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MSC MODELLING AND MANAGEMENT OF RISK

SOXA
THE WHY'S, WHEN'S AND HOW'S

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'Americans will always do the right thing...

after they have exhausted all other options'.

Sir Winston Churchill

SCOPE

This white paper aims to analyze the components of Corporate Governance prior to and after the well known Sarbanes –Oxley Act (SOXA). The enforcement of this legislation has been a highly debated issue and numerous controversial opinions and interpretations have been expressed on the subject. The purpose of this paper is to provide a brief but clarified and consolidated view of what SOXA is about, as well as how and why it can provide assistance to a company in managing its risks and enhancing its corporate governance policies. This white paper will be of interest to corporations' senior most officers, trainee and professional auditors, investors and Risk Management or MBA students. It is most relevant to companies that are listed in the US Stock Exchange, as such corporations fall within the scope of the legislation in question.

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INTRODUCTION

In the first section of this paper we shall examine Corporate Governance, its basic elements and key roles. We shall also illustrate how Corporate Governance as an abstract concept is not always sufficient, by describing events that led to major corporate failures and scandals, as well as the impact of those events to the general climate of the global market. As such, the requirement for the enforcement of a protective and preventive legislation is outlined. The satisfaction of such a requirement began with the launch of SOXA. Several and similar Codes of Best Practice that are afoot in Europe are also listed in the fourth section, whereas special attention is paid to the UK legal frame. Finally, we shall take a closer look at SOXA, its controls, the risks it identifies as well as a compatible framework that can not only lead to compliance with SOXA, but to a better state of affairs for a company as a whole.

DEVELOPMENT OF CORPORATE GOVERNANCE

Corporate governance is an extremely important and critical element for the success of a company. During the last few decades, in the never ending quest for higher returns, a trend has been created to continuously improve corporate governance. Increasing competition, demand for better quality and innovative product, corporate liquidations and failures are just some of the reasons. Defining corporate governance is an extremely difficult task. A quite complete definition is given by OECD: 'Corporate Governance looks at the institutional and policy framework for corporations –from their very beginnings, in entrepreneurship, through their governance structures, company law, privatisation, to market exit and insolvency. The integrity of corporations, financial institutions and markets is particularly central to the health of our economies and their stability'.¹

Modern corporate governance has its root in the Watergate scandal in the United States. This led to the development of the Foreign and Corrupt Practices Act of 1977, which contained specific provisions regarding the establishment, maintenance and review of systems of internal control. This was followed in 1979 by the SEC of USA's proposals for mandatory reporting on internal financial controls. In the 1980's, following a series of high profile business failures in the USA, the most notable one being the 'Savings and Loan' collapse, the Treadway Commission was established. The Treadway report published in 1987, highlighted the need for a proper control environment, independent audit committees and an objective internal audit function. Accordingly, COSO was born with the purpose of implementing internal controls to the corporate environment. Many Regulations and Committees were subsequently created in order to propose ways for improving and making corporate governance more effective.

The role of Corporate Governance

Corporate governance involves a set of relationships between a company's² stakeholders. Stakeholders of a company include:

- The management, which consists of senior officers like the CEO, the CFO, the CIO

¹ OECD, 2004

² OECD, 2004

and the CRO.

- The shareholders, which implies every individual or corporation that owns shares of the company.
- The employees of the company.
- The customers that have a business relation with the company, and
- The suppliers that provide the company with the necessary materials or knowledge.

It provides a structure through which a company sets its objectives and monitors its performance, in alignment with the interests of the company and its shareholders. An effective corporate governance system, within a company and across an economy as a whole, helps improve the confidence level that is necessary for the proper functioning of a market economy. So, one can tell that good corporate governance tends to lower the cost of capital by improving the resources usage and leads to economic growth.

Corporate governance is only one part of the larger economic framework in which firms operate. This includes macroeconomic policies, competition, interest and exchange rates and inflation. Other factors include the legal, regulatory and institutional environment the company operates in, which in practice involve:

- The regulators whose main role is to supply the frameworks, optional or mandatory.
- The internal and external auditors that ensure the proper function of the company.

Additionally, its business ethics, corporate awareness of the environment and societal interests of the local community also have an impact on a corporation's reputation and its long-term success. Conclusively, good corporate governance is an increasingly important factor for investment decisions.

The key objectives

Effective corporate governance requires a proactive, focused state of mind on the part of the non-executive directors, the CEO, the senior management and the audit committee, as it is far more than a 'check box' list of minimum board and management policies and duties.

- The Board of Directors

The Board of Directors³ must interact effectively and respond quickly to changing circumstances, within a framework of solid corporate principles, to provide enduring value to the stockholders.

The board delegates to the CEO and the senior management the authority and responsibility for handling the everyday affairs of the corporation.

- Audit Committee –Internal and External Audit

The audit committee has the critical task of controlling the internal and external auditors, and at the same time checking the processes within the company. If corporate governance is to work, internal and external auditors have to effectively check every single key control and accurately report about it. We can define internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Auditors have to provide assurance to directors and management about the adequacy of internal controls. Management is required to make an assessment of the effectiveness of internal controls and procedures used by the company to account and report financial information. As an important part of the audit committee, external auditors can make corporate governance more effective, and with the collaboration of internal auditors can improve the accuracy of their work.

- Non exec Directors

Non executive directors bring to the corporation a range of experience, knowledge and judgment and monitor management on behalf of the corporation's stockholders. Effective directors maintain an attitude of constructive scepticism; they ask incisive, probing questions and require accurate, honest answers; they act with integrity; and they demonstrate a commitment to the corporation, its business plans and long-term stockholder value. Many independent committees propose that boards should have a separate, independent chair. If the CEO serves as chair, a 'lead director' has to be established and selected by the non-executive directors⁴ to clearly define the roles and responsibilities.

³ The Business Roundtable, May 2002

⁴ Board Leadership, October 2004

IT Governance

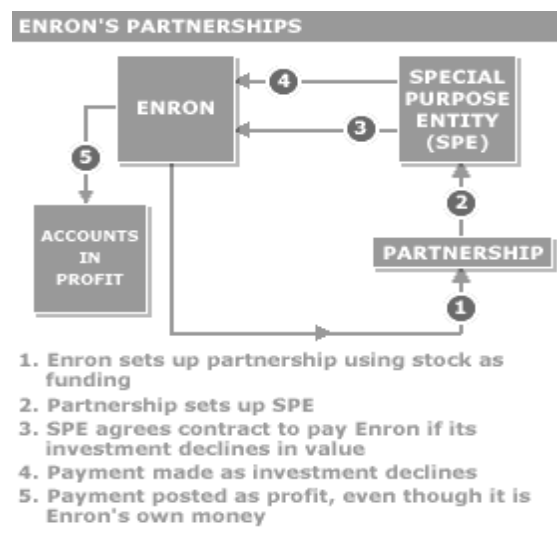
A relatively new, but nowadays integral component of corporate governance, is IT governance. It can be defined as a structure of relationships and processes to direct and control the enterprise in order to achieve the enterprise's goals by adding value while balancing risk versus return over IT⁵. The advances in technology led to the enhancement in the role of IT governance and the automated controls that were incorporated in the company's processes. Its importance is based on the fact that it can increase the value of the business, mitigate risk and provide exceptional opportunities for growth and renewal.

⁵ www.bitpipe.com

WHAT WENT WRONG?

Enron was the outcome of the Houston Natural Gas merger with InterNorth in July 1985. In 15 years it became one of the world's largest energy traders and the seventh largest company in the U.S, with assets worth almost \$62bn. Enron undoubtedly was one of the formers of today's energy trading in America, both affecting and affected by the Clinton and Bush administrations.

On 8 November 2001 the company admitted inflating its profits for the past four years by almost \$600m. Enron had created almost 3500 affiliates, some of which were used to hold assets from the parent's balance sheet. These SPEs were considered as off-balance sheet, since 3% of their capital was owned by independent companies.⁶ Thus, by moving assets of low performance to those affiliates, Enron was not required to include them in its balance sheets, maintaining its growing image. Until the end of 1999 Enron not only had moved almost half of its assets and part of its debts to these entities but had also stated long-term profits from contracts as immediate ones in its financial accounts. Enron and its SPEs were acting as both buyers and sellers creating circular transactions and investments.⁷



Many of these SPEs were primarily financed with Enron stock. This circular mechanism would work as long as the stock kept rising. But if the stock were to fall then

⁶ Hill, A., Fidler, S., 29 January 2002

⁷ August 2001, BBC NEWS

these SPEs would be under water. This is exactly what happened after the failure of the fibre optic cable network project, causing a stock price decrease. Spreading rumours regarding Enron's manipulations and the resignation of CEOs, led to the SEC initiating a research and the share price dropping from \$95 to less than \$1. The company filed for bankruptcy on 2 December 2001, leaving 21000 employees without a job and pension.

Enron's collapse sent shock waves across the world, especially since the fraud seemed to be conducted in accordance with the US GAAP, causing nervousness in the market, known as 'Enronitis'. The accounting policies of companies came under intense scrutiny because of the consequent effects it had on share prices and market policies. FASB committed to tighten the standards for consolidating SPEs into financial statements and inspected SPEs more closely. Enron's generosity towards its CEO's drove regulators to examine the way companies employ non-executive directors. Major companies recruiting executives from companies of similar magnitude as non-execs led to what looked like a cosy circle of top people endorsing one another's conduct and approving each others pay rises. Their investigation was extended to the sources of funding US political campaigns.

But Enron wasn't meant to be just a case of one 'rotten apple' in America's corporate history. In 1998 WorldCom with less than \$8bn in revenue shocked the telecom industry by making a successful bid for number-two U.S. long-distance giant MCI, a \$19.7bn company. On 22 July 2002, WorldCom, the second largest long-distance telecom company in the U.S, unable to cope with its \$40bn debt, filed for bankruptcy, admitting having overstated its profits by \$11bn between January 2001 and March 2002⁸, thus creating the largest ever accounting fraud. WorldCom had stated its normal operational expenses as investments and long-term expenses related to acquisitions of capital assets, presenting the \$11bn expenses as profits. Hours after the news, the company's share price dropped by 75%. In March, the SEC initiated investigations and after the loss of 3700 jobs, the U.S. Justice Department launched its own research. Meanwhile, WorldCom's founder and CEO Bernie Ebbers resigned after the SEC revealed that the company lent him \$339,7millions to cover loans, used to buy his own shares.⁹ In June 26 the SEC filed

⁸ 26 June 2002, BBC NEWS

⁹ Sridhar, V., 20 July 2002

a suit against WorldCom and its top management accusing them of ‘securities fraud’, ‘disguise of the company’s true operating performance’ and ‘misleading investors about the company’s reported earnings’.¹⁰ The news caused severe attack of the jitters on Wall Street and all the other markets around the world. At a time when the market seemed to be slowly recovering since the 1999-2000 US market crash, the September 11th attacks and the ‘Enronitis’, the investor confidence was once again damaged and the markets reacted unfavourably.

Nearly 17000 employees were fired and many lost their pensions, whereas WorldCom investors and creditors lost their money. However, WorldCom managed to emerge from bankruptcy and currently operates under the name MCI Inc.

The collapse of two major companies initiated a domino effect of corporate failures. Global Crossing, the largest telecommunication company, filed for bankruptcy on 28 January 2002. In April the SEC filed a lawsuit against Xerox, probably the biggest photocopy company, for misstating four years worth of profits, resulting in an overstatement of almost \$3bn. In early June, Qwest, a dominant local telephone company in 14 States, announced that it had improperly accounted for about \$1.16bn in sales. On 25 June Adelphia, the sixth largest American cable television operator, filed for bankruptcy and admitted not only inflating its profits but also the number of subscribers.

Events at Enron, WorldCom and the scandals that followed provoked reviews of the rules relating to auditors’ independence. A common element between Enron and WorldCom was their accounting firm, Arthur Andersen, one of the oldest and best-known accountants in the world. Andersen’s reputation was severely damaged after the Enron collapse. While Enron was under investigation by the SEC Arthur Andersen were shredding thousands of documents concerning Enron’s audit. On 13 December 2001 Andersen admitted to the Congress that they had warned Enron about ‘possible legal acts’ when they found out that Enron was withholding important financial data from them. In the case of WorldCom, Andersen had audited the firm’s financial statements for 2001 and reviewed its books for the first quarter of 2002.¹¹ They claimed that the WorldCom CFO did not inform Andersen about the line cost transfers nor did he consult with Andersen

¹⁰ Sridhar, V., 20 July 2002

¹¹ Clinton, M., 26 June 2002

about the accounting treatment. In 25 June 2002 Arthur Andersen was convicted of obstruction of justice for the destruction of Enron documents and was barred from auditing clients.¹²

The collapse of Andersen has heavily dented the reputation of accountancy as a profession. A number of companies in the US and many in Europe have decided to stop commissioning consulting work from their auditors. Accountancy bodies such as the ICAEW and the ICAS have observed a decrease of 3.8% in student numbers from 2001 until 2002. As a result the ICAS increased their annual membership fees, so as to avoid reporting a budget deficit.

¹² www.riskglossary.com

It was obvious that the market was intensely affected by those scandals. Investors were losing confidence in the America's corporate governance system and capital markets. The system seemed inadequate to prevent similar scandals. The US government tried to change the corporate environment in order to make corporate governance more transparent and at the same time to set clearly the responsibilities of the management. Indeed on July 30, 2002, President Bush signed the Sarbanes -Oxley Act of 2002 into law. Its primary intent is to hold corporate executives and the independent accountants of public companies more responsible to public shareholders imposing much stricter penalties in cases of frauds. The Sarbanes –Oxley Act generally applies to 'issuers' which, for purposes of the Act, are defined as companies that have securities registered under the Securities Exchange Act of 1934 or have an effective or pending registration statement.¹³

¹³ Metzger, B., Colihan, J., Stubblefield C., Best, S.

WHAT EUROPE HAS TO SAY

Corporate Governance laws and regulations have long existed in Europe. Local regulations are based on each country's culture and legal frame and do not always have a statutory basis.

For instance, the Netherlands are operating under the effective *Dutch Corporate Governance Code* or *Tabaksblat Code*. Italy's market for limited liabilities companies functions under the guidance of the *Handbook of Corporate Governance Reports* (February 2004) published by *Assonime*. Listed companies consult the non mandatory *Report & Code of Conduct* (The Preda Report, 1999) issued by the *Committee for Corporate Governance for Listed Companies*. The French regulations, *Recommandations sur le gouvernement d'entreprise*, were drafted in 1998 and last modified in 2004, and are provenance of the French Asset Management Association. Germany's government adopted the *German Corporate Governance Code* (Crome Code, 26 February 2002), revised by the *Amendment to the German Corporate Governance Code* (21 May 2004). This Code provides a framework of operation, in an attempt to clarify rules of corporate governance and to strengthen investors', employees' and customers' confidence.¹⁴

Several reports and regulations concerning the members of the European Union have also been published, under the principle '*comply or explain why*'. Companies are advised to comply with the recommendations provided and a reasonable justification should be presented in the event of deviation. From 1991 through 2001 more than 35 codes have been published in the EU, the most significant being:

¹⁴ Capell, K., 17 May 2004

European Regulations

International Organization of Securities Commissions	Organization for Economic Co-operation and Development	Commonwealth Association for Corporate Governance	European Commission	Bank for International Settlements (BIS)	International Accounting Standards Board
<ul style="list-style-type: none"> • Objectives and Principles of Securities Regulation (IOSCO Principles, 1998, 2002) • Multilateral memorandum of understanding (IOSCO MOU, 2002) • IOSCO Assessment Methodology (2003) 	<ul style="list-style-type: none"> • Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets (Millstein Report, 1998) • OECD Principles of Corporate Governance, (1999, 2002) 	<ul style="list-style-type: none"> • CACG Guidelines: Principles for Corporate Governance in the Commonwealth (1999), aiming to 'promote excellence in corporate governance in the Commonwealth' • CACG Guidelines: Corporate Governance Principles for Annual Reporting in the Commonwealth (2003) 	<ul style="list-style-type: none"> • <i>Comparative Study of Corporate Governance: Codes Relevant to the European Union and Its Member States</i>, (27.03.2002), aiming to identify the 'differences and commonalities' of corporate governance regulations that are afoot in the EU • Plan on 'Modernizing Company Law and Enhancing Corporate Governance in the European Union' (Action Plan, 21 May 2003), following a preparative <i>Winter Report</i>, (High Level Group of Company Law Experts, 04 November 2002). • Directive of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts, (Brussels, Proposal presented on 16 March 2004, directive under discussion) 	<p><i>The International Convergence of Capital Measurement (Basel II Accord, 2004)</i> is a replacement of the original <i>Basel Accord (1988)</i>. It is a framework of banking regulation standards. The Basel Accord does not have a regulatory status and will be implemented in the EU through the <i>Capital Requirements Directive (CRD)</i>.</p>	<p><i>International Financial Reporting Standards</i> which should be adopted by all EU public companies from January 2005</p>

However, corporate malfeasance along with all its consequences not only shook the US market, but dramatically affected the European world as well. Similar events were observed in major European countries and involved companies of great magnitude. The most well-known is that of Parmalat¹⁵, Italy's eighth largest company, which brought 36,000 employees on the rim of unemployment while investors were left with worthless stock and bonds. Calisto Tanzi (CEO) was taken to trial presided by the SEC¹⁶ and is presently imprisoned.

Several of the regulations mentioned above were a reaction to those events and to the publication of SOXA. However, the European Commissioner in charge of financial regulation announced¹⁷ (20 January 2005) that there is no need for an EU-wide corporate governance code. Alternatively, it was stated that separate regulations from all the Member States should be led into better convergence.

The *Transatlantic Corporate Governance Dialogue* has already been founded by the *European Corporate Governance Institute* and the *American Law Institute (ALI)*, in an attempt to bridge the legal and cultural differences of global markets and provide consolidated guidance.

The UK

Special attention should be paid to the UK regulatory regime. UK alone has more than 25 reports and several regulations. Some very important reports that had an impact in Britain's way of understanding corporate governance are:

¹⁵ Sverige C., 6 January 2004

¹⁶ Parmalat had issued bonds and notes worth \$1.5bn. to US investors. The SEC filed a civil suit to the New York federal court.

¹⁷ Buck T., 21 January 2004

UK Regulations (1992 – 2001)

1992-----1995-----1998-----1999-----2001

PROVENANCE

Cadbury Committee	Confederation on British Industry	Committee on Corporate Governance	Institute of Chartered Accountants in England and Wales	Committee on Corporate Governance
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REGULATION

<p style="text-align: center;">Report of the Committee of the Financial Aspects of Corporate Governance (Cadbury report) December 1992</p>	<p style="text-align: center;">Greenbury Report: Study Group on Directors' Remuneration July 1995</p>	<p style="text-align: center;">The Hampel report (Combined Code) January 1998.</p>	<p style="text-align: center;">Internal Control: Guidance for Directors on the Combined Code report (Turnbull report) September 1999</p>	<p style="text-align: center;">Combined Code: Principles of Good Governance and Code of Best Practice. May 2000</p>
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AIM

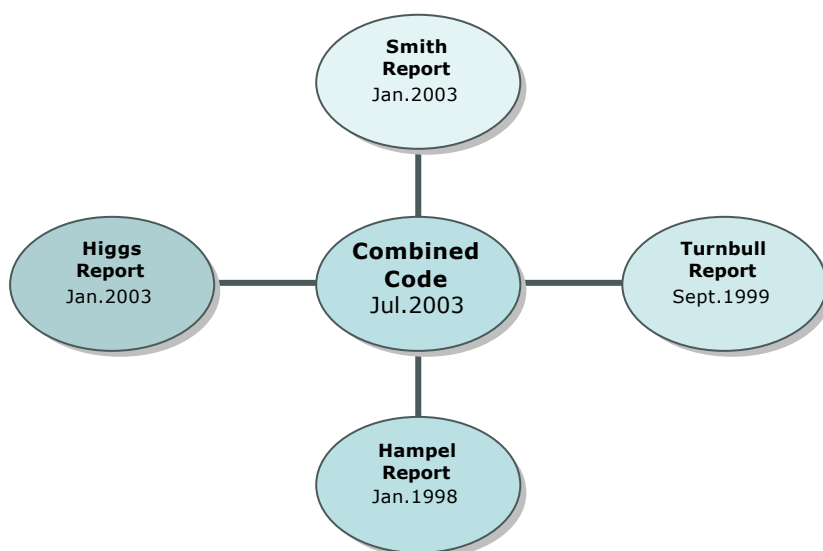
<p>It was the report with the greatest impact on UK corporate governance. It also introduced control framework</p>	<p>A report on Directors' Remuneration, mainly focused on public listed companies</p>	<p>The Committee was established by following the recommendations of the Cadbury & Greenbury committee. This report is a review of the implementation of their findings</p>	<p>Focuses on internal control and its framework. It is of a significant importance and was published with the support and endorsement of the London Stock Exchange</p>	<p>Is based upon the Committee's Final Report and the Cadbury & Greenbury Reports which engaged most of the principles and guidance of previous reports.</p>
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At that time the UK legal framework consisted of the Companies Act 1985 as amended by Companies Act 1989, the Pensions Act 1995, the Financial Services and Markets Act in 2000 as well as the London Stock Exchange Listing Rules.

As the public's interest on the issues of Corporate Governance escalated due to scandals and corporate failures mentioned earlier, the number of reports published increased as well as their impact on business practice. Very important codes and reports were published in 2002 –2003:

REPORT	PROVENANCE	AIM
Responsibilities of Institutional Shareholders & Agents –2002	Institutional Shareholders Committee	Statement of Principles
Higgs Report –2003	Department of Industry and Trade	Review of the role and effectiveness of non-executive directors
Smith Report –2003	Financial Reporting Council	Review the role of Audit committees
The Combined Code on Corporate Governance –2003	Financial Reporting Council	Comprises of provisions and principles as well as guidance on best practice (framework)

The Combined Code is of significant importance as it embodies four major 'chapters' of the UK regulatory history.



Moreover the Government has issued a number of legislative changes to complement the non-legislative measures. In 2004 came the revised Companies (Audit, Investigations and Community Enterprise) Act 2004, and a draft of Companies Act 1985/Regulations 2005, which will implement great changes.

Up until now, the UK regulatory system has also been based on the approach ‘comply or explain why’, which applies to ‘codes of best practice’ mandatory or not. The flexibility it offers has been widely welcomed both by company boards and investors. It is for shareholders and others to evaluate the company’s statement.¹⁸ But with the Companies Act 2004 and the one of 2005, it will be a whole different world for the companies, especially their boards.

According to the Companies Act 2005, a statutory OFR¹⁹ and an expanded directors’ report will have to be prepared for financial years commencing on or after 1 April 2005. Both of the aforementioned reports will have to be included in the audit. If the statements are not consistent with the accounts, then the supervising body, FRRP, will be authorised to fine and even ask in court the imprisonment of the directors. At this point it is important to note that even though the 2005 Companies Act presents similarities to section 404(a) of SOXA, a significant detail demarcates the one from the other. As far as the OFR is concerned the auditors have to form an opinion, as to the board’s process for assessing effectiveness, whereas in SOXA, they have to identify whether or not they are in agreement with the board’s view as to the effectiveness of their internal controls.²⁰

¹⁸ The Combined Code, Page 1, Preamble, Nr. 4, The Financial Securities Authority, July 2003

¹⁹ OFR is intended to be a balanced analysis of the development and performance of the business, including the main trends and factors underlying the performance and financial position of the business during the year and those who are likely to affect its performance in future years

²⁰ Explanatory Memorandum to the Draft Companies Act 1985 (Operating and Financial Review and Directors Report etc) Regulations 2005, Page 36

‘MAY THE SOX BE WITH YOU...’

Since SOXA has come into effect, corporate governance is viewed from a different angle. The boards of companies around the world are reviewing their words. Changes are becoming a reality and these are some of the effects:

- **Senior management is required to pay more attention to auditing and controlling functions.**

The introduction of new responsibilities is threatening non-complying senior officers with serious penalties in case of fraud or defection. Other actions that might cover frauds are also penalised, like obstruction of justice and destruction of evidence.

- **The boards are becoming more independent and power is being transferred from CEO to the board committees.**

It is a requirement for US listed companies that the non-executive directors should regularly meet separately. Appointments to public company boards were normally arranged by CEO through personal contracts, or with the help of a recruitment consultant. Currently, these powers are in the hands of committees of non-exec directors.

- **Greater demand for skilled non executive directors.**

Non executive directors are now being required to do a more professional job. They have to allocate more of their time on board duties and to assume greater responsibilities due to board independence and transferring of power. Their role has become critical and analysts are expecting great changes in this area.

- **IT Governance is becoming a critical part of a company.**

One particularly challenging area of SOXA, involves IT controls, as many business processes are driven by it. Compliance with SOXA requires the creation of automated controls, aiming to reduce or even eliminate the possibility of errors. Thereby, IT experts need to ensure that relevant issues are taken into consideration during implementation.

Since financial data rests on servers, security and documentation of IT systems is imperative to ensure the integrity of the data. Corporations must have reliable, replicable and audit proof details about control of and access to the infrastructure that supports financial data.

ACCOUNTABILITY OF SENIOR OFFICERS

Section 302 and 404 include very important changes which can be accomplished in combination with other smaller changes described in SOXA and the US Code.

Section 302 requires management to evaluate and report on the effectiveness of disclosure controls and procedures with respect to the quarterly and annual reports. The principal executive and financial officers must certify that:

- They have reviewed the report, believe that the report does not contain untrue statements or omit material facts, and the financial statements and other financial information are fairly presented.
- They (1) are responsible for establishing and maintaining disclosure controls and procedures (2) have designed such disclosure controls and procedures to ensure that they are aware of material information (3) have evaluated the effectiveness of the company's disclosure controls and procedures and (4) have presented in the report their conclusions about the effectiveness of the disclosure controls and procedures.
- They have disclosed to the auditors and audit committee (1) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls and (2) any fraud, whether or not material, that involves management or other employees who play a significant role in the company's internal controls.

They have indicated whether there have been significant changes in internal controls over financial reporting or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Section 404 of Sarbanes-Oxley requires management to document and evaluate the design and operation, and report on the effectiveness of its internal controls over financial reporting. The internal control report must be incorporated into the annual reports and must include the following components:

- Management's recognition of its responsibility for establishing and maintaining adequate internal controls and procedures for financial reporting.
- The framework used by management in its evaluation.

- Management's assessment of the effectiveness of the company's internal controls over financial reporting. The assessment must include disclosure of any 'material weaknesses' in the company's internal controls over financial reporting identified by management.
- A statement indicating that the issuer's external auditors have issued an attestation report on management's assessment of effectiveness of internal controls over financial reporting.

The issuer must also include in its annual report the attestation report of the external auditors.

Other smaller but equally important changes are:

- **Section 406:** Code of Ethics. According to the code of ethics the senior officer must avoid any actual or apparent conflict of interest, as well as any other situation or activity that would compromise their ability to carry out their duties ethically. Also, no senior officer shall request or be granted a loan or payroll advance from the company. The senior officers are responsible for upholding the company's policy to make full, fair, accurate, timely and understandable disclosure in compliance with all applicable securities laws and regulations and company policies. Internal auditors and independent auditors are to be given full access to all information within the company necessary or appropriate for them to fulfil their responsibilities. The senior officers will make diligent efforts to ensure that the finance department has the appropriate resources and functional expertise to properly fulfil its responsibilities, and an atmosphere of candour in which finance personnel feel it appropriate to communicate unfavourable as well as favourable information and results, and to report and address mistakes promptly after they are discovered. The Senior Officers will ensure that reported financial data is not influenced by performance or compensation objectives, plans or forecasts or other organizational commitments. If an employee has information about a violation of the code of ethics he must report it to the highest ranking senior officer that is uninvolved in the violation. This employee will not be penalized by the company for reporting his good faith belief that such violation or conflict of interest has occurred, provided that the senior officer or the employee is not a party to or responsible (alone or with others) for the violation.
- **Whistleblower Protection** The Act also provides new protections for whistleblowers against retaliation in terms of employment. Section 806 makes it a crime for anyone, with the intent to retaliate, to take any action that is harmful to any person, including interference with lawful employment or livelihood, for 'providing to a law enforcement officer any truthful

information relating to the commission or possible commission of any Federal offence'. The maximum punishment is 10 years incarceration and a fine.

- **Insider trades.** Any profit realized by a director or executive officer from inside trades during pension fund blackout periods should be cancelled. In case of failure to comply with that, the director will be prosecuted. If an action is to be taken the SEC must be informed.

Responsibilities of the signing officers

1. The signing officer has reviewed the reports.

2. Based on the officer's knowledge, the reports do not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading.

3. Based on such officer's knowledge, the financial statements, and other financial information included in the reports, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the reports.

A new provision was added to the US Code (Title 18) section 1519 claiming as criminal offense the obstruction of justice by document destruction and retaliation against information.²¹

As anticipated, due to the hastiness of SOXA, the early reactions to the new responsibilities of senior officers were justifiable. A lot of hype was created until the final interpretation of the SEC. This was more a result of the time space between the publication of SOXA and SEC's interpretation, as many tried to understand its true meaning, many contrapositions were raised. This situation triggered a highly charged environment with auditors trying to promote their services, and software companies launching new compliance products. Nothing of all these was really according to the main purpose of SOXA; to improve the investor's confidence through better control of corporate governance.

²¹ Congress of the United States of America, 23 January 2002

THE ROAD TO COMPLIANCE

The alteration of internal control began in the early '80s and became more evident in the 1990s. Nowadays, the improvement of internal controls has become a public concern and a legal obligation in order to meet the requirements of SOXA.

One of the major concerns that managers face is a breakdown of their financial management system. For many years internal control on financial processes was regarded as a particular field where experts applied a variety of logical tools, such as questionnaires, checklists and ratings to ensure the good functioning of their organisation. It was believed to be the rational guide of the organisation's well being.

The debate is about the level of coexistence between the span of control and the chain of command. SOXA puts the responsibility back to the people who have the power. A robust internal control system can detect inconsistencies in the financial process and can prevent a company from fraud and all the relevant risks. It also ensures the smooth operation of the company, excluding risks like bribing and any kind of problems related to the Financial Statements and secures the company's goodwill in the market. It protects employees and all those who are affected by the performance of a company, since their income and their pension funds are often directly linked to the company's performance.

This is best described in Section 404 of the Act, which specifies the responsibility of management in developing and monitoring internal controls and of the internal audit in verifying management's actions. Management is required to state, in year end filings, the adequacy and effectiveness of the company's internal controls.

The PCAOB, under the supervision of SEC, has referenced the use of a control model known as COSO, for the implementation of internal controls. COSO was published in 1992 and is the only framework that has the approval of SEC.

The need of a new framework that deals better with unfolding the risks became vital. In 2001, COSO with the contribution of PricewaterhouseCoopers developed a new framework that focuses more to enterprise risk management. The COSO's ERM Framework, released in 2004, is based in COSO's initial framework with some adjustments.²²

The objectives that COSO sets are officially recognised by PCAOB and include important aspects of the internal control that can lead to a secure organisational structure

²² Approva Corporation, 2003

within a risk-controlled environment and create a common basis for all public companies. A study from NASA²³ highlighted the poorly defined objectives as the top reason for unsuccessful projects. Hay Group study²⁴ indicated the changing of objectives as the most significant reason for team failure. A company should be viewed as an asset facing hazards and its path can lead to different situations. Documented scenarios for expected or unexpected risks and their quantification,²⁵ depending on the balance between risk tolerance and appetite set by the company,²⁶ should be electronically accessible and securitised. Visibility and transparency is guaranteed by a proactive warning system built to detect hazards or even false alarms. Consequently COSO represents a TQM framework created for reducing variability in companies' risks. A chaotic control system, which can emerge from a non regulated environment, can result in defaults and therefore conflicts with the maximisation of shareholders wealth.

²³ 650 projects were analyzed occurring between 1960 and 1970

²⁴ USA Today, August 1997

²⁵ An example is the Boston based matrix

²⁶ These should be in concordance to the company's credit ratings

COSO-ERM Objectives

Internal Environment

- Risk Management Philosophy
- Integrity
- Ethical Values

Objective settings

- Well Defined
- Solid Aims
- Risk appetite Based

Event Identification

- Known Risks
- Unknown Knowns
- Unknown UnKnowns

Risk assessment

- Type of Risk
- Analysis
- Evaluation

Risk Response

- Prevention
- Mitigation
- Acceptance

Control activities

- Policies
- Procedures

Information & Communication

- Documentation
- JAD session
- Deficiency Rating

Monitoring

- TQM Procedures
- Walkthroughs

We also have to acknowledge the significant role of Information Technology in compliance with SOXA and with sections 302 and section 404 more specifically. A framework, known as COBIT was developed by the IT Governance Institute (established in 1998) that connects the processes of Information Technology and Systems with the objectives a company must set to make SOXA compliance more applicable through continuous proactive inspections within its controls. COBIT assigns the internal control needed in order to handle information in general, within a company. IT Governance Institute argues that COSO forces in its rules a subset of Information Technology framework whose application can be completed through the processes IT governance poses. It is a framework that is 100% compliant with COSO, but its unpopularity compared to COSO derives from the unendorsed attitude by the SEC or the PCAOB. Companies willing to apply only COBIT are in a greater risk of succeeding in COBIT's objectives but not in SOXA's. Therefore, a company willing to comply with SOX's requirements and become more 'SOX'-neutral²⁷ might think to adopt both COSO and COBIT. Certainly COBIT's flexibility to a company's 'spirit' and its wider concentration apart from section 404, addresses its global recognition. However, the most important aspect of its wide appearance is the fact that it poses less costs to companies than COSO requires and it is closer to Europe's views. Its difference to COSO is that it has more general objectives that can colour different styles companies use in their IT systems.

Despite the benefits, if one concentrates in the letter of the law, one may lose objectives and intents. The need for manual confirmation is therefore imperative.

Furthermore, the high cost and strict requirements of Sarbanes-Oxley corporate governance rules is preventing potential overseas clients from going to the US. International companies with US listings will have to meet these expensive requirements of Section 404 of the Act from December 31 2005²⁸.

China Construction Bank, for example, one of China's Big Four state lenders, is considering of listing its shares only in Hong Kong and 'shunning' New York. According to an industry insider 'the old rule that a US listing is always a must does not apply any more because of Sarbanes Oxley'.²⁹

²⁷ ? s 'risk'-neutral

²⁸ Roberts, D., January 2005

²⁹ Guerrero, F., January 2005

Two studies from Foley and Lardner LLP law firm unveil the following costs of governance reform among public and private companies. There are a 67% of the public companies that insist SOX is too strict in contradiction to an 83% of private that consider it 'about right'. It is the reason why companies try to shift from public to private, according to CFO magazine.³⁰ The fees have increased by 23% in 2002 to 2003. CEO's say that Section 404 has significant costs due to D&O insurance.³¹ Public companies increased by 130% their average costs for inception of SOX.

Lots of silver-bullet products appeared having high costs of incorporation. Cost both in hours and dollars have risen,³² due to the high need for control over the financial information SOXA demands.

³⁰ Going private means an asset disposition or a merger. Mergerstats indicate that going private transactions has risen steadily for 197(2000) to 316(2002). Such a change needs the proof of the shareholders.

³¹ When a company and its directors are sued for mismanagement or worse, who pays for the settlement? Usually, an insurance company. Each year, America's biggest firms spend a few million dollars apiece on premiums to cover their directors and officers in case disgruntled shareholders, employees or regulators take them to court

³² Spend 25,667 internal hours, 5,037 external hours and \$1,037,100 on software and IT consulting

SOXA'S EFFECT ON RISK

Companies cannot organize themselves in a risk neutral world, since breakdowns caused by human failures and fault decisions are necessary in the path towards evolution.

The implementation of SOXA is forcing the companies to record, report, map and model the critical processes, as we have already discussed, but what about risk corporations face? The new regulatory environment puts a company's cards on the table through the process of reporting a risk profile and assessing management with graveness. This makes some of the principal business risks easy to identify; a step towards risk reduction.

According to a company's appetite, there are risks that have to be ventured, since uncertainty represents both risk and opportunity. It can be argued that SOX helps companies to decide how enterprise risks should be managed, since objectives are related to reliable and compliant regulations reports.

COSO sets principles for appropriate controls over financial reporting and provides directions for their assessment. The management of derivative transactions and their consequences after their implementation is a scope of the COSO framework especially after the mass of failures caused by their wrong usage. For example, derivatives trading can increase or hedge specific risks a company has to engrave and their complication will draw attention and inspection by the CEO, CFO and auditors due to the large impact of an improper confirmation. Therefore, documents must be carried forward to prove that someone has the accountability of controls. Controls presume that an independent financial expert with a background in derivatives is required by SOX as a non-executive officer in the audit committee. BT for example, an NYSE listed company, has to consider for the 2005 financial year, the possibility of including a member who is an 'audit committee financial expert', after the recommendations of the 'narrow and prescriptive' definition of the SEC,³³ as they were stated in their Annual report. The independence between traders and treasury officers should be taken into account, since inadequate controls have proven to lead

³³ BT's 2004 annual report, page 57

into fraud acts.³⁴

SOX requires a company to assess the risk related to structures and procedures. The transparency provided by the new regulatory environment, reduces operational surprises and losses. The most valuable asset of a company is its personnel, but also the one that must be observed in order to avoid any involuntary or voluntary defects. Employees should be well acquainted and orientated in the company's priorities so that risk of misstatement or omission or even fraud can be mitigated. It is a matter of objectivism. As observed by Stephen D. Poss, an attorney with Boston-based Goodwin Procter LLP, more disclosures, more internal controls and a stronger audit committee, which meets with the CEO on a regular basis, could expose a company to fewer risks and therefore to fewer failures. Creating value for shareholders means creating security more effectively.³⁵ Most of the disclosures companies make, are related to financial systems, personnel oversight issues, and governance procedures.

Another issue is that of fraudulent financial reports.³⁶ Corruption or misappropriation can occur in the upper or lower level of the company's structure. In the former case when top management personnel overrides the controls or influence in order to conceal such acts SOX (section 806) deters from veiled attempt. In the latter case, the frequent monitoring controls SOX requires, (sections 404, 409) detect and disclose any contingent fraud. Moreover, the probability of a material weakness can be decreased as the annual tests force the executives to disclose them and take actions under the provision of the auditors. Nevertheless more than 86% of the material weaknesses are not referred or at least detected by management, in respect of their compliance convergence, but by the external auditors.³⁷ More than half of the internal-control weaknesses were fraud-related; a fact that reveals the need for strict measures that will form a reliable environment in the markets. Significant shareholder

³⁴ According to Susan Skerit, partner at Treasury Strategies, 'Treasury should look at Sarbanes-Oxley as an opportunity to refresh and strengthen controls, instead of simply trying to satisfy the minimum requirements of the legislation'.

³⁵ In December 2004, 56 companies disclosed material weaknesses with Sec. 404. Just 14 in December 2003. 582 companies made these kinds of disclosures for all 2004.

³⁶ The collapse of Barings Bank in 1995, resulting from the activities of the rogue trader Nick Leeson is associated with operational Risk. (www.demos.co.uk)

³⁷ A.R.C. Morgan analyzed more than 500 SEC registrants with reportable material weaknesses; Of those, 350 show that fees increased on companies and cost more than expected, when weaknesses were discovered. All registrants, including those not based in the United States, were judged by U.S. standards and rules.

impact was caused due to restatement of earnings³⁸ in 65% of the cases.

Another challenge that companies have to face, because of SOXA, is the creation of an infrastructure able to collect, process and present important data from individual and interdependent systems. In that sense, a source of effective and secure information is formed. 'We can grab information at a transaction level, and wrap controls and key risk indicators around it'.³⁹

Considering the above, SOX directly effects a company's reputation. The public opinion about the legitimacy of the company is as valuable as the legitimacy itself.⁴⁰ Reputation is an intangible asset whose risk is reduced by transparency and consistency. Transparency provides the confidence of the investors and consistency requires that every financial statement which is published is true and complete and it is easily comprehended from investors. Hence, it can consolidate the capital market and address the concerns about creditability of financial reports.

The cost side-effects become less important, if one considers a newer stronger control environment or a more enhanced relationship and credibility with shareholders. Since it is too early to draw conclusions on the ability of SOXA to affect financial disclosures, we can only analyze the behavior of investors and their preferences in markets with strict laws. According to the results of a European Commission⁴¹ research, outside investors seem to prefer foreign companies that have listings in the US than companies listed only in their home market. This explains why companies want to declare their commitment to smaller shareholders by entering into a more cost-effective market but with more strict laws.⁴² The relatively low-level of investor protection, in terms of accountability in countries outside the US explains partially the home bias of US investors.⁴³

However, PricewaterhouseCoopers points the existence of 470 non-US listed companies in the NYSE with a total market capitalization of \$3.8trillion or 30% of the total capitalization in the exchange. PWC insists that costs drive companies to retire

³⁸ Like in the Enron's case

³⁹ Julian Fisher, head of operational risk practice at Reuters

⁴⁰ The firm of Arthur Andersen which collapsed following revelations about its role in the demise of Enron. The local actions of a small number of individuals, and the shredding of documents, was able to bring into question the legitimacy of the entire global organization to practice audits. (www.demos.co.uk)

⁴¹ Issues in Corporate Governance N° 200, March 2004

⁴² Empirical analysis by Doidge et al. 2001

⁴³ Dahlquist et al., 2002

from the exchange since the costs of remaining listed are not worth the benefits.⁴⁴

For small companies, it is difficult, at the moment, to sustain such expenses and be forced to pass into debt or to sell assets; thereby, increasing their liabilities and at the same time, the credit risk. However, for the purpose of small or midsize companies the implementation of COSO had to be different. The application on a small enterprise could be less strict and organized but also effective. Consequently, COSO will issue, in late 2005, a new framework, COSO's Control Framework for Smaller Businesses that will help them achieve SOXA's compliance.

In conclusion, corporate world worries whether a transition to a stricter internal environment and a more accountable management has a significantly propitious financial impact, or whether the costs a company has to maintain are disappointingly high. The question one has to pose is: 'How much is your company's trust worth for?' If we consider that SOXA was brought to rebuild public trust after the well-known corporate failures, costs seem meaningless for investors, since they guarantee, to an extent, that 'best practices' will be incorporated into legislative actions.

⁴⁴ PWC, 8th Annual Global CEO Survey

WHAT SEEMS TO WORK

1. *Audit committee and external auditor work more closely; increased productivity (John B. Vander Sande, 60, Cecil and Ida Green Distinguished professor, MIT, Cambridge)*
2. *Board members look at their role of shareholder representative more thoroughly (President, Texas A&M University, Corpus Christi Hanover Compressor)*
3. *Focus less on revenue generation and more on auditing duties. (Jock Patton, Investor)*
4. *Accountability for the broad-scale performance of the company. (William B. Ellis, Retired Chairman and CEO, Northeast Utilities, Catalytica Energy Systems.*
5. *Former ERNST & YOUNG audit partner sentenced to one year in prison for criminal violations of the SOX Thomas Trauger pled guilty to falsifying records in a federal investigation in violation of the Sarbanes-Oxley Act yesterday (29-10-2004)*
6. *According to Compliance Week, 119 companies made filings that revealed “material weaknesses or significant deficiencies in internal controls, or provided material updates on the status of their control-improvement processes” in November. The newsletter reported that the number of companies reporting “new material weaknesses, significant deficiencies or reportable conditions” had nearly doubled from October and almost quadrupled from July. (02-02-2005)*

WHAT SEEMS NOT TO WORK

1. *Straining the resources of smaller companies. (Peter T. Kissinger, Chairman and CEO, Bioanalytical Systems)*
2. *No time to spend on strategic planning of the company on a long-run prospectus (Rosina B. Dixon, Consultant, Church & Dwight, Enzon Pharmaceuticals)*
3. *Benefit of the Big Four accounting companies (Gregory Davies President and Director, Wabtec, Wilmerding)*
4. *Time is valuable and making regulations won't save human lives. (Frederic Wackerle, Fred Wackerle Inc.) referring to pharmaceutical companies.*
5. *Monopoly of accounting firms, a monopoly with no price constraints. (Patrick Murray, CEO and Director, Dresser Inc.)*
6. *They have latitude in terms of the scope and depth of their work should exercise care and judgment and be cognizant of the cost-to-benefit ratio. However, compliance cannot produce higher levels of accountability or defer from auditing without integrity. That remains in the hands of senior management to set a proper tone at the top and act for the sake of the shareholders. (FEI's Sayther)*
7. *I think about internal controls all the time. I didn't need the law to get me to think about them. (Bill Teuber, a CFO)*

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APPENDIX A–Definitions

Board: A board is an organizations governing body, such as a board of directors, supervisory board, head of an agency or legislative body, board of governors or trustees of a non profit organization.

Control: Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

Credit Risk: The risk that arises when counterparty defaults on its obligation.

Derivatives: The financial contracts that derive their value from the performance of underlying assets (such as stock, bond, or physical commodity) interest or currency exchange rates, or a variety of indices (such as a composite stock index like the Standard & Poor’s [S&P]500). (*COSO*)

Enterprise Risk: The risk applied in strategy setting and across the enterprise and mentioned in potential events that may affect the entity. Its management is within company’s risk appetite, providing reasonable assurance regarding the achievement of entity objectives. (*PricewaterhouseCoopers*)

Financial management: The planning controlling implementation and monitoring of fiscal policies and activities including the accounting and audit of revenue, expenditure, assets and liabilities. (*Cain, P., Brech, D., 1999*)

Material Weakness: A condition in which the design or operation of one or more of internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. (*AICPA*)

Operational Risk: The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. (*Basel Committee on Banking Supervision*)

Risk Appetite: The level of risk that is acceptable to the board or management. This may be set in relation to the organization as a whole, for different groups of risks or at an individual risk level.

APPENDIX B—Organizations Regulations and Codes of Best Practice

Action Plan: The High Level Group of Company Experts is a body formed by the European Commission in September 2001. Their task was to examine the existing company laws and make their recommendations towards a more efficient code. They published their final report, also known as the Winter Report on 4 November 2002, suggesting among others that the European Union adopts an action plan on modernising corporate governance regulations in the EU. The Report's recommendations were indeed adopted by the Commission, which on 21 May 2003 published the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union. The Action Plan aims to improve European Company Law as well as the principles of statutory audit. This action of the European Commission to have a consolidated approach of company law at EU level is a response to the Sarbanes-Oxley Act.

ALI: The *American Law Institute* came into existence in 1923, after a study issued by judges, teachers and law experts, suggesting the American Law has two major deficiencies, them being uncertainty and complexity. The institute has undertaken the task of restating and clarifying US legislation, in order '*to promote the clarification and simplification of the law and its better adaptation to social needs, to secure the better administration of justice and to encourage and carry on scholarly and scientific work*'.

BIS: The *Bank for International Settlements* was established in 1930 and deals with issues of international banks cooperation. Its action as a financial institution is closely linked to the Basel I Accord in 1988, as well as to its revision, the Basel II Accord.

CACG: The *Commonwealth Association for Corporate Governance* was set up by twenty four Commonwealth country-members that participated in a corporate governance technical workshop held in London, UK, in April 1998. The Association aims to promote corporate governance excellence and business efficiency for its members, through publications and guidelines. A number of its members already have markets that are well –developed. A majority of the members however is underdeveloped or in transitional stages. The Association provides significant guidance to this majority, benefiting from the expertise of the developed members and of similar global organizations.

CACG Guidelines: *Corporate Governance Principles for Annual Reporting in the Commonwealth:* A draft of these guidelines was published in November 2003 and applies to all kinds of companies of any magnitude, private or public, state or family owned. Their aim is to provide guidance and suggestions so as to protect investors by ensuring transparency of financial statements. The Principles are mandatory only if included in a country's respective legal frame. The report has taken into account several preceding documents such as the *OECD Principles on Corporate Governance*, the *Cadbury Report* and the *CACG Guidelines: of Corporate Governance in the Commonwealth(1999)*.

Comparative Study of Corporate Governance: Codes Relevant to the European Union and Its Member States: This is a Code of Best Practice, published by the European Union in January 2002. As mentioned in the Executive Summary of the document, '*...The purpose of this Comparative Study is to further the understanding of commonalities and differences in corporate governance practices among EU Member States through an analysis of corporate governance codes and - to a limited extent - relevant elements of the underlying legal framework. This Study identifies and compares existing corporate governance codes in the fifteen EU Member States and other corporate governance codes that may affect the operation of companies within the European Union. As explained in greater detail below, for purposes of this Study, a "corporate governance code" is generally defined as a non-binding set of principles, standards or best practices, issued by a collective body, and relating to the internal governance of corporations*'.

CRD: The European Union *Capital Requirements Directive* is closely linked to the Basel II Accord. It is still in preparatory stage and its aim will be to bring the Basel II guidelines in line with the existing EU regulations. It will apply to credit institutions and investment firms, thus having a wider scope than the actual Accord. The Directive will come into effect in combination with the *Statutory Audit Directive*, which is being drafted to deal with issues such as the Parmalat scandal and similar events that have shaken the global and European market.

ECGI: The *European Corporate Governance Institute* is an international scientific organization, established in 2002, aiming to improve corporate governance and promote best practice. The ECGI has been involved in significant research combining the expertise of independent scholars from all over the globe.

FRRP: The Financial Reporting Review Panel was established in 1990 as a subsidiary of The Financial Reporting Council. The FRRP seeks to ensure that the provision of financial information by public and large private companies complies with relevant accounting requirements. Finally, the Panel is responsible to examine whether or not the Operating Financial Review was conducted under the required standards.

IASB: The *International Accounting Standards Board* is an independent privately-funded body, stationed in London, UK. The Board has nine country- members and is an international standard- setter, founded to replace the Board of International Accounting Standards Committee (IASC). The IASC had been active from 1973 until 2001, when the IASB took up the task of accounting standards setting, also known as the International Financial Reporting Standards (IFRS). The Standards issued by the IASB are not mandatory, since the Board has no authority to make such claims. However, in the event that the Standards are adopted by a domestic legal framework, they are regarded to be compulsory for all publicly traded companies.

International Convergence of Capital Measurement, Basel II Accord: This Accord is a Revision of the original Basel Accord of 1988 –which was considered to be insufficiently risk sensitive– and was agreed in 2004. The deadline of implementation by local regulators throughout the world is July 2006. The Accord applies to banks and provides a guideline on Capital Requirements, highlighting the different types of risk, along with risk management techniques. Its structure consists of three main Pillars. The first focuses on Minimum Capital Requirements, the second on the Supervisory Review Process and the third on Market Discipline. The Accord will come into effect through the Capital Requirements Directive.

IOSCO: The *International Organization of Securities Commissions* was founded in Ecuador in April 1983. It is a cooperative international forum of securities regulators, initially counting eleven founder- members, reaching today 181 members. IOSCO regulates a big percentage of the worlds' securities markets and is globally recognized as one of the key international standard setting bodies.

Objectives and Principles of Securities Regulations: This document was published by IOSCO in 1998 and was revisited in 2002, aiming to provide high regulatory standards and advice for securities markets, so as to protect investors and reduce systemic risk. Its main source of information and principles are the IOSCO reports and Resolutions. The Code applies to IOSCO members and is set out to be the basis of each member's legal frame. Changes and adaptations of the Principles deriving from each member's unique legal system are a responsibility and fall in the jurisdiction of the local regulator. The IOSCO Objectives and Principles of Securities Regulations were complemented by the 2002 Multilateral Memorandum of Understanding, aiming to promote the better co-operation among financial services regulators, to strengthen the exchange of information among domestic markets and prevent their usage for the purposes of criminal activities. An Assessment Methodology was also published in 2003, to facilitate the compliance to the Principles. Benchmarks and key elements to compliance are highlighted, whereas action plans are suggested when compliance is not achieved.

OECD: It stands for the *Organization for Economic Co-operation and Development*, originally founded on 14 December 1960 by twenty countries, to replace the *Organization for European Economic Co-operation*. Its main aim, as stated in the relevant document signed at the Paris Convention on the above date, is to pursue economic strength and prosperity of the United Nations, taking into account principles such as individual liberty and peaceful co-operation among nations. The OECD publishes reports, regulations and statistics, setting the rules and proposing strategies to both governments and companies.

Principles of Corporate Governance: This report was initially published by the OECD in 1998 and was reviewed in 2004, incorporating all the changes emerging from the markets' evolution. They are a non-binding instrument, providing standards, good practices and advice which can be incorporated in each country's domestic legal frame. Governments and domestic regulators can use the principles as a guideline towards more effective laws and regulations on corporate governance. The Principles apply to both members and non-members of the Organization.

TCGD: The *Transatlantic Corporate Governance Dialogue* was set up by the ECGI and the ALI, in order to bridge the differences between corporate governance in

Europe and the US and promote a consolidated approach towards the issues that have come about in the global market. Academics from various fields are brought together with regulators, investors and numerous personalities from other relevant areas to discuss about bringing together the two sides of the Atlantic. The first Dialogue was held in Brussels on 12 July 2004, whereas a succeeding meeting has been scheduled to take place in the United States on 27 September 2005. The founding parties are considering the option of extending the Dialogue to the Eastern market across the Pacific. All activities of the TCGD are endorsed by the European Commission.

The Commonwealth Secretariat: It is one of the three intergovernmental organizations of the Commonwealth association. The association has 53 country-members and deals with numerous subjects, such as development, democracy, debt management and trade. Its fundamental principles are laid out in article 4 of the Harare Declaration.

GLOSSARY OF TERMS

AICPA:	American Institute of Certified Public Accountants
CEO:	Chief Executive Officer
CFO:	Chief Finance Officer
CIO:	Chief Information Officer
COBIT:	Control Objectives for Information and related Technology
COCO:	The Canadian's Institute of Chartered Accountants Criteria of Control Board
COSO:	The Committee of Sponsoring Organizations of the Treadway Commission
CRO:	Chief Risk Officer
D&O:	Directors and Officers
ERM:	Enterprise Risk Management
FASB:	Financial Accounting Standards Board
FRRP:	Financial Review Reporting Panel. Part of the Financial Reporting Council
GAAP:	Generally Accepted Accounting Principles
ICAEW:	Institute of Chartered Accountant in England and Wales
ICAS:	Institute of Chartered Accountants in Scotland
NYSE:	The New York Stock Exchange
OECD:	Organisation for Economic Co-operation and Development
OFR:	Operating and Financial Review
PCAOB:	The Public Company Accounting Oversight Board
SEC:	The U.S. Securities and Exchange Commission
SOXA:	The Sarbanes-Oxley Act of 2002. Also referred to as SOX.
SPE:	Special Purpose Entity
TQM:	Total Quality Management