

Sarbanes-Oxley and Pakistan: way forward?



A Discussion Paper by *ACCA Pakistan*

ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest-growing global professional accountancy body with 296,000 students and 115,000 members in 170 countries. We aim to offer the first choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our students and members throughout their careers, providing services through a network of nearly 80 offices and centres. We have established more than 50 global accountancy partnerships, through which we deliver qualifications and a range of services which promote global standards, benefit the accountancy profession and enhance the value of accountants in the workplace. We work closely with more than 470 registered tuition providers and nearly 8,500 employers of accountants and finance professionals.

We use our expertise and experience to work with governments, donor agencies and professional bodies to develop the accountancy profession. We aim to achieve and promote the highest professional, ethical and governance standards and advance the public interest.

ACCA's reputation is grounded in over 100 years of providing accounting and finance qualifications. Our long traditions are complemented by modern thinking, backed by a diverse, global membership.

Augmenting ACCA's strong position in a worldwide market is ACCA's well-respected research programme, generating high-profile, high-quality, cutting-edge research with global focus, wide dissemination and strong emphasis on public policy influence and practical value.

ACCA Pakistan is a not for profit organisation established under Section 42 of the Companies Ordinance and is committed to supporting over 15,000 students, affiliates and members in Pakistan and our objectives mirror ACCA's mission above.

Apart from providing support to ACCA students, affiliates and members *ACCA Pakistan* is involved in projects like the ACCA-WWF Pakistan Environmental Reporting Awards (PERA). *ACCA Pakistan* is also working in the public interest by participating in consultative processes, conducting innovative research and informative capacity building workshops, orientations and seminars.

Further information about *ACCA Pakistan* public interest projects is available at:

[Http://www.accaglobal.com/pakistan/publicinterest/](http://www.accaglobal.com/pakistan/publicinterest/)

SARBANES-OXLEY and PAKISTAN: way forward?

Dr. Afra Sajjad

Head of Education and Policy Development, *ACCA Pakistan*
(e-mail: afra.sajjad@pk.accaglobal.com)

and

Ahsan Saeed Kirmani

Former Policy Development Executive, *ACCA Pakistan*

DISCLAIMER AND LIMITATIONS TO THE DISCUSSION PAPER

Any views expressed in this report are those of the finance executives, auditors and other relevant stakeholders interviewed for the purpose of the discussion paper and do not necessarily represent the views of *ACCA Pakistan*.

This discussion paper has been prepared as a reference document and is not intended to be exhaustive. While utmost care has been taken in the preparation of this publication, it should not be relied upon as a substitute for legal advice, or as a basis for formulating business decision.

This publication should not be reproduced in whole or in part without the written permission of the copyright holder i.e. *ACCA Pakistan*.

The information presented in this report was obtained as a result of literature review and interviews conducted with different stakeholders between October 2006 and April 2007. Any subsequent developments were not taken into consideration in the finalisation of the report.

ACKNOWLEDGMENTS

ACCA Pakistan would like to thank all the finance executives, auditors and other stakeholders who took time to participate in interviews conducted for the purpose of the discussion paper. The information provided by them was invaluable in completing the discussion paper and formulating conclusions and recommendations.

This discussion paper is available on the website of *ACCA Pakistan*
<<http://www.accaglobal.com/pakistan/publicinterest>>

We are particularly thankful to Mr. Aamir Allaudin, Chairman Corporate Governance (North) Sub-committee of *ACCA Pakistan*; Mr. Sardar Muhammad Abubakar, member of Professional Development Sub-committee (North) of *ACCA Pakistan* and Mr. Asad Feroze, member of Budget and Taxation Sub-committee (North) of *ACCA Pakistan* for their invaluable assistance during the course of completion of the discussion paper.

FOREWORD

The landmark Sarbanes-Oxley Act of 2002 also known as the Public Company Accounting Reform and Investor Protection Act of 2002 was intended to reform public accounting practices and other corporate governance processes and enhance the performance of the capital markets. It was signed in the wake of corporate governance debacles like the Enron and the WorldCom that resulted in a loss of reputation and public trust in accounting and reporting practices. These scandals touched a raw nerve amongst US legislators. An outcome of these scandals was the Sarbanes-Oxley Act that was passed by an overwhelming majority of congressional votes 522 for, 3 against and 9 no votes.



The Sarbanes-Oxley legislation has far reaching effects as it establishes enhanced standards for all public company boards, management and public accounting firms. Supporters of the Sarbanes-Oxley Act consider it as a necessary and useful reform while its critics believe that the costs of complying with Sarbanes-Oxley Act outweigh the benefits. The Sarbanes-Oxley Act thus remains a controversial piece of legislation that many US listed companies find hard to comply with.

A handwritten signature in black ink, appearing to read 'Arif Masud Mirza'.

Arif Masud Mirza
Head of ACCA Pakistan

While non-US listed companies are not required to comply with the Sarbanes-Oxley Act, discussions on benefits and costs of adopting various provisions of Sarbanes-Oxley Act are not only confined to United States. In many jurisdictions of the world, the discussion has centred around assessing the business case for adopting certain provisions of Sarbanes-Oxley Act as best practices rather than as legislation. At ACCA we believe in discussions and debate on global legislations, codes, principles and regulations as at times through discussions and debates, consensus on best practices and future course of action develops.

The main aim of ACCA Pakistan Discussion Paper on “Sarbanes-Oxley and Pakistan: way forward?” is to provide an opportunity to various stakeholders to critically analyse the extent to which the Sarbanes-Oxley requirements can be possibly adopted or not in Pakistan as best practice, with or without modifications, even when there is no obligation to comply. We hope that this discussion paper will stimulate a positive and healthy discussion on provisions of Sarbanes-Oxley Act in particular and future Corporate Governance reforms in general.

LIST OF ACRONYMS

| | |
|-------|--|
| ACCA | Association of Chartered Certified Accountants |
| AICPA | American Institute of Certified Public Accountants |
| COSO | Committee of Sponsoring Organisations of the Treadway Commission |
| DFIs | Development Financial Institutions |
| ICAP | Institute of Chartered Accountants of Pakistan |
| PCAOB | Public Company Accounting Oversight Board |
| ROSC | World Bank Report on the Observance of Standards and Codes |
| SEC | Securities and Exchange Commission, United States of America |
| SECP | Securities and Exchange Commission of Pakistan |
| SOX | Sarbanes-Oxley Act |

In this report:

'Act' refers to the Sarbanes-Oxley Act

'Board' refers to the Public Company Accounting Oversight Board

'Code' refers to the SECP Code of Corporate Governance

CONTENTS

| | |
|---|-----------|
| Executive Summary | 1 |
| Section 1. Introduction | 2 |
| 1.1 Aims and objectives | 2 |
| 1.2 Structure of the report | 3 |
| Section 2. Overview of the Sarbanes-Oxley Act | 4 |
| Section 3. The Impact of Sarbanes-Oxley Act on Pakistani Businesses | 6 |
| 3.1 Extent and Level of Compliance | 6 |
| 3.2 Benefits of Sarbanes-Oxley Act Compliance | 7 |
| (a) Better audit aware environment | 10 |
| (b) Increased value for investors | 11 |
| (c) Enforcement mechanisms | 12 |
| (d) Public Company Accounting Oversight Board | 13 |
| 3.3 Costs and Obstacles of Sarbanes-Oxley Act Compliance | 15 |
| Section 4. Sarbanes-Oxley Act and the Future of Corporate Governance Regulations in Pakistan | 20 |
| 4.1 Existing Corporate Governance Regulations and Section 404 of the Sarbanes-Oxley Act | 20 |
| 4.2 Sufficiency of SECP Code of Corporate Governance | 21 |
| Section 5. Conclusion and Recommendations | 25 |
| Annexe Comparison of SECP Code of Corporate Governance and the Sarbanes-Oxley Act | 27 |

Executive Summary

OVERVIEW

The jurisdiction of the much talked about Sarbanes-Oxley Act, also known as SOX¹, extends beyond the United States of America. A number of multinationals and local listed companies have also been affected by the Act. ACCA Pakistan has undertaken this research in the public interest to explore the extent to which the businesses operating in Pakistan are being affected by the Act as well as its potential future implications in the context of Pakistan. A number of interviews were held with various stakeholders to obtain their views on the Act.

MAIN RESEARCH FINDINGS

1. It was observed that although the Act is an external legislation, a number of companies in Pakistan, mainly multinationals or local listed companies aspiring for a listing on a US stock exchange or a merger or acquisition with a US listed company, were affected by the SOX legislation.
2. SOX-compliant companies in Pakistan are generally implementing only Section 404 of the Act in Pakistan.
3. Most of the multinationals in Pakistan have been 'de-scoped' from complete compliance even with Section 404 of the Act. This means that even though the parent company is implementing the Act on a global level, the subsidiary or affiliate company in Pakistan is not doing so. The de-scoped locations of a global concern would not therefore be subject to internal control verification by an external auditor.
4. The perceived benefits of SOX compliance are: more effective and transparent internal controls, creation of a better audit environment, increased value for investors, and the creation of the Public Company Accounting Oversight Board.
5. The perceived barriers to implementation of the Act are the time and effort involved in implementing the internal controls it requires, unavailability of qualified human resources to implement, test and verify those controls, as required by Section 404, and the increased cost of hiring consultants to do this work.

MAIN RECOMMENDATIONS

1. In order to strengthen the control framework of listed companies, SECP and the stock exchanges should encourage companies to adopt the COSO framework of internal control, recommended by the US Securities and Exchange Commission.
2. The establishment of an oversight board, similar to global best practices may be considered by SECP.
3. The professional accounting bodies must play a key role in nurturing and cultivating a large number of professional accountants.

¹http://www.sarbanes-oxley.com/section.php:level=2&pub_id=Sarbanes-Oxley&chap_id=PCAOB1

Section 1. Introduction

Since the 1990s, the term 'Corporate Governance' has attracted a great deal of public interest because of its apparent significance for the economic health of corporations and society in general. Following the release of the Cadbury Report in 1992, regulators in various countries have issued a number of Corporate Governance standards and legislations, which specify best practices in Corporate Governance. One such Corporate Governance legislation is the SarbanesOxley Act of 2002 ('the Act'), more commonly known as SOX.

The Act has not been made into a law anywhere in the world except the US. Despite being a US legislation, the jurisdiction of SOX is extended to the non-US companies that have shares or American Depository Receipts (ADRs) trading on the New York Stock Exchange (NYSE), National Association of Securities Dealers Automated Quotations System (NASDAQ) and other US exchanges; non-US companies operating in the US, including those listed on the NYSE and the NASDAQ; or are subsidiaries of US and non-US companies that are registered with the Securities and Exchange Commission (SEC) of the US. Non-US companies that have more than 300 US shareholders are also covered by this Act. In addition to this, the companies that may go public in the future by listing on a US exchange, or those that have a significant business partner relationship with one or more US-listed public companies are also affected.

Since 2002, US and non-US companies alike have been critical of the Act, particularly because of the high costs of compliance with it.

"The average cost of compliance with Section 404 has been estimated at between \$1 million and \$3 million in the US². A significant portion of the cost can be attributed to the consultants the companies are hiring to help them implement SOX."³

Many non-US companies are of the view that the costs and obstacles to compliance with SOX are too high and outweigh the benefits of a listing⁴ on the US Stock Exchange. Air China picked the London Stock Exchange instead of the NYSE for its secondary listing and Porsche decided not to go forward with its intended listing on the NYSE, owing to the Act.⁵

1.1 AIMS AND OBJECTIVES

There is no documented research on the possible impact of external legislation such as SOX on Pakistani businesses.

The main objectives of the research were:

- to gain a clearer understanding of the reasons why some companies in Pakistan are already complying with the Act
- to gain a clearer understanding of the level and extent to which businesses in Pakistan are complying with the Act
- to ascertain whether there is a need for greater transparency and accountability in the affairs of listed companies in Pakistan and, if so, whether certain provisions of the Act can address this
- to investigate the costs and obstacles to compliance with the Act in Pakistan

²White & Case. "Non US Companies Get Reprieve on Sarbanes-Oxley." *SRI Media* 6 Apr. 2006. Jan.-Feb. 2007 <http://www.srimedia.com/artman/publish/articles/article_894.shtml>.

³Ainsworth, Richard T. "What Sarbanes-Oxley Really Means for Tax Services." *International Tax Review* 15 (2004). Jan.-Feb. 2007.

⁴Carney, Beth. "Foreign Outfits Rue Sarbanes-Oxley." *Business Week* 15 Dec. 2004. Jan.-Feb. 2007 <http://www.businessweek.com/bwdaily/dnflash/dec2004/nf20041215_9306_db016.htm>.

⁵Woo, Christopher. "The Effects of Sarbanes-Oxley on Foreign Private Issuers." Diss. Harvard Law School, 2003.

The above objectives were achieved by conducting semi-structured interviews with various stakeholders including the partners of 'Big Four' auditing firms, partners of smaller auditing firms, finance directors / controllers of multinationals in Pakistan that are implementing the Act, finance directors / controllers of local-listed companies, financial analysts in securities firms, and regulators.

1.2 STRUCTURE OF THE REPORT

Beside the introductory section, the report has the following sections:

Section 2: Overview of the Sarbanes-Oxley Act

Section 3: The Impact of Sarbanes-Oxley on Pakistani Businesses

Section 4: Sarbanes-Oxley and the Future of Corporate Governance Regulations in Pakistan

Section 5: Conclusion and Recommendations

Section 2. Overview of the Sarbanes-Oxley Act

"No business legislation in recent history has elicited a broader range of reaction among financial professionals than the Sarbanes-Oxley Act of 2002." (CPA Journal, 2004)

The Sarbanes-Oxley Act was instigated by a wave of accounting and corporate scandals in the US in the early 2000s, resulting in a loss of investor confidence and a market downturn. The Act has been described as the most significant overhaul of federal securities regulation in the US, particularly with regard to accounting, since the Securities Act of the 1930s.⁶ The Act's stated purpose is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes.

Shortly after the enactment of SOX, The Confederation of British Industry met with the SEC Chairman William Donaldson to intimate that New York was in danger of losing its preferred position as the international capital market of first choice.⁷ The US regulators, nevertheless, have maintained the stance that the Act is absolutely essential for preventing future corporate accounting debacles and for reinstating public confidence in the audited financial statements of listed companies. As a result of the SOX legislation, many non-US issuers are now opting to list on capital markets outside the US, which do not have the same compliance costs.⁸ In order to escape compliance costs and increased scrutiny under SOX, many US and non-US companies have de-listed from the US exchanges.⁹ Immediately

after the promulgation of the Act, Frits Bolkestein, the EU Financial Services Commissioner threatened retaliation against the US regulators. Later, however, he suggested drastic changes in EU law with the proposal of a new SOX - like directive that would be applicable to all public accounting firms throughout the European Union.¹⁰

One of the major criticisms of SOX has been the high costs of compliance. The maximum costs are incurred in the first year of SOX application, but after that the costs start decreasing.¹¹ In the long term, SOX compliance results in defining compliance roles and responsibilities for employees and specific functions.¹²

The Act aims specifically at improving corporate governance, promoting ethical business practices and enhancing the transparency of financial statements and disclosures. Table 2.1 briefly explains the main provisions.

⁶Hill, Nancy T., John E. McEnroe, and Kevin T. Stevens. "Auditors' Reaction to the Sarbanes-Oxley and the PCOAB." *CPA Journal* (2005): 32-34. Jan.-Feb. 2007.

⁷"Analysis: The State of America," *LAWYER*, Jan. 24, 2005, at 19 (explaining that British Petroleum, Rank Group, and Siemens have all threatened to delist from the NYSE as a reaction to the costs of compliance with Sarbanes-Oxley). Source: "Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by the Sarbanes-Oxley." *Brigham Young University Law Review* (2006): 175-208. Jan.-Feb. 2007.

⁸"Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by the Sarbanes-Oxley." *Brigham Young University Law Review* (2006): 175-208. Jan.-Feb. 2007

⁹"Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by the Sarbanes-Oxley." *Brigham Young University Law Review* (2006): 175-208. Jan.-Feb. 2007.

¹⁰Ainsworth, Richard T. "What Sarbanes-Oxley Really Means for Tax Services." *International Tax Review* 15 (2004). Jan.-Feb. 2007.

¹¹The results of the Third Annual Survey of Corporate Governance, published by the Business Roundtable, an association of CEOs of 160 major US companies, reaffirmed this. Source: Hemphill, Thomas A. "The Sarbanes-Oxley Act of 2002 Reviewing the Corporate Governance Scorecard." *Journal of Corporate Citizenship* (2005): 23-26. Jan.-Feb. 2007

¹²Hemphill, Thomas A. "The Sarbanes-Oxley Act of 2002 Reviewing the Corporate Governance Scorecard." *Journal of Corporate Citizenship* (2005): 23-26. Jan.-Feb. 2007.

TABLE 2.1: BRIEF EXPLANATION OF THE IMPORTANT PROVISIONS OF THE SARBANES-OXLEY ACT

| Section | Brief explanation |
|---------|---|
| 101 | The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCAOB - 'the Board'), which is responsible, with SEC oversight, for establishing or adopting standards for quality control, ethics, independence, and anything relating to the preparation of audited financial statements. The Board also conducts investigations and disciplinary proceedings, and imposes sanctions on individuals or audit firms. |
| 201 | An auditor is prohibited from providing a current audit client with non-audit services, including bookkeeping; actuarial services; internal-audit outsourcing services; human resources services; broker-dealer, investment adviser, or investment banking services; legal services and expert services unrelated to the audit. |
| 302 | <p>Officers must certify annual or quarterly reports submitted to the SEC. The certifications include that:</p> <ul style="list-style-type: none"> • the signing officers have reviewed the report • the report does not contain any material untrue statements or material omission or anything that could be considered misleading • the financial statements and related information fairly present the financial condition and the results in all material respects • the signing officers are responsible for internal controls and have evaluated these internal controls within the previous 90 days and have reported on the findings. • officers must provide: <ul style="list-style-type: none"> i) a list of all deficiencies in the internal controls and information on any fraud that involves employees who are involved with internal activities ii) details of any significant changes in internal controls or related factors that could have a negative impact on the internal controls. |
| 401 | The SEC must implement rules requiring issuers to disclose material off-balance sheet transactions. |
| 404 | Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting. This statement shall also assess the effectiveness of such internal controls and procedures. |
| 406 | The SEC must issue rules requiring issuers to disclose whether they have adopted a Code of Ethics for senior financial officers, or if not, why not. |
| 802 | Any accountant who conducts an audit of an issuer is required to maintain all audit or review work papers for a period of five years from the end of the fiscal period in which the audit or review was concluded. |
| 906 | Each 'periodic report containing financial statements' filed by an issuer must 'be accompanied by' a certification by the issuer's CEO and CFO that the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer. |

Section 3. The Impact of Sarbanes-Oxley Act on Pakistani Businesses

"These requirements are tough, and they will entail extra work and cost. However, the objective of achieving the best possible assurance that a company's financial statements are reliable is simply too important to demand any less."

(William McDonough, Chairman, PCAOB)

3.1 EXTENT AND LEVEL OF COMPLIANCE

A number of multinationals in Pakistan are implementing the Sarbanes-Oxley Act because they have affiliates or parent companies operating in the US and hence it is mandatory for them to comply with the Act. These multinationals have hired auditing firms to help them to do so. Some local listed Pakistani companies are in the initial stages of implementing compliance with the Act, either because they are exploring the option of secondary listing on a US Stock Exchange or are considering expanding operations to other parts of the world, or mergers with or acquisitions by a US company.

3.1 (a) COMPLIANCE WITH SECTION 404

Section 404. Management assessment of internal controls

"(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

- (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
- (2) 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.

Continued

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a) each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement."

(Sarbanes-Oxley Act, 2002)

In general, SOX-compliant companies in Pakistan are implementing only Section 404 of the Act, because such companies are mainly the subsidiaries of multinationals:

"...it is not that we are required to comply only with Section 404. It is just that most of the other provisions of Sarbanes-Oxley Act are being complied with at the headquarters level. To take an example, Section 406 of the Act requires that every issuer come up with a Code of Ethics for the senior management. Now, this Code of Ethics is made by the Head Office. Section 404 requires management to certify internal controls over financial reporting. These internal controls are necessary for the entire operations of the business, not just at the headquarters level. Hence, our business in every country must have documented and tested internal controls."

(SOX Compliance Officer of a Multinational Enterprise)

3.1 (b) DE-SCOPING FROM COMPLETE COMPLIANCE WITH SECTION 404 OF THE SARBANES-OXLEY ACT

Even in terms of compliance with Section 404, multinationals in Pakistan have been 'de-scoped'¹³ from complete compliance.

“Sarbanes-Oxley Act requires proper cost, time and efforts. The Head Office has thus designed a tier system. The first tier is for bigger countries such as Japan, China, US and Europe, which have to follow the Sarbanes-Oxley Act to the full extent. For countries such as Pakistan, which are in the second tier, a short version, which is a generic test plan covering certain aspects of Section 404, has been developed. That means that Pakistani operations are immaterial, as far as compliance with this Act is concerned. This is mainly because Pakistan is a very small entity for our company as a whole. When SOX was implemented, as our company is listed on the New York Stock Exchange, we were given a comprehensive plan to implement SOX in its entirety in Pakistan. Then we were informed that the Head Office had come up with a global balance sheet and had decided to cover only 80% to 85% of the balance sheet portfolio. Pakistan was not included in the 85% and thus de-scoped.”

(CFO of a Multinational Enterprise)

One of the requirements of Section 404 is that the soundness and effectiveness of the internal controls must be verified by an external auditor. For a de-scoped location such as Pakistan, this requirement is waived. The de-scoped locations of a global concern are not subject to internal control verification by an external auditor.

“For a full-scope country, the auditor will have to verify the internal control structure but for a de-scoped country the auditor will not have to verify the internal controls on the assumption that if systems and procedures of the full-scope countries have been approved by auditors then the systems and procedures

being used in the de-scoped countries are also credible as we are using the same systems and procedures.”

(Chief Internal Auditor of a Multinational Enterprise)

De-scoping Pakistani operations from complete compliance with Section 404 is certainly interesting. It can thus be concluded that the Act is being implemented on a very small scale by multinationals in Pakistan. There is so far no documented research about this de-scoping from Sarbanes-Oxley Act in other parts of the world. It was indicated by interviewees that other countries, such as Bangladesh and Sri Lanka, might also be de-scoped from compliance with Section 404.

3.2 BENEFITS OF SARBANES-OXLEY ACT COMPLIANCE

In a survey of CFOs in the US, only 30% of the respondents thought that the benefits of Sarbanes-Oxley Act would exceed the costs in terms of time spent, professional fees, and other resources used.¹⁴ The CFOs of multinational and local-listed companies interviewed for the purpose of the present discussion paper also expressed reservations about the costs of implementation of the Act. There was, however, a consensus that even though it is an overreaction to Enron, if complying companies can view SOX as more than a law that has to be complied with and understand its spirit, they will derive a number of benefits.

“Sarbanes-Oxley Act has received so much negative feedback in the US but now if you look at the research that is coming out, it outlines that many companies have attained great benefits by implementing Sarbanes-Oxley Act. Research has shown that Sarbanes-Oxley Act encourages transparent reporting and effective internal controls.”

(Partner of a Local Auditing Firm)

This section outlines the perspective of different stakeholders of the perceived benefits of compliance with the Sarbanes-Oxley Act.

¹³Even though the parent company is implementing SOX on a global level, the subsidiary or affiliate company in Pakistan is not doing so.

¹⁴Beasley, Mark S., and Hermanson R. Dana. “Going Beyond Sarbanes-Oxley Compliance: Five Keys to Creating Value.” CPA Journal 74 (2004): 11-13. Jan.-Feb. 2007.

One of the main benefits perceived by the interviewees was more effective and transparent internal controls as a result of the SOX legislation.

“To a certain extent, we already had the internal control demanded by SOX but Sarbanes-Oxley Act has given a new meaning to the importance of effective internal controls. It helps in development of a control framework and it specifies COSO as the framework to be used. Unfortunately, even though the Code of Corporate Governance of Pakistan and other codes also emphasise implementation of internal controls, they generally do not specify what kind of controls and what kind of framework to follow. SOX is very precise about internal controls. Even though I have reservations about the costs of compliance with SOX, it has given a proper direction to internal controls.”
(CFO of a Multinational Enterprise)

The partner of an auditing firm stated:

“The greatest advantage of SOX is its comprehensive approach towards implementation of internal controls. In terms of principles, Sarbanes-Oxley Act has been and would be extremely useful, as companies will actually see what the design gaps are in their own internal control structure. The Code of Corporate Governance needs to take a cue from the SOX legislation relating to internal controls and come up with something like SOX. Perhaps the regulator here should specify an internal control framework such as COSO for companies to adopt.”

Section 404 of SOX mandates that a company's internal control over financial reporting should be based upon a recognised internal control framework and the US SEC has suggested COSO¹⁵ as the model framework.¹⁶ Despite their reservations about different aspects of the SOX legislation, a number of the stakeholders interviewed were in favour of implementation of the COSO framework of internal controls¹⁷ in Pakistan.

“COSO provides a sound basis for establishing internal control systems and determining the effectiveness of internal controls. The basis of SOX is the COSO framework. The Code of Corporate Governance does mention internal controls but if it could specify a framework such as COSO as a best practice, many local companies will have a definite framework to adopt as well as having some guidance to follow.”
(Partner of an Auditing Firm)

¹⁵Further detail on the COSO framework can be found at www.coso.org

¹⁶Abrahami, Abe. "Business Governance: Sarbanes-Oxley Act (SOA) Compliance." *Management Services* (2005): 28-31. Jan.-Feb. 2007.

¹⁷Issued by the Committee of Sponsoring Organisations of the Treadway Commission.

The COSO framework for internal controls

In 1992, the Committee of Sponsoring Organisations of the Treadway Commission (COSO) developed a model for evaluating internal controls. This model has been adopted as the generally accepted framework for internal control and is widely recognised as the definitive standard against which organisations measure the effectiveness of their systems of internal controls. The COSO model defines internal control as 'a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance of the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations.

There were, nevertheless, reservations expressed about whether, through the adoption of stringent internal controls outlined by the Act, future scandals such as Enron can be prevented.

"As far as Sarbanes-Oxley Act goes, it is something that happened in US that prompted this Act and the requirements are too stringent, because they are probably thinking everyone in the world is inclined to commit fraud. In Pakistan we do not need Sarbanes-Oxley Act because we do have certain values and ethics. The Act is an extreme overreaction. Pakistani companies have been run very diligently and we haven't had many serious cases of corporate mismanagement. SOX emphasises the implementation of effective internal controls, but did Enron happen because of failure of internal controls? It happened because of the failure of top-level senior management. The majority of corporate failures in the US have happened because the top-level, senior management was doing something fraudulent. They were not the result of failure of internal controls. SOX should have come up with stringent mechanisms to deal with boardroom and top-level issues rather than internal controls. SOX has not diminished the possibility of a fraud like Enron. So then what are the benefits really?"

(Chief Internal Auditor of a Multinational Enterprise)

At the same end of the spectrum was another multinational that claimed not to have gained any substantial benefits from complying with the Act.

"Section 404 actually asks you to document each and every control, and then get those controls tested first yourself and then by the external auditor as well. And then the external auditor has to certify and give his opinion on the effectiveness and the design of the control. I don't think this rigorous process would add much value to our company. It might add value from the investors' point of view, but in terms of the operations of the company, I don't think it would add much to that. We were already complying with most of the controls. It is just that now we have to document these controls - it took a lot of time to document those controls, and it involved massive costs. Other than investor satisfaction, I don't think our company has added anything by the documentation of internal controls. Why do you need to document internal controls and then get them audited? Internal controls are an internal operational issue that should not be dictated by regulations and legislations. SOX compliance has, however, created awareness of internal audit function in our company. While documenting our internal controls, we found some gaps and loopholes and so in complying with SOX requirements we were able to have a better control environment, but then the costs of compliance are very high in the first year, though they have come down now."

(Internal Auditor of a Multinational Enterprise)

Even though the benefits of compliance with the Act are acknowledged, the reluctance to accept that it is useful in improving the control framework may in part be a

reaction to legislation that is generally considered stringent and draconian. SOX was a reaction to Enron, which was mainly a failure of management although also of internal controls. Pakistan has been a witness to financial scams such as the Crescent Standard Investment Bank and Bankers Equity Limited, which were also a combination of failure of management and internal controls. If effective and stringent internal controls had been in place, management would not have been able to take actions that were against the interest of the company.

In terms of Pakistan, it may be worthwhile considering the suggestion of outlining COSO as the best practice internal controls framework in the Code of Corporate Governance. The Code as it stands now outlines certain practices as mandatory but does not explain how to implement such practices. The Code states that a listed company's board of directors should establish a system of sound internal control that is effectively implemented at all levels within the company, but it does not specify the best practices for internal controls. Guidance notes on internal controls will be very helpful to local companies. In this context, the COSO framework may be used as the starting point for developing the guidance. One of the recommendations of this report is that the SECP, like its counterpart in the US, should also encourage the use of the COSO framework of internal control for listed companies in Pakistan.

3.2 (a) BETTER AUDIT AWARE ENVIRONMENT

The general perception is that SOX Section 404 has resulted in the creation of a better audit environment. The requirement of Section 404(b), to have a full scale external audit report which attests to and reports on the assessment of internal controls made by the management, was also outlined as an important benefit of the Act as it had resulted in an urgent need for a better control framework.

“Now every employee knows - of course he was being audited before that - but he knows that now there will be an external auditor doing that exercise rather than

an internal auditor. There has always been a different kind of reaction to an internal auditor and to an external auditor. Now that the external auditor has looked into the internal controls, we have a more audit-aware environment than before.”

(Internal Auditor of a Multinational Enterprise)

The partner of an auditing firm stated:

“Under SOX it is mandatory for the auditors to look into the design and implementation of internal controls. It is the auditor's responsibility to check that there are control designs and whether they are being implemented or not. The auditor has to have a detailed discussion with the top and middle managers so as to detect what possible frauds there could be in the company and what sort of procedures have been incorporated to detect the potential frauds.”

(Partner of a Big Four Auditing Firm)

Code of Corporate Governance of Pakistan and Internal Controls.

The requirements on internal control outlined in the SECP code are as follows.

- The board of directors establishes a system of sound internal control, which is effectively implemented at all levels within the listed company.
- In the directors' report to the shareholders, the directors shall include a statement to the effect that the system of internal control is sound in design and has been effectively implemented and monitored.
- The audit committee, according to its terms of reference, will ascertain that the internal control system, including financial and operational controls, the accounting system and reporting structure, are adequate and effective.

Although according to the SECP Code the external auditor is supposed to verify that a listed company is complying with the Code in general, there is no requirement in the Code relating specifically to the external auditor's verification of the internal controls. Unlike SOX, the Code does not require an external auditor's verification of the internal control system. The CFO of a multinational firm explained how the SOX legislation differed from the SECP Code as far as internal controls were concerned:

"Even though Sarbanes-Oxley Act is an extremely reactionary Act, it is definitely the required step forward as it aspires to give a more transparent picture to shareholders. Under the Code of Corporate Governance of Pakistan, auditors are required to submit a review report. A review report by definition has much less scope and places significantly fewer responsibilities on the auditor as compared with the full-scale audit report. Under Sarbanes-Oxley Act, auditors are expected to give a full audit report on internal controls and not just a review report. So that is a big difference. The full report greatly enhances the responsibilities of the auditor. I think in order to improve the control framework of listed companies and to encourage transparent reporting, the review report required under the Code of Corporate Governance should be replaced by a full-scale audit report."

(CFO of a Multinational Enterprise)

The above quote and similar opinions expressed by other interviewees suggest that in order to encourage the listed companies to have a better internal control system the external auditor should be required to verify the internal controls and the review report currently required under the SECP Code should be replaced by a more comprehensive full-scale audit report verifying the internal controls. This is one area the SECP needs to look at when considering a revision of the Code.

3.2 (b) INCREASED VALUE FOR INVESTORS

In a survey by Financial Executives International (FEI) in the US, out of the 217 companies surveyed, 55% agreed that Section 404 gives investors and other external users more confidence in a company's financial report.¹⁸ There was support for this view from some of our interviewees.

"I think there is a great value in SOX as far as investors are concerned as SOX ensures effectiveness of internal controls and eventually ensures that the financial statements that are prepared and that the public inspects have integrity. This results in increased investors' confidence. SOX aims to ensure transparency in the operations and disclosures of the company. Some may find this onerous but once you have taken the public's money then you have a responsibility towards them. SOX aims to make organisations perform this responsibility efficiently. Auditors object to SOX as it has resulted in greater pressure on them but those who have chosen to be in this profession have to deal with this extra burden."
(Interview with a Partner of a Big Four Auditing Firm)

Nonetheless, in the context of Pakistan reservations were expressed about whether the average local investor can perceive any value in implementation of SOX.

"I do not think that the common investors are even aware of the financial reportings let alone the governance of the company, and I am talking about the common investor at the Karachi Stock Exchange. The institutional investors perhaps, but again not so much on the governance practices: they probably look at the financial results and profitability. Even institutional investors are not concerned about Corporate Governance in Pakistan, so do you expect local investors to be concerned about something like Sarbanes-Oxley Act? May be foreign institutional investors are concerned about SOX implementation in

¹⁸Hill, Nancy T., John E. McEnroe, and Kevin T. Stevens. "Auditors' Reaction to the Sarbanes-Oxley and the PCAOB." *CPA Journal* (2005): 32-34. Jan.-Feb. 2007

Pakistan but then how many foreign institutional investors do we have in Pakistan? CalPERS¹⁹ may have millions invested in Asia but not a single dollar in Pakistan."

(Financial Analyst of a Securities Firm)

Investors in Pakistan have a short-term vision. Their main aim is to maximise profitability, but investment companies in Pakistan may take the view that a properly governed company with an effective internal control framework will have more sustainable profits. Until this view is generally accepted, it may be difficult for investors to foresee benefits in the implementation of SOX. It is noteworthy that one of the main reasons for scandals such as Mehran Bank, Crescent Standard Investment Bank and Bankers Equity Limited was lack of governance, and this resulted in financial loss to the public. So investors need to realise that properly governed companies create sustainable profits.

3.2 (c) ENFORCEMENT MECHANISMS

The Code of Corporate Governance does not specify the penalties for companies that do not comply with it. There is no evidence of de-listing due to non-compliance with the Code. It was observed that despite reservations about different aspects of SOX legislation, interviewees generally were appreciative of the system of penalties for enforcement envisaged by SOX.

"The good thing about Sarbanes-Oxley Act is the enforcement mechanism - the penalties mentioned by the SOX Act. This is a good tool to stop management fraud and move towards proper internal controls. Many may find it draconian and hellish but if you are a public limited company and you have betrayed the trust of public, you should be given an exemplary punishment."

(Interview with Finance Controller of a Local-Listed Enterprise)

SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

"§ 1350. Failure of corporate officers to certify financial reports.

(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS. — Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

"(b) CONTENT. — The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

"(c) CRIMINAL PENALTIES.—Whoever—

"(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or

"(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both."

¹⁹The California Public Employees' Retirement System (CalPERS) provides pension fund, healthcare and other retirement services for approximately 1.5 million California public employees. As of May 2007, it owned \$240 billion worth of stock, bonds, funds, private equity and real estate. It is the largest pension fund in the United States. Further information on CalPERS can be found on www.calpers.ca.gov

Cotinued

(B) CLERICAL AMENDMENT. —The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"1350. Failure of corporate officers to certify financial reports."

(Sarbanes-Oxley Act, 2002)

3.2 (d) PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board²⁰ (PCAOB 'the Board') as a non-profit corporation, consisting of five members, to oversee the audit of public companies that are subject to US securities laws. The Board is funded independently of the SEC, but the SEC has regulatory oversight of the Board, including the appointment of its members. One of the benefits foreseen in the context of Pakistan was establishment of a similar body for Pakistan - an idea for improved Corporate Governance and accountability also suggested by the World Bank Report on Observance of Standards and Codes (ROSC).

The Institute of Chartered Accountants of Pakistan (ICAP) has been an important force for corporate governance reforms in Pakistan. However its role in the oversight of the accounting and auditing professions is now under review, given the international consensus that the professions' self-regulatory arrangements and authority to impose sanctions should be balanced with adequate and independent oversight systems.

(ROSC - World Bank Report on Observance of Standards and Code - Accounting and Auditors²¹
ROSC - World Bank Report on Observance of Standards and Code - Corporate Governance²²)

By establishing the Board, the Act put an end to over five decades of professional self-regulation. The accounting profession in the US no longer has the authority to set or enforce these standards. The authority both to set and enforce standards was delegated to the Board.

Did you know?

SOX has also given the Board the prerogative to carry out inspections of the large audit firms. In 2004, the Board published the results of an inspection of 11 of KPMG's 90 practice offices. The report specified deficiencies in 19 out of a total of 76 audits inspected. In some cases there were failures by KPMG to identify or address errors in the application of GAAP, some of which were likely to be material to a company's financial statements. There were also cases of failures to perform necessary audit procedures. In a letter released with the Board's report, KPMG accepted the results of the inspections.²³

KPMG's acknowledgement of the findings of the inspection by the Board indicates that there are advantages in having an independent regulatory body to oversee the auditing profession. The interviewees belonging to local listed and multinational companies in Pakistan were very much appreciative of the work of the Institute of the Chartered Accountants of Pakistan but were of the opinion that an independent oversight board will enhance the credibility of the accounting and auditing profession of Pakistan.

"One of the reasons for the occurrence of Enron was an auditing firm called Arthur Anderson. The auditors have to be overseen by an independent oversight body. Sarbanes-Oxley Act has brought about an oversight board for the auditing profession, which the accounting and auditing profession in this country

²⁰Further detail on the PCAOB can be found on www.pcaobus.org

²¹http://www.worldbank.org/ifa/rosc_aa_pak.pdf

²²http://www.worldbank.org/ifa/rosc_cg_pak.pdf

²³"US Audit Watchdog Reveals KPMG Deficiencies." *Accountancy* 30 Sept. 2005. Jan.-Feb. 2007 <<http://www.accountancymag.co.uk/main.asp?storyid=7826&pagetype=10>>.

does not like; they do not want an oversight board. But the point is that everybody has to have an oversight; nobody is beyond oversight. The argument that the profession has given is that we are self-regulatory so why do we need an oversight board? ICAP has done a great job but even ICAP will admit that there is a conflict of interest; the ICAP council includes auditing firms' representatives, the President is usually a partner of a Big Four auditing firm. Is this not conflict of interest? This situation can be improved by having an independent oversight board."
(Interview with the CFO of a Local-Listed Enterprise)

The proposal for an independent oversight board expressed by the World Bank in ROSC and echoed by a number of stakeholders interviewed during the course of this project needs to be explored realistically and practically.

3.3 COSTS AND OBSTACLES OF SARBANES-OXLEY ACT COMPLIANCE

"First, there are increased costs associated with the required additional auditing services. Second, compliance places additional responsibilities on members of corporate boards, increasing board members' workloads, and requiring increased compensation. Third, compliance also creates an opportunity cost as companies spend time and resources complying with the Sarbanes-Oxley Act rather than focusing on core business activities that could lead to increased earnings. Finally, indirect costs are incurred by corporations when they expend resources as part of the compliance effort that could have been utilized in a more productive and profitable manner."

(Brigham Young University Law Review, 2006)

Like any other regulation, Sarbanes-Oxley also necessitates costs of compliance. This section of the report gives a brief overview of the costs and obstacles to SOX implementation in Pakistan.

3.3 (a) TIME AND RESOURCES REQUIRED FOR COMPLIANCE

Compliance with Sarbanes-Oxley has been termed 'a major drag on the economy'²⁴ and compared to throwing 'buckets of sand into the gears of the market economy'.²⁵

'What Directors Think'

One out of five directors surveyed (20%) agreed that the Sarbanes-Oxley Act has created an environment where management is so distracted that company performance will be affected.²⁶

"SOX requires that everything should be tested, physically signed off and verified. This is additional work. Complying with the Sarbanes-Oxley requirement is thus a very lengthy exercise for any organisation because you have to document each and every

transaction - from the transaction level to the reporting of it into the financial statements, and the disclosure of that transaction. This requires time and resources and this might affect our earnings. It is not that our company did not have the internal controls and all the stuff required by SOX but we did not have them documented and now we have to do it and that is distracting us from our core business of earning profits."

(Chief Internal Auditor of a Multinational Enterprise)

Another representative of a multinational operating in Pakistan stated:

"Corporate Governance is very significant issue. But it is not the primary purpose of the business. SOX is Corporate Governance. It requires a substantial time commitment from the management. The management has to go through a detailed internal review with the consultants and they have to comply with it continuously. I do think SOX has benefits but the time and effort spent is a nuisance."

(Financial Controller of a Multinational Enterprise)

The above comments are interesting. It is important to note that these interviewees did not deny the importance of internal controls for the effectiveness of

²⁴Mario J. Gabelli, the CEO of Gabelli Asset Management in the US. Source: "Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by the Sarbanes-Oxley." *Brigham Young University Law Review* (2006): 175-208. Jan.-Feb. 2007.

²⁵CEO of Sun Microsystems, Scott McNealy. Source: "Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by the Sarbanes-Oxley." *Brigham Young University Law Review* (2006): 175-208. Jan.-Feb. 2007.

²⁶On 20 October 2004, Corporate Board Magazine and PricewaterhouseCoopers released the results of the third annual 'What Directors Think' study, which measures the opinions of directors and CEOs of the top 2,000 publicly traded companies (*Corporate Board Magazine* and PricewaterhouseCoopers, 2004).

organisations but were apprehensive about the time and costs. These opinions are not very different from the ones expressed in the 2005 US survey by Financial Executives International referred to in the subsection 3.2(b) where nearly all companies applauded the added focus on internal controls given in Section 404, but many respondents believed that the level of detail required is impractical and requires too much time and effort.²⁷

“Well, I think the foremost cost is the time and effort put in by everyone. It is not just the project team working on the SOX implementation project in isolation; the whole organisation has to be involved. Then we have to fulfil the internal and external audit requirements. The time cost is the most significant cost. Then there is the people factor. It takes time for them actually to agree to SOX compliance. They find it hard to accept all the controls. People think they are being put to the sword. The goal is much broader. SOX does not aim to create hurdles for business. It can be implemented in a flexible environment where the business can be done better and in a more efficient manner.”

(SOX Compliance Officer of a Multinational Enterprise)

This is a noteworthy comment: even though the cost and people factors are outlined as obstacles in implementation of SOX, there is recognition of the value of SOX compliance.

“As far as documentation, controls or implementations are concerned, I think despite the high costs they are key areas. We had started taking the internal controls seriously after the Code of Corporate Governance but the Code does not emphasise assessments and documentation of your internal controls as much as Sarbanes-Oxley Act does. SOX takes documentation and implementation of internal controls to new levels and I think that is the way forward. SOX compliance costs will not be high for those companies that already have some internal control procedures, compliance

procedures and risk management procedures. If costs are high they are high for those companies that have not concentrated on internal controls, but if they have not done so, they should have.”

(CFO of a Multinational Enterprise)

Did you know?

A study in the US found that in 1999, 50% of the revenues of what were then the 'Big Five' accounting firms (in the US) came from consulting services, and only 34% came from auditing. By 2002, almost 75% of fees for auditors came from non-audit services such as those covered by SOX.²⁸

One of the main reasons for the high costs is the fee of the consultants recruited to implement SOX.

“First-year compliance costs are strictly high in term of resources and in terms of implementations of new policies, controls and procedures. Going forward, when the requirements and internal controls are embedded in day-to-day procedures and the management takes proper responsibilities, then the cost will definitely come down. If you look at the breakdown of the costs you will find that the largest portions of the costs are consultants' fees. There are no other huge costs such as buildings to be purchased as a compliance requirement or obtaining more computer technology, etc. Consultants specialise in the knowledge to implement Sarbanes-Oxley Act and gradually, when they have educated management about the controls, their participation will decrease. But right now they are needed and they are expensive.”

(CFO of a Multinational Enterprise)

Reservations were expressed, however, about the need for using consultants to implement SOX.

²⁷Hill, Nancy T., John E. McEnroe, and Kevin T. Stevens. "Auditors' Reaction to the Sarbanes-Oxley and the PCOAB." *CPA Journal* (2005): 32-34. Jan.-Feb. 2007.

²⁸Ainsworth, Richard T. "What Sarbanes-Oxley Really Means for Tax Services." *International Tax Review* 15 (2004). Jan.-Feb. 2007.

“Implementing companies do not understand the principles of SOX legislation and especially those of Section 404. The intention and objective of SOX was that the board of directors, management and all the people running the company should go through the rigorous exercise of coming up with control policies and documenting them so as to make everyone appreciate the need to have an effective control framework. In that process they would be able to identify both their own control weaknesses and what control policies were needed in their businesses. This way they would get better awareness of the governance of the company. This objective cannot be achieved by outsourcing implementation of SOX. Costs are being incurred because of outsourcing of SOX implementation. You are getting an external party to come in and do your own documentation. So that, in my opinion, by-passed the intention. You are still in compliance with the SOX, but are you really achieving the main objectives? Enron happened because of management failure to have comprehensive internal controls. SOX aims to create a culture of appreciation of awareness of internal controls by management as well as everyone else, thus aiming to prevent future failures.”

(Financial Controller of a Local-Listed Enterprise)

Companies across the globe, however, have outsourced this process to auditors simply because they do not have the level of understanding and expertise required to implement SOX Section 404. In the opinion of the auditors the costs are high mainly because the extent and nature of audit required under SOX requirements makes it very tedious, comprehensive and time consuming.

“About the auditors' fee as consultants, I would like to articulate one point. SOX requires a substantial time commitment of the senior audit staff, as it requires special expertise and experience which only the senior auditors have. You simply cannot ask the trainees to do the work. As far as traditional auditing is concerned, you can always send trainees, but not with Sarbanes-Oxley Act. You require a good team, but I think internationally it has been agreed that the

benefits are far more than the fee.”
(Partner of a Big Four Auditing Firm)

A partner from another Big Four Auditing Firm further elaborated on this issue. This partner admitted that some auditors in Pakistan had to undergo training first before they could assist in Section 404 implementation. He also accepted that SOX consultancy and audit had generated considerable revenue for the firm.

“I would not say exactly that SOX has made our job difficult but we suddenly had to go through a lot of training processes for SOX. In fact, it has given us a chance to make more revenue. Another reason why SOX is difficult to implement in Pakistan is because we do not have enough talented professionals for its implementation.”

(Partner of a Big Four Auditing Firm)

The issue of lack of qualified people in Pakistan who can undertake Sarbanes-Oxley Act execution is discussed later in detail in this report. It is pertinent to mention that, even in the US, the first-year compliance costs exceeded the CFOs' expectations, mainly owing to the high costs of consultants.²⁹

Perhaps the way forward is for the management to phase out the external consultants slowly by working closely with them for a few years, after which they will be able to design and implement effective internal controls independently.

It can thus be concluded from this sub-section that even though the costs of compliance with SOX are high, there is recognition of the value of compliance with it and a hope that the costs of compliance will come down after the first few years.

3.3 (b) HUMAN RESOURCES CONSTRAINTS

The real challenge in Section 404 compliance is documenting the processes, identifying the risk areas and designing controls to cover those risk areas.

²⁹Ainsworth, Richard T. "What Sarbanes-Oxley Really Means for Tax Services." *International Tax Review* 15 (2004). Jan.-Feb. 2007.

"In Pakistan one of the main problems faced is the quality of the human resources. Everyone has to be involved in implementation of SOX but in Pakistan one cannot even find a competent qualified SOX implementation project manager - it is generally impossible. The main challenge to SOX implementation in the long run is not the high costs of compliance but getting the right people to implement SOX."

(Financial Controller of a Multinational Enterprise)

A partner from one of the Big Four Auditing Firms further emphasised the unavailability of human resources as one of the main challenges in implementation of SOX:

"SOX is a very onerous law that requires the commitment of human resources. SOX has increased the work-load of auditors but in Pakistan, even though work relating to SOX implementation is increasing, it is difficult finding the required human resources. Somehow young people join us very much interested in knowing about SOX and two months down the line after having gained an understanding of SOX decide to go abroad to implement SOX or verify controls as auditors. Implementation of SOX requires establishment of a full-time set-up to continuously evaluate the internal controls. But there are not enough qualified people in Pakistan to be part of this full-time set-up."

(Partner in a Big Four Auditing Firm)

Designing and implementing internal controls is not an easy task and both SOX-compliant companies and auditing firms expressed reservations about the quality and quantity of human resources for implementing SOX, at this stage, in Pakistan.

"In Pakistan it is difficult to get audit staff. Now auditing firms need more staff for SOX audits. It is the acute shortage of auditors that is resulting in increased audit fees. The plethora of corporate governance legislations and regulations such as SOX has no doubt created a lot of additional work and opportunities for auditors but we face a critical shortage of qualified accountants."

(Partner of Big Four Auditing Firm)

It should be mentioned, however, that other countries are also facing a shortage in qualified human resources equipped to deal with SOX. With the upsurge in demand for auditing services, the average auditing costs in the US have escalated by 60% since the Act was passed.³⁰

The situation relating to shortage of accountants and auditors needs to be resolved on an urgent basis.

All the professional accounting bodies have to play a crucial role.

3.3 (c) RISK AVERSENESS

*"[The **Sarbanes-Oxley** Act] may well succeed in stopping the next Enron but it could crib-kill the next Cisco, Microsoft and Starbucks ... Cash-starved startups may have to dump three engineers for one lawyer."*

(Forbes publisher Rich Karlgaard)

"The most serious effect will be to discourage risk..., executives will naturally become ultra-cautious, even timid. Bold new [ventures] will be shunned ... By penalizing risk, certification threatens chronic economic paralysis."

(Alan Reynolds, Senior Fellow, CATO Institute)

Another major concern in the US regarding SOX is that businesses will be so wary of risky ventures that they will not be keen to take any new risks at all, thus curbing economic growth. This concern, however, was not cited by any of the interviewees in Pakistan. Perhaps it is premature for the Pakistani business community to worry about such issues at this stage.

3.3 (d) DELISTING

One of the companies stated that the excessive cost of compliance with SOX is resulting in de-listing of companies from the US Stock Exchanges.

³⁰Ainsworth, Richard T. "What Sarbanes-Oxley Really Means for Tax Services." *International Tax Review* 15 (2004). Jan.-Feb. 2007.

“We decided to de-list from the US Stock Exchange, because when we evaluated the costs of implementations with the benefits we could have obtained from being listed on US stock markets, the benefits were not worth it at all. It required too much work. We were listed on the US market to access capital but again the benefits were not attractive so we de-listed as there were huge SOX compliance costs.”

(Senior Accounts Manager of a Multinational that decided to de-list from the US Stock Exchange)

In the US and Europe there have also been several cases where companies have de-listed or have opted against listing on a US Stock Exchange owing to the high cost of compliance with the Act. A record 198 companies de-listed in 2003, the first full year after the passage of the Act, and another 134 did so in 2004.³¹

“I think SOX is very desirable. People who are running the business must make sure that the falsification of accounts will not take place. The argument against SOX is that the costs of implementation are very high. It costs millions of dollars to implement it. I do not agree. The point is that the basic question of integrity and correctness of financial statements is the prime responsibility of the management of the company and the costs are meaningless., The cost of implementing Sarbanes-Oxley Act are very high but what about the cost of not implementing Sarbanes-Oxley Act? Enron, I believe. Thus the cost of not doing it is much higher than the cost of doing it. So then this argument that it costs much more to implement it, is futile now. It is a weak argument.”

(A Stakeholder)

CONCLUSION

Subsections 2 and 3 in this section have presented an overview of the benefits and costs of compliance with Sarbanes-Oxley Act. Among the major benefits perceived by the companies implementing the Act are more effective internal controls, a more audit-aware environment within the company, increased value for investors and the surveillance by the Public Company Accounting Oversight Board. The main problems faced were the high costs of compliance, particularly the high fees paid to SOX consultants, and the lack of human resources. It can, however, be concluded that even though there are substantial costs associated with SOX compliance, there is recognition of its long-term benefits in the improved effectiveness of internal controls and oversight. The costs are expected to reduce in subsequent years as external consultants are gradually phased out.

³¹Feldman, Amy. "What Does Sarbanes-Oxley Mean for Companies That Want to Go Public?" *Inc.Com* Sept. 2005. Jan.-Feb. 2007 <<http://www.inc.com/magazine/20050901/surviving-so-sidebar.html>>.

Section 4 - Sarbanes-Oxley Act and the Future of Corporate Governance Regulations in Pakistan

The Sarbanes-Oxley Act was a response to Corporate Governance failures such as Enron and WorldCom in the United States. Pakistan has also witnessed a number of corporate debacles.

TABLE 4.1: MAJOR CORPORATE DEBACLES OF PAKISTAN

| Year | Company Involved |
|------|--|
| 2006 | Crescent Standard Investment Bank Limited (CSIBL). |
| 2001 | National Development Finance Corporation |
| 2000 | Indus Bank Limited |
| 1996 | Bankers Equity Limited |
| 1994 | Mehran Bank Limited |
| 1991 | Cooperative Societies |

Corporate Governance regulations in Pakistan has emerged much more recently than in the developed countries. Table 4.2 lists the main milestones in the implementation of Corporate Governance regulations in Pakistan.

TABLE 4.2: MILESTONES IN IMPLEMENTATION OF CORPORATE GOVERNANCE REGULATIONS IN PAKISTAN

| | |
|------|--|
| 1997 | The Securities and Exchange Commission of Pakistan Act is passed by Parliament. |
| 1999 | The Securities and Exchange Commission of Pakistan (SECP), having autonomous status, becomes operational and replaces the Corporate Law Authority. |
| 2002 | SECP issues Code of Corporate Governance and makes it part of the listing requirements in Pakistan. |

Today, the Securities and Exchange Commission of Pakistan (SECP) has the authority to regulate the entire corporate sector, capital market, non-banking financial sector, i.e. investment financial services, leasing companies, housing finance services, venture capital investment, discounting services, investment advisory services and asset management services. In addition to this, the federal government of Pakistan has delegated power to the Commission to regulate various external service providers that are linked to the corporate sector, such as chartered accountants, rating agencies, corporate secretaries.

Although the SECP implemented the Code of Corporate Governance in March 2002, corporate financial collapses, such as the one relating to the Crescent Standard Investment Bank Limited, still continue to surface. One of the objectives of our research was to ascertain whether or not there is a need for greater transparency and accountability in the affairs of listed companies in Pakistan and whether certain provisions of the Sarbanes-Oxley Act can fulfil those needs. This section of the report deals specifically with this objective of the research.

4.1 EXISTING CORPORATE GOVERNANCE REGULATIONS AND SECTION 404 OF THE SARBANES-OXLEY ACT

The main Corporate Governance regulation in Pakistan at this stage is the Code of Corporate Governance ('the Code') issued by the SECP, which is part of the listing regulations of the Karachi, Lahore and Islamabad Stock Exchanges. The State Bank of Pakistan (SBP) is also a regulator of the financial sector of Pakistan.

Pakistani banks and Development Financial Institutions (DFIs) are also required to comply with the circulars issued by the SBP. The requirements of Banking Surveillance Department (BSD), Circular Number 07, 2004³² appears very similar to those of SOX Section 404. Table 4.3 compares and contrasts the main requirements of the BSD 7, 2004 circular issued by the State Bank of Pakistan and those of Section 404 of the Sarbanes-Oxley Act.

³²The complete BSD 07, 2004 circular can be found on <http://www.sbp.org.pk/bsd/2004/C7.htm>

TABLE 4.3: BRIEF COMPARISON OF BSD 7, 2004 CIRCULAR OF SBP AND SECTION 404 OF SOX

| BSD 7, 2004 Circular of State Bank of Pakistan | Section 404 of the Sarbanes-Oxley Act |
|---|---|
| All employees are responsible for operating an efficient internal control system. The Board of Directors is responsible for ensuring existence of an efficient internal control system. The management is responsible for appropriate design and functioning of the system. Internal audit is responsible for monitoring and evaluating the system. | Management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. |
| External auditor is responsible for evaluating the system with respect to its design, performance and management's understanding regarding its adequacy. | External auditor is responsible for attesting to and report is on the assessment of internal controls made by the management of the issuer. |

Both regulations demand a sound internal control system, which is supposed to be certified by the external auditor. The banking sector of Pakistan has not found it easy to comply with the requirements of the circular.

According to the original BSD 7, 2004 Circular, all banks / DFIs were supposed to submit a half-yearly progress report (the year-end being 31 December 2004) for compliance with this circular, with a statement of attestation from each organisation's external auditors. The date for compliance with this requirement was, however, deferred for one year till December 31, 2005 via the BSD Circular Letter No. 03 dated 26 January 2005. The deadline was again deferred for another year, according to the BSD 1 Circular Letter No. 1 issued on 14 January 2006.³³ Therefore, according to BSD 01 Circular dated 14 January 2006, the banks and DFIs were required to be compliant for the year ending 31 December 2006.

4.2 SUFFICIENCY OF SECP CODE OF CORPORATE GOVERNANCE

The main problem in implementing BSD 07, 2004 Circular has been the unavailability of human resources. It is, however, important to note that a circular has been issued with certain provisions that bear a resemblance to the provisions of SOX. SECP's Code is the principal Corporate Governance regulation in Pakistan. But is this regulation adequate to ensure Corporate Governance of the highest standards in the country or is there room for significant improvement? The overwhelming response obtained from most interviewees was that in many respects the Code is sufficient but it does need a review and possible incorporation of some of the provisions of SOX legislation.

"Well, there is always room for improvement in everything. Our Code covers the operational effectiveness and also deals with strategic issues of companies. It is not just limited to the financial issues. So the Code in its present form, I feel, is not sufficient at all. There are some areas that can be improved; these can be borrowed from the Sarbanes-Oxley Act. Our Code lacks a system of punishment for

³³The complete BSD 01, 2006 circular can be found on <http://www.sbp.org.pk/bsd/2006/C1.htm>

non-compliant companies. My view is that the Pakistani Code should also have some sort of penalties for people who commit fraud and who provide incorrect information. And the penalty should not be a fine of a thousand rupees so that those who want to mock the regulation can easily pay the fine and get away with it. The penalties should be much more severe, like the one given in SOX.”

(Finance Controller, of a Local-Listed Enterprise)

A number of interviewees suggested that the COSO framework of internal control, recommended by the US SEC for Section 404 compliance, should also be included in the Code as the recommended framework of internal control.

“Even our own Code of Corporate Governance requires that the company has internal controls. But companies do not really bother with this provision because there is no framework specified or recommended by the SECP against which to judge the internal controls of a company. All of them have compliance statements that state that the company has an adequate system of internal controls. But how many of them actually do? The SEC in America does not specify the COSO framework but it strongly recommends it. We should have something like COSO here too.”

(Partner of a Big Four Auditing Firm)

Many interviewees also commented that the SECP Code is very broad in scope and does not focus on any one aspect of governance. SOX, they felt, emphasised the importance of internal controls over financial reporting. This kind of emphasis was required in the Code of Corporate Governance of Pakistan.

“The SOX Act deals with Corporate Governance in general but the specific reporting requirements of Sections 302 and 404 focus on internal controls over financial procedures and financial reporting. Section 404 covers only the reliability of financial reporting and compliance with laws and regulations aspect of the COSO definition of internal control. The Code of Corporate Governance is broader in scope to the extent that it not only focuses on reliability of financial reporting but also encourages listed

companies to focus on effectiveness and efficiency of operations by having a mission / vision statement and policies and procedures in the areas of risk management, HR, marketing, and health. We should also have a more stringent regulation dealing with internal controls.”

(Finance Director of Local-Listed Enterprise)

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

“(a) REGULATIONS REQUIRED.—The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that

- (1) the signing officer has reviewed the report;
- (2) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
- (3) based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;
- (4) the signing officers—
 - (A) are responsible for establishing and maintaining internal controls;
 - (B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;

(Continued)

- (C) have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and
- (D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
- (5) the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—
 - (A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
 - (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
- (6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

H. R. 3763—34

- (b) FOREIGN REINCORPORATIONS HAVE NO EFFECT.—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.
- (c) DEADLINE.—The rules required by subsection (a) shall be effective not later than 30 days after the date of enactment of this Act.

(Sarbanes-Oxley Act, 2002)

A unique feature of the Act is that it establishes the PCAOB, a new regulator, to oversee the audit of public companies and deal with other areas such as quality control, ethics and independence of auditors, to conduct inspections of registered firms and to carry out investigations where necessary. Furthermore, the Act takes the power of issuing standards on auditing, quality and associated areas away from the American Institute of Certified Public Accountants (AICPA), the US equivalent of Pakistan's ICAP.

In Pakistan, overseeing the work and quality assurance of the external auditors rests with the ICAP, through its quality control programme, and the SECP, through its review of audited financial statements. Pakistan generally subscribes to internationally enforced International Standards on Auditing, but the technical releases and circulars of ICAP also have significant impact. Quality control of external auditors in Pakistan is formally carried out by ICAP whereas SOX took that power away from the AICPA. One of the reasons for that was that the AICPA comprised Certified Public Accountants (CPAs), the same group comprising the partners of auditing firms. In Pakistan too, Chartered Accountants are partners of auditing firms as well as being council members of ICAP.

There was a general feeling that the auditing profession should no longer be self-regulated.

"I personally think SOX is a good thing...one of the principal features of this legislation was that it restricted the role of the auditor. An important feature of Sarbanes-Oxley Act is that it has established an oversight board for the auditing profession. In Pakistan we do not have any such thing because the accounting and auditing profession in this country does not want an oversight board. Everyone needs some oversight, however: no one should consider themselves beyond oversight. The big firms, which are practising auditing firms, have more than the proportionate representation in the ICAP, so even though they claim they are self-regulatory where is the independent oversight?"

(CFO of a Local-Listed Enterprise)

Other than internal controls and the accounting oversight board, there are certain areas where the SECP Code can be made more stringent by borrowing some provisions from the Sarbanes-Oxley Act. For example, both the Code and the Act require the existence of an audit committee but while the Code requires only that the majority of the members of this committee should be non-executive, the Act goes further than this and requires that all audit committee members be independent and at least one of them must be a financial expert.

The Act also provides whistle-blower protection, which the SECP Code lacks. The Code also lacks any requirement relating to the disclosure of material changes. The Act, on the other hand, requires disclosure by companies of any material changes in financial condition or operations, on a rapid and current basis.

Perhaps one of the most significant distinctions between the SECP Code and the Act is that the Code is only enforceable through the listing regulations of Pakistan's Stock Exchanges while the Act is legislation, and so is legally enforceable in the US.

Section 5 - Conclusion and Recommendations

1. CONCLUSION

This research report has reviewed the current state of SOX compliance in Pakistan. The research suggests that the level of SOX compliance in Pakistan is very low. Generally only a few multinationals are complying with SOX, and compliance is largely limited to Section 404. The compliance is further limited by the fact that even these multinationals are de-scoped from complete compliance with Section 404. This means that even though they are designing and implementing internal controls, these internal controls are not subject to verification by an external auditor.

The companies in Pakistan also face a number of obstacles in complying with the Sarbanes-Oxley Act. Other than increased costs, one of the greatest obstacles to the implementation of the provisions of this Act in Pakistan is the shortage of accountants and auditors who are qualified to understand and implement Sarbanes-Oxley provisions as best practices in Pakistan. This shortage of qualified personnel needs to be resolved on an urgent basis.

The main benefits of SOX as perceived by SOX-compliant companies in Pakistan are better internal controls, the development of a more audit-aware environment, and increased investor confidence. Interviewees were generally in favour of the COSO model of internal controls, which is advocated by the US SEC, and were of the opinion that the same model should be adopted in Pakistan to ensure better and effective internal controls.

This research report also compared the Sarbanes-Oxley Act with the current Corporate Governance regulation in Pakistan, primarily the SECP Code of Corporate Governance. The SECP Code was a much-needed first step in instilling good Corporate Governance practices in Pakistani businesses. Financial collapses have continued to surface in Pakistan even after the implementation of the Code, which has been in place for about five years now. This leads us to the further conclusion that the Code can be strengthened and enhanced.

In this context the discussion paper makes a number of recommendations.

2. RECOMMENDATIONS

On the basis of the research conducted for this discussion paper we recommend that some of the provisions of the Sarbanes-Oxley Act be incorporated in the Code of Corporate Governance of Pakistan.

We recommend that the Code should require the management's assessment of internal controls and external auditors' verification of this assessment, in line with Section 404 of the Sarbanes-Oxley Act. It should be reiterated here that the regulator of the financial sector in Pakistan, the State Bank of Pakistan, has already issued a similar regulation BSD Circular No. 7, issued in 2004. We also strongly recommend that the SECP should encourage, if not require, the adoption of the COSO framework of internal control.

It should also be mentioned here that the US SEC, realising the extremely high cost of compliance with Section 404 of SOX, has announced a series of actions it intends to take to improve the implementation of the Section 404 internal control requirements. One such action is to publish a guideline for the management of companies on how to complete their assessment of internal control over financial reporting, as required by Section 404 of SOX. The other important step the SEC plans to take is the revision of Auditing Standard number 2. The proposed revisions would, among other things, ensure that during integrated audits the auditors focus on areas that pose higher risk of fraud or material error. All these steps are geared towards making it easier and less costly for companies to comply with Section 404. We therefore recommend that the Pakistani regulator should also take similar steps to ensure that the internal control requirement does not pose unnecessary costs and obstacles for Pakistani companies.

We also recommend that the SECP, while formulating a revised Code modeled on the international best practice, may consider regulating the auditing profession in Pakistan through an independent oversight board.

It can be concluded from the interviews conducted for the discussion paper that an oversight board is perceived as an important benefit of SOX.

Having a more effective Corporate Governance regulation in the country, with some provisions from Sarbanes-Oxley Act, would provide a major boost to investor confidence in the country.

The concept of whistle-blowing also needs to be introduced in the revised Code of Corporate Governance.

Bearing in mind the problems regarding lack of suitable personnel that interviewees reported during this research, a crucial recommendation of this discussion paper is that all the professional accounting bodies must play a key role in nurturing and cultivating auditors equipped with modern knowledge and skills.

ANNEXE: COMPARISON OF SECP CODE OF CORPORATE GOVERNANCE AND THE SARBANES-OXLEY ACT

| | SECP Code of Corporate Governance | Sarbanes-Oxley Act |
|--|---|--|
| Status | A Code enforceable through listing regulations of stock exchange. | Enacted legislation and enforceable as law. |
| Audit partner rotation | Requires listed companies to change the firm of external auditors it appoints every five years, and if this is not practical then to rotate the partner in charge of the audit engagement after obtaining the consent of the SECP. However, the 'change of firm' condition has been relaxed for listed companies, other than financial institutions, and rotation of partner is enough. | Sets a five-year limit on the lead and reviewing partner who provides services to an issuer. It also requires a second partner review and approval of audit reports. |
| Conflict of interest | Requirements stipulate that no listed company shall appoint a person as the CEO, CFO, or internal auditor or as a director of the listed company who was a partner in the firm of its external auditors (or an employee involved in the audit of the listed company) at any time during the two years preceding such appointment, or one who is a close relative of such a partner or employee. | Prohibits registered public accounting firms from auditing issuers whose CEO, CFO or chief accounting officer was employed by the accounting firm and participated in the audit of the issuer in any capacity during the one-year period prior to initiation of the audit. |
| Assessment of internal controls | Requires only that the Directors' Report should state that the system of internal control is sound in design and has been effectively implemented and monitored. The auditor has no responsibility in this regard. External auditors however are required to submit a 'review report' on compliance with the Code of Corporate Governance. | Requires that an issuer's annual report contain a report from management on internal control stating their responsibility for establishing and maintaining an adequate internal control structure and their assessment of the effectiveness of internal control over financial reporting. The external auditor is required to attest to management's assertion concerning its assessment of internal control as part of audit. External auditors are required to express an 'audit report' on internal controls. |

| | | |
|---------------------------------------|---|--|
| Audit committee | Lays out the responsibilities, powers and functions of the board of directors and the audit committee and also requires every listed company to have an internal audit function. It requires only that a majority be non-executive directors. | Requires every issuer to have an audit committee with defined terms of reference and also requires board oversight. Also requires that all members shall be independent and that one audit committee member is a 'financial expert'. |
| Penalties For non-compliance | Does not contain any provisions related to fines, penalties resulting from non-compliance with the Code. Lawmakers have stated that non-compliance will attract the same penalties, fines, etc as would any non-compliance with the listing regulations and in some areas, the Companies Ordinance, 1984. | Material non-compliance, incorrect certifications of financial conditions and results by the CEO and / or CFO, may lead to fines or imprisonment for the CEO and CFO. |
| Whistle-blower protection | Not covered under the Code. | Whistle-blower protection is extended to employees of companies and accounting firms by SOX. |
| Disclosure of material changes | Not covered under the Code. | Requires disclosure by companies on material changes in financial condition or operations on a rapid and current basis. |



