

Hofstra University  
Fourth Annual Business Conference

International Accounting &  
Governance Issues after  
Sarbanes-Oxley

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# Recent History

- n Sarbanes-Oxley Act Passed in 2002
- n Created the Public Company Accounting Oversight Board which regulates the accounting profession.
- n Section 203 mandates lead audit partner rotate every 5 years
- n Section 301 requires the establishment of an independent audit committee and empowers it to hire and fire external auditors
- n Section 302 creates certification requirements for principal financial and executive officers
- n Section 401 requires that pro-forma financial information be reconciled to GAAP figures
- n Section 404 requires that management assess the adequacy of their system of internal controls and the registered accountants must independently test management's assertion.
- n Importantly, it provided no accommodations to foreign issuers

# Results to Date

- n Large U.S. companies have spent millions to comply with the internal control requirements of Section 404.
- n Delistings of US based companies are up 30%
- n M&A is impacted as it becomes more difficult to sell “dirty” companies (KBR)

# International Implications of SOX

- n SOX affects over 1300 foreign corporations listed on U.S. exchanges
- n The European Union objected strenuously:
  - n Originally an American Problem
    - n Lost that argument with Parmalat, Hollinger, Shell & Royal Ahold
  - n Infringed on rights of sovereign nations to regulate their companies and accounting professions
  - n Some reporting requirements conflict with European privacy laws
  - n Requirements that all financial communications had to be reconciled to GAAP rather than international accounting standards is burdensome
  - n Cost of complying with internal control documentation requirements is excessive
  - n And if a company wants out they may be trapped as delisting is difficult and expensive.

# International Implications of SOX (Cont'd)

- n The creation of Audit Committees are a problem in countries that have statutory accounting or audit boards
- n Director independence rules conflict with companies with labor (Germany) or government (France) board members.
- n Foreign firms auditing US listed companies must register with the PCAOB and meet related standards that could conflict with local laws

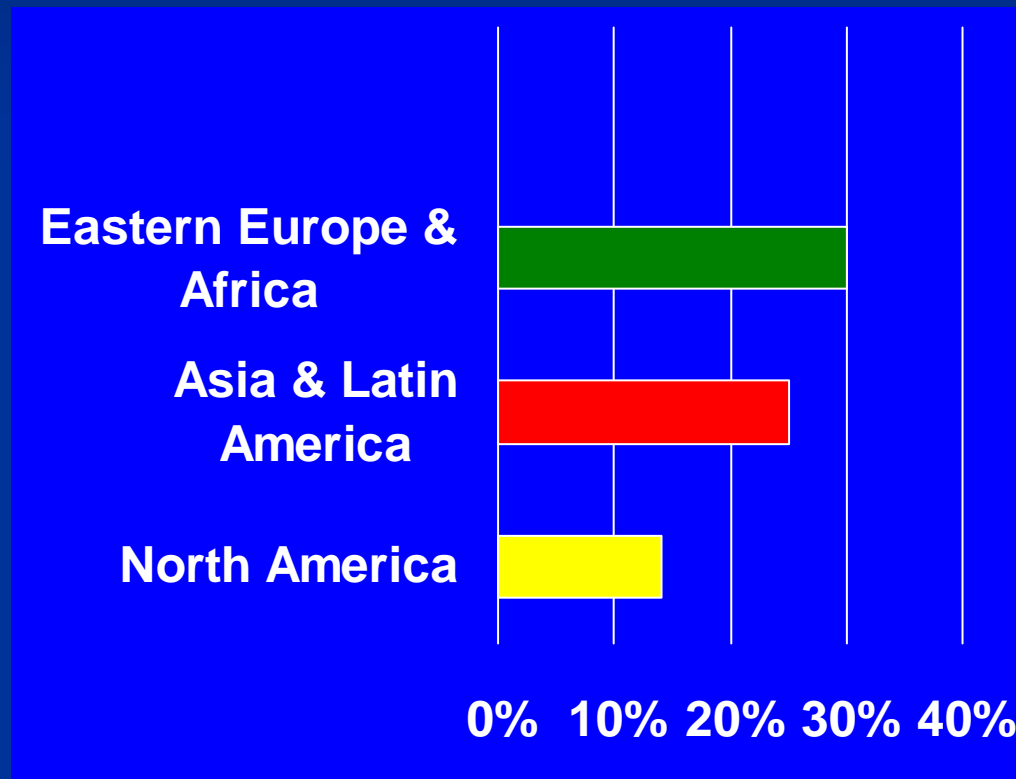
# Outcomes

- n EU has passed their own corporate governance road map to reclaim their right to regulate corporate governance and audit standards.
- n Company decision making is frozen:
  - n Foreign companies will delay listing until the rules and costs become clear
  - n Other foreign companies are considering whether to deregister, but are fearful of the process and costs (Rule of 300)
  - n M& A deals must take SOX into consideration. Where US acquirers are concerned, they must gain confidence that the acquisition does not come with 302 or 404 risks.

# U.S. Regulatory Response

- n PCAOB approved rules that would rely on national oversight of the accounting profession for those countries with developed regulatory regimes
- n SEC & PCAOB is also working to address privacy conflicts with EU nation states and adjusting information requests.
- n Audit partner rotation was eased providing up to seven years before rotation is required.
- n SEC has delayed implementation of SOX 404 for foreign issuers until next summer
- n SEC has provided independence exemptions for labor and one government representative sitting on audit committees
- n SEC has provided an exemption for creation of an audit committee for countries that mandate statutory auditors or board of auditors.
- n SEC has exempted foreign issuers from having to reconcile communications outside of the US to GAAP.
- n SEC is proposing the easing of delisting requirements to aid those that wish to delist rather than comply.

# Premium for High Governance Standards



Source: McKinsey & Co. Global Investor Survey



# Conclusions

The SEC and, to a much lesser extent, the PCAOB have provided some accommodation, but:

- n The PCAOB still extends their oversight reach to foreign-based auditing firms
- n Foreign issuers still need to comply with Section 404
- n M&A transactions will still need to consider the consequences of SOX including financial certification in the first quarter following acquisition and an internal control assessment by year end.
- n From a privacy perspective, certain information requests, such as that required for an anti-trust investigation, may force companies to choose which nation's law they break.

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