be the subject of much interpretation in the courts is Section 3, which says simply that any violation of Sarbanes-Oxley is a violation of the Securities Exchange Act of 1934,[53] which, in fact, is amended by many of the Sarbanes-Oxley provisions.[54] Are there then new causes of action for failure to meet some of the Sarbanes-Oxley standards? Surely, these will be tested and the question of whether they give rise to civil liability on behalf of shareholders or others will be a subject of litigation. But whether or not that is true, the statute has clearly added fuel for existing causes of action. New elements to 10b-5 actions will be framed around failures under the Sarbanes-Oxley legislation. For example, any assertion of material misrepresentation will now undoubtedly include an assertion that the company failed to have an adequate disclosure control system in place.

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[53] Securities Exchange Act of 1934, 15 U.S.C. §§ 78 et seq.

[54] Sarbanes-Oxley Act § 3(b)(1).

Expanded Crimes

The statute creates seven new crimes, though some are similar to each other.[55] One is an expansion of the crime of securities fraud.[56] Another consists of changes to, or expansions of, obstruction of justice crimes that have been created for document destruction, tampering, and for inducing others to do the same.[57] There is a specific crime for retaliation against informants as well as for interference with whistle blowers.[58] Attempts and conspiracies to undertake these crimes are themselves crimes.[59] Finally, as mentioned above, the false certification crime has been created.[60] One result of these changes, and of the Andersen litigation,[61] is increased attention by companies to their document management policies. These are being revised and consistent enforcement is becoming the order of the day.

Expanded Penalties

The statute has created new penalties, has expanded others, and in many ways enlarged the exposure of individuals and companies for violations. For example, if financial statements need to be restated due to material noncompliance, senior management may have to return bonuses for the period in which the incorrect information was used.[62] Disgorgement funds are specifically created.[63] Violators can be prohibited from future public company service.[64] Statutes of limitations have been expanded.[65] Fines have been increased;[66] sentences have been

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55 *See infra* notes 55–59 and accompanying text.

56 Sarbanes-Oxley Act § 807.

57 *Id.* §§ 802, 1102.

58 *Id.* §§ 1107, 806.

59 *Id.* § 902.

60 *Id.* § 906.

61 *In re* Enron Corp. Securities, Derivative & ERISA Litigation, 2003 WL 1089307, (S.D.Tex. Mar. 12, 2003).

62 Sarbanes-Oxley Act § 304.

63 *Id.* § 308.

64 *Id.* § 1105.

65 *Id.* § 804.

increased;[67] and the statute mandates changes to the sentencing guidelines.[68]

Relationship with Changes in Stock Exchange Rules: Impact on Corporate Governance

The legislation was preceded in 2002 by active intervention by the SEC and the two principal stock exchanges: The New York Stock Exchange (NYSE) and The Nasdaq National Market System. In February 2002, the Chairman of the SEC requested the stock exchanges to consider changes in their listing requirements.[69] These changes were to increase committee responsibility as well as to require more independence of directors from management.[70]

The Chairman's action was a necessary first step because of the anomalies of the federal system. There is no federal corporate statute. While the SEC and other regulatory bodies clearly impact corporate behavior, except for proxy rules for public companies, there are no direct federal corporate governance mandates. Corporate law is a creature of state law.

Therefore, in order to install corporate governance standards, the stock exchanges must impose them as conditions to maintaining a listing on the exchanges. The stock exchanges, however, as creatures of the Securities Exchange Act of 1934, can only change their rules by recommending changes or presenting proposed rules to the SEC for its approval. Consequently, the SEC requested the exchanges to review their current listing requirements and to consider demanding expanded corporate governance standards. The exchanges responded by creating a series of proposals that were presented to the SEC for its approval in the fall of 2002. In the spring of 2003, these proposals, slightly modified, were presented again to the SEC, and the SEC has published some of them for comment, which presages their

66 *Id.* §1106.

67 *Id.* § 1106.

68 *Id.* § 905.

69 *See* Report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee (June 6, 2002), *available at* http://www.nyse.com/pdfs/corp_govreport.pdf (on file with the North Carolina Journal of International Law and Commercial Regulation).

70 *See id.*

adoption.

In any event, some changes in corporate governance will surely occur. Boards will be required to contain a majority of independent directors. In addition to audit committees, it appears companies will be required to have nominating committees, compensation committees, and governance committees. Some of these committees will be charged with such matters as reviewing compensation of senior management, undertaking succession plans, and monitoring and evaluating board and committee performance. Codes of ethics and governance principles will be required. It appears director education may also be required with some level of certification. Whether this will be on an annual basis or according to some other system is not yet clear.

Is More Change to Come?: The Studies

In addition to all the other changes legislated in Sarbanes-Oxley and invoked in the new Sarbanes-Oxley culture, the statute requires the SEC and other agencies to undertake nine studies and report the results at various times to congressional committees.[71] Some of these specifically ask for consideration and a report on the utility or advisability of additional legislation.[72] Most of the studies have now been delivered, but it is too early to suggest the consequences. The studies are:

- Off-balance sheet transactions and the use of special purpose entities – especially the adequacy of current accounting standards and the reporting requirements to force sufficient disclosure.[73]
- The role of credit rating agencies, especially impediments to accurate appraisals and dissemination of information, barriers to entry, and conflicts of interest.[74]
- The limitations created by the consolidation of accounting firms and the need for additional accounting firms.[75]

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71 *See infra* notes 70–80 and accompanying text.

72 *See infra* notes 70–80 and accompanying text.

73 Sarbanes-Oxley Act § 401(c).

74 *Id.* § 702.

75 *Id.* § 701.

- Security law violations of secondary actors – the auditors, the investment banks, the lawyers, the investment advisors, the financial advisors, and others. This is a clear attempt to review the present state of penalties for aiding and abetting. The Supreme Court decision in *Central Bank of Denver*[76] is often considered to have put an end to liability for secondary actors. In fact, *Central Bank* only provided an end to aiding and abetting liability.[77] Secondary actors could still be held liable as primary wrongdoers. Most recently in the *Enron*[78] decision of December 19, 2002, the judge carefully picked her way through the standards of behavior required of secondary actors for liability as primary wrongdoers. In her 300-page decision, she dismissed one law firm, refused to dismiss another and refused to dismiss all investment banks, save one as to one count. Whether all this portends a return to legislation installing aiding and abetting liability remains to be seen, but that was clearly left open by the Supreme Court decision in *Central Bank* and is clearly one possible result of the study mandated by the statute.[79]
- A review and analysis of enforcement actions to identify the areas of reporting most susceptible to fraud, manipulation, and earnings management, such as revenue recognition and use of off-balance sheet transactions, including a recommendation of additional regulatory action or legislation.[80]
- Review and analysis of enforcement actions by the SEC–with a recommendation for additional legislation or regulatory action.[81]

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76 Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).

77 *Id.* at 191.

78 *In re* Enron Corporation Securities, Derivative & ERISA Litigation, 235 F. Supp. 2d 549, (S.D. Tex. Dec. 19, 2002).

79 Sarbanes-Oxley Act § 703.

80 *Id.* § 704.

81 *Id.* § 308(c).

- Role of investment banks and financial advisors in assisting to carry out fraud, and a recommendation of additional regulatory action or legislation.[82]
- The advisability of rotation of audit firms. This would mean not only the rotation of audit personnel from within a firm, but the requirement that a public company change audit firms on a regular timetable.[83]
- A study on the adoption of a principles-based accounting system.[84]

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82 *Id.* § 705.

83 *Id.* § 207.

84 *Id.* § 108(d).