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# THE EXTRATERRITORIAL EFFECTS OF THE SARBANES-OXLEY ACT OF 2002

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# The Extraterritorial Effects of the Sarbanes-Oxley Act of 2002

## Introduction

The Sarbanes-Oxley Act of 2002 (the "Act") is a recent American law mandating numerous reforms to enhance corporate responsibility, to improve financial disclosures and to combat corporate and accounting fraud. It introduces new or reinforced obligations for firms whose securities are listed on an American stock exchange as well as for various other entities and individuals. The Sarbanes-Oxley Act of 2002 also creates the Public Company Accounting Oversight Board, which has the responsibility and the power to oversee the activities of the auditing profession. According to its introductive text, the Act was passed to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes".

The Sarbanes-Oxley Act of 2002 was enacted by the one hundred seventh Congress of the United States of America, which begun on January 23, 2003. President Bush signed the Act into law on July 30, 2002. The context of the promulgation of the Act was one of near panic among investors, politicians and pension-funds members. The collapse of the energy giant Enron in 2001 had made people suddenly realize that nobody can be protected from bad surprises regarding the value of any stock or bond. The pension-fund of Enron, for example, owning itself a major amount of Enron shares, saw its capital reduced to almost nothing when the stock price of the Enron title fell, and was therefore unable to carry out its engagement of guaranteeing pensions for the employees participating in the fund.

People became aware that the rules valid at that time were allowing a company to keep a lot of essential information, without which one could not realistically assess the value of the company, hidden. As a reaction, the American Congress rapidly drafted a far-reaching law, the Sarbanes-Oxley Act, meant to apply to any private issuer listed in the United States of America ("U.S."), irrespective of the country of incorporation or first quotation of such issuer. This broad range of application of the Act is a breakthrough of the previous approach adopted by national securities authorities, which was based on mutual recognition. Issuers incorporated in non-U.S. countries but having registered shares in the U.S. are today facing an additional set of rules and procedures, must bear additional administrative charges and might encounter situations where they will violate either their home-office laws or the new rules introduced by the Sarbanes-Oxley Act.

Before the Sarbanes-Oxley Act of 2002 was enacted, the problem of the companies having securities listed in two or more different jurisdictions was dealt with by means of reciprocal recognition. Under certain conditions, each national securities authority would consider the compliance with the other jurisdiction's rules as sufficient. The U.S. securities authority was already imposing a reconciliation of the financial statements of foreign issuers listed on an American stock exchange to the generally accepted accounting principles ("GAAP"). The Sarbanes-Oxley Act, however, goes further and imposes a lot of obligations with no consideration to foreign laws and regulations. Numerous commenters, therefore, complain about the "extraterritorial effects" of the Sarbanes-Oxley Act.

One should, however, keep in mind that the so-called "extraterritorial" effects are maybe not as extraterritorial as one might think. Companies whose securities are listed on a U.S. stock exchange have chosen to do so, therefore subjecting themselves to the rules and regulations governing the U.S. securities market. The connecting factor is that these companies have registered stock or bonds on a U.S. stock exchange, whereas the country of their incorporation or first quotation only plays a secondary role.

The purpose of this paper is to analyze which effects the Act has on non-U.S. issuers and the related persons thereof, and which consequences such effects have. To do this, we will first describe briefly the enforcement bodies that were foreseen, how the rulemaking process works, the range of application of the Act and the sanctions that might apply in case of non-compliance. In a second part we will list the various effects of the Act, concentrating on the ones that are likely to affect non-U.S. issuers. The third part will discuss the different conflicts with foreign national laws as well as the exemptions that were conceded and the problems that persist.

When using examples, this paper will focus mainly on West-European countries rather than extending the discussion to every existing jurisdiction. Due to its broad range of application, however, the Act will have similar effects in most countries.

# 1 General on the Sarbanes-Oxley Act: Implementation, Range of Application, Sanctions

In this section, we will examine which are the bodies responsible for enforcing the provisions of the Act, how the rulemaking process works, how broad the range of application of the Act is and what kind of sanctions are applicable in case of violation.

## 1.1 Implementation of the Sarbanes-Oxley Act – How the Process Works

### 1.1.1 Enforcement Bodies

Responsible for the implementation of the Act and the supervision over compliance with the new legal dispositions are the Securities and Exchange Commission (the “SEC” or “Commission”) and the newly created Public Company Accounting Oversight Board (the “Board” or “PCAOB”). The Commission edicts implementation rules, verifies the documents that the issuers have to file with it, undertakes controls and investigations and may impose sanctions. The control over the auditors is exercised by the PCAOB, which lies under the supervision of the SEC. The Board registers the public accounting firms and adopts rules regarding auditing and related professional practice standards. These rules, however, do not take effect unless approved by the Commission. The Board also has the power to conduct large-scale inspections, investigations, to perform supervision tasks and to impose sanctions.

#### 1.1.1.1 Securities and Exchange Commission

The SEC was established 1934 to enforce the securities laws, to promote stability in the markets and to protect investors. It has a general duty of “monitoring the securities industry” as primary overseer and regulator of the U.S. securities market.

The main laws governing the securities industry in the U.S. are the Securities Act of 1933 (the “Securities Act”), the Securities Exchange Act of 1934 (the “Exchange Act”), and since July 2002 the Sarbanes-Oxley Act of 2002[1]. The Securities Act’s purpose is to guarantee that investors receive sufficient information concerning listed companies and to prohibit deceit, misrepresentations, and other frauds in the sale of securities. The Exchange Act provides the legal basis for the SEC as overseer and regulator of the U.S. securities market.

[1] The three texts can be consulted on the Internet. See references table below.

The Commission has the same powers with regard to the Act as with regard to the other securities laws. Among others, the Commission will oversee corporate disclosure of important information, establish and maintain standards for fair, orderly and efficient markets, investigate possible violations of securities laws, impose sanctions, initiate action when appropriate, either in a federal court or before an administrative law judge, and negotiate settlements.

Most of the provisions of the Act require implementation rules. The competence of the Commission to promulgate such rules is emphasized in section 3 (a) of the Act: “The Commission shall promulgate such rules and regulations as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act”. Along with this general delegation of the rulemaking power, many of the different sections of the Act set forth that the Commission shall promulgate implementation rules for specific provisions in a given period of time, calculated as of the enactment of the Act on July 30, 2002. Several sets of application rules are in force in their final version, whereas some are at the stage of “proposed rules” or not yet made public. The rulemaking process is discussed in point 1.2.2 below. Even among the final rules, there are still some provisions that will need specification, for example as to how they will apply to non-U.S. companies.

#### 1.1.1.2 The Public Company Accounting Oversight Board

The Board has been established “to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies whose securities are sold to, and held by and for, public investors”[2].

The Act states that the Board shall not be an agency or establishment of the United States Government and that no person acting for the Board shall be deemed to be acting for the Federal Government[3]. Furthermore, the Board states in all of its releases to the public that it is a private-sector, non-profit organization[4]. This might, however, not be sufficient to avoid that foreign authorities consider the Board an agent of a foreign government (see section 3.1.1.1 below). The members of the Board are, as a matter of fact, appointed by the Commission (whose members are themselves appointed by the President of the United States with advice and consent of the Senate). The Commission also has oversight and enforcement authority over the Board[5].

As a rule, the Board is responsible for everything that has to do with public accounting firms. It will register public accounting firms that prepare audit reports for issuers, establish or adopt, or both, standards relating to the preparation of audit reports for issuers, conduct inspections of registered public accounting firms, conduct investigations and disciplinary

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[2] See section 101 (a) of the Act.
[3] See section 101 (b) of the Act: “The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service”.
[4] In its letter paper, the Board indicates: “The Board is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002. Its mission is to protect investors in the U.S. securities markets and to further the public interest by ensuring that public company financial statements are audited according to the highest standards of quality, independence, and ethics. The Board will be principally funded by fees collected from public companies. The costs of processing and reviewing public accounting firm registration applications will be recovered from registration fees paid by those firms.”
[5] See section 107 of the Act.

proceedings concerning registered public accounting firms and associated persons of such firms, and impose appropriate sanctions, where justified, upon such entities and individuals[6].

The rules of the Board may provide for various obligations of the firms or powers of the Board. They may, for example, require the testimony of the firm or of any person associated with a registered public accounting firm, or they may require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, or they may allow the Board to inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied.

No rule of the Board, however, shall become effective without prior approval of the Commission. As mentioned above, the Commission has oversight and enforcement authority over the Board and may among other things modify, cancel, reduce or require the remission of the sanctions imposed by the Board[7].

### 1.1.2 Rulemaking Process

In the United States, rulemaking is the process by which federal agencies implement legislation passed by Congress and signed into law by the President[8].

The Sarbanes-Oxley Act and the other securities laws provide the framework for the SEC's overseeing of the securities markets. These statutes are generally broadly drafted, establishing basic principles and objectives. This is why the rulemaking process of the Commission (or the Board) is required.

Rulemaking by the Commission involves several steps, including concept release, rule proposal, and rule adoption[9]:

**Concept Release:** The rulemaking process usually begins with a rule proposal, but is sometimes preceded by a request for public input if an issue is especially sensitive or complicated. If public input is sought, a concept release is issued describing the area of interest and the Commission's concerns and usually identifying different approaches to addressing the problem, followed by a series of questions that seek the views of the public on the issue. The public's feedback is taken into consideration as the Commission decides which approach, if any, is appropriate.

**Rule Proposal:** The staff of the Commission drafts a detailed formal rule proposal and presents it to the full Commission. Unlike a concept release, a rule proposal is specific in its objectives and methods for achieving its goals. Following approval by the Commission, the rule proposal is presented to the public for a specified period of time, typically between 30 and 60 days, for review and comment.

**Rule Adoption:** Taking this input into account, the staff of the Commission presents a final draft to the Commission for consideration. If adopted, the measure becomes part of the

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[6] See section 105 (b) (1) of the Act: among other things, the Board may "conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto".

[7] See section 107 (a), (b) (2) and (c) (3) of the Act.

[8] See on the homepage of the SEC "What We Do" (see references table below).

[9] See on the homepage of the SEC "What We Do" (see references table below).

official rules that govern the securities industry. If the rule is a major rule, it may be subject to congressional review and veto prior to becoming effective.

In those cases where the Board is involved in the rulemaking process, such process is very similar to the one described above. There is, however, one supplementary level: the Board publishes the proposed rules, takes the public input into consideration, and then issues rules that are submitted to the Commission for approval. The Commission seeks public comments on these proposed rules, and may then approve them so that they become final rules of the Board.

The process of rulemaking with regard to the Sarbanes-Oxley Act is at various stages of completion. Several sets of rules are final; others are at a less advanced stage of the rulemaking process.

## 1.2 Range of Application

The Sarbanes-Oxley Act does not explicitly list the territories where it will apply. The Act and the respective implementation rules apply to "issuers", their auditors, as well as other agents of the issuers or persons performing services for them, irrespective of the place of incorporation or principal place of business of such entities or persons.

### 1.2.1 Issuers

As used in the Sarbanes-Oxley Act[10], the term "issuer" means an issuer[11]:

- "the securities of which are registered under section 12 ("Registration Requirements for Securities") of the Exchange Act[12], or
- that is required to file reports under section 15 (d) ("Registration and Regulation of Brokers and Dealers") of the Exchange Act (i.e. a registered broker or dealer effecting transactions in securities that are not registered under section 12), or
- that files or has filed a registration statement that has not yet become effective under the United States Securities Act of 1933, as amended (the "Securities Act")[13], and that it has not withdrawn".

Therefore, will have to comply with the Sarbanes-Oxley Act of 2002 any person who issues or proposes to issue any security (other than an exempted security) on a securities exchange in the United States of America. Any firm that has listed corporate stocks or bonds on a U.S.

[10] See section 2 (a) (7) of the Act.

[11] As defined in section 3 of the United States Securities Exchange Act of 1934, as amended ("the Exchange Act"), 15 U.S.C. §78a et seq. section 3 sets forth: "The term "issuer" means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is, or is to be, used."

[12] Section 12 a of the Exchange Act sets forth: "It shall be unlawful for any member, broker, or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange […]."

[13] 15 U.S.C. §77a et seq.

stock exchange (like NYSE, AMEX or NASDAQ) and any firm that has to file reports with the Commission is an issuer as meant in the Act and must therefore comply with the Act[14].

From now on we will use the term "issuer" to designate an issuer that is subject to the Act and will use a special qualification to designate other issuers.

In a few cases, the provisions of the Act may also apply to companies other than those meeting the Act's definition of an issuer. Section 302 of the Act, for example, indicates that it applies to "each company filing periodic reports under section 13 (a) or 15 (d) of the Securities Exchange Act", thereby indicating an intended target circle that is broader than the companies that are required to file under either of those sections. It comprises for example companies that file voluntarily under section 15 (d) of the Exchange Act as a result of a contractual requirement.

It is not always clear in the wording of the Act whether a specific disposition applies only to the issuers required to file reports or also to those filing reports on a voluntary basis. Since the distinction would require more developments than the scope of this paper allows and requires, we will not analyze this issue any further and assume that, as a whole, the Act applies to any public company that is required to file reports with the Commission or that has filed a registration statement for a public offering of securities.

### 1.2.2 Auditors (public accounting firms)

According to the Act, "the term "audit" means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission […], for the purpose of expressing an opinion on such statements."[15]

The Act comprises an important number of dispositions regulating the audit work for the issuers as meant in point 1.2.1 of this section. The public accounting firms performing audit services for an issuer and the persons associated with such accounting firm are subject to several rules relative to audit partner rotation, auditor reports to audit committees, conflicts of interest, etc.

As regards non-U.S. auditors (foreign public accounting firms), are subject to the provisions of the Act:

- <u>Foreign public accounting firms preparing audit reports for "issuers"</u>. These firms are subject to the Board's registration and oversight regime[16].

  The term "foreign public accounting firm" includes any associated person of a public accounting firm.

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[14] To get a better idea of the different ways for a foreign issuer to be listed in the U.S. (with respect to ADR's), see part I of the Proposed Rules: Additional Form F-6 Eligibility Requirement Related to the Listed Status of Deposited Securities Underlying American Depositary Receipts.

[15] See section 2 (a) (2) of the Act.

[16] Section 106 (a) (1) of the Act provides: "Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer shall be subject to this act". Section 106 (d) of the Act: "In this section, the term "foreign public accounting firm" means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof." According to the wording of the Act (see section 2 (a) (11)), a "public accounting firm" means

- a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and
- to the extent so designated by the rules of the Board, any associated person of such entity.

An “associated person of a public accounting firm” is a person or entity that, in connection with the preparation of any audit report, shares the profits of or receives compensation from that firm or participates as agent or otherwise on behalf of such accounting firm in any activity of that firm[17].

This means that every entity of a group of accounting firms will be subject to the Act if one member of the group provides audit services to an issuer, wherever each entity is situated/has its registered offices. Moreover, each partner of an accounting firm, since he/she will normally share the profits of that firm, will be subject to the dispositions of the Act if such a firm prepares audit reports for an issuer. As a consequence, all these persons and entities will be subject to rules regarding the independence of the auditor as if they were performing the audit themselves, will need to comply with the rules regarding the production of documents in particular and will be subject to the sanctions as described in section 1.3 bellow.

- Foreign public accounting firms playing a substantial role in the preparation or furnishing of an issuer’s audit report. These firms are subject to the Board’s registration and oversight regime[18].

  According to the interpretative rules of the Board[19], to play a substantial role means (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer (this does not include non-audit services provided to a non-audit client) or (2) to perform the majority of audit procedures with respect to a subsidiary or component of any issuer, the assets or revenues of which constitute 20 percent or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer.

  The Rules of the Board add: “For purposes of paragraph (1), the term “material services” means services, for which the engagement hours or fees constitute 20% or more of the total engagement hours or fees, respectively, provided by the principal accountant in connection with the issuance of all or part of its audit report with respect to any issuer”[20].

- Foreign public accounting firms issuing an opinion or performing material services upon which a registered public accounting firm relies in issuing its opinion[21]. Such firms are deemed to have consented to produce their working papers and to be subject

[17]The terms “person associated with a public accounting firm” (or with a “registered public accounting firm”) and “associated person of a public accounting firm” (or of a “registered public accounting firm”) mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report (i) shares in the profits of, or receives compensation in any other form from, that firm; or (ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm” (see section 2 (a) (9) of the Act). The Rules of the Board specify that “these terms do not include a person engaged only in clerical or ministerial tasks or a person whom the public accounting firm reasonably believes is a person primarily associated with another registered public accounting firm” (See rule 1001 (p) (i) of the Board).

[18] The relevant disposition of the Act (section 106 (a) (2)) states that the Board may determine that a foreign public accounting firm (or class of such firms) plays such a substantial role in the preparation of an audit report that it should be treated as a public accounting firm for registration and oversight purposes. The Board made use of this rulemaking power in his “Proposed Rules Relating to Registration System”, approved by the Commission with an order of June 16, 2003. Rule 2100 (b) of the Board requires the registration of any public accounting firm that “plays a substantial role in the preparation or furnishing of an audit report” with respect to any issuer.

[19] Rule 1001 (p) (ii) of the Board.

[20] See Note 1 to rule 1001 (p) (ii) of the Board.

[21] Sometimes also referred to as “contributing firms”.

> to the jurisdiction of the U.S. courts for purposes of enforcement of the Board's production requests. A registered public accounting firm that relies on the opinion of a foreign public accounting firm is deemed to have consented to supplying the working papers of that foreign public accounting firm and to have secured the agreement of the foreign public accounting firm to produce the audit working papers in response to the Board's request.

From this follows that not only the auditors of companies which have issued securities listed in the U.S. are subject to the provisions of the Act, but in many cases the auditors of the subsidiaries of these issuers as well[22].

### 1.2.3 Others

A substantial number of persons providing services for an issuer are affected by the Act as well. As described below in section 2 with more details, this is the case for the CEO, the CFO and the directors of any issuer, to a certain extent for any person employed by an issuer, for attorneys appearing before the SEC, brokers and dealers, financial analysts performing work for such brokers or dealers, etc.

## 1.3 Sanctions

A violation of the Sarbanes-Oxley Act, or of any rule or regulation of the Commission issued under the Act, or of any rule of the Board, is treated in the same manner as a violation of the Securities Exchange Act of 1934 or the rules and regulations thereunder[23]. This means that, unless a different penalty is foreseen for a specific violation, a person violating a provision of the Act may be fined up to $5,000,000 (natural person) or $25,000,000 (person other that a natural person), or imprisoned up to 20 years[24].

Moreover, the violation of the Act and its implementation rules may lead to the delisting of a company that does not comply with the securities laws[25].

As regards the accounting firms, a registered public accounting firm or any associated person thereof that refuses to testify, to produce documents, or to otherwise cooperate with the Board in connection with an investigation related to a violation of the Act, may be suspended or barred from registration (and therefore from auditing issuers) or, for associated persons, from accomplishing any audit work for an issuer, or be subject to any lesser sanction by the Board[26]. The Commission has the authority thereafter to enhance, modify, cancel, reduce or require the remission of such sanctions[27].

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[22] As illustration and order of magnitude, 13 to 14 Swiss companies have a secondary listing in the U.S. and around 1,000 companies that have their registered offices in Switzerland are subsidiaries of U.S.-listed companies. In Germany, 22 companies are listed on a U.S. stock exchange (See LUTHERMENOLD, "The Sarbanes-Oxley Act – Do we need Sworn Financial Statements in Germany?").

[23] See section 3 (b) (1) of the Act: "a violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations".

[24] See Exchange Act section 32 a.

[25] See for example Final Rule: Standards Relating to Listed Company Audit Committees.

[26] See section105 (b) (3) of the Act: "If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may (i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association; (ii) suspend or revoke

# 2 Effects of the Sarbanes-Oxley Act which are Likely to Affect Foreign Companies

This section is aimed at giving to the reader an idea of the various consequences that the Act and its implementing rules can have on non-U.S. companies and persons subject to the Act, rather than giving an exhaustive list of the effects of the Act, since this would go beyond the scope of this paper.

The Act is divided into eleven titles, each dealing with one topic area. In order to facilitate the referral to the text of the Act, we will abide by the division into titles of the Act and discuss the relevant points of this section based on eleven subdivisions referring to the eleven titles of the Sarbanes-Oxley Act.

## 2.1 Public Company Accounting Oversight Board (sections 101 – 109)

This title of the Sarbanes-Oxley Act deals with the Public Company Accounting Oversight Board and with the obligations of the public accounting firms subject to the Act.

Public accounting firms that prepare or issue audit reports for issuers shall among others:

- Register by the Board within 180 days of the date when the Commission decides that the Board is ready to fulfill its tasks (not later than 270 days after enactment of the Act)[28]. On April 25, 2003, the Commission decided that this was the case. This means that public accounting firms that wish to participate in or contribute to the preparation of audit reports must register by October 22, 2003 (foreign public accounting firms benefit from an additional 180 days to register, see point 3.1.2 below). Since the Board has 45 days as of the date of receipt of the application to issue a written notice of disapproval or request more information from the prospective registrant[29], the application has to be filed about two months before the date after which a firm is no longer allowed to provide audit services to issuers if not registered by the Board. Registration involves the payment of a registration fee and an annual fee[30].
- By registering with the Board, a public accounting firm must specify the names of all issuers for which it prepared or issued audit reports during the immediately preceding calendar year, or for which it expects to prepare or issue audit reports during the current calendar year[31]. It must specify as well the fees received by the firm from each such issuer for audit services, other accounting services and non-audit services[32] and submit copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer[33]. The accounting firm must also submit a list of all accountants participating in or contributing to the preparation of an audit report for an issuer and other specific information about the

the registration of the public accounting firm; and (iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board".

[27] See section 107 (c) (3) of the Act.

[28] See section 102 (a) and section 101 (d) of the Act.

[29] See section 102 (c) (1) of the Act.

[30] See section 102 (f) of the Act.

[31] Section 102 (b) (2) (A) of the Act.

[32] Section 102 (b) (2) (B) of the Act.

[33] Section 102 (b) (2) (G) of the Act.

associated persons of the firm, like information related to criminal, civil, or administrative actions or disciplinary proceedings pending against them in connection with an audit report[34]. The Board extended this requirement to include information related to any pending criminal proceeding, here without the additional wording "in connection with an audit report"[35].

- Submit an annual report to the Board and provide such additional information as the Board or the Commission may specify in order for the information given by the time of the application to be updated or completed[36].
- Give their consent to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities and an agreement to secure and enforce similar consents from each of their associated persons as a condition of their continued employment by or other association with such firm.[37]
- As part of the compliance with extended new Auditing, Quality Control, and Independence Standards and Rules:
  - Prepare, and maintain for a period of not less than 7 years, audit work papers and other information related to any audit report, in sufficient detail to support the conclusions reached in such report[38].
  - Provide a concurring or second partner review and approval of the audit report and other related information[39].
  - Describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer[40].
- Be inspected by the Board (quality assurance and investigative procedures) on a regularly basis (annually for firms that audit more than 100 issuers, every three years for all others) in connection with their performance of audits, issuance of audit reports, and related matters involving issuers[41].
- Be subject to investigation by the Board in case of violation of any provision of the Act, the rules of the Board, the provisions of the securities laws relating to audit reports and the obligations and liabilities of accountants with respect thereto. This includes being required to testimony, produce audit work papers and any other document or information in their possession or in the possession of any associated person thereof, having their books and records inspected, seeing the testimony and production of any document in the possession of any other person, including any client of a registered public accounting firm, requested, being faced with a subpoena requiring the testimony of and production of any document in the possession of any person including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section (and being suspended from registration or barred from being associated with a registered public

[34] See section 102 (b) (2) (A) to (H) of the Act.
[35] See Rules of the Board as of August 4, 2003, Appendix Form 1, part V Item 5.1 a. 1, p. 32.
[36] See section 102 (d) of the Act.
[37] See section 102 (b) (3) of the Act.
[38] See section 103 (a) (2) (i) of the Act.
[39] See section 103 (a) (2) (ii) of the Act.
[40] See section 103 (a) (2) (iii) of the Act.
[41] See section 104 (a) and (b) of the Act.

accounting firm, or other sanctions), being subject to disciplinary proceedings, etc. Once an accounting firm falls within the jurisdiction of the Board, there is therefore a risk that the Board could argue for far-reaching powers to investigate any aspect of the firm, its clients and its business, regardless of whether those clients and the related business are SEC registered. Note that the Commission may enhance, modify, cancel, reduce or require remission of the sanctions imposed by the Board[42].

- Subject themselves to U.S. jurisdiction. The impact of this aspect of registration for foreign accounting firms is, however, limited to controversies between the Board and the foreign accounting firm[43]. The act of subjecting to the jurisdiction of U.S. courts is to be distinguished from the power of the Board to conduct inspections or investigations and request document production from outside the jurisdiction of the U.S. It is this extraterritorial enforcement power of the Board that creates a series of conflicts with provisions of foreign mandatory law more than the fact that the registered foreign accounting firms subject themselves to U.S. jurisdiction for limited purposes.
- Accept to produce their audit workpapers and the ones of any foreign public accounting firm, upon which opinion they rely (context of audit of a group), for the Board or the Commission in connection with any investigation by either body with respect to that audit report, and have secured the agreement of the foreign public accounting firm, upon which opinion they rely, to such production, as a condition of their reliance on the opinion of that foreign public accounting firm[44].

## 2.2 Auditor Independence (sections 201 – 209)

This title aims at guaranteeing that the auditor of an issuer, when preparing its audit report, cannot be influenced in any way by the issuer for which it prepares the report or the executive persons of such issuer. It has to be read in parallel with the Final Rule on Strengthening the Commission's Requirements Regarding Auditor Independence, published January 28, 2003, and effective May 6, 2003[45].

Section 201 of the Act modifies the Securities Exchange Act of 1934 to add a list of prohibited activities applying to registered public accounting firms. According to this list, it shall be unlawful for a registered public accounting firm that performs any audit for any issuer to provide to that issuer, contemporaneously with the audit, any non-audit service, including

- bookkeeping or other services related to the accounting records or financial statements of the audit client;
- financial information systems design and implementation;
- appraisal of valuation services, fairness opinions, or contribution-in-kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;

[42] See section 105 of the Act.
[43] See section 106 (b) (1) (B) of the Act.
[44] See section 106 (b) (1) and (2) of the Act.
[45] See references table below.

- broker or dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit;
- any other service that the Board determines, by regulation, is impermissible[46];

The final rule provides that the provision of these services will not impair an accountant's independence until May 4, 2004, provided those services are pursuant to contracts in existence on May 6, 2003[47]. This means that if an auditor renders a specific service to an issuer based on a contract between the issuer and its auditor that was entered into before May 6, 2003, the auditor may continue to render this service until May 4, 2004, and still be considered sufficiently "independent". As of May 4, 2004, the rule of section 201 of the Act will apply without exception. The performance of any non-audit service comprised in the above list by the auditor of an issuer to this issuer will be prohibited even if the service is rendered pursuant to a contract in existence on May 6, 2003.

Provided that they are not included in the above list, non-audit services, including tax services, are allowed on condition that the activity is approved in advance by the audit committee of the issuer, or that the Board has granted an exemption from the prohibition to the issuer, the public accounting firm or the transaction (on a case-by-case basis), or that the "de minimis exception" applies to it. The "de minimis exception" applies if (1) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor, (2) such services were not recognized by the issuer at the time of the engagement to be non-audit services, and (3) such services are promptly brought to the attention of the audit committee and approved prior to the completion of the audit by at least one member of the audit committee who is member of the board of directors and to whom authority to grant such approvals has been delegated by the audit committee. The audit committee has to disclose to investors in periodic reports its decisions to pre-approve audit services[48].

To improve auditor independence, the Act and the consecutively amended other securities laws also provide that or require (among others):

- A rotation of the lead or coordinating audit partner and the reviewing partner every five years[49]. The final rule of the Commission goes further, imposing a five-year "time out" period upon rotation and prohibiting any "audit partner" to serve on an audit engagement team for more than seven consecutive years with a two-year time-out. Audit partners are partners on the audit engagement team who have responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management and the audit committee. According to the final rule, the definition includes thus all the partners who serve the client at the issuer or parent level, other than specialty partners, as well as the lead partner on subsidiaries of the issuer whose assets or revenues constitute 20% or more of the consolidated assets or revenues of the issuer[50]. Transitional periods are established by the final rule: the rotation requirements applicable to the lead partner are effective for the first fiscal year ending after the

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[46] See section 201 (a) of the Act.
[47] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence and Code of Federal Regulations ("C.F.R."), title 17, part 210.2-01, section (e) (1) p. 248.
[48] See section 201 (a) and section 202 of the Act.
[49] See section 203 of the Act.
[50] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, section II.C and C.F.R., title 17, part 210.2-01, section (c) (6) p. 247, (f) (ii) and (D) p. 249.

effective date of these rules (May 6, 2003), for the concurring partner as of the end of the second fiscal year after the effective date of these rules, and for other partners the rules are effective as of the beginning of the first fiscal year after the effective date of these rules, whereas the first fiscal year will however constitute the first year of service for such partners in determining the time served[51].

- Auditor reports to the audit committees of all critical accounting policies and practices to be used, all alternative treatments of financial information within GAAP that have been discussed with management officials of the issuers, and other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences[52].

- A high executive person of the issuer cannot have been employed by the company's audit firm and have participated in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit ("cooling-off period")[53]. If it is the case, the audit firm will not be allowed to perform the audit of that issuer. The implementing rules of the Commission go even further and extend this mandatory cooling-off period to any former member of the audit engagement team beginning employment in a "financial reporting oversight role" at the issuer, a "financial reporting oversight role" being a role in which a person is in a position to, or does influence the contents of financial statements, or anyone who prepares them. The text of the Act "only" speaks about a person being "a chief officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer". Among others, and as set forth in the final rule, "the term financial reporting oversight role captures other key positions, such as members of the board of directors, who may have significant interaction with the audit engagement team"[54]. The Sarbanes-Oxley Act also instructs the Comptroller General of the United States[55] to conduct a study and review of the potential effects of the mandatory rotation of registered public accounting firms[56]. This study has not been made public yet. Therefore, one cannot rule out the possibility of a rotation requirement applicable to the whole public accounting firm as such in the future.

- The implementing rules of the Commission provide that an accountant will not be independent from an audit client if, at any point during the audit and professional engagement period, any audit partner other than specialty partners earns or receives compensation based on selling engagements to that audit client for services other than audit, review or attest services. The rule exempts certain small accounting firms from this requirement[57].

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[51] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, section II.C and C.F.R., title 17, part 210.2-01, section (e) (1) (5) p. 248.
[52] See section 204 of the Act.
[53] See section 206 of the Act.
[54] Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, section II. A and C.F.R., title 17, part 210.2-01, section (c) (2) (iii) (A) p. 245 and (f) (3) (ii) p 248.
[55] The Comptroller General is the head of the General Accounting Office (GAO). The GAO is the audit, evaluation and investigative arm of Congress. It is an agency that examines the use of public funds, evaluates federal programs and activities, and provides analyses, options, recommendations, and other assistance to help the Congress make effective oversight, policy, and funding decisions. See the webpage of the GAO: http://www.gao.gov/main.html.
[56] See section 207 of the Act.
[57] Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, section II. E and C.F.R., title 17, part 210.2-01, section (c) (8) p.248.

## 2.3 Corporate Responsibility (sections 301 – 308)

The title regarding corporate responsibility introduces dispositions with respect to mandatory audit committees, the duty of the CEO and CFO of an issuer to certify the financial statements, and various other obligations aimed at enhancing the protection of investors by insuring good and efficient corporate governance by each issuer. Most of the new dispositions do not, however, create wholly new obligations: most of such requirements were already known, either in a slightly to pronounced different form, or as recommendations, as in the existing codes of corporate governance with respect to the audit committees for example.

Foreign issuers that did or did not follow such recommendations must now comply with the mandatory dispositions of the Act: they must for example have an audit committee composed of independent members, introduce a certification of the financial statements not only by the CFO but also by the CEO, or comply with new sets of standards (whereas the home country standards, until the enactment of the Sarbanes-Oxley Act of 2002, were as a rule recognized as equivalent by the SEC).

### 2.3.1 Requirements Regarding the Audit Committee

Pursuant to the wording of the Act, the audit committee is a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer (if no such committee exists: the entire board of directors of the issuer)[58]. The main requirements introduced by the Act regarding the audit committee are the following:

- The audit committee of each issuer shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm performing the audit of that issuer[59].
- Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer and shall otherwise be independent. This is the so-called “non-compensation prong”: other than in his capacity as a member of the audit committee, of the board of directors, or of any other board committee, a member of the audit committee of an issuer shall not accept any consulting, advisory, or other compensatory fee from the issuer or be an affiliated person of the issuer or any subsidiary thereof[60]. Accordingly, the audit committee should include only board members who are not company employees so that the audit committee and the outside auditor can watch each other[61].
- The audit committee shall establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters[62].

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[58] See section 205 (a) of the Act.
[59] See section 301 (2) of the Act.
[60] See section 301 (3) of the Act.
[61] ZALEWSKI PETER, Special report – white collar crime.
[62] See section 301 (4) of the Act.

- The audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties[63].

### 2.3.2 Other Requirements

- The CEO and CFO of each issuer shall certify in each annual or quarterly report filed or submitted that they have reviewed the report, that (based on the officer's knowledge) the financial statements and disclosures contained in the periodic report are appropriate and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer. The signing officers are responsible for establishing and maintaining effective internal controls and shall present in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date. This rule became effective on August 29, 2002[64]. By giving the certification, the signing officers become personally responsible for the correctness of their declaration. They are subject to criminal penalties if they knowingly give wrong indications (see section 2.9 below).
- It shall be unlawful for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any auditor engaged in the performance of the audit for the purpose of rendering the financial statements materially misleading. This prohibition shall be in addition to any other provision of law or any rule or regulation and the Commission has exclusive authority to enforce it[65].
- If an issuer is required to prepare a restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement, the CEO and CFO shall reimburse the issuer for any bonus or other incentive-based or equity-based compensation received during the 12-month period following the issuance or filing of the non-compliant document and any profit realized from the sale of securities of the issuer during that period. In any action brought by the Commission for violation of the securities laws, federal courts are authorized to grant any equitable relief that may be appropriate or necessary for the benefit of investors[66].
- The Commission may seek before court a prohibition from serving as an officer or a director if such person has violated the securities laws and the person's conduct demonstrates unfitness to serve as an officer or director of an issuer. Until the enactment of the Sarbanes-Oxley Act of 2002, such unfitness had to be substantial to potentially lead to a prohibition[67].
- It shall be unlawful for any director or executive officer of an issuer to purchase or sell any equity security of the issuer during any pension fund blackout period if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer[68]. Any profits resulting from sales in

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[63] See section 301 (5) of the Act.
[64] See section 302 of the Act and Final Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports.
[65] See section 303 of the Act.
[66] See section 304 of the Act.
[67] See section 305 of the Act.
[68] According to section 306 (4) of the Act, a "blackout period" means, subject to certain exceptions, "any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or

violation of this section shall inure to and be recoverable by the issuer. If the issuer fails to bring suit or prosecute diligently, a suit to recover such profit may be instituted by the owner of any security of the issuer[69].

- The Act instructs the Commission to issue rules setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or to the CEO of the company, and if the counsel or officer does not appropriately respond to the evidence, requiring the attorney to report the evidence to the audit committee of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors[70].

  On January 29, 2003, the Commission published its Final Rule on Implementation of Standards of Professional Conduct for Attorneys, effective August 5, 2003[71]. Before that, the proposed rules of the Commission (published November 21, 2002)[72] had provided for attorneys aware of material violations of securities laws or breach of fiduciary duty or similar violation not only to report evidence of the violation to the issuer, but, if no measures had been taken, to notify the Commission that they had withdrawn from the representation of the issuer based on professional considerations. This is the so-called "noisy withdrawal". The proposed rules would also have permitted attorneys to report evidence of material violations to the Commission and took a broad view of who could be found to be appearing and practicing before the SEC[73]. The proposed rules had also provided that a violation of these rules by any attorney appearing and practicing before the Commission in the representation of an issuer would be treated for all purposes in the same manner as a violation of the

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otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan".

[69] See section 306 of the Act.

[70] See section 307 of the Act.

[71] See references table below.

[72] See Proposed Rules: Implementation of Standards of Professional Conduct for Attorneys; Release No. 33-8150.

[73] See Proposed Rules: Implementation of Standards of Professional Conduct for Attorneys; Release No. 33-8150. Among others: "Where an attorney who has reported evidence of a material violation […] does not receive an appropriate response, or has not received a response in a reasonable time, to his or her report, and the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or investors, an attorney retained by the issuer shall (A) Withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional considerations; (B) Within one business day of withdrawing, give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations; and (C) Promptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading; […] An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary: (i) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to result in substantial injury to the financial interest or property of the issuer or investors; (ii) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to perpetrate a fraud upon the Commission; or (iii) to rectify the consequences of the issuer's illegal act in the furtherance of which the attorney's services had been used".

Securities Exchange Act of 1934, and that any such attorney would be subject to the same penalties and remedies, and to the same extent, as for a violation of that Act.

## 2.4 Enhanced Financial Disclosures (sections 401 – 409)

This title increases the financial disclosures requirements that were in force until the enactment of the Sarbanes-Oxley Act. Noteworthy is in particular the disclosure of material off-balance sheet transactions and other relationships with unconsolidated entities "that may have a material current or future effect on the financial condition of the issuer". Had this requirement already been in force before the Enron-case, the latter would maybe have ended up differently[74].

The requirements of the Act are the following:

- Each financial report that contains financial statements and that is required to be prepared in accordance with (or reconciled to) GAAP shall reflect all material correcting adjustments that have been identified by a registered accounting firm[75].
- Each annual and quarterly financial report shall disclose all material off-balance sheet transactions and other relationships with unconsolidated entities that may have a material current or future effect on the financial condition of the issuer[76].
- Pro forma financial information shall be presented so as not to contain an untrue statement or omit to state a material fact necessary in order to make the pro forma financial information not misleading and be reconciled with the financial condition and results of operations of the issuer under generally accepted accounting principles[77].
- As a rule, it will be unlawful for an issuer to extend credit to any director or executive officer. Consumer credit companies may make home improvement and consumer credit loans and issue credit cards to their directors and executive officers if it is done in the ordinary course of business on the same terms and conditions made to the general public[78].
- Directors, officers, and 10% owners must file an ownership statement at the time of the registration of the security on a U.S. exchange or within 10 days after he becomes such beneficial owner, director, or officer, and report designated transactions by the end of the second business day following the day on which the transaction was executed[79].
- Each annual report shall state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial

[74] Enron had entered into derivatives transactions with more than 3,000 off-balance sheet subsidiaries and partnerships to shield volatile assets from quarterly financial reporting and to inflate artificially the value of certain Enron assets. Those transactions did not appear in Enron's financial statements, therefore permitting Enron to hide spectacular losses and hudge debts from its shareholders. See PETER HENRY, Creative Accounting et Corporate Governance, and its reference to the testimony of Prof. Frank Partnoy before the United States Senate, January 24, 2002, available at *http://www.senate.gov/~gov_affairs/012402partnoy.htm*.

[75] See section 401 (a) (i) of the Act.

[76] See section 401 (a) (j) of the Act.

[77] See section 401 (b) of the Act. As defined by the SEC in its SEC Press Release form January 1, 2003, "pro forma financial information" are financial information that include "non-GAAP financial measures".

[78] See section 402 (a) of the Act.

[79] See section 403 (a) of the Act.

reporting and contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting. Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. This attestation shall not be subject of a separate engagement[80]. It is, however, not clear how far this requirement of attestation report on management's assessment of the company's internal control over financial reporting from the auditor will go, and if the auditor will thus have to assess itself the effectiveness of the internal control structure and procedures of the issuer for financial reporting. As such, internal audit is, however, a "prohibited activity" pursuant to section 201 of the Act (see section 2.2 above).

- Each issuer shall disclose whether it has adopted a code of ethics for its senior financial officers and the content thereof[81].
- Each issuer shall disclose whether at least one member of its audit committee is a "financial expert"[82]. The final rule of the SEC goes a little further and provides that if at least one audit committee financial expert is serving in the audit committee, the registrant must disclose the name of such audit committee financial expert and whether that person is independent. If the registrant discloses that the registrant's board of directors has determined that the registrant does not have an audit committee financial expert serving on its audit committee, the registrant must explain why it does not have such audit committee financial expert[83].
- The Commission shall review the disclosures of the issuers at least every 3 years[84].
- Issuers must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis[85].

## 2.5 Analyst Conflicts of Interest (section 501)

This title provides that U.S. securities exchanges and registered securities associations must adopt conflict of interest rules for research analysts who recommend equities in research reports. The rules adopted by the Commission require among others that brokers and dealers registered with the Commission and their associated persons that publish, circulate or provide research reports include in those research reports a statement by the research analyst (or analysts) certifying (1) that the views expressed in the research report accurately reflect his or her personal views about the subject securities and issuers, and (2) that no part of his or her compensation was related to the specific recommendations or views contained in the research report, or else include the source, amount and purpose of such compensation and disclose that it may influence the recommendation in the research report[86].

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[80] See section 404 (a) of the Act.
[81] See section 406 of the Act.
[82] See section 407 of the Act.
[83] See Final Rule: Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002; Release 33-8177, and C.F.R., title 17, part 229.401 as amended.
[84] See section 408 of the Act.
[85] See section 409 of the Act; the Swiss Listing Regulations contain a similar obligation: listed companies must inform the market of facts that are likely to influence the stock exchange price of their shares (art. 72 of the Listing Regulations).
[86] See Final Rule: Regulation Analyst Certification; Release Nos 33-8193; 34-47384.

## 2.6 Commission Resources and Authority (sections 601 – 604)

This title deals with SEC appropriations, with appearance and practice before the Commission, with federal court authority to impose penny stock bars[87] and with qualification of associated persons of brokers and dealers. Since these issues are not very relevant for our analysis, we will not go further into them.

## 2.7 Studies and Reports (sections 701 – 705)

This title deals with different studies and reports that have to be made regarding consolidation of public accounting firms, credit rating agencies, violators and violations, enforcement actions and investment banks. Since these studies and reports will not be performed by non-U.S. persons, we will leave this title aside as well.

## 2.8 Corporate and Criminal Fraud Accountability (sections 801 – 807)

According to section 801 of the Act, this title may be cited as the "Corporate and Criminal Fraud Accountability Act of 2002". It deals with new corporate and criminal fraud provisions and introduces new criminal penalties while extending the statute of limitations of certain existing crimes:

- Whoever destroys or creates documents to impede, obstruct or influence any existing or contemplated federal investigation, shall be fined, imprisoned up to 20 years, or both[88].
- Auditors are required to maintain all audit or review workpapers for five years[89]. Whoever knowingly or willfully violates this provision shall be fined, imprisoned up to 10 years, or both.
- The statute of limitations on securities fraud claims is extended to the earlier of five years from the fraud, or two years after the fraud was discovered, from three years and one year respectively[90].
- Employees of publicly traded companies benefit from an extended "whistleblower protection" that prohibits the issuer or any officer, employee, contractor, subcontractor or agent of the issuer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim, or file a claim for violation of the securities laws themselves. Whistleblowers are also granted a remedy of special damages and attorney's fees[91].
- The new crime of "securities fraud" foresees criminal penalties of fines and up to 25 years imprisonment for defrauding shareholders of publicly traded companies[92]

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[87] A court may, under certain conditions, prohibit certain persons from participating in an offering of penny stock: see section 603 of the Act. According to the SEC Penny Stock Rules, "The term "penny stock" generally refers to low-priced (below $5), speculative securities of very small companies".
[88] See section 802 of the Act, amending United States Code ("U.S.C."), §1519, chapter 73 of title 18.
[89] See section 802 of the Act, amending U.S.C. §1520, chapter 73 of title 18.
[90] See section 804 of the Act, amending U.S.C. §1658 of title 28.
[91] See section 806 of the Act, adding U.S.C. §1514A, chapter 73 of title 18.
[92] See section 807 of the Act, adding U.S.C. §1348, chapter 63 of title 18.

## 2.9 White-Collar Crime Penalty Enhancements (sections 901 – 906)

According to the wording of section 901 of the Act, this title may be cited as the "White-Collar Crime Penalty Enhancement Act of 2002".

- The new crime of "attempt and conspiracy" is introduced to subject any person who attempts or conspires to commit a fraud (mail fraud, including securities fraud) to the same penalties as those prescribed for the fraud itself[93].
- Maximum imprisonment penalty for mail and wire fraud is increased from five to twenty years[94].
- In addition to the civil certification provisions of section 302, the new crime "Failure of corporate officers to certify financial reports"[95] punishes a CEO or CFO who certifies the compliance of the financial statements with the requirements of the securities laws knowing that the periodic report accompanying the statement does not comport with all the requirements of the securities laws to a fine up to $1 million or imprisonment up to 10 years or both. The maximum fine is of $5 million and maximum imprisonment to 20 years if it is done willfully.

## 2.10 Corporate Tax Returns (section 1001)

In this very short title (one section), the Senate advises that the Federal income tax return of a corporation should be signed by the CEO of such corporation.

## 2.11 Corporate Fraud Accountability (sections 1101 – 1107)

According to the wording of section 1101 of the Act, this title may be cited as the "Corporate Fraud Accountability Act of 2002". It introduces the following new corporate fraud penalties:

- Commits a crime whoever tampers with a document or otherwise impedes an official proceeding or attempts to do so[96].
- The Commission is given the authority to seek court freeze of extraordinary payments to directors, officers, partners, controlling persons, agents or employees of an issuer of publicly traded securities[97].
- The Commission may prohibit anyone convicted of securities fraud from being an officer or director of any publicly traded company[98].
- Penalties for willful violations or false and misleading statements are increased from USD 1,000,000 to USD 5,000,000 for natural persons and from USD 2,500,000 to

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[93] Added by section 902 of the Act as U.S.C. §1349, chapter 63 of title 18.
[94] See section 903 of the Act, amending U.S.C. §1341 and §1343 of title 18.
[95] Added by section 906 of the Act as U.S.C. §1350 of title 18.
[96] Section 1102 of the Act, amending U.S.C. §1512 of title 18.
[97] Sec 1103 (a) (3) (i): "Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days."
[98] See section 1105 of the Act.

25,000,000 for the others; imprisonment is increased from 10 years to a maximum of 20 years[99].

- Retaliation against informants is punishable with a fine or imprisonment up to 10 years or both[100].

There is already an instance of application of one of the topic dispositions on corporate fraud accountability on an international level: on September 2003, the SEC made use of section 1103 of the Act and sought an order compelling Vivendi Universal S.A. ("Vivendi") to freeze any extraordinary payment that it may make to its former CEO, Jean-Marie Messier ("Messier"). On September 23, 2003, the SEC also filed an emergency motion to halt Messier's efforts to collect on a state court judgment enforcing an arbitration panel's decision ordering Vivendi to pay Messier approximately $23 million pursuant to a termination agreement with Vivendi. On September 24, 2003, the judge of the district court in which the applications were filed issued two orders temporarily preventing Vivendi from paying the $23 million or anything more to Messier. The orders require Vivendi to escrow any extraordinary payments that it might otherwise make to Messier and they temporarily enjoin any efforts that seek to execute the district court judgment regarding the $23 million that Messier had obtained from the arbitration panel. The events of the next weeks will show how this decision is executed or whether Vivendi, Messier and the SEC will agree on an out-of-court solution[101]. Vivendi has indicated that it would fully cooperate with the SEC[102]. This is not surprising since Vivendi did not want to pay the $23 million to Messier in the first place.

## 3 Conflicts with Existing Foreign National Laws, Exemptions or Special Treatment Granted and Fields where Problems Persist

In this third section, we will examine each relevant title of the Act from two different points of view:

1. Conflicts with existing foreign national laws

   The Act has raised a lot of doubts and criticism around the world about its so-called extraterritorial effects. As mentioned above, this new U.S. law is meant to apply to any public company whose securities are registered or listed in the United States, regardless of whether the dispositions of the Act are in conflict with existing national laws or not. This may force the concerned persons and issuers to choose between complying with the Act or with the local laws of their registered offices or of the country of their primary listing. It will, in any case, raise the costs of compliance for any firm concerned.

   Conflicts occur due to various dispositions of the Sarbanes-Oxley Act. We will examine them along with some issues that are not in "conflict" with foreign national laws as such but will nevertheless be burdensome for foreign companies.

   The most critical conflicts with existing national laws are related to section 1 of the Act, which creates the Public Company Accounting Oversight Board. This section imposes strict and large-scale obligations on companies that are not themselves listed

[99] See section 1106 of the Act.
[100] See section 1107 of the Act.
[101] See SEC Litigation Releases No. 18352 and 18373 (reference below).
[102] See Press Release Vivendi Universal, September 16, 2003 at *http://www.vivendiuniversal.com/vu/en/press_2003/20030916_Press_release_SEC.cfm*.

on an American stock exchange but "merely" perform the audit of issuers or subsidiaries thereof.

2. Exemptions or special treatment that were granted, including discussion of the non-solved problems.

There is no general disposition in the Act stating that the Commission or the Board is competent to issue special rules for foreign companies in general[103]. The exemptions are possible because the Commission (and the Board in specific cases) is required to adopt rules which permit the implementation of the Act and the other securities laws and regulations. Adapting the dispositions of the Act to specific categories of firms, like foreign firms, small businesses, investment companies and others is part of this rulemaking power. The exemptions or cases of special treatment detailed below are partially applicable to U.S. firms, but were chiefly encouraged by comments referring to non-U.S. firms and individuals.

## 3.1 Public Company Accounting Oversight Board

### 3.1.1 Conflicts with Existing Foreign National Laws

The Sarbanes-Oxley Act applies to foreign public accounting firms that issue audit reports, play a substantial role in the preparation of the audit report, or provide material services in the context of the audit (see point 1.1.2 above).

By registering with the Board, such a firm must submit various details about audit clients and accountants working with it. Moreover, the Act gives the Board the power to conduct inspections and investigations, request testimonies and documents and impose disciplinary sanctions against registered foreign accounting firms and their associated persons, all in relation to the violations of the Act or any related rules or regulations.

The above applies irrespective of whether the information or documents are covered by a secrecy obligation under foreign laws, whether they relate to audit work or to other work performed for audit clients, or whether they relate to work performed for non-audit clients. The only stipulation is that the information or documents relate to alleged violations of the Act. Since the Act is very broad and contains obligations not only for auditors but also for CEO's and CFO's, attorneys appearing before the SEC, etc, work done by an accounting firm, whether on the basis of a direct mandate or as subcontractor for a third party, may be relevant in a variety of ways regarding violations of the Act.

Moreover, the fact that an accounting firm would have to disclose information concerning disciplinary proceedings relating to all partners of the firm, regardless of whether they deal with SEC registrants or not, could cause reputation damage and may bring criminal sanctions on the audit firm.

#### 3.1.1.1 Potential Conflicts with Confidentiality Rules

Potential conflicts may appear regarding two kinds of data subject to special confidentiality rules in some jurisdictions: data of audit clients of the public accounting firms and data about persons associated with these firms. Such conflicts may be very far-reaching because

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[103] Only section 106 on Foreign Public Accounting Firms specifically gives the Board and the Commission certain powers regarding the treatment of foreign public accounting firms.

associated persons of a public accounting firm as well as firms playing a substantial role in the preparation or furnishing of an issuer's audit report, and contributing firms to a certain extent, are subject to the Act as well. Many of these entities are likely to have their registered office in a non-U.S. country, especially in the context of group accounts.

1. Data Relative to Audit Clients of the Public Accounting Firms

Unless the respective client has given permission to the accountant to disclose all, or specific pieces of information on the client's matters, the information requirements for purposes of registration might contravene the accounting firms' duty of secrecy as prescribed by a special disposition of the law in many jurisdiction (art. 730 CO in Switzerland[104]). A current client that is itself an issuer might be deemed to have given its consent to the disclosure, since it has "chosen" to list securities on a U.S. stock exchange. This might not be the case for subsidiaries of issuers or clients for which the accounting firm has been the auditor during the preceding calendar year but is no longer during the current calendar year.

The inspections, investigations and requests of testimonies and documents potentially involve important conflicts with confidentiality rules as well (violation of secrecy obligations and violation of public interest laws) [105]: since audit work papers contain a lot of detailed information gathered in any form by an auditor with regard to audit work, they are, for example in Switzerland, protected by the Secrecy Obligation of article 730 Swiss Code of Obligations, article 321 Swiss Penal Code and article 47 Banking Act (Banking Secrecy). The provisions protect not only the confidentiality interests of the audited company, but also the confidentiality interests of various third parties. It would probably not be possible to eliminate client names or other relevant third party information from audit work papers or other material collected or produced by auditors in the course of their mandate. Thus consent of an audit client would not be sufficient since it could not have any impact on such third parties. The Board would moreover act without any permission by Swiss authorities; therefore, the confidentiality obligation could not be waved beforehand, even in cases where a Swiss authority might have the power to do so. If the Board is considered to be a public authority, which might well be the case since the SEC has very broad competences towards the Board[106], Swiss Penal Code art. 271 (Illegal Acts in Favor of a Foreign State) could become relevant and the sovereignty of Switzerland would be affected. The same would apply to testimonies that have to be made by Swiss auditors before or in favor of the Board. The situation is very similar in the European Union (E.U.), where several Member States forbid foreign inspectors - on a regulatory or legal level - to conduct inspections of local audit firms on their national territory. The Board members responsible for the inspections could be arrested in the respective Member States for such actions.

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[104] Art. 730 SCO sets forth: "(1) When reporting and giving information, the auditors shall safeguard the business secrets of the Company. (2) Auditors are prohibited from communicating to individual shareholders or third parties any observations they have made while carrying out their duties. The duty to inform a special auditor (art. 697d, para.2) remains reserved."

[105] In Switzerland, for example, the involved confidentiality rules are in particular, but not limited to, Swiss Code of Obligations art. 730 (Safeguarding Business Secrets; Discretion), Swiss Penal Code art. 321 (Violation of Professional Secrecy), art. 162 (Violation of Production and Business Secrets), art. 273 (Economic Espionage) and art. 271 (Illegal Acts in Favor of a Foreign State), Data Protection Act, Banking Act art. 47 (Banking Secrecy), and Federal Act on Stock Exchanges and Securities Trading art. 43 (Professional Secrecy Obligations of a Securities Trader).

[106] See section 2.1 above.

There are international agreements with regard to the exchange of information[107] as well as specific rules in many countries with regard to administrative assistance[108]. The Act and its implementation provisions disregard these rules based on the connecting factor of the place of listing. This is hardly acceptable for non-U.S. jurisdictions. It should be replaced with a system of mutual recognition of actions of other national supervisory authorities, where such actions are sufficient, or at least with special procedures that would ensure the compliance with international treaties and foreign national laws[109].

Leaving aside the legal issues, the many different languages in numerous non-U.S. countries will also make it very difficult for PCAOB inspectors to conduct investigative procedures themselves. This speaks if favor of letting the national supervisory authority accomplish the tasks of the PCAOB in at least some non-U.S. jurisdictions, subject to the national supervisory authority offering sufficient guarantees of reliability.

2. Data Relative to Persons Associated with a Public Accounting Firm

Regarding the information that a firm must submit about its associated persons, i.e. mostly the accountants working for the accounting firm and providing audit services, the firm might violate personality rights of such accountants, for example by submitting information regarding pending criminal, civil or administrative procedures.

#### 3.1.1.2 Potential Conflicts Relative to Data Protection

A further problem arises with regard to data protection since the Board declares in advance that it will not treat the registration data confidentially. As a rule, an application for registration will be publicly available. Requests for confidential treatment are possible, however no guaranty that the request will be granted is given[110]. The confidential treatment is also limited and does not preclude the Board from providing the information to the Commission or from complying with a subpoena validly issued by a court or other body of competent jurisdiction[111].

Regarding investigations and disciplinary proceedings, all documents and information received by the Board in connection with an inspection or an investigation shall be confidential. The Act provides, however, a long list of exceptions and limitations: without the loss of its status as confidential and privileged in the hands of the Board, all information may be made available to the Commission and, at the discretion of the Board, to the Attorney General of the United States, the appropriate Federal functional regulator, State attorneys

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[107] For example the American-Swiss Treaty on Mutual Assistance in Criminal Matters, available at *http://www.admin.ch/ch/f/rs/c0_351_933_6.html*. An overview of the most important treaties regarding mutual assistance between Switzerland and the U.S. is available on the Website of the Swiss-American Chamber of Commerce at *http://www.amcham.ch/switzerland/m_mutual_assistance.htm*.

[108] In Switzerland, article 38 Stock Exchange Act, according to which Swiss supervisory authorities may grant administrative assistance to foreign supervisory authorities if certain conditions are met.

[109] See the press communication of the Federal Department of Finance dated March 14, 2003, available at *http://www.efd.admin.ch/f/dok/medien/medienmitteilungen/2003/03/treuhand.htm*: a working group composed of representatives of the private economy is currently working on a way to structure the surveillance of auditors that could be considered as being equivalent to the U.S. system. Similar efforts are made by the E.U. authorities: see the press release of the European Commission dated April 24, 2003: “EU concerned about US audit registration step”, available at *http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/571&format=HTML&aged=0&language=EN&guiLanguage=en*.

[110] See Rules of the Board as of August 4, 2003, rule 2300 (b) – (g).

[111] See Rules of the Board as of August 4, 2003: rule 2300 (a).

general in connection with any criminal investigation, and to any appropriate State regulatory authority[112].

#### 3.1.1.3 Potential Conflicts Relative to Double Oversight

The fact that the Act's registration requirement potentially affects all major and many other audit firms in the European Union and elsewhere leads such registered firms to be subject to double oversight. This may result in conflicts between two oversight mechanisms; it will be in any case burdensome and might also be inefficient. Registration fees and the costs of preparing the information for registration as well as the ongoing duties to maintain the registration represent a significant additional administrative and financial burden for audit firms, which already have such duties in their home country.

#### 3.1.1.4 Potential Conflicts Relative to a Prohibition to Provide Audit Services to an Issuer

In some Member States of the E.U., such as Belgium, France and Germany, the statutory auditor is not permitted to withdraw from an engagement once accepted, except in very limited and clearly defined circumstances. Situations may therefore arise in which an E.U. audit firm – even against its explicit wish – becomes inadvertently subject to registration. Problems may also appear in situations where a registered public accounting firm does not have any partners who could assume the audit for a company subject to the dispositions of the Act, could not maintain the previous leading partner because of the mandatory partner rotation, but would not be able to resign from its "statutory auditor" role because of the applicable law or regulatory action[113].

Along with the above-mentioned, the new standards established according to section 103 (a) (1) of the Act might be incompatible with several foreign standards. The accounting firms might then face two contradicting sets of standards and will be bound to respect the national standards, or "home country requirements", therefore potentially not complying with the standards established by the Board. It is to hope, however, that the different sets of standards will converge towards internationally accepted standards. Efforts in this direction are in progress: in the Norwalk Agreement of September 18, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) agreed, as a matter of high priority, to work towards the removal of differences between U.S. GAAP and International Accounting Standards, IFRSs, which include International Accounting Standards, IASs[114].

### 3.1.2 Exemptions or Special Treatment Granted, Fields where Problems Persist

The far-reaching dispositions of this title about the PCAOB refer to the rules and regulations of the Board or the Commission for all the details and exceptions needed.

Most discussed and insistently demanded by the European Union, Japan and Switzerland among others, is the potential exemption from registration by the board for public accounting firms in countries where the oversight over the accountants is effective and sufficient. The Board and the Commission have to date refused to accept such a limitation of their authority and powers. The discussions are still going on. Yet, it is doubtful whether a total exemption

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[112] See section 105 (b) 5 of the Act.
[113] See among others Comment Letter Deloitte & Touche LLP, part II. F.
[114] The text of the Norwalk Agreement is available at *http://www.fasb.org/news/memorandum.pdf*.

will be granted, at least in the next years, or until non-U.S. countries have adopted regulations identical to the Act and have accepted to let the U.S. authorities have supervision and intervention powers on their territory, which seems to be rather unrealistic. The process of rulemaking with regard to a stronger control over audit firms has in any case started in Europe and might well lead to drastic changes in the near future[115]. In Switzerland, for example, amendments to the Code of Obligations are foreseen with regard to the independence of auditors, and a new law on the surveillance of auditors is in preparation[116]. Further, the Swiss Federal Banking Commission announced on April 25, 2002, its project to create a new structure aiming at controlling the controllers of banking institutions[117].

According to the speech of SEC Commissioner Roel C. Campos on "Embracing International Business in the Post-Enron Era", as prepared for delivery to the Center for European Policy Studies in Brussels, Belgium on June 11, 2003[118], the Board has "indicated a desire to work with non-U.S. accounting regulatory bodies to develop cooperative reporting, inspection, and disciplinary programs. Although the Board's final rules call for registration of non-U.S. firms by April 2004, the Board hopes, before that time, to be able to make substantial progress with its foreign colleagues in developing harmonized registration and oversight models".

The Proposed Rules of the Board, filed to the Commission on May 8, 2003, published for comments by the Commission on June 5, 2003, and adopted by the latter on July 16, 2003, provide two ways to accommodate foreign public accounting firms[119]:

Registration Requirements

On the one hand, foreign accounting firms benefit from an extended time allowance before the registration by the Board becomes mandatory. For domestic firms, the registration requirement will be effective on October 22, 2003 (in light of the 45-day review period, such firms' registration applications had to be filed by, at the latest, early September 2003), whereas registration will be mandatory for foreign public accounting firms as of July 19, 2004[120]. It is recommended, however, that these firms begin to compile the information necessary to complete Form 1 as soon as possible.

Apart from this, foreign public accounting firms also benefit from an accommodation regarding the information to submit by registering with the Board: foreign public accounting firms must "only" list "all accountants who are a proprietor, partner, principal, shareholder, officer, or manager of the applicant and who provided at least ten hours of audit services for any issuer during the last calendar year", whereas non-foreign public accounting firms must list "all accountants who are persons associated with the applicant and who provided at least ten hours of audit services for any issuer during the last calendar year"[121]. Regarding criminal, civil and administrative proceedings to be reported to the Board, the same restriction is applied for the scope of persons concerned: "Foreign public accounting firm applicants need only disclose such proceedings for the applicant and any proprietor, partner, principal,

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[115] See among others NIELS LUTZHÖFT in the Financial Times Deutschland, June 3, 2003.
[116] An overview of the projects is available on the Website of the Federal Department of Justice and Police at *http://www.bj.admin.ch/f/index.html*.
[117] See *http://www.ebk.admin.ch/e/archiv/2002/aktuelles2002.html*.
[118] See references table below.
[119] Notice of Filing of Proposed Rules Relating to Registration System, June 5, 2003, Order Approving Proposed Rules Relating to Registration System, July 16, 2003, and Rules of the Board as of August 4, 2003.
[120] See Rules of the Board as of August 4, 2003, rule 2100.
[121] See Rules of the Board as of August 4, 2003, Appendix Form 1, part VII, note to Item 7.1.

shareholder, officer, or manager of the applicant who provided at least ten hours of audit services for any issuer during the last calendar year"[122].

Conflicting Non-U.S. Laws[123]

Rule 2105 of the Board deals with conflicting non-U.S. laws and provides that "an applicant may withhold information from its application for registration when submission of the information to the Board would cause the applicant to violate a non-U.S. law if that information were submitted to the Board".

In order to benefit from this possibility of withholding information, the applicant must:

(1) identify the information that it claims would cause it to violate non-U.S. laws if submitted, and

(2) include "(i) a copy of the relevant portion of the conflicting non-U.S. law;

(ii) a legal opinion that submitting the information would cause the applicant to violate the conflicting non-U.S. law; and

(iii) an explanation of the applicant's efforts to seek consents or waivers to eliminate the conflict, if the withheld information could be provided to the board with a consent or a waiver, and a representation that the applicant was unable to obtain such consents or waivers to eliminate the conflict".

These exhibits must be submitted in English.

One should keep in mind that Rule 2105 of the Board refers only to the registration. This means that the remedy offered by Rule 2105 to submit evidence of the conflict is limited to the submission of information as part of the registration process, for example to avoid submitting personal information about the accountants associated with the accounting firm. This has to be distinguished from the consequences of registration, including but not limited to the continuing inspection, investigation, and sanctioning power of the Board, likely to create as much conflict with non-U.S. laws as the registration requirements themselves. No solution has been found yet to deal with the conflicts occurring due to the consequences of registration[124].

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[122] See Rules of the Board as of August 4, 2003, Appendix Form 1, part V, note to Item 5.1, p. 33, and note to Item 5.2, p. 34.

[123] See Rules of the Board as of August 4, 2003, rule 2105.

[124] The Board published on April 21, 2003, a Working Paper Regarding Board Investigations and Disciplinary Proceedings, describing in particular the various rules that the Board intends to propose. The Working Paper, however, does not mention any special treatment for foreign public accounting firms, except for the duty of the Board to report the sanction to any appropriate State regulatory authority or any foreign accountancy licensing board with which the disciplined firm or associated person is licensed or certified. On July 28, 2003, the Board published his Proposed Rules on Inspections of Registered Public Accounting Firms. These rules set forth (part A. 7) that "the nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies will be the subject of dialogue between the Board and its foreign counterparts".

## 3.2 Auditor Independence

### 3.2.1 Conflicts with Existing Foreign National Laws

- Section 201 (a) (3) lists the contribution-in-kind reports among the prohibited non-audit services. In some Member States of the E.U., the statutory auditor is legally required to provide the contribution-in-kind report: in these Member States the contribution-in-kind report is an attestation service and not a valuation service.
- Partner Rotation[125]: as the comments of Deloitte & Touche to the Commission on January 10, 2003, explain, this rule may create special problems in foreign countries: "In many foreign regions, there are a limited number of audit partners who have obtained the requisite level of knowledge of accounting principles generally accepted in the United States ("U.S. GAAP"), auditing principles generally accepted in the United States ("U.S. GAAS"), and Commission regulations to provide effective audit services to their clients that are registrants or affiliates of registrants. […] most large multinational clients require several "line" partners to complete their audits. In some countries, the number of audit partners that currently serve, or could serve, U.S. public companies is so limited that compliance with the proposed rotation rule is not currently possible[126]."
- Cooling-off period: in certain countries, an accounting firm might not be allowed to prevent its former employees from entering an employment relationship with an audit client.

### 3.2.2 Exemptions and Special Treatment Granted, Fields where Problems Persist

In its Final Rule on Strengthening the Commission's Requirements Regarding Auditor Independence, the Commission points out that "many of the modifications to the proposed rules, such as those limiting the scope of partner rotation and personnel subject to the "cooling off period" have the added benefit of addressing particular concerns raised about the international implications of these requirements. Moreover, additional time is being afforded to foreign accounting firms with respect to compliance with rotation requirements. The release also provides guidance on the provision of non-audit services by foreign accounting firms, including the treatment of legal services and tax services"[127].

#### 3.2.2.1 Partner Rotation

Taking into account that the requirements which were first proposed (rotation of all the audit partners after 5 years, 5 years time-out period) could have a particularly adverse impact in foreign countries, especially in emerging countries, where there may be a very limited pool of accountants and experts conversant in U.S. GAAP and U.S. GAAS, and indicating that the proposed rotation requirements would cause firms to rotate hundreds of partners in scores of countries, the Commission decided not to apply the rotation as broadly as proposed[128]. As mentioned in section 2.2 above, the rotation of audit partners other than the lead or concurring

[125] See section 203 of the Act.
[126] See Comment Letter of Deloitte & Touche LLP on the Commission's Proposed Rule implementing sections 201, 202, 203, 204, and 206 of the Sarbanes-Oxley Act of 2002, part II. F.
[127] Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, Summary.
[128] Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. I.

partner is mandatory after 7 years instead of 5. Moreover, foreign accounting firms benefit from an extended transitional period, since in many foreign jurisdictions partners were previously not subject to rotation. For all partners with foreign accounting firms, the dispositions of the final rules are effective as of the beginning of the first fiscal year after the effective date of these rules (May 6, 2003), and that first fiscal year will constitute the first year of service for such partners, without regard to the number of years the partner had previously served in that capacity[129].

The final rules allow accounting firms with fewer than five audit clients that are issuers and fewer than ten partners to be exempted from the rotation requirement. The Board will conduct a review of all such firm's engagements subject to the rule on auditor independence at least every three years[130].

#### 3.2.2.2 Conflicts of Interest Resulting from Employment Relationships[131]

In response to the concerns raised that in certain foreign jurisdictions it may be extremely difficult or costly to comply with the requirements, and recognizing that other unusual situations than the ones like conflicts created through merger or acquisition may arise, the final rule provides for certain exemptions:

- The cooling-off period will apply to members of the audit team only if they provide more than ten hours of audit, review or attest services.
- It will apply only with regard to key positions at the issuer. Members of the audit engagement team, including those employed by a foreign accounting firm, will thus be able to take positions with the subsidiaries or affiliates of an issuer.
- The prohibition will not apply in case of conflicts that are created through merger or acquisition.
- An additional exemption is foreseen in case of emergency or unusual circumstances: if applicable, the members of the audit engagement team will also be allowed to take key positions at the issuer in certain circumstances and upon the approval of the audit committee (or a similar body). The Commission, however, indicates that it anticipates that this exemption will be invoked very rarely.

#### 3.2.2.3 Width of Certain Notions for Non-Audit Services

Legal services: the final rule states that "an accountant is prohibited from providing to an audit client any service that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided". In determining whether or not a service would impair the accountant's independence solely because the service is labeled a legal service in a foreign jurisdiction, the Commission will consider whether the provision of the service would

[129] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. C. 6 and C.F.R., title 17, part 210.2-01, section (e) (1) (B) p. 248.

[130] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. C. 4.

[131] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. A and C.F.R., title 17, part 210.2-01, section (c) (e) p. 244 ff.

be prohibited in the United States as well as in the foreign jurisdiction[132]. As an example, the final rule mentions the case of the jurisdictions where it is mandatory that someone who performs tax work be licensed to practice law, and where an accounting firm providing such services would therefore be deemed to be providing legal services pursuant to the final rule. Since tax services provided by the auditor are not prohibited in the U.S., however, such tax service would not be deemed to impair the accountant's independence, even if it must be performed by someone licensed to practice law in the jurisdiction where it is provided (this is subject to exceptions, see subsection on "tax services" below).

Expert services: the final rule specifies that an accountant is prohibited "from providing expert opinions or other services to an audit client, or a legal representative of an audit client, for the purpose of advocating that audit client's interests in litigation or regulatory, or administrative investigations or proceedings". The final rule points out that it does not "preclude an audit committee or, at its direction, its legal counsel, from engaging the accountant to perform internal investigations or fact finding engagements"[133].

Tax Services: the final rule provides that "accountants would impair their independence by representing an audit client before a tax court, district court, or federal court of claims" and that "audit committees should scrutinize carefully the retention of an accountant in a transaction initially recommended by the accountant, the sole business purpose of which may be tax avoidance and the tax treatment of which may be not supported in the Internal Revenue Code and related regulations"[134]. This means that some tax services can still impair auditor's independence. It is not possible to define which ones yet, and this unclear point might cause serious uncertainties since it is left to the appraisal of the audit committee and the public accounting firm until the Commission intervenes.

As regards contribution-in-kind reports or valuation services, the Commission didn't grant the exemption asked for by some foreign countries. In its final rule, the Commission states that it will continue to take an ad hoc approach, as before, and consider requests for exemptive relief from foreign auditors[135].

## 3.3 Corporate Responsibility

### 3.3.1 Conflicts with Existing Foreign National Laws

Much debated in this title are the certification of the financial statements by the CEO and CFO and the requirements of independence of the audit committee members. The appointment of the auditors was also an issue to be solved. The noisy withdrawal of attorneys was a controversial topic among lawyers of foreign jurisdictions as well, this, however, only until the Commission decided to restrict the circle of concerned persons almost to lawyers practicing in the U.S.

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[132] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. B. 9 and C.F.R., title 17, part 210.2-01, section (c) (4) (ix) p. 246 and 241.
[133] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. B. 10.
[134] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. B. 11.
[135] See Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, part II. I.

Appointment of the auditors

Section 301 (2) of the Act states that the audit committee of each issuer shall be directly responsible for the appointment, compensation and oversight of the work of the auditors. This means that the audit committee itself should appoint the auditors. It is contrary to some foreign national laws, like Swiss law, according to which auditors have to be appointed by the general assembly of the shareholders so that the independence of the auditors from the board of directors and the management is guaranteed. The rule is also contrary to the Swiss Code of Best Practice for Corporate Governance, which recommends in its Recommendation 24 that "the Audit Committee should assess (…) the fees charged by the external auditors": the management has the responsibility for the compensation of the auditors whereas the audit committee's role is to review the compensation[136]. Since it is the task of the audit committee to form a judgment of the quality of the external auditor (Recommendation 24), and because of the independence problems related to having the controlled person be responsible for the compensation of the controlling person, it would make sense to have the audit committee be also responsible for the compensation of the auditors, as does the Act require. Both solutions can be more or less reconciled if, where the general assembly needs to appoint the auditor, the decision is made based on a proposition prepared by the audit committee, and as far as the compensation of the auditor is concerned, if the auditor's fees are reviewed by the audit committee before the bill of costs is accepted by the management.

Independence of audit committee members

According to section 301 (3) of the Act, each member of the audit committee of the issuer shall be a member of the board of directors of the issuer and shall otherwise be independent. This is contrary among others to the laws of some E.U. Member States, like Germany, which require as a rule that non-management employees, who would not be viewed as "independent" under the requirements, serve on the supervisory board or audit committee[137].

Such a vast independence requirement is also problematic with regard to controlling shareholders or shareholder groups where the controlling shareholder or group of shareholders is represented in the audit committee of each subsidiary.

In the cases of private issuers having issued special shares owned by a government, or a government having significant shareholdings in a private issuer and entitled to exercise certain rights relating to this issuer, the representatives of the government sitting in the audit committee may lack the required independence. On the other hand, some foreign governments are themselves issuers and will not be able to comply with the requirements either.

In some countries, such as Italy and Japan, auditor oversight is provided through a board of auditors, or similar body, that is in whole or in part separate from the board of directors[138].

Duplication of civil liability and penal rules, double jeopardy

As a whole, the legal situation in the U.S. with regard to the certification of the financial statements is not very different from, for example, the one in Switzerland: Swiss law (article 961 CO) requires the persons entrusted with the management to sign the inventory, profit and loss statement and balance sheet personally. This can be used against the signing persons in the context of civil liability claims. The signing persons may also be subject to criminal

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[136] See Swiss Code of Best Practice for Corporate Governance in the references table below.
[137] See Final Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. i.
[138] See Final Rule: Standards Relating to Listed Company Audit Committees, footnote 160.

procedures[139]. However, conflicts appear because of the duplication of civil liability and of penal rules. In several Member States of the E.U., certification of the financial statements is a collective responsibility of the (management) board. From the European point of view, this system is considered equivalent to protect the investors' interests. For example, all the Members States have requirements for executives to sign off financial statements, which form the basis for civil and penal procedures under national law. Additional U.S. certification leads to situations where executives of E.U. issuers could be held liable in the E.U./national jurisdiction as well as in the U.S. This violates the internationally accepted principle "ne bis in idem", i.e. that no one should be prosecuted twice for the same offence. See also point 3.6.1 below.

"Noisy Withdrawal" of Attorneys

As published on November 21, 2002, the proposed rules of the Commission were in flagrant conflict with numerous other national laws, since they took a broad view of who could be found to be appearing and practicing before the SEC. It covered lawyers licensed in foreign jurisdictions, whether or not they were also admitted in the United States. The rigorous up-the-ladder reporting requirement, and moreover the so-called noisy withdrawal, would not be permitted in several jurisdictions, like Switzerland, where attorneys and lawyers acting on behalf of a company have to observe strict confidentiality rules, whereas violations are sanctioned by criminal law[140].

### 3.3.2 Exemptions and Special Treatment Granted, Fields where Problems Persist

The title on corporate responsibility is implemented by different sets of rules. Most of them contain no special rule applicable to foreign companies. The Final Rule on Standards Relating to Listed Company Audit Committees[141], however, adopted on April 9, 2003, and effective since April 25, 2003, has largely taken into account the requirements of foreign jurisdictions. The rules issued are required by section 301 (1) of the Act and "direct the national securities exchanges and national securities associations to prohibit the listing of any securities of an issuer that is not in compliance with the audit committee requirements mandated by the Sarbanes-Oxley Act of 2002".

Transitional period

Foreign private issuers that are listed benefit from an extended transitional period and must be in compliance with the new listing rules by July 31, 2005, instead of the earlier of the listed issuer's first annual shareholders meeting after January 15, 2004, or October 31, 2004[142].

Employee Representation

Under the final rule of the SEC, "non-executive employees can sit on the audit committee of a foreign private issuer if the employee is elected or named to the board of directors or audit committee of the foreign private issuer pursuant to the issuer's governing law or documents,

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[139] Article 152 Swiss Penal Code. See VON DER CRONE, PROF. DR. HANS CASPAR, ROTH KATJA, in AJP/PJA, section IV. C. 1. p. 137.
[140] Article 321 Swiss Penal Code.
[141] See references table below.
[142] Final Rule: Standards Relating to Listed Company Audit Committees, part I.

an employee collective bargaining or similar agreement or other home country legal or listing requirements"[143]

Two-Tier Board Systems

Should any foreign private issuer have a two-tier board system, with one tier designated as the management board and the other tier designated as the supervisory or non-management board, the final rule clarifies that the term "board of directors" means the supervisory or non-management board for purposes of this rule. If the entire supervisory or non-management board is independent, the entire board can thus be designated as the audit committee[144].

Controlling Shareholder Representation

Under the final rule, "an audit committee member can be a representative of an affiliate of the foreign private issuer, if the "non compensation prong" of the independence requirement is satisfied[145], the member in question has only observer status on, and is not a voting member or the chair of, the audit committee, and the member in question is not an executive officer of the issuer"[146]. A member of the audit committee can thus not be a voting member if he is linked to an affiliate of the issuer.

Foreign Government Representation

The final rule allows any audit committee member to be a representative of a foreign government or foreign governmental entity if the "non compensation prong" of the independence requirement is satisfied[147] and if the member in question is not an executive officer of the issuer, regardless of the manner in which the foreign government owns its interest[148].

Listed Issuers that are Foreign Governments

Under the final rule, listed issuers that are foreign governments are exempted from the final rule on Standards Relating to Listed Company Audit Committees[149].

Boards of Auditors or Similar Bodies

Under the final rule, a foreign private issuer will be exempt from all of the audit committee requirements if it meets the following requirements:

- "The foreign private issuer has a board of auditors (or similar body), or has statutory auditors (collectively, a "Board of Auditors"), established and selected pursuant to home country legal or listing provisions expressly requiring or permitting such a board or similar body;

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[143] Final Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. i and VIII (Text of Amendments).
[144] Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. ii and VIII.
[145] See section 2.3.1 above: other than in his capacity as a member of the audit committee, of the board of directors, or of any other board committee, a member of the audit committee of an issuer shall not accept any consulting, advisory, or other compensatory fee from the issuer or be an affiliated person of the issuer or any subsidiary thereof.
[146] Final Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. iii and VIII.
[147] See section 2.3.1 or note 126 above.
[148] Final Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. iv and VIII.
[149] Final Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. v and VIII.

- The Board of Auditors is required to be either separate from the board of directors, or composed of one or more members of the board of directors and one or more members that are not also members of the board of directors;
- The Board of Auditors are not elected by management of the issuer and no executive officer of the issuer is a member of the Board of Auditors;
- Home country legal or listing provisions set forth or provide for standards for the independence of the Board of Auditors from the issuer or the management of the issuer;
- The Board of Auditors, in accordance with any applicable home country legal or listing requirements or the issuer's governing documents, is responsible, to the extent permitted by law, for the appointment, retention and oversight of the work of any registered public accounting firm engaged (including, to the extent permitted by law, the resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer; and
- The remaining requirements in the rule, such as the complaint procedures requirement, advisors requirement and funding requirement, apply to the Board of Auditors, to the extent permitted by law."[150]

Possible Conflicts With Other Requirements

The final rule clarifies that the requirements regarding auditor responsibility do not conflict with, and are not affected by, "any requirement or ability under an issuer's governing law or documents or other home country legal or listing provisions that requires or permits shareholders to ultimately vote on, approve or ratify such requirements". If the issuer provides recommendations or nominations regarding such matters to its shareholders, the final rule provides that the audit committee of the issuer, or body performing similar functions, must be responsible for making the recommendations or nominations, unless a legal or listing requirement in an issuer's home jurisdiction prohibits the full board of directors from delegating such responsibilities to the audit committee or limits the degree of such delegation. The final rule also points out that it does not conflict with any legal or listing requirement in an issuer's home jurisdiction vesting such responsibilities with a government entity or tribunal[151].

As a whole, one can foresee that there should be no conflict between the Act as implemented by the Commission and foreign rules regarding audit committees in the future. The creation of audit committees has been widely encouraged in the last decades and is or will probably be set forth in most codes of corporate governance[152].

Concerning the so-called noisy withdrawal of attorneys, no solution seems to have been found yet for the lawyers who are subject to the rules of the SEC. The Commission has therefore extended the comment period on this specific issue[153]. The final rule, however, excludes most

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[150] Rule: Standards Relating to Listed Company Audit Committees, part II. F. 3. a. vi and VIII.
[151] Rule: Standards Relating to Listed Company Audit Committees, part II. B. 2.
[152] See for example Rule V. E. of the OECD Principles of Corporate Governance and part 3.1.3 of the Communication from the Commission to the Council and the European Parliament on Modernizing Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, Brussels May 21, 2003. See also HANS CASPAR VON DER CRONE, KATJA ROTH, "Der Sarbanes-Oxley Act und seine extraterritoriale Bedeutung", part III. A. 2. footnote 29.
[153] Final Rule: Implementation of Standards of Professional Conduct for Attorneys, part I. Executive Summary. See also Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, January 29, 2003.

foreign attorneys not licensed to practice law in the United States from coverage under the SEC's attorney conduct rules. As a general matter, only foreign attorneys who provide advice regarding U.S. securities law may still be subject to the rule, whereas "non-appearing foreign attorneys" are expressly excluded from its range of application[154] and "an attorney practicing outside the United States shall not be required to comply with the requirements of this part to the extent that such compliance is prohibited by applicable foreign law"[155].

Regarding the certification of disclosure in companies' quarterly and annual reports, no exemption or special treatment has been foreseen for foreign issuers[156]. The double jeopardy, therefore, persists. The "best of their knowledge" wording in the certification does not give a lot of comfort to the signing persons, because CEO's and CFO's are required to have an adequate internal control system. This means, basically, that they are supposed to know everything. Moreover, the management has to issue an internal control report and an assessment thereof[157], and the auditor has to certify the functioning of the internal control system[158]. In light of these requirements, the wording "to the best of their knowledge" is an especially far-reaching notion.

It is nevertheless doubtful whether the sanctions potentially imposed by the Commission will be enforceable in foreign jurisdictions (the prohibition from serving as officer or director of section 1105 of the Act for example). In most jurisdictions, bans imposed by foreign courts and public authorities may not automatically be enforced, but must first be officially acknowledged by a national court. It is questionable whether such acknowledgement would occur.

## 3.4 Enhanced Financial Disclosures

### 3.4.1 Conflicts with Existing Foreign National Laws

The general prohibition on personal loans to executives[159], with some exceptions regarding home improvement loans, manufactured home loans and consumer credit, is in conflict with certain foreign national legislations considering such loans as unproblematic if granted at arm's length and reported to shareholders with disclosure of their amount and conditions. The Act grants an exemption applicable to U.S. banks only. This is discriminatory towards non-U.S. companies and does not ensure the level playing field[160].

Regarding the rule of section 407 (a) of the Act, according to which each issuer shall disclose whether or not, and if not, the reasons therefor, at least one member of its audit committee is a "financial expert", non-U.S. issuers may face a situation where they do have an audit committee member who is a financial expert with regard to the home country requirements, but where this person may not be recognized as "financial expert" by the Commission because their expertise relating to U.S. GAAP is not sufficient. A definition of the "financial

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[154] Final Rule: Implementation of Standards of Professional Conduct for Attorneys, and C.F.R. part 205.2, section (a) (2) (ii).
[155] Final Rule: Implementation of Standards of Professional Conduct for Attorneys, and C.F.R. part 205.6, section (d).
[156] Final Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports.
[157] See section 404 of the Act.
[158] Section 103 (2) (iii) of the Act.
[159] Section 402 of the Act.
[160] See section 402: "Paragraph (1) does not apply to any loan made or maintained by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b)."

expert" that involves expertise relating to U.S. GAAP could burden foreign private issuers who use home country accounting principles or international accounting standards to prepare their primary financial statements.

### 3.4.2 Exemptions and Special Treatment Granted, Fields where Problems Persist

As underlined by SEC Commissioner Campos on Regulating International Business[161], foreign firms have been granted several accommodations already before the Sarbanes-Oxley Act 2003 was enacted, such as the following:

1. "Interim financial reporting is done on the basis of home country practice, rather than on a quarterly basis, as is required of U.S.-based issuers.
2. Foreign private issuers are given longer deadlines for submitting annual reports.
3. Foreign private issuers also use different registration forms for filing annual reports that are tailored particularly for them and that take into account existing home country requirements.
4. Since 1989, the Commission has provided an exemption from registration to foreign broker-dealers to facilitate dealing with certain U.S. institutional investors.
5. Aggregate executive compensation disclosure is allowed for foreign issuers, rather than individual disclosure, if permitted by the issuer's home country."

With regard to the prohibition of personal loans to directors and executive officers, one of the much debated requirements of this title four, the SEC issued on September 11, 2003, proposed rules that would, if adopted as final rules, and under certain conditions, extend to foreign banks the exemption granted to U.S. banks[162]. Comments on the proposed rules can be submitted until October 17, 2003.

Concerning section 407 on Disclosure of audit committee financial expert, the final rule, published January 23, 2003, and effective March 3, 2003, takes the skills of foreign directors of the board into account and expands the definition of an "audit committee financial expert" to include individuals who have expertise in the generally accepted accounting principles of the home country of the issuer[163].

The other requirements, except for the specific rules regarding disclosures reconciled with GAAP and some slightly postponed compliance dates, are for the most part not granting any special treatment to foreign firms.

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[161] *http://www.useu.be/Categories/CorporateGovernance/June1103CamposCEPSSpeech.html*.

[162] See Proposed Rule: Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act.

[163] See Final Rule: Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002; Rel. No. 33-8177, part II. A. 4. d. The final rules define an audit committee financial expert as a person who has the following attributes: "An understanding of generally accepted accounting principles and financial statements; The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; An understanding of internal controls and procedures for financial reporting; and An understanding of audit committee functions". However, the SEC adds an instruction that "with respect to foreign private issuers, the audit committee financial expert's understanding must be of the generally accepted accounting principles used by the foreign private issuer in preparing its primary financial statements filed with the Commission".

## 3.5 Analyst Conflict of Interest

Special accommodations have been foreseen for non-U.S. persons, in particular CFR 242.503: "A foreign person, located outside the United States and not associated with a registered broker or dealer, who prepares a research report concerning a foreign security and provides it to a U.S. person in the United States in accordance with the provisions of § 240.15a-6(a) (2) of this chapter shall be exempt from the requirements of this regulation", "foreign security" meaning a security issued by a foreign company for which a U.S. market is not the principal trading market[164].

## 3.6 Corporate and Criminal Fraud Accountability (title VIII), White-Collar Crime Penalty Enhancement (title IX) and Corporate Fraud Accountability (title XI)

### 3.6.1 Conflicts with Existing Foreign National Laws

The whistleblower protection of section 806 of the Act, which prohibits retaliation measures against a whistleblower having disclosed information, can be in conflict with the national legislation of certain countries, like Switzerland, where business secrets are protected and the transmission of information violating business secrets to foreign authorities is prohibited. In Switzerland, for example, violations of the prohibition to transmit information violating business secrets to foreign authorities are prosecuted ex officio and lead to civil liability and criminal sanctions. The necessary involvement of the company in the respective proceeding of prosecution taking place according to Swiss law against a whistleblower could be seen as an unlawful retaliation pursuant to the Act[165].

The application of section 906, creating the new crime "Failure of corporate officers to certify financial reports", may lead to a violation of the fundamental principal "ne bis in idem", i.e. that no one should be prosecuted twice with respect to the same offence, if applied in parallel to national criminal laws punishing the falsifying of documents[166]. If the violation is already prosecuted in the country of incorporation of the issuer, the additional prosecution by the U.S. authorities will thus conflict with guiding principles of law as stipulated in the UN Human Rights Declaration and the International Covenant on Civil and Political Rights. See also section 3.3.1 above.

According to section 1105, the Commission may prohibit persons from serving as officers or directors. Other national laws, like Swiss Law, know no equivalent provision. Moreover, the Swiss Constitution, for example, guarantees the freedom to choose and exercise a profession[167]. A prohibition to serve as officer or director issued by the Commission and having impacts on appointments in Switzerland can thus conflict with constitutional rights of the affected persons. As mentioned in section 3.3.2 above, it is doubtful whether such prohibition would be enforceable in foreign jurisdictions. Also doubtful is the enforcement of temporary freezes of extraordinary payments by the Commission in non-U.S. countries. Under Swiss law, for example, such freezes will be considered a matter of administrative law and will thus not be enforceable as such within Switzerland if they are issued by a foreign court. The Commission might in such cases arrange for negotiations to agree on a settlement

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[164] As introduced by Final Rule: Regulation Analyst Certification.
[165] See also section 1107 of the Act.
[166] For Switzerland: art. 251 Swiss Penal Code.
[167] Art. 27 Swiss Constitution.

with the concerned issuer and the person that would receive the extraordinary payments. Should the negotiations fail, the Commission would have to resort to the usual means of international mutual aid or to find a way to impose the sanctions on entities situated in the U.S.

### 3.6.2 Exemptions and Special Treatment Granted

No exemptions or special treatment have been granted to respond to the concerns of foreign firms regarding titles VIII, IX and XI of the Act.

## Final Remarks

Nobody can really foresee how the Sarbanes-Oxley Act of 2002 will be implemented with respect to firms and persons outside the United States. The tasks undertaken by the Commission and the other implementing authorities and entities seem to be endless and almost too large to be executed. It is uncertain how the Act, through the Commission and the Board mainly, will be applied. The Commission might be extremely severe in a few "example cases", but it is doubtful whether it will be in a position to undertake sufficient investigative procedures to reveal every instance of non-compliance.

With regard to implementation outside the United States of America, there will inevitably be differing approaches taken by firms in different jurisdictions in response to the Act, depending on local advice. This runs counter to the important goal of international convergence.

The potential reciprocity requirements of the E.U. towards U.S. audit-firms, whereas U.S. audit-firms of E.U. issuers (or associated persons of such firms) would have to register in all of the 15, or 25 Member States, the possibility of which has been pointed out several times menacingly[168], is probably not really considered as a possible counter-move by the competent decision-maker of the E.U. Such reciprocity requirements seem to be rather excessive.

Other factors will obviously play a role in the potential recognition of E.U. authorities by the Commission and the Board (the E.U. is taken here as example because of its significant size; it could be other jurisdictions as well). In view of the growing number of international groups of companies, it seems almost inevitable that the U.E. and the U.S. find a solution for the reciprocal recognition of each other's authority of supervision over the accounting firms, since it would be practically impossible for a U.S. entity to exercise efficient supervision over every "associated person" of a public accounting firm and foreign public accounting firm playing a substantial role in the preparation or furnishing of an issuer's audit report around the world. Extremely important with respect to such international groups of companies will also be that the rules of the Commission converge towards internationally accepted principles.

In any case, the implementation of the Sarbanes-Oxley Act of 2002 is, and will be, very expensive. One can wonder whether this additional price, which at the end will be born by the investors, is worth the enhanced protection with which the Act is meant to provide such investors. On the other side, this claimed protection might even give current and potential investors a false idea of security and bring severe drawbacks if a company whose financial stability was trusted suddenly collapses.

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[168] See for example R. VON HÖLTSCHI in the Neue Zürcher Zeitung, April 15, 2003, and FRANCESCO GUERRERA and GARY SILVERMANN in the Financial Times, June 15, 2003.

Another problem that might appear due to the new obligations and restrictions imposed upon foreign accounting firms is the potential drastic concentration of the market for audit-services. Small E.U. firms with only few clients that are "issuers" as defined in the Sarbanes-Oxley Act might well prefer to renounce to register by the Board rather that to comply with the strict rules of the Board, and would therefore have to give up on auditing such issuers or the subsidiaries thereof.

A move towards privatizations has also been observed since the enactment of the Sarbanes-Oxley Act of 2002, both for foreign firms and for U.S. issuers. Due to the costs of compliance with the Act, many smaller U.S. companies are thinking about going private[169]. Non-U.S. companies might for the same reason decide to exit the U.S. market. Another option open for a company that wishes to avoid the costs and administrative inconveniences of the Act is to choose a different listing: a trend has been observed with companies choosing London instead of New York. London is already making efforts to intensify this trend, as noted by the Financial Times on July 4, 2003: "In the wake of the Sarbanes-Oxley Act, the London Stock Exchange ("LSE") has tried to present itself to international companies as a more accommodating venue for their listings than New York, targeting Asian multi-national companies and European technology groups in particular in its effort to win new business from the NYSE […] Even though the size and depth of the U.S. capital markets, with their millions of retail investors, make them almost impossible to ignore for companies looking to expand, some world-renowned groups, such as Samsung of South Korea and Germany's BMW, have resisted the idea of listing shares in the U.S. despite appeals from institutional investors to do so."[170] Yet, non-U.S. listings have been a significant growth area for the NYSE. Should the above-mentioned trends be confirmed, this might put pressure on the Commission to arrange for more accommodations towards foreign market-participants in its implementation rules.

The fact that a company complies with the strict rules of the Act might, however, be a market advantage for such company and be more likely to awake the trust of investors. On the other hand, the same investors should beware of the false idea of security that the subjection to the Act might convey: the Commission will not be able to control everything.

Finally, one can conclude that the aims of the Sarbanes-Oxley Act of 2002 are generally recognized as making sense and being positive. The ideas that are thereby implemented are for the most part not new but existed for example as recommendations in various codes of corporate governance. A probable development is therefore that other regulators worldwide will adapt their own rules in order to converge towards the ideas of the Sarbanes-Oxley Act[171]. In the European Union for example, as in Switzerland, the legislative projects that had partially begun before the enactment of the Sarbanes-Oxley Act of 2002 with respect to corporate governance and supervision over audit firms are taking the new U.S. law into account. Their result will most probably be strongly influenced by it[172]. On the other hand, the Act goes sometimes so far in the regulation of details that it impedes any coherency with non-U.S. laws. This will hopefully change with the commenters continuing to make themselves

[169] See by way of illustration TAMARA LEWIS, in New York Law Journal, May 1, 2003, Business Wire April 14, 2003, MARSHALL MCKNIGHT, in NJBIZ, June 9, 2003, and MEG RICHARDS, The Philadelphia Inquirer, June 14, 2003.

[170] ANDREI POSTELNICU, "Sarbanes-Oxley Act – A little breathing space", Financial Times, July 4, 2003.

[171] According to the Rüdiger Scheidges Handelsblatt, Düsseldorf (Germany), August 1, 2003, "Das Bundesjustizministerium nannte die Vorschläge "eine wertvolle Hilfe" für die Regierung beim Entwurf eines neuen Gesetzes".

[172] See ALEXANDRE BRUGGMANN in Le Temps, August 4, 2003.

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## Appendix II: Abbreviations

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|---|---|
| Act | Sarbanes-Oxley Act of 2002 |
| ADR | American Depositary Receipt |
| AMEX | American Stock Exchange |
| Board / PCAOB | Public Company Accounting Oversight Board |
| C.F.R. | Code of Federal Regulations |
| CO | Swiss Code of Obligations |
| Commission / SEC | Securities and Exchange Commission |
| et seq. | Et sequens (and the following pages) |
| E.U. | European Union |
| Exchange Act | United States Securities Exchange Act of 1934, as amended |
| FASB | Financial Accounting Standards Board |
| GAAP | Generally accepted accounting principles |
| GAO | General Accounting Office |
| IASB | International Accounting Standards Board |
| IASs | International Accounting Standards |
| i.e. | Id est |
| IFRSs | International Financial Reporting Standards |
| LSE | London Stock Exchange |
| NASDAQ | National Association of Securities Dealers Automated Quotation System |
| NYSE | New York Stock Exchange |
| SEC / Commission | Securities and Exchange Commission |
| Securities Act | United States Securities Act of 1933, as amended |
| SROs | Self-regulatory organizations: any national securities exchange, registered securities association, or registered clearing agency |
| PCAOB / Board | Public Company Accounting Oversight Board |
| U.S. | United States of America |
| U.S.C. | United States Code |