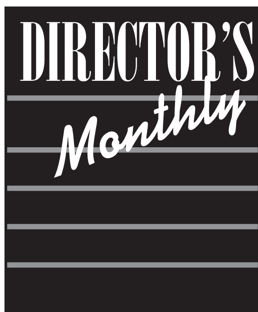

DM Extra!

Research Edition

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Research Edition

Timely Commentary on Critical Events and Regulatory Developments

WorldCom: Six Questions for Directors

Director Summary

On June 26, 2002, the world woke up to headlines about the discovery of a $3.8 billion accounting misstatement at **WorldCom**. This misstatement, like other troubling financial disclosures in the past several months (at **Enron**, **Global Crossing**, **Tyco**, **ImClone**, **Xerox**, and **Adelphia**, to name a few) raises (or should raise) at least six basic questions in the minds of corporate directors everywhere.

1) Facts: ***What happened—what was misstated at WorldCom and how?***

On the day the WorldCom board announced the discovery of a misstatement, the **Securities and Exchange Commission** filed a civil action in federal district court in New York naming the global communications provider.[1]

In its complaint, the Commission alleges that WorldCom fraudulently overstated its income before income taxes and minority interests by approximately $3.055 billion in 2001 and $797 million during the first quarter of 2002. The complaint claims that WorldCom portrayed itself untruthfully as a profitable business during 2001 and the first quarter of 2002 by reporting "earnings that it did not have." The SEC alleges that WorldCom did this by "capitalizing (and deferring) rather than expensing (and immediately recognizing) approximately $3.8 billion of its costs." The company transferred these costs to capital accounts in violation of established generally accepted accounting principles (GAAP) as well as certain provisions of federal securities law.[2] In a related action, the Commission ordered WorldCom to file with the Commission, under oath, a detailed report of the circumstances and specifics of these matters by 8 a.m. Monday, July 1. However, SEC Chairman **Harvey Pitt** characterized their response negatively, saying "WorldCom's statement is wholly inadequate and incomplete. It demonstrates a lack of commitment to full disclosure to investors and less than full cooperation with the SEC."

2) Definitions: ***What exactly is an accounting misstatement and are all accounting misstatements punishable?***

The SEC defines an accounting misstatement as a failure to follow GAAP. Material misstatements are punishable by law.

The SEC's Staff Accounting Bulletin No. 99 (SAB No. 99, issued in August 1999) explains what makes a misstatement "material." Some of the circumstances listed in SAB No. 99 that should be considered are whether a misstatement:

- masks a change in earnings or other trends
- hides a failure to meet analysts' consensus expectations for the enterprise
- changes a loss into income or vice versa
- concerns a segment of the registrant's business that plays a significant role in the registrant's present or future operations or profitability
- affects compliance with loan covenants or other contractual requirements, and
- has the effect of increasing management's compensation.

Intentional misstatements, even of small amounts, that were made to manage earnings may be inappropriate. Public companies must maintain books, records, and accounts that "in

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1 Litigation Release No. 17594 / June 28, 2002. Securities and Exchange Commission v. WorldCom, Inc., Civil Action 02 CV 4963 (S.D.N.Y.) (June 27, 2002)

2 Sections 10(b) and 13(a) of the Securities Exchange Act of 1934 (Exchange Act) and Exchange Act Rules 10b-5, 13a-1, 13a-13, and 12b-20.

3 As stated in the footnotes to SAB No. 99, "Criminal liability may be imposed if a person knowingly circumvents or knowingly fails to implement a system of internal accounting controls or knowingly falsifies books, records, or accounts. 15 U.S.C. §§ 78m(4) and (5). See also Rule 13b2-1 under the Exchange Act, 17 CFR 240.13b2-1, which states, 'No person shall, directly or indirectly, falsify or cause to be falsified, any book, record, or account subject to Section 13(b)(2)(A) of the Securities Exchange Act.' Further, SAB No. 99 clarifies that "The books and records provisions of Section 13(b) of the Exchange Act originally were passed as part of the Foreign Corrupt Practices Act (FCPA). In the conference committee report regarding the 1988 amendments to the FCPA, the committee stated, 'The conference committee adopted the prudent man qualification in order to clarify that the current standard does not connote an unrealistic degree of exactitude or precision. The concept of reasonableness of necessity contemplates the weighing of a number of relevant factors, including the costs of compliance.

Cong. Rec. H2116 (daily ed. April 20, 1988).' "

4 Rule 10(b)-5 of the 1934 Securities Exchange Act or Section 17(a) of the Securities Act.

reasonable detail, accurately and fairly reflect the transactions of a company."[3] SAB No. 99 sets forth various factors, in addition to those used to evaluate materiality, that a company may consider in deciding whether a misstatement violates its obligation to keep books and records that are accurate "in reasonable detail." Some of these factors are:

1. the significance of the misstatement, which means inconsequential misstatements may be treated differently than more significant ones
2. how the misstatement arose, for example, whether it is part of an effort to manage earnings or an insignificant flaw in an operations system
3. the cost of correcting the misstatement, and
4. the clarity of the authoritative accounting guidance with respect to the misstatement.

Research from **Prof. Thomas Weinrich** of **Central Michigan University** shows that there are several common techniques to misstate financial results, based on a study of 96 accounting and auditing enforcement releases (AAERs) issued from July 1, 1997, to December 31, 1999, involving 38 audits by the **Big Five** firms. The most frequently misstated transactions and accounts were as follows:

- revenues and accounts receivable (26 cases)
- expenses (13) (this was the kind of misstatement WorldCom made)
- cost of sales and inventory (9)
- sales discounts and allowances (8)
- property, plant, and equipment (7)
- accounts paying and accrued liability (5), and
- securities valuations (3).

These findings were consistent with a study issued in 1999 by the Committee on Sponsoring Organizations of the Treadway Committee (COSO), and reported in the September 1999 issue of *Director's Monthly*, pp. 4-5.

Since the most common kind of accounting misstatement involves inappropriate recognition of revenues, it is good to know when revenues may be recognized. Under GAAP, revenue is recognized when it is earned and realized or realizable. The SEC's SAB No. 101 addresses this topic. It sets forth four underlying conditions that must exist in order for revenue to be recognized. First, there must be persuasive evidence that the company has an *arrangement* to receive the revenue. Second, the company recognizing the revenue must have actually *delivered* the goods or rendered the service. Third, the *price* of the goods or services must be fixed or at least determinable. And finally, the company must have reasonable assurance that it can *collect* the revenue. For more on SAB No. 99 and SAB No. 101, see http://www.sec.gov/news/speech/spch359.htm.

3) Risk: ***Are accounting misstatements relatively common—and thus likely to be a problem at companies where I serve?***

Accounting misstatements that are "material" (important) enough to warrant regulatory action have been relatively rare in recent years, but seem to be increasing in frequency. According to the COSO study cited above, only 300 companies were named in fraud-focused AAERs from the SEC between January 1987 and December 1997.[4] Furthermore, the COSO study found that most of the companies accused of fraud were small—with median assets of $16 million, and not listed on the major stock exchanges.

In the past five years, however, the number of larger companies named in such matters has grown, raising broader problems. In a letter to the editor of the *COA Journal* in April 2001, **Abraham J. Briloff**, Emanuel Saxe Distinguished Professor Emeritus, **Baruch College**, New York City, wrote that the AAERs that served as the basis for the COSO report did not reflect the "periodic high-profile cases of fraudulent financial reporting," such as **Cendant**, that "raise concerns about the credibility of the U.S. financial reporting process" and that "call into question the roles of auditors, regulators, and analysts in financial reporting." Interestingly, this letter appeared at the precise time that WorldCom managers began to capitalize some expenses. Sadly, Professor Briloff's warning about more widespread problems went unheeded.

4) Exposure: ***If a major accounting misstatement is discovered at a company where I serve, can I be sued as a director for failing to detect it?***

Depending on the allegations made in the lawsuit, there is some chance of legal exposure under state law, common law, and/or federal law. The duties, responsibilities, and powers of all corporations, whether publicly traded or not, and whether large or small, are defined under state law, which varies from state to state. Additional principles for boards have evolved

under common law, which automatically applies nationwide through judicial interpretation on a case-by-case basis. Additional legal restraints may be imposed by federal law—for example federal securities law or broadly applicable federal laws such as the Foreign Corrupt Practices Act. Finally, stock exchanges also impose rules in the form of listing requirements (e.g., independent audit committees). Each of these sources of rules can add an extra layer of liability exposure for a board.

Under state law, expressed with various nuances, certain powers of the corporation are reserved to the board. Only the board has these powers. These include the power to sell the corporation or substantial assets, to declare dividends, and to declare bankruptcy. In addition, there are certain functions normally expected of the board, under state law: to oversee management of the corporation, to review strategic plans, etc. In exercising its powers and in fulfilling its functions, state law requires that directors must act with care (duty of care) and loyalty (duty of loyalty). Thousands of court cases have helped define exactly what these duties imply.

Director decisions, if made with due care and loyalty, are protected by the common law judicial doctrine known as the Business Judgment Rule. This judicial tradition (which is not written up in any legal code or rule) says that directors who make decisions with due care and loyalty cannot be sued for their decisions, even if the decisions turn out to be wrong. In the case of an accounting misstatement, if it is found that directors exercised due care and had no conflicts of interest, there would be no liability. A litigant may charge that directors failed to exercise due care with respect to the corporations internal accounts or external audit. To disprove this charge, and thus gain the protection of the Business Judgment Rule, directors would have to show that they received reasonable assurances that the internal auditor system was sufficient, and the the external auditors were competent and had no conflicts of interest. Furthermore, to show that they met the duty of loyalty standards, directors would have to show that they had no conflicts of interest with regard to the misstatement.

It is generally agreed that the duty of care implies a duty to be reasonably informed. In the **Delaware Chancery Court** case *In Re Caremark International, Inc.* (1996), Judge William Allen opined that the board cannot meet its duty to be reasonably informed "without assuring [itself] that information and reporting systems exist in the organization that are reasonably designed to provide to the senior management and to the board itself timely, accurate information sufficient to allow management and the board, *each within its scope*, to reach informed judgments concerning both the corporation's compliance with law and its business performance." (Emphasis added.)

Although there is some question as to what the "scope" of a board's understanding should be, in the case of public companies, this is becoming clearer. The **New York Stock Exchange** and **Nasdaq** require listed companies to have independent audit committees composed of members who are "financially literate." This new requirement does not imply that audit committee members have an affirmative duty to use their financial literacy to detect fraud. Given the increasing frequency of discovery of major accounting frauds in recent months, however, directors would do well to refresh their knowledge of this topic—known generally as "forensic accounting."[5]

5) Prevention, Detection, and Reporting: ***What can directors do to ensure the prevention, detection, and proper reporting of accounting misstatements?***

As for prevention, it is best to follow the guidelines of the **Federal Sentencing Commission** pertaining to compliance. These seven guidelines are as follows:

1. The organization must have established standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.
2. Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.
3. The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.
4. The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, e.g. by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.
5. The organization must have taken reasonable steps to achieve compliance with its stan-

5 See David B. Kaufman, "Employing Forensic Accounting Techniques to Detect Fraud in Financial Statements," Director's Monthly, February 1999, pp. 13-15. See also Report of the NACD Best Practices Council: Coping with Fraud and Other Illegal Activity (1998), "Procedures and Red Flags to Help Stop Fraud," by Herrington Bryce, Director's Monthly, March 1999, p. 14; The Report of the NACD Blue Ribbon Commission on Audit Committees: A Practical Guide (2000).

dards, e.g. by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by it employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.

6. The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate is case specific.
7. After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses—including any necessary modifications to its program to prevent and detect violations of the law.

Detection means looking for red flags in both financial reporting and management behavior. See the "red flags" list of the NACD Blue Ribbon Commission on Audit Committees, and the financial risk list from the **American Institute of Certified Public Accountants**' Statement on Audit Standards No. 82 (SAS No. 82) on "risk factors."

Red Flags

- Complex business arrangements not well understood and appearing to serve little practical purpose.
- Large last-minute transactions that result in significant revenues in quarterly or annual reports.
- Changes in auditors over accounting or auditing disagreements (i.e., the new auditors agree with management and the old auditors do not).
- Overly optimistic news releases or shareholder communications, with the CEO acting as an evangelist to convince investors of future potential growth.
- Financial results that seem "too good to be true" or significantly better than competitors—without substantive differences in operations.
- Widely dispersed business locations with decentralized management and a poor internal reporting system.
- Apparent inconsistencies between the facts underlying the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and the President's letter (e.g., the MD&A and letter present a "rosier" picture than the financial statements warrant).
- Insistence by the CEO or CFO that he/she be present at all meetings between the audit committee and internal or external auditors.
- A consistently close or exact match between reported results and planned results—for example, results that are always exactly on budget, or managers who always achieve 100 percent of bonus opportunities.
- Hesitancy, evasiveness, and/or lack of specifics from management or auditors regarding questions about the financial statements.
- Frequent instances of differences in views between management and external auditors.
- A pattern of shipping most of the month's or quarter's sales in the last week or last day.
- Internal audit operating under scope restrictions, such as the director not having a direct line of communication to the audit committee.
- Unusual balance sheet changes, or changes in trends or important financial statement relationship—for example receivables growing faster than revenues, or accounts payable that keep getting delayed.
- Unusual accounting policies, particularly for revenue recognition and cost deferrals—for example recognizing revenues before products have been shipped ("bill and hold"), or deferring items that normally are expensed as incurred.
- Accounting methods that appear to favor form over substance.
- Accounting principles/practices at variance with industry norms.
- Numerous and/or recurring unrecorded or "waived" adjustments raised in connection with the annual audit.
- Use of reserves to smooth out earnings—for example, large additions to reserves that get reversed.
- Frequent and significant changes in estimates for no apparent reasons, increasing or decreasing reported earnings.
- Failure to enforce the company's code of conduct.
- Reluctance to make changes in systems and procedures recommended by the internal and/or external auditors.

Risk Factors[6]

Risk Factors Relating to Management Characteristics

- A failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process.
- A significant portion of management's compensation represented by bonuses, stock options, or other incentives, the value of which is contingent upon the entity achieving unduly aggressive targets for operating results or financial position.
- An excessive interest in maintaining or increasing the entity's stock price or earnings trend through the use of unusually aggressive accounting practices.
- Nonfinancial management's excessive participation in, or preoccupation with, the selection of accounting principles or the determination of significant estimates.
- A practice by management of committing to analysts, creditors, and other third parties to achieve what appear to be unduly aggressive or unrealistic forecasts.
- High turnover of senior management, counsel, or board members.
- Known history of securities law violations or claims against the entity or its senior management alleging fraud or violations of securities laws.
- Strained relationship between management and the current or predecessor auditor.

Risk Factors Relating to Industry Conditions

- New accounting, statutory, or regulatory requirements that could impair the financial stability or profitability of the entity.
- High degree of competition or market saturation, accompanied by declining margins.
- Declining industry with increasing business failures.
- Rapid changes in the industry, such as significant declines in customer demand, high vulnerability to rapidly changing technology, or rapid product obsolescence.

Risk Factors Relating to Operating Characteristics and Financial Stability

- Significant pressure to obtain additional capital necessary to stay competitive considering the financial position of the entity—including need for funds to finance major research and development or capital expenditures.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve unusually subjective judgments or uncertainties, or that are subject to potential significant change in the near term in a manner that may have a financially disruptive effect on the entity, such as ultimate collectibility of receivables, timing of revenue recognition, realizability of financial instruments based on the highly subjective valuation of collateral or difficult-to-assess repayment sources, or significant deferral of costs.
- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- Significant, unusual, or highly complex transactions close to year and that pose difficult "substance over form" questions.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.
- Overly complex organizational structure involving numerous or unusual legal entities, managerial lines of authority, or contractual arrangements without apparent business purpose.
- Difficulty in determining the organization or individual(s) that control(s) the entity.
- Unusually rapid growth or profitability, especially compared with that of other companies in the same industry.
- Especially high vulnerability to changes in interest rates.
- Unusually high dependence on debt or marginal ability to meet debt repayment requirements. Debt covenants that are difficult to maintain.
- Unrealistically aggressive sales or profitability incentive programs.
- Threat of imminent bankruptcy or foreclosure.
- Adverse consequences on significant pending transactions, such as a business combination or contract award, if poor financial results are reported.
- Poor or deteriorating financial position when management has personally guaranteed significant debts of the entity.
- Inability to generate cash flows from operations while reporting earnings and earnings growth.

6 These risk factors are excerpted from AICPA Statement on Auditing Standards 82, "Consideration of Fraud in a Financial Statement Audit" (1997). That statement was issued to provide guidance to auditors in fulfilling their responsibility "to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." Although these risk factors cover a broad range of situations, they are only examples. In the final analysis, audit committee members should use sound informed judgment when assessing the significance and relevance of fraud risk factors that may exist.

BOX 1. Excerpts from Remarks by Chairman Harvey L. Pitt, U.S. Securities and Exchange Commission

Remarks before the Economic Club of New York,* June 26, 2002

After acknowledging the presence and leadership of Chairman Dick Grasso of the New York Stock Exchange, Chairman Pitt outlined the SEC's plans for reform. He pointed out that WorldCom's announced $4 billion restatement puts a "sharper point" on concerns that our system has had serious "dysfunctional aspects" for quite some time.

Actions Regarding WorldCom

- The Commission is actively investigating the events related to WorldCom's appalling disclosures. To inform the market, we've ordered the company to file under oath ... a detailed report of all the specifics, including the relevant circumstances that led to the restatements. We will make that public as soon as we get it. By the way, this is the third time in history that we have invoked this authority, all within the last few months.
- We also have filed a fraud suit against WorldCom in federal district court here in New York seeking the appointment of a corporate monitor to ensure WorldCom does not destroy any documents or information related to the SEC's pending investigation, and to assure no asset dissipation occurs to any affiliates, or current or former officers, directors, or employees from the Company while it is in the process of restating its financial statements. http://www.sec.gov/litigation/litreleases/lr17588.htm. See also http://www.sec.gov/litigation/litreleases/lr17594.htm

Other Actions

- We plan to require our 1,000 largest companies [companies with revenues of $1.2 billion or higher] to file a formal certification with us on the accuracy and completeness of their last annual reports. http://www.sec.gov/rules/other/4-460.htm.** The President has emphasized the need for individual responsibility on the part of CEOs and CFOs, and we are determined to assure investors that the financial statements they presently rely upon are in fact reliable. These certifications will be required to be provided by the time most companies file their next quarterly report August [14].
- We formally released our proposed reform of the oversight of the accounting profession this morning... We have been helping Congress on their legislative proposals, and if there is legislation, we will implement it. However, in the event there is no legislation, my hope now is that we can begin implementing our proposals as shortly after the close of the comment period as is possible.
- We've been actively assisting FASB in retaining its independence and addressing key issues on a more timely basis and in a way that will better adapt to changing business environments and emphasize overall accuracy. We have been pleased with FASB's responses on these issues.
- We've also begun a retooling of disclosure requirements to help ensure that investors have the information they need, when they need it, and can understand it when they receive it. Our initiatives in this area include:
  —a proposed rule that requires companies to discuss the effects of their critical accounting policies;
  —reminders to companies to disclose off-balance sheet financing arrangements, and about the appropriate use of, and limitations on, pro forma financial information;
  —enforcement actions underscoring that technical compliance with GAAP, without more, can still produce insufficient disclosure;
  —a proposed rule to require accelerated reporting of insider transactions, including company loans
  —a proposed rule to more than triple the number of items that companies must report currently, and to accelerate those disclosures; and
  —a proposed rule to accelerate the deadline for annual reports from 90 to 60 days, and quarterly reports from 45 to 30 days.
- Similarly, in partnership with the NYSE and Nasdaq, we're working on the most dramatic and far-reaching changes in corporate governance in decades.
- After months of intensive focus by the House Financial Services Committee, the Commission's staff, and the SROs, we adopted real reforms to minimize and disclose research analysts' conflicts of interest.
- We are considering other ways to improve the quality of information investors receive directly from issuers, including requiring disclosure of current trend and evaluative data upon which corporate executives base critical decisions.
- We also will propose later this summer, for the first time, that public companies vest in fully independent audit committees the sole authority to hire, fire and retain auditors. These rules will also vest in audit committees, not senior management, sole authority whether, when and how to hire outside auditors to perform non-audit services. Moreover, we've promised that, by mid-summer, we will put out for public comment rules regarding auditor independence that could extend beyond independence rules approved in 2000 that take effect this August.
- The recent large restatements of earnings that were misreported over the last several years have caused unacceptable and horrendous losses for large numbers of innocent people; but, the broader damage to investor confidence that these and other recent events have caused, including WorldCom's announced $4 billion restatement, presents a far more serious ongoing problem for our markets and crisis is not too strong a word for it.

We have laid out, and are implementing, a creative and aggressive reform agenda. We can achieve these fundamental reforms, and make no mistake we will. We're counting on your support.

Thank you.

* Note: These remarks are excerpted from a speech accessible on the sec.gov web site. http://www.sec.gov/news/speech/spch573.htm They reflect solely the personal views of Mr. Pitt, and do not necessarily reflect the views of the Commission, the individual members of the Commission, or its Staff."

**The recent SEC Section 21(a) order on certification for large companies implicates the audit committee in a serious way. Audit committee members should ask counsel for guidance in this area.

As for reporting, the following should occur. Whoever finds the misstatement should report it to the audit committee, which should report it to the SEC, or ask the external auditor to do so. In the WorldCom case, this correct procedure was followed. The problem is that the reporting took place too late—15 months after the misstatement first appeared.

6) Policy: ***What is the single most important thing corporate America can do to restore confidence in equity markets?***

This question came from corporate director **Barbara Hackman Franklin** when she recently shared a forum with SEC Chairman **Harvey Pitt**. The former Secretary of Commerce and current NACD director was present as a designated questioner during SEC chairman's **June 26 speech at the Economic Club of New York** (See Box 1 on p. 6). Chairman Pitt said that the main answer lies in "better and faster disclosure" as an integral part of the many reforms he emphasized in his speech—including holding corporate leaders more accountable, and punishing them if they violate the corporate trust. In response to Hon. Franklin's questions, Chairman Pitt emphasized the value of having a new, independent oversight board to monitor the work of auditors. Currently, there are multiple proposals for such a board—including an SEC proposal and the ones contained in Congressional bills—including S. 2673 (see Box 2) and the **House-passed H.R. 3763, Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002**, introduced by **Rep. Michael G. Oxley** (R-OH). Chairman Pitt that the main proposals are trying to do the same thing. Whatever happens, he said, the SEC will be "ready to go." If there is legislation, he added, the SEC will incorporate whatever it says. He emphasized the need for speed in getting this body set up.

BOX 2: S. 2673

Public Company Accounting Reform and Investor Protection Act of 2002 introduced by Sen. Paul Sarbanes (D-MD) (Placed on Calendar in Senate)

Beginning
- Sec. 1. Short Title; Table Of Contents.
- Sec. 2. Definitions.
- Sec. 3. Commission Rules And Enforcement.

Title I—Public Company Accounting Oversight Board
- Sec. 101. Establishment; Administrative Provisions.
- Sec. 102. Registration With The Board.
- Sec. 103. Auditing, Quality Control, And Independence Standards And Rules.
- Sec. 104. Inspections Of Registered Public Accounting Firms.
- Sec. 105. Investigations And Disciplinary Proceedings.
- Sec. 106. Foreign Public Accounting Firms.
- Sec. 107. Commission Oversight Of The Board.
- Sec. 108. Accounting Standards.
- Sec. 109. Funding.

Title II—Auditor Independence
- Sec. 201. Services Outside The Scope Of Practice Of Auditors.
- Sec. 202. Preapproval Requirements.
- Sec. 203. Audit Partner Rotation.
- Sec. 204. Auditor Reports To Audit Committees.
- Sec. 205. Conforming Amendments.
- Sec. 206. Conflicts Of Interest.
- Sec. 207. Study Of Mandatory Rotation Of Registered Public Accounting Firms.
- Sec. 208. Commission Authority.
- Sec. 209. Considerations By Appropriate State Regulatory Authorities.

Title III—Corporate Responsibility
- Sec. 301. Public Company Audit Committees.
- Sec. 302. Corporate Responsibility For Financial Reports.
- Sec. 303. Improper Influence On Conduct Of Audits.
- Sec. 304. Forfeiture Of Certain Bonuses And Profits.
- Sec. 305. Officer And Director Bars And Penalties.
- Sec. 306. Insider Trades During Pension Fund Blackout Periods Prohibited.

Title IV—Enhanced Financial Disclosures
- Sec. 401. Disclosures In Periodic Reports.
- Sec. 402. Enhanced Conflict Of Interest Disclosures.
- Sec. 403. Disclosures Of Transactions Involving Management And Principal Stockholders.
- Sec. 404. Management Assessment Of Internal Controls.
- Sec. 405. Exemption.
- Sec. 406. Code Of Ethics For Senior Financial Officers.
- Sec. 407. Disclosure Of Audit Committee Financial Expert.

Title V—Analyst Conflicts Of Interest
- Sec. 501. Treatment of Securities Analysts by Registered Securities Ass'ns.

Title VI—Commission Resources And Authority
- Sec. 601. Authorization Of Appropriations.
- Sec. 602. Appearance And Practice Before The Commission.
- Sec. 603. Federal Court Authority To Impose Penny Stock Bars.
- Sec. 604. Qualifications Of Associated Persons Of Brokers And Dealers.

Title VII—Studies And Reports
- Sec. 701. GAO Study And Report Regarding Consolidation Of Public Accounting Firms.
- Sec. 702. Commission Study And Report Regarding Credit Rating Agencies.

National Association of Corporate Directors (NACD), an independent not-for-profit organization founded in 1977, is the country's only membership organization devoted exclusively to improving corporate board performance. The NACD conducts educational programs and standard-setting research, and provides information and guidance on a variety of board governance issues and practices. Membership comprises board members from U.S. and overseas companies ranging from large publicly held corporations to small over-the-counter, private, and closely held firms. NACD lists all interested members on The Director's Registry, which is used by member companies and others that seek qualified directors. With chapters in many major cities providing educational programs and networking opportunities, NACD operates at both a national and local level. To educate the corporate community and to provide networking links among NACD chapter members, the NACD holds an annual Corporate Governance Conference, where it presents a Director of the Year Award.

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