Sarbanes-Oxley Act in Perspective

2012–2013 Edition

by Harold S. Bloomenthal
and Samuel Wolff

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To Joseph Krys

A lawyer's lawyer

–Harold Bloomenthal

To Sally Wolff King

With love, admiration and deep appreciation

–Sam Wolff

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About the Author

The late **Harold S. Bloomenthal** was counsel to the firm of Holme Roberts & Owen, L.L.P., of Denver, Colorado. Mr. Bloomenthal held a B.S. degree from Marshall University, a J.D. degree from Duke Law School, and a J.S.D. degree from Yale Law School. Mr. Bloomenthal commenced his law career as an enforcement attorney in the Denver Regional Office of the Securities and Exchange Commission. He practiced securities law in Denver, Colorado for over 37 years and taught securities law as a member of the faculty at the University of Wyoming College of Law, Denver University, and Northwestern School of Law of Lewis and Clark College, and as a Visiting Professor at Duke Law School, Colorado University, the University of Arizona, and The Hastings College of the Law. He is the author of *Sarbanes-Oxley Act in Perspective and Securities and Federal Corporate Law Reports*, coauthor of *Securities Law Handbook*, *Going Public Handbook*, *Securities and Federal Corporate Law*, *Going Public and the Public Corporation*, *Emerging Trends in Securities Law*, and co-author and co-editor of *International Capital Markets and Securities Regulation*. He is the author of numerous law review articles relating to securities law, administrative law, and natural resources law.

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Harold S. Bloomenthal
Denver, Colorado
July 4, 2005

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Samuel Wolff
Washington, D.C.
November 30, 2011

Preface

The Sarbanes-Oxley Act of 2002 (SOA) was signed into law by President Bush on July 30, 2002. Alluding to the war on terror, the President said: "In the aftermath of September the 11th, we refuse to allow fear to undermine our economy. And we will not allow fraud to undermine it either."[1] He attributed the need for the legislation to "[c]orporate corruption," which "has struck at investor confidence, offending the conscience of our nation." He referred to the Act as the "most far-reaching reforms of American business practices" since the creation of the SEC during the great depression. The Senate had passed the Act without a dissenting vote, something reserved for anti-terror legislation. The overwhelming Congressional support is ironic as less than a year earlier the Congress passed legislation to reduce fees paid on SEC filings that Senator Gramm and others characterized as a tax on capital. See § 9:14. Unfortunately, the tax on capital had not been converted into an adequate enforcement budget for the Commission that might have averted in part the unparalleled financial fraud tax on the American investor.

July 30, 2007 marked the fifth anniversary of the enactment of Sarbanes-Oxley. Several provisions of the Act mandated that the Commission adopt implementing rules by specified dates, all within the first year of the enactment of the Act. The Commission's immediate chores were substantially completed by July 30, 2007, although it has a number of continuing responsibilities, including as discussed below providing guidance for management's Section 404 assessment. The Public Company Accounting Oversight Board (PCAOB) although a centerpiece of the Act was not officially up and running until April 25, 2003. See § 6:4. The Board, however, made up for lost time and the second year after adoption of the Act featured the adoption of a number of rules by the PCAOB, all of which had to be and were approved by the Commission. The Act in many areas had an immediate impact and posed a tremendous challenge to the SEC and its staff in adopting within statutory time frames implementing rules and undertaking a number of mandated studies. The Commission immediately took action in two areas required under the Act to be taken by August 28, 2002. The Commission fortuitously had started down the road of proposing the certification of periodic reports filed under the Exchange Act. See § 2:1. The Commission was able to adapt, with appropriate modifications faithful to what Section 302 of the Act required, those proposals as a basis for regulations requiring principal executive and financial officers of virtually all public companies (including investment companies) to certify their periodic reports filed with the Commission. The Act and the implementing regulations also require public companies to put in place disclosure controls and procedures that provide some assurance that the company has available all the information needed to accurately complete its annual and quarterly reports, and for the certifying officers to accept responsibility for the periodic reports filed with the Commission. See § 2:7. The Commission subsequently fine-tuned its initial certification regulations to coordinate them with regulations adopted implementing Section 404 of the Act, which requires an annual assessment of internal control over financial reporting. See § 2:4. The Commission also modified the application of the certification provisions to accommodate the nature of reporting by investment companies. See § 2:9. Finally, in the certification context the Commission worked out with the Department of Justice a procedure for having the overlapping Section 906 certification "furnished" to the

[1] See Greg Hitt, *Bush Signs Sweeping Legislation Aimed at Curbing Business Fraud,* WALL ST. J. (Online ed.) July 31, 2002.

Commission as an Exhibit to periodic reports including financial statements. See § 2:11. The Commission also acted almost immediately to put in place rules as required by the Act that assure that only limited and defined transactions by insiders subject to Section 16(a) reporting transactions in the issuer's securities will escape the requirement of the Act that such transactions be reported before the end of the second business day after the day of the transaction. See § 5:14. The Commission, as required by the Act, by June 30, 2003 had in place regulations requiring that Form 4s and other Section 16(a) reports be filed electronically on EDGAR and be made available through the company's website. See § 5:15.

We concluded the Preface of the first edition of Sarbanes-Oxley Act in Perspective with the following: "This book in many respects is Chapter 1 as events involving SOA will unfold over a period of several years. We attempted to bring this to you as soon as possible after August 29, 2002 the date by which the Commission had to implement the Section 302 certification provisions and the accelerated filing of Form 4s under Section 16(a) of the Exchange Act." What followed was not only the fine tuning of Section 302 and the requirement that Form 4s be filed electronically, but the filling in by rules and regulations adopted by the Commission, within a period of less than a year the broad statutory outline that impacts so many diverse areas of securities regulation. The second edition covered these developments. The third edition, added the developments during the second year following adoption of the Act, featuring in large part the PCAOB efforts to fill in the interstices requiring action by it and as a perquisite to commencing its oversight role.

The Public Company Accounting Oversight Board (PCAOB or Board) is a creature of and a centerpiece of the Sarbanes-Oxley Act.[2] Since it had to be created from the ground up, however, the initial year following adoption of the Act was largely devoted to getting it up and running. The Board got off to a bad start when circumstances relating to the selection of the Chairman of the Board led to both his resignation before assuming his responsibilities as such and the resignation of SEC Chairman Pitt. See § 6:1. The remaining members of the Board held an organization meeting on January 9, 2003 and by April 25, 2003 had taken the minimal steps that had to be taken by that date in order for the SEC to declare[3] that it was "organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof."[4] As discussed at § 6:3, it was a race to the wire to accomplish this task and the declaration that date on the Board's website (http://www.pcaobus.org) that "our Web site is currently under development" could be applied to the Board as well.

Once the PCAOB was up and running it hastened to put in place the mechanism for registration of public accounting firms. The Act required that all public accounting firms be registered with the PCAOB by October 22, 2003, 180 days from the date the Commission declared the PCAOB organized and functioning. Subsequent to that date it became unlawful for any public accounting firm not registered with the PCAOB to "prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any" public company The PCAOB accommodated foreign accounting firms by extending the registration date for them to July 19, 2004. The PCAOB put into operation an online registration system (see § 6:12) and as of July 26, 2005 there were 1530 accounting firms registered, including 56 from Canada, 45 from the United Kingdom, 28 from India, 25 from France, 33 from Australia, 24 from Germany, 19 from China, 14 from Mexico, 9 from Japan, 8 from

[2] Pub. L. 107-204, Title I, 15 U.S.C.A. § 7211.

[3] See Sec. Act Release No. 8223 (Apr. 25, 2003), 2003 WL 1956164, also available at http://www.sec.gov/rules/other/33-8223.htm.

[4] Pub. L. 107-204, § 101(d), 15 U.S.C.A. § 7211(d).

Switzerland, 9 from Italy as well as firms from several other countries. The PCAOB put in place regulations covering inspections of registered public accounting firms, created a Division of Registration and Inspections, was carrying out inspections from New York City, Washington D.C., Atlanta, Dallas, Denver, Orange County California, and San Francisco. See Chapter 6, Part V.A. The PCAOB has also adopted rules of practice covering investigations, disciplinary proceedings, and disciplinary sanctions. See Chapter 6, Part V.B. Interestingly, all disciplinary sanctions imposed by the PCAOB are subject to review by the SEC. See § 6:43.

The PCAOB adopted on an interim basis auditing standards of the American Institute of Certified Public Accountants (see § 6:16), but immediately began the process of replacing them on a standard by standard basis. See § 6:17. The PCAOB finalized three accounting standards of its own—Accounting Standard No. 1, References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board; Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements (AS-2), and Auditing Standard No. 3, Audit Documentation. All are important, but Auditing Standard No. 2 is of particular significance. Auditing Standard No. 2 not only required auditors in connection with the annual audit of public companies to attest, as required by Section 404(b) of Sarbanes-Oxley to managements' evaluation of the company's internal control over financial reporting, but to audit and report on the company's internal control over financial reporting. This 216 paragraph Standard included detailed requirements that had to be followed by the auditors in auditing the company's internal control over financial reporting in an effort to identify serious deficiencies and material weaknesses that keep management from determining that internal control over financial reporting is effective. See Chapter 6, Part III. As discussed below, AS-2 was criticized for what critics view as the excessive costs of compliance and has been superseded by Auditing Standard No. 5. Auditing Standard No. 1 prescribes the representations that must be included in an auditor's report of the financial statements of a public company (see § 6:18), and requires reference to compliance with the auditing standards of the PCAOB rather than Generally Accepted Auditing Standards (GAAS). Auditing Standard No. 3 establishes audit documentation preservation standards that supplement and go beyond those required by the Commission. See § 6:34. The PCAOB also has adopted new rules governing auditor's performing tax services for audit clients. See § 7:12.

The need for and creation of an oversight board to regulate accounting firms auditing public companies provided much of the initial impetus for the adoption of the Act. The title of S. 2673 (see Appendix B), which in large part became the basis for Sarbanes-Oxley, was the Public Company Accounting Reform and Investor Protection Act of 2002. In the course of mark-up in Committee and amendments in the legislative process (particularly in the Senate) it became much more than an Act to create the PCAOB. If the first year after the adoption of Sarbanes-Oxley featured rules adopted by the Commission implementing the Act, the second year featured the activities of the PCAOB to assume its oversight role of all accounting firms auditing public companies as well as to commence down the road of establishing new auditing standards. The PCAOB, its powers and role are discussed in depth in Chapter 6. Interestingly, however, the Commission not only reviews and has to approve all regulations adopted by the PCAOB and all of its disciplinary actions, but retains its own authority to disqualify accountants from practice before the Commission for improper professional conduct. The Commission's Division of Enforcement appears to have increased its focus on initiating Rule 102(e) proceedings to disqualify accountants from appearing and practicing before the Commission for improper professional conduct. See § 7:6. In the process, respondents have challenged the attempt to apply the *Checkosky* inspired 1998 amendments to Rule 102(e) as the standard of improper professional conduct applicable to accountants

codified by Section 602 of Sarbanes-Oxley to conduct that occurred prior to the adoption of the amendments. Although the Circuit Court of Appeals for the District of Columbia held that the amended Rule 102(e) could not be applied retroactively, the court adopted going-forward the very liberal interpretation of reckless disregard of professional standards advanced by the Commission. See § 7:5. The Commission also shares with the PCAOB authority to determine what non-audit services can be performed by accountants auditing public companies and is the ultimate authority in determining auditing standards, which in the first instance are determined by the FASB and not the PCAOB. The Commission's continuing role in the regulation of public accountants and in setting accounting standards is the subject of Chapter 7.

Chapter 1 outlines the road from the demise of Enron to the adoption of Sarbanes-Oxley and summarizes the impact of the Act on accountants and accounting principles (§ 1:12), reporting under the Exchange Act (§ 1:13); CEOs and CFOs (§ 1:14), boards of directors (§ 1:15); the SEC (§ 1:16), attorneys appearing and practicing before the Commission (§ 1:17), investment banks, analysts, and research (§ 1:18), and on private securities litigation (§ 1:19). Sarbanes-Oxley, reflecting the rush to adopt legislation and the political implications of legislation that is in the limelight, included overlapping provisions in more than one area, but particularly with respect to attempting to impose responsibility on the principal executive and financial officers and management generally for periodic reports and financial statements filed with the Commission. The Commission ultimately integrated the several provisions relating to certification of periodic reports and the assessment of internal controls and in the process made them fit not only reporting companies generally, but investment companies that file significantly different reports. The process and procedures implementing the certification/assessment regime of periodic reports and financial statements is the focus of Chapter 2. The objective of the certification regime is to reinforce the continuous disclosure system of which the periodic reports filed pursuant to the Exchange Act are an integral part. The Act reinforces Exchange Act reporting in a number of other respects, including, among other things, real-time disclosure and enhanced review of periodic reports by the Division of Corporation Finance. Specifically the Act required insiders to report transactions in the company's securities within two business days of the transaction, to report them on EDGAR and on the company's website, if it maintains one. See Chapter 5, Part III.A. The Commission created the OnlineForms Edgar Filing website (https://www.onlineforms.edgarfiling.sec.gov) on which to prepare and file Section 16(a) insider transaction reports. See § 5:16. Although not limited to Section 16(a) filers, the requirement to file Section 16(a) reports increased the EDGAR filers several fold and the Commission created the EDGAR Filer Management website (https://filermanagement/edgarfiling/sec.gov) as the exclusive means of obtaining access codes that filers must have in order to file on EDGAR. See § 5:20. The Commission effective August 23, 2004 completely made over the filing of current reports on Form 8-K so that it includes a much wider spectrum of corporate events that trigger the need to file a Form 8-K and accelerated the filing requirement for most such events to four business days after the occurrence of the event. See Chapter 5, Part IV The new wide encompassing Form 8-K became effective on August 23, 2004. The Commission subsequently added items to Form 8-K that in effect require private companies attempting to go public through the acquisition of a shell reporting company to make disclosure on a Form 8-K of substantially the same information that would have to be included if registering a class of securities on Form 10 or Form 10-SB. The Commission also added a new Section 6 to Form 8-K as part of a new extensive disclosure scheme relating to asset-backed securities. See § 5:24.

Corporate governance has always been an ancillary concern at best of the federal securities laws, but Sarbanes-Oxley and initiatives undertaken by the New York

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Stock Exchange (NYSE) and Nasdaq Stock Market will have a tremendous impact on the role of the board of directors of public companies. If there is anything apparent from the Enron, WorldCom, and other corporate financial frauds that led to the adoption of Sarbanes-Oxley, it is the dismal failure of boards of directors to rein in out of control CEOs and/or CFOs. Sarbanes-Oxley puts a lot of faith in the assumption that audit committees composed of independent directors and appropriately empowered can change the corporate milieu. The NYSE and Nasdaq have gone much beyond the Act to require that a majority of the board of directors be independent directors, in establishing the criteria for determining independence of directors, and empowering the independent directors. Corporate governance is the subject of Chapter 3. The Act also looks to the self-regulatory organizations as the vehicle to protect the purity of the research product of investment banking firms that was largely impugned by the dot.com IPO bubble and analysts continuing to recommend securities of Enron, WorldCom and other Fortune 500 companies all the way into bankruptcy. Some significant aspects of what the Act requires the SROs to implement in this context was overtaken by regulatory action taken by state and federal regulators against ten major investment banking firms, with the New York Attorney General initially taking the lead. See Chapter 8.

The events leading to the adoption of Sarbanes-Oxley featured the CEOs and CFOs who cooked the books and the inept auditors who failed to discover or overlooked same. Consequently, the wrath of Congress was directed primarily at corporate officers and auditors, but attorneys were not entirely overlooked by the Act. Senator Edwards led the charge to include an amendment that became Section 307 of the Act, which directs the Commission to require by rule an attorney representing an issuer to report "evidence of a material violation of securities laws, a breach of fiduciary duty, or similar violations by the company or any agent of the company" to the chief legal officer or chief executive officer of the company. If appropriate corrective action is not taken, the attorney is to go up-the ladder to the audit committee, or a committee of the board consisting of non-management directors, or to the board of directors. There are few provisions of the Act that produced more critical comment to the proposed implementing rules; the Commission retreated but did not back off from the daunting task. Section 307 and the implementing rules dramatically impact attorneys who appear and practice before the Commission and has not fully played out as a reproposal of the noisy withdrawal provision is still to be considered. See Chapter 4. The Commission, perhaps, because of differences among members of the Commission, appears to have put noisy withdrawal on a backburner. See § 4:26. Although the Commission has not initiated any proceeding on the basis of Part 205, it is apparent that the Division of Enforcement has targeted attorneys through Rule 102(e) and other proceedings for apparent misconduct. See § 4:23. The rules included as Part 205 of Title 17 of the Code of Federal Regulations implementing Section 307 includes a provision allowing attorneys under certain limited circumstances to disclose information to the Commission without, at least insofar as the Commission can ordain same, violating the attorney-client privilege. See § 4:25. The House of Delegates of the American Bar Association at its annual meeting on August 11-12, 2003 adopted by a narrow vote amendments to Rule 1.13 of the Model Rules of Professional Conduct that requires an attorney in the event of violations of law likely to result in a substantial injury to the corporation "to refer the matter to higher authority in the corporation." At the same meeting, the House of Delegates adopted amendments to Model Rule 1.6, "Confidentiality of Information," allowing an attorney to reveal information necessary "to prevent a client from committing a crime or fraud reasonably certain to result in substantial injury to the financial interests or property of another," provided the attorney's services were used "in furtherance" of the crime or fraud. See § 4:28.

The politicos in both parties from the President on down competed to prove who could be the toughest in adopting provisions that would assure the time fits the crime securities-wise. The well-publicized increase of maximum sentences actually have less impact than the instructions to the U.S. Sentencing Commission to amend the sentencing guidelines with respect to white collar crime in general and financial fraud in particular. The Sentencing Commission had already started down this road before the adoption of the Act, but the action taken implementing the sentencing guidelines provisions of the Act make it highly likely that those found or plead guilty of securities fraud violations will serve a significant amount of time. See Chapter 9, Part I.B. The U.S. Sentencing Commission as required by Sarbanes-Oxley on April 30, 2004 added effective November 1, 2004, unless Congress intervenes, new corporate sentencing guidelines. See § 9:8. The Supreme Court in a 5-4 decision involving state sentencing guidelines insisted that provisions of sentencing guidelines enhancing the sentence are a question for the jury. This created a furor at the Department of Justice, which during the sought and was granted expedited review of two pending federal cases to resolve this issue on the federal level. The Supreme Court majority in *Booker* rendered a mixed verdict, holding mandatory guidelines that required the judge to take into account facts not found by a jury unconstitutional as a violation of the Sixth Amendment right to a jury trial. The Court, however, severed the mandatory aspect of the Act establishing the guidelines and preserved them as "advisory, requiring a sentencing court to consider Guidelines ranges, . . . but permitting it to tailor the sentence in light of other statutory concerns." Since the guidelines must be taken into account, in practice the holding may provide defendants if convicted, with little relief.[5] The decision consists of separate majority opinions on the issue of constitutionality and whether the mandatory aspect of the Sentencing Guidelines can be severed. There were four dissenting opinions objecting in part to one aspect or another of what is the opinion of the court. Leaving aside the maize of applying Booker in cases in which defendants were sentenced before *Booker*,[6] the courts for some time will be dealing with related guideline issues implicated by the Court's decision in *Booker*. See § 9:7.

Sarbanes-Oxley also strengthens the Commission's ability to obtain disgorgement in civil actions, allows civil penalties to be added to disgorgement funds for distribution to victims of securities fraud, reduces the threshold of unfitness the Commission must establish to bar securities violators from acting as an officer or director of a public company, and authorizes the Commission to impose officer/director bars in administrative actions. The Commission is using its authority under the Act to combine amounts recovered as disgorgement and penalties in a Fair Fund to be returned to defrauded investors. The Commission claims approximately $5.2 billion has been contributed to Fair Funds as a result of actions brought by the SEC since the enactment of Sarbanes-Oxley through approximately March 31, 2005.[7] The Commission maintains on its website a page (http://www.sec.gov/divisions/enforce/claims.htm) with links to relevant information concerning each of the Investor Claim Funds that have been established under the

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[5] United States v. Booker, 125 S.Ct. 738, 743 (2005).

[6] See, for example, difference between the Second Circuit on the one hand and the the Eleventh and Tenth Circuit as to whether in determining to remand a sentencing case in which the right to appeal was not timely preserved the circuit court of appeals is to determine whether the plain error rule permits remand and reconsideration or whether that determination is to be made by the district court on remand. The Second Circuit held the determination is to be made by the district court. United States v. Crosby, 397 F.3d 103, 118-19 (2nd Cir. 2005). The Eleventh and Tenth Circuit held the determination is to be made by the circuit court. United States v. Rodriguez, 398 F.3d 1291, 1305 (11th Cir. 2005); United States v. Gonzalez-Huerta, 403 F.3d 727, 733-4 (10th Cir. 2005).

[7] Testimony of William H. Donaldson, "Testimony Concerning the Impact of the Sarbanes-Oxley Act," House Committee on Financial Services (April 21, 2005), available at http://www.sec.gov/news/testimony/ts042105whd.htm.

Fair Funds provision. See § 9:11 The provisions of the Act strengthening enforcement are discussed in Chapter 9. The Act does not amend the Private Securities Litigation Reform Act and does little directly to encourage private actions, although it does lengthen the period of limitations for initiating a securities fraud private action. The courts that have considered this provision appear to be in agreement that it applies only to private actions based on the anti-fraud provisions of the Securities Acts and is not applicable to private actions based on Section 11 of the Securities Act relating to misrepresentations or omissions in a registration statement. See § 10:2, There are some that believe that the Act nonetheless increases the opportunities for the securities fraud class action lawyers, and there are some provisions, such as the certification of periodic reports, and management's assessment of the effectiveness of the company's internal control over financial reporting (see § 2:22), that may indirectly enhance the opportunities of the securities fraud class action lawyers. Reports of material weaknesses in the company's internal control over financial reporting reflected in management's assessment and/or the auditors reports called for by the now superseded Auditing Standard No. 2 at least in the early stages of the process triggered a number of securities fraud class actions. See § 10:17.The impact of the Act on private actions provisions as well as the provisions designed to protect whistleblowers are the subject of Chapter 10.

Sarbanes-Oxley includes in concept an interesting division of responsibility between the SEC and the PCAOB with respect to Section 404 internal controls over financial reporting. Section 404(a) imposes upon the Commission the responsibility for prescribing the content and process for preparing management's annual report assessing the effectiveness of the company's internal control over financial reporting. See Chapter 2, Part IV. The PCAOB under Section 404(b) has the responsibility for establishing the standards for auditors attesting to management's report, and has construed this provision to require that the auditors conduct an audit of the company's internal control over financial reporting in order to attest to management's report, prescribing in great detail the procedures to be followed in Auditing Standard No. 2. See Chapter 6, Part III. The Commission in implementing Section 404(a) sensibly integrated the rules relating to Section 302 certification as the certification pertains to internal control over financial reporting. See § 2:8. Accordingly, the Section 302 certification and management's Section 404(a) annual report of the effectiveness of the company's internal control over financial reporting and the Section 404(b) auditor's audit of such controls and attestation of management's report all interrelate in a number of significant areas.

The SEC and the PCAOB coordinated the compliance dates for companies to include in the annual report on Form 10-K, the Section 404(a) management report on the effectiveness of the company's internal control over financial reporting, and the auditor's report on the Section 404(b) audit of the company's internal control over financial report and attesting to management's conclusions as to the effectiveness of the company's internal control over financial reporting. The annual report for fiscal years ending after November 15, 2004 for accelerated filers and fiscal years ending after July 15, 2005 for all other reporting companies triggered compliance with the Section 404(a) management's report on effectiveness of the company's internal control over financial reporting, the Auditing Standard No. 2 auditors audit of internal control over financial reporting and attestation to the management's assessment. Compliance with Auditing Standard No. 3 on audit documentation is required for all filers for fiscal years ending after November 15, 2004. The need to be in compliance in all of these areas imposed a tremendous burden in terms of resources and costs that the Commission alleviated only to a limited extent (see § 2:21) and resulted in a good deal of less than complimentary comment from public companies. The early Section 404(a) reports resulted in a significant number of companies reporting material weaknesses that in some instances resulted in

companies being downgraded by analysts; in several instances being the subject of a class action focusing on such weaknesses, and other unpleasant consequences. The Commission responded with a Roundtable on Implementation of Internal Control Reporting Provisions on April 13, 2005, also attended by members of the PCAOB. The SEC and its staff (see § 2:24) and the PCAOB and its staff subsequently published additional guidance as to how reporting companies could more efficiently cope with the internal control over financial reporting regulatory regime. See Chapter 6, Part IV. The PCAOB also adopted a new auditing standard (Auditing Standard No. 4) that permits auditors if engaged by the reporting company to do so to report on the elimination of previously reported material weaknesses, if appropriate. See § 6:35. The Commission also created an Advisory Committee on Smaller Business Companies with a very broad mandate but one aspect of which was to consider the "framework for internal control over financial reporting, management's assessment and auditing standards relating to such internal controls." See § 2:21.The Commission and PCAOB in response to requests of the Advisory Committee and in response to continued criticism of Section 404 responded initially by twice delaying compliance dates for non-accelerated filers to the present (and presumably final) ones of annual reports for years ending after December 15, 2007 as to the Section 404(a) management assessment of the effectiveness of the company's internal control over financial reporting (ICFR), and for fiscal years ending after December 15, 2008 as to the Section 404(b) auditor's audit of the company's ICFR. See § 2:31.

Although the SEC rules implementing Section 404(a) did not escape criticism, it was the PCAOB Auditing Standard No. 2 that bore the brunt of the criticism for the high cost of compliance. The cost, among other things, according to the critics, was driving IPOs (particularly global IPOs) to other world capital markets. On May 25, 2007, the SEC in an open meeting[8] adopted an Interpretive Release, published on June 20, 2007,[9] together with the an amendment to the rules that implement Section 404(a) providing the manner in which management's report is to be prepared. The Interpretive Release is titled, "Commission Guidance Regarding Managements Report on Internal Control on Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934," hereinafter "the SEC Guidance." The amendments to the referenced rules provide that "an evaluation that is conducted in accordance with the interpretive guidance issued by the Commission in" the Interpretive Release constitutes compliance with the referenced rules; hence, with Section 404(a) of Sarbanes-Oxley. See Part VII. of Chapter 2.

On December 19, 2006, the PCAOB responded by proposing a new Accounting Standard to supersede Auditing Standard No. 2 The PCAOB on May 24, 2007 with significant revisions to the proposed new standard adopted, subject to SEC approval, Auditing Standard No. 5 to supersede Auditing Standard No. 2.. The Commission in an open meeting On June 25, unanimously approved Auditing Standard No. 5. An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements (AS-5). See Part III. of Chapter 6. It remains to be seen how the SEC Guidance and AS-5 play out over time.

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[8] SEC Press Release 2007-102 (May 23, 2007), available at http://*www.sec.gov/news/press*/2007/2007-102.htm.

[9] 9 Exch. Act Release No. 55,929 (June 20, 2007), 2007 WL 1791162.

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