What is the Sarbanes-Oxley (SOX) Act of 2002?

In 2002, Congress passed new regulations designed to improve corporate governance of public corporations and reduce fraudulent corporate financial reporting. The U.S. Public Company Accounting Reform and Investor Protection Act of 2002, commonly referred to as the Sarbanes-Oxley Act, intends to rebuild investor confidence in public corporations after a wave of high publicity corporate accounting scandals that began with the Enron crisis.

The Sarbanes-Oxley Act imposes strict penalties for non-compliance and holds CEOs and CFOs personally responsible for the accuracy of their financial reporting. This includes fines and imprisonment. The law is generally intended to:

- Establish greater independence between public accounting firms and their audit clients
- Remove incentives for management to misrepresent the corporation's financial condition
- Provide sanctions for corporate/accounting firm misconduct
- Establish oversight of the accounting practice

Who is affected by Sarbanes-Oxley?

Public Companies

Sarbanes-Oxley applies to public companies that are registered with the Securities and Exchange Commission (SEC.)

Private Companies

Any private company that aspires to go public will become subject to the act upon filing a registration statement with the SEC in anticipation of an IPO. Additionally, any company that might be acquired by a public company or that has significant business partnerships with public corporations will need to assess the impact of Sarbanes-Oxley on future and current business partnerships.

Impact on HR/Payroll Functions

The Sarbanes-Oxley Act is a far-reaching piece of legislation. There are three major areas of interest in the act for HR and Payroll professionals: internal control provisions (Section 404,) whistleblower provisions and 401(k) plan blackout provisions.

Section 404 and Internal Controls for HR/Payroll

Section 404 requires companies to establish, maintain and evaluate an adequate internal control structure related to financial transactions and financial reporting. Companies must also report on the assessment of these internal controls on an annual basis. The "assessment of internal controls" report is designed to assure the SEC as well as investors that a company has the necessary procedures and controls in place to adequately ensure the integrity of financial data.

Although the Sarbanes-Oxley Act is targeted primarily at board governance and accounting practices, its reach extends across the organization and to human resources processes that have a direct and material impact on corporate financial statements.

From an auditor perspective, anything having a material impact on financial statements is important, and this includes many HR-related processes such as:

- Payroll payments and transactions
- Payroll tax liability calculations and reports
- Compensation management
- Employee benefit liability calculations

HR data integrity has a significant impact on security and internal control including:

- Data accuracy and integrity including data audit trails and documented approval workflows
- Physical data security
- Information access rights and logs

The HR management system (HRMS) is the primary system of record regarding who works for the company. This information is often shared with IT security administrators to establish access rights. Key challenges in managing the integrity of HR data arise because this data is constantly changing and its use is so pervasive throughout the organization.

Whistleblower protection

Sarbanes-Oxley prohibits publicly traded companies from taking any adverse employment action against employees who raise allegations of fraud to a federal agency, a member of Congress, any person with supervisory authority over the employee or any other person working for the company who has the authority to investigate, discover or terminate misconduct. The law allows corporate whistle-blowers to file lawsuits seeking compensatory damages if their employer retaliates against them.

In addition, the law contains other provisions directly relevant to whistleblower protection:

- Publicly traded corporations must establish procedures for employees to file confidential internal whistleblower complaints.
- New ethical standards are required for attorneys who practice before the SEC. This code of ethics is intended to promote honest and ethical conduct; full, accurate, timely and understandable disclosure; and compliance with governmental rules and regulations.
- The federal obstruction of justice statute was amended to criminalize retaliation against whistleblowers that provide "truthful information" to a "law enforcement officer" about the "commission or possible commission of any Federal offense." This provision of Sarbanes-Oxley is not limited to publicly traded corporations; it covers every employer nationwide.
- The SEC has jurisdiction to enforce every aspect of Sarbanes-Oxley, including criminal penalties for the whistleblower-related provisions.

401(k) Blackout Provisions

A blackout period is any period of more than three consecutive business days during which participants or beneficiaries of a 401(k) plan cannot direct or diversify assets credited to their accounts, or obtain loans or distributions. The act requires plan administrators (often HR or consultants under the direction of HR) to provide notices to affected participants and beneficiaries at least 30 days in advance of covered blackout periods. The notice must be in writing and stated in a way that the average plan participant can understand. If the blackout period prevents at least 50 percent of plan participants from engaging in transactions involving company stock held in their plan accounts, then the law also prohibits directors or executive officers from engaging in trading involving company stock held outside the plan during the blackout period. This applies to any stock acquired in connection with the insider's services or employment.

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