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THE MAGNITUDE OF PROFESSIONAL RISK CREATED BY THE SARBANES-OXLEY ACT OF 2002 AND THE COMPANIES ACT OF 2006

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Abstract

This study explores the professional risk for accounting professionals in the United States and the United Kingdom by examining the countries' most recent, dominant accounting laws: the Sarbanes-Oxley Act of 2002 and the Companies Act of 2006. The United Kingdom provides a good comparison to the United States because of their shared common law traditions of codification and legal precedents. There are two arms of risk: the magnitude of the consequence and the probability that the consequence will be issued. This paper assesses only the magnitude of professional risk in the two countries by studying the provisions for personal liability for the commission of fraud created by the two pieces of legislation. The question is approached by comparing the magnitude of penalties, the scope of the laws' provisions, and the intent of the legislators. Because the Sarbanes-Oxley Act of 2002 was a reform law intended to amend market weaknesses seen by the widespread fraud and the Companies Act of 2006 was intended to compile and streamline corporate law, the Sarbanes-Oxley Act of 2002 treats the fraudulent behavior of directors and auditors of publicly traded companies more severely.

I. *Introduction*

The discovery of corporate accounting frauds are common in modern business practice, but it usually takes a large-scale fraud involving massive sums, intricate schemes, and villainous executives to capture national attention. The discovery of large frauds seems to happen in clusters, with a rash of simultaneous investigations in the news. After each wave of accounting fraud, authorities examine the existing law to determine whether it provides sufficient discouraging consequences. Often under a magnifying glass of media and public attention, laws and regulations are updated with stiffer penalties for perpetrators of fraudulent activity. But how severe are the consequences for the individuals, rather than the corporate bodies, who participate in or fail to discover a fraud scheme? This question holds more interest for auditors, directors, and accounting professionals than does the question of general corporate liability, since signing their names means taking on significant personal and professional risk.

There are two elements of risk: the magnitude of the potential consequence and the likelihood that those consequences will be imposed. This paper will address the first element of risk for accounting professionals by examining the penalties and sentences contained in the law for individuals charged with fraudulent misconduct.

This paper will widen the assessment of the magnitude of the risk for accounting professionals in the United States by comparing it to the risk of the profession in the United Kingdom. Though the United Kingdom may seem at first to be an arbitrary choice for comparison, both countries operate under a national system of codification made by judges for their criminal court systems, known as common law. This is different from civil court and damages, which this paper will not address. The similarities of these two common law family countries and the shared legal history between them provide constants and thus allow for a valid, telling comparison between their respective accounting fraud legislation.

I will therefore examine the current dominant laws governing accounting fraud in the two countries: The Sarbanes-Oxley Act of 2002 in the United States and The Companies Act of 2006 in the United Kingdom. After exploring the rationale for comparing two common law countries, I will give a brief description of the laws' general stipulations. I will then examine the new provisions in each law for personal liability for the commission of fraud, with a focus on individual sentences and fines. What do the laws specifically set forth for the penalties for individuals? What provisions did these laws create anew, rather than only carry forward from previous legislation? What are the differences for the individual committing securities fraud in the United States compared to his or her colleague in the United Kingdom?

An interesting underlying element of this investigation is whether increasingly stringent punishments for participating in a securities fraud or the failure to execute professional responsibility and catch a securities fraud will scare talented individuals away to a less risky field. While I cannot provide a complete answer to that question here, it provides perspective to the comparative stiffness of individual consequences in the United States and the United Kingdom for corporate misconduct.

II. *Law Background*

II.I *Law Families*

The broad range of commercial law has two distinct categories: civil law, which was originally embodied in Roman law and is currently the basis of the French, German, and Scandinavian law families, and common law, which is most well known as English law (La Porta 1998). Modern legal systems can be traced back to their origin through a legal family ancestry. Developed legal systems still fit into these law families because laws in different countries are not usually written anew, but instead transported from a few legal families or traditions, the transfer itself being either voluntary or not (Watson 1974). Most commonly, a country's legal system was adopted involuntarily, through either conquest or colonization (La Porta 1998).

Because of the tendency of legal systems to be transplanted as opposed to being developed wholly anew, foreign legal systems can be divided into the two categories: civil and common. The categorization of legal systems reveals patterns in the countries' ability to provide legal protection, enforcement, recourse, and remedy, based on their family origin (La Porta 1998).

Civil law and common law are distinct from either other in their ability to provide those legal protections, both in theory and in practice. A study by La Porta, Lopez-e-Silanes, and Shleifer (1998) found that of the legal families, common law countries have the strongest corporate shareholder and creditor protection, both in the law and in enforcement. The study further found that common law countries tend to have stronger enforcement across the board than their civil law counterparts, even when controlling for per-capita income. For example, in France, a civil law country, shareholder and investor rights are weakly protected, as opposed to England, which provides robust legal protection (La Porta 1998). While the quality of enforcement is related positively to per-capita income, enforcement and accounting standard quality come down to legal family, not the size of the economy (La Porta 1998).

II.II *Contrast of Common Law Family to Civil Law Family*

Judges resolving specific disputes is the source English common law. Judges' decisions form legal precedents, which create the content common law. Civil law content is developed from the world of legal scholars, rather than by judges, and thus does not draw on legal precedents to make current decisions. Instead, if a rule is not encoded in law, it cannot be used to determine a case's outcome (La Porta 1998). This can indicate an advantage in strength for common law, that its enforcement is made consistent by the use of legal precedents, and is perhaps why La Porta found that common law countries have stronger enforcement than their civil law neighbors.

To exemplify this assertion, we observe that La Porta found that the French legal family is the weakest in all the study's measured components: shareholder protection, creditor protection, enforcement, and quality of accounting. As the French legal system is of the civil law family, this result shows that the structure of a legal system, owed to its legal family, does affect the enforcement and practice of law. Therefore, a comparison between American and French accounting fraud laws would be muddied by other factors, preventing a clear comparison.

For these reasons, a comparison between the laws of the United States and the United Kingdom is useful not only because of their large economies, but also from their similar legal structures.

II.III *How American Law Developed from British Common Law*

English common law spread around the world through British colonialism, establishing its rule in the United States, Canada, Australia, India, and many other countries (La Porta 1998). Though many of the British colonies one-by-one asserted their independence from the Empire, their legal systems can still be traced back to English common law.

The American colonists had left England looking for land, religious freedom, and political escape, but it was natural that they brought with them their cultural perspective on religion, politics, and society. Those perspectives are the building blocks of the formation of law, and so it is not surprising that the American common law is similar to that of their British ancestor. However, the colonists were determined to be American, not merely Britons in a new land, something that was shown over time by the development of a unique American language and, of course, the revolution. Therefore, the Americans also allowed their common law base to evolve, their laws adapting to their new lives and needs, which makes the American common law distinct form its British predecessor (Adams 2005).

American law had already diverged from British law by the time of the U.S. Civil War. Though a process of reconfiguration that was much more than revision, judges had transformed the principles of tort, contract, and property liability, the allocation and definitions of burdens of proof, the adjudication of cases, and so on. English common law was organized into numerous categories and subcategories, and the legally enforceable obligations of one individual to another depended on the relationship between them. American common law organized itself around the broader, unified categories of tort, contract, and property law, categories in which it still operates today. Furthermore, American law replaced the relational basis for the evaluation of conduct against an objective standard (Schweber 2004). The American objective standard can be understood in relation to the American saying that "justice is blind," meaning that all persons can receive equal treatment under the law, regardless of position, rank, or circumstances. The British court can incorporate such aspects into its evaluation of a case, which illuminates a crucial difference between American common law and its legal predecessor.

Therefore, though American law sprung from British law, the two have diverged and thus cannot be expected to have identical regulations and legislation on the subject of accounting fraud. It is their similar structures and shared history that make a comparison of the two bodies of law worthwhile. Rather than having to control or compensate for drastically different legal structures or theoretical approaches to law, the similarities and differences found in this study can give some indication of the sociological experiences of past accounting frauds and societal expectations of professional behavior.

If one country chooses to address a type of misconduct and the other does not, we may deduce that the latter country either has not extensively experienced that type of problem in the past, or does not hold the issue in high enough esteem to specifically punish it. If one country punishes a type of misconduct more severely than the other, we may loosely infer that the country in question has a higher standard of professional behavior than the other and thus issues a stiffer penalty when that standard of professional behavior is breached.

III. *Modern Dominant Law*

III.I *United States: The Sarbanes-Oxley Act of 2002*

III.I.A *The Legislation's Passage*

From the mid-1990s until early 2000, the U.S. economy experienced huge gains, especially in the Internet and communications sectors. It was not until the stock price bubble burst in the second quarter of 2000 and companies began declaring bankruptcy and revealing that their profitable operations had been propped up by questionable or non-existent transactions that the market realized that the period of explosive growth had a twin: fraud, corporate malfeasance, and a deficiency of applied business principles (Donaldson 2003). The Enron, WorldCom, Tyco, and Adelphia frauds were the most notable in the rash of accounting fraud and corporate misconduct, and the headlines were saturated with corporate scandal, abusive corporate executives, and cooperative auditors. Congress decided that legislation was necessary to regain investor confidence in the American markets. The Sarbanes-Oxley Act of 2002 was the legislative result.

III.I.B *Overview of the General Stipulations*

The Sarbanes-Oxley Act was arguably the most sweeping and most significant securities legislation passed since the first Federal securities laws were enacted in the 1930s (Donaldson 2003). The Act itself lists as its goals to "restore confidence in the accounting profession, to strengthen enforcement of the Federal securities laws, to improve the 'tone at the top' and executive responsibility, to improve disclosure and financial reporting, and to improve the performance of 'gatekeepers'" (Donaldson, 2003).

In an attempt to shield corporate employees who catch a fraud in action, Sarbanes-Oxley provides extensive protection for whistleblowers and those employees who cooperate with Federal investigations or enforcement, including both criminal punishment and civil suit remedies for corporate retaliation ("Sarbanes-Oxley Act: Overview"). To address systematic issues that can create opportunities for fraud, Section 404 of the Sarbanes-Oxley Act added broad requirements for corporate internal control over financial reporting (Donaldson 2003). In addressing corporate attitude toward fraudulent or unethical behavior, Sarbanes-Oxley Section 406 allowed the SEC to require that companies annually disclose whether corporate principal executive officers and senior financial officers have adopted a code of ethics (Donaldson 2003).

Sarbanes-Oxley reinforced its rules for auditor independence in its attempt to restore investor confidence, addressing improper client influence on auditors and audit documentation retention (Donaldson 2003). Part of that effort was the establishment of a new oversight board for auditors, the Public Company Accounting Oversight Board (PCAOB), which was up and running within a year (Donaldson 2003). The PCAOB now has authority over the auditors of public companies and conducts reviews to monitor auditor independence and the exercise of due professional care in the audits of registered, publicly traded companies.

Sarbanes-Oxley called for multiple studies, including investigations into the role played by credit rating agencies in the securities market, aiding and abetting liability, principles-based versus rules-based accounting standards, and consolidations in the accounting industry ("Sarbanes-Oxley Act: Overview" and Donaldson 2003). Though the law does not offer new regulations for these issues, the studies were presumably for the purpose of future legislative action. The results of some of these studies are discussed in the Enforcement section of this paper.

III.II *Specific Provisions of The Sarbanes-Oxley Act of 2002*

III.II.A *Securities Fraud Felony*

Sarbanes-Oxley Section 807 made securities fraud a felony with serious penalties. The use of a covered security to knowingly defraud or attempt to defraud any person now carries a 25-year maximum prison sentence (Pub. L. No 107-204[1] and "Sarbanes-Oxley Act: Overview"). The Fraud Enforcement and Recovery Act of 2009 updated Section 807, extending the scope of the statute to include commodities in addition to securities ("Sarbanes-Oxley Act: Overview").

The additions provided by Section 807, both originally and after the 2009 amendment, provides simpler standards for prosecutors to meet in proving securities and commodities fraud. Before their passage, a jumble of regulations listed technical offenses and particular securities and commodities law violations, but the new statute made any plan or attempt of defrauding or otherwise obtaining the money or property of any persons in a fraudulent manner carry a more stringent penalty ("Sarbanes-Oxley Act: Overview").

III.II.B *Mail and Wire Fraud*

In building Federal cases of fraud and other corporate malfeasance, prosecutors often use mail and wire statutes. Section 903 of the Sarbanes-Oxley Act substantially increased the power of such statutes by extending the maximum prison term for Federal mail and wire fraud offenses from five years to 20 years (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

[1] The Sarbanes-Oxley Act of 2002, Pub. L. No 107-204, 116 Stat 745.

III.II.C *Document Retention and Obstruction of Justice*

When the media relay stories of corporate frauds, there is usually a description of paper-shredding binges by employees, ordered to destroy documents before they can be used as evidence. It is natural that Sarbanes-Oxley addresses document retention and the related obstruction of justice charges for the destruction of documents in order to protect potential evidence. Section 802 contains two statutes addressing the destruction of documents. The first of these provisions requires a fine and/or up to 20 years in prison for anyone who

> "knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency… or any case filed under title 11, or in relation to or contemplation of any such matter or case… ("Sarbanes-Oxley Act: Overview")

In its second statute, Section 802 closes loopholes in prior anti-document shredding laws with two new anti-shredding provisions, setting forth concrete rules for the preservation of financial audit records. Corporate audit documents must be retained for five years, the time period of the statute of limitations for most Federal prosecution. The second destruction of documents provision covers audit paper retention by accountants and auditors. Records such as workpapers, supporting documents, memoranda, correspondence and communications, and electronic records that are connected to an audit or review must be retained for the same five year period. Accountants, auditors, and other parties who breach these retention regulations can be issued a fine and/or up to ten years imprisonment (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

Sarbanes-Oxley updated other obstruction of justice charges in addition to document shredding. Previously existing obstruction of justice provisions were only useful in prohibiting individuals from influencing others to engage in obstruction. Those statutes did cover individual acts of document destruction, but were interpreted by the courts to only apply to pending proceedings where evidence for which subpoenas had been issued. In considering the development of new law, Congress concluded that even an individual who acts alone in destroying or altering documents, even before the issuance of a subpoena, ought to be subject to criminal liability. Thus, Sarbanes-Oxley permits the prosecution of an individual who destroys pertinent evidence before any grand jury subpoena is issued. Such violators can receive a fine and/or a maximum 20-year prison sentence (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

III.II.D *Exchange Act Penalties*

Sarbanes-Oxley Section 1106 strengthens Section 32(a) of the Exchange Act, which addresses individuals who make an untrue or deliberately misleading statement on an issue of material fact in any SEC filing. The penalty used to be $1 million and ten years in prison for an individual and $2,500,000 for a corporation. Sarbanes-Oxley dramatically increased the penalties to $5 million and a 20-year sentence for individuals (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

III.II.E *ERISA Penalties*

Remembering that the collapse of Enron brought with it the destruction of the corporate employee pension plan, which invested heavily in Enron stock, puts the provision for violations of the Employee Retirement Income Security Act of 1974 (ERISA) in Section 904 of Sarbanes-Oxley in context. Criminal violation of ERISA carries penalties of $100,000 or $500,000 and maximum 10 years in prison, compared to the prior fines of

$4,000 and $100,000, respectively, and a 1-year maximum prison sentence (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

III.II.F *Statute of Limitations*

Sarbanes-Oxley increases prosecutors' ability to pursue cases by extending the statute of limitations for prosecution of private securities fraud. Such actions must now begin within two years of discovery of the fraud within the additional parameter of five years after the fraud occurred. The previous statute of limitations was established by the Supreme Court case *Lampf, Pleva, Lipkin, Prupis & Petigrow v. Gilbertson* (US Sup. Ct. 1001, 1001 CCH Dec Para.96,034), in which the court outlined a limit of one year from discovery of the fraud within three years of the fraud's occurrence (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview").

III.II.G. *Sentencing Guidelines*

While Sarbanes-Oxley did not itself change sentencing guidelines, in Section 1104, Congress strongly recommends that the U.S. Sentencing Commission review the sentencing guidelines for cases of corporate and accounting transgressions. The statute particularly calls attention to the need for increased prison time for corporate officers and directors involved in criminal fraud (Pub. L. No 107-204 and "Sarbanes-Oxley Act: Overview"). The statute reflects Congress's desire that those executives who breach their corporate fiduciary duties ought to be assigned severe sentences ("Sarbanes-Oxley Act: Overview").

III.III.H *Enforcement*

During the fiscal year through August 20, 2003, the SEC filed 543 Sarbanes-Oxley enforcement actions. While only 147 of them were financial fraud or reporting violations, the SEC's actions clearly showed its intent to fully enforce the provisions passed in Sarbanes-Oxley (Donaldson 2003).

The Securities and Exchange Commission study on aiding and abetting liability provides for this study an indication of the second element of risk, the probability that consequence will be given to a violator. The SEC executed the Sarbanes-Oxley-mandated study on aiding and abetting liability by examining the securities professionals who were found to be violators of Federal securities law in the years 1998 through 2001 (SEC 2003). Clearly, the Sarbanes-Oxley Act did not apply to any of these cases. The study found that 1,596 securities professionals were convicted of committing and/or of aiding and abetting the commission of violations. The study included an additional 117 professionals who either failed to adequately supervise employees or were otherwise involved in unprofessional conduct. The most common punishments assigned to the charged professionals were as follows: 782 were issued permanent injunctions from practice, 730 were ordered to pay civil monetary penalties, 673 were forcefully discharged, 613 were issued permanent cease-and-desist orders, and 434 were barred from association with broker-dealers (SEC 2003). The prior listing is not exhaustive in establishing all the consequences handed to the violating securities professionals, but does give a stark indication of what lies in wait for anyone who violates or aids and abets the violation of Federal securities law: for 1,713 securities professionals, at least 3,232 penalties were issued.

From these enforcement actions, accounting professionals can draw the serious intent of the United States government to investigate, pursue, and prosecute the commission of fraudulent activity and/or the aiding and abetting of fraudulent activity to the extent allowed by law. The current political landscape, indicated by the enforcement actions taken by the government, is not one in which professionals can expect their transgressions to be smoothed over or condoned.

III.III *United Kingdom: The Companies Act of 2006*

III.III.A *The Legislation's Passage*

The Companies Act of 2006 was passed with the intent of updating the long-standing Companies Act of 1985 to make British corporate law simpler and better suited modern business necessities and situations. In that effort, the law restates and reworks statutes from the prior Companies Acts. In particular, the law streamlines the incorporation process and augments the role of shareholders (Holden 2007). The Companies Act of 2006 also created new provisions designed to address modern business developments such as Section 155, which requires that at least one director of a company be an individual, so that one company cannot be the sole director of another ("Companies Act 2006"). Ironically, the bill, which was intended to streamline the Companies Acts, is the longest legislation ever passed by the British Parliament and does not supercede all provisions of all Companies Acts before it. Notably, the parts of the Companies Act of 1989 and the Companies Audit, Investigation, and Community Enterprise Act of 2004 that address and regulate investigations, foreign regulatory bodies, the Financial Reporting Review Panel, and the Financial Reporting Council are still effective law (Holden 2007).

III.III.B *Overview of the General Stipulations*

Because the Companies Act of 2006 was intended to codify all corporate law in one piece of legislation, the topics of its stipulations cover a broad range of corporate areas, including the powers of the Secretary of State in corporate investigations, corporate formation, corporate political donations, and requirements for corporate secretaries, audits, reports, and meetings ("Companies Act 2006").

One of the most significant contributions made by the Companies Act of 2006 is its statutory codification of directors' fiduciary duties to their company. However, rather than being widely appreciated, the record of regulations caused concern that spelling out executive duties would lead to rampant litigation (Holden 2007). It is common for shareholders in the United Kingdom to sue auditors for breach of care owed to them and the corporation if the auditors do not discover problems prior to the company's downfall (Pettet 2005). Some people thought that the tendency of shareholders to bring suit against auditors would translate to shareholder lawsuits against the former directors of failed companies because of the new, clear legislation on the fiduciary duties of directors.

In an effort for increased transparency, Section 1277 grants the Secretary of State the ability to mandate that pensions, unit trusts, and similar entities disclose the process of exercising any voting rights connected to either directly or indirectly held shares (Holden 2007). This section forces companies to be more forthright about their control of other entities through their investment shares, allowing clearer communications and investigations and dispelling ambiguity about voting rights.

The Companies Act of 2006 was phased in slowly, with implementation beginning in November 2006 and full implementation planned for October 2008 (Holden 2007). This was perhaps a concession to the negative reaction to the law's huge size; rather than engaging in an abrupt overhaul, companies could adjust to statutes over an extended period of time. However, some protested that prolonging the implementation period for the 2006 Act would only increase the cost and administrative burden for companies (Holden 2007).

III.IV *Specific Provisions of the Companies Act of 2006*

III.IV. A *Directors and Conflicts of Interest*

To enforce the idea that the director of a company ought to be motivated to the company's benefit, Section 175 of the Companies Act of 2006 extensively outlines a director's duty to avoid conflicts between his or her interests and the interests of the company. Section 176 extends Section 175 by codifying the rule that prohibits directors from exploiting their position for personal gain, including accepting benefits and bribes ("Companies Act 2006"). Section 183 restates the statute from the Companies Act of 1985 that provides penalties for directors who fail to properly declare an interest in compliance with the Act. A director who is convicted of a violation of these requirements is subject to an unlimited fine, though if found guilty on summary conviction, the fine cannot exceed the statutory maximum of £5,000 ("Companies Act 2006").

III.IV.B *Directors' Reports*

Section 463 of the Companies Act of 2006 outlines a director's liability for false or misleading statements made in the directors' reports required in other sections of the 2006 Act, such as the Section 420 Directors' Remuneration Report, and any summary financial statements which were built upon the basis of these directors' reports. Directors' liability to the company is limited to the amount of loss suffered for any deliberate or reckless omission, untrue assertions, or misleading statements of required information regarding a material issue. However, these provisions have no affect on other statutes for directors' civil or criminal liability connected to deliberately misleading reports ("Companies Act 2006").

III.IV.C *Accounting Records*

Requiring companies to keep accounting records may seem like a rudimentary issue to address in corporate legislation, but such requirements are useful in fraud investigations. Sections 386 to 389 update requirements in the 1985 Act for companies to keep accounting records, complete with specifications of where the records were taken and what time periods they cover. Because the phrase "accounting records" is not specific, the records may vary in complexity based upon the company's size. The key to the requirement is that they must enable a third party to understand the company's financial position. Failure of any director to comply with the records requirements is a criminal offense carrying the penalty of imprisonment or a fine, an update of the penalties in the 1985 Act ("Companies Act 2006").

III.IV.D *Register of Members Information*

Section 119 of the Company Act of 2006 creates two new offences relating to false or misappropriated information. To strengthen the requirement to provide information about a company's register of members contained in Section 116, Section 119 makes the act of purposefully or recklessly making a misleading, false, or deceptive statement relating to a material matter a criminal offense. Section 119 further protects Section 116 by making the disclosure of information obtained under Section 116 by an individual to another person when the individual has knowledge or reason to expect that the information may be misappropriated illegal ("Companies Act 2006").

To ensure the quality of this information, Section 120 of the Company Act of 2006 requires that company directors inform any person exercising their right to inspect or request a copy of the company's register of members when the information was last updated. Violation of this requirement makes the director and company subject to a fine ("Companies Act 2006").

III.IV.E *Fraudulent Trading*

Section 993 of the Companies Act of 2006 restates the stipulations from the 1985 Act for fraudulent trading, but increases the maximum sentence to ten years imprisonment from the prior seven-year limit ("Companies Act 2006").

III.IV.F *Auditor Liability*

Section 507 of the 2006 Act creates a new criminal offense for auditors who deliberately or recklessly write a report that includes misleading, false, or deceptive information or omitting required information about any faults or issues in the company's accounts or audit. Statements of omission include the auditor being unable to obtain from the company the information, data, and client explanations to properly form an opinion. Section 507 clarifies that this offense applies to individuals who are accountants qualified to act as an auditor of a company in his own right. The penalty for violation of this section is an unlimited fine ("Companies Act 2006").

Section 463, which addresses directors' liability for false or misleading information in reports, stipulates that third parties, including auditors, are still liable to the company for any negligence in preparing their report ("Companies Act 2006").

Section 532 prohibits any contract between a company and its auditor that would indemnify the auditor against claims related to the company's audit. The section renders such indemnification contracts void and unenforceable. The exceptions are those indemnities permitted by Sections 533 to 536 of the 2006 Act. Section 533 allows the company to indemnify the auditor for costs of a successful defense against a claim but eliminates the prior exception that permitted the company to purchase insurance against claims for the auditor ("Companies Act 2006").

Section 534 addresses liability limitation agreements between auditors and the company, defined as any agreement that attempts to limit the auditor's liability for negligence, default, breach of duty, or breach of trust to a client company. So long as a Section 534 agreement complies with Sections 535, which contains rules for the terms of such an agreement, and Section 536, which outlines how the members of the company must authorize the agreement, it can be an exception from Section 532. Section 537 outlines the test of fairness and reasonableness for Section 534 agreements. Under these requirements, contracts are not enforceable if they result in the company recovering from the auditor an amount that is less than a fair and reasonable amount. In determining what is fair and reasonable, courts do consider the auditor's responsibilities and contractual obligations, but are not to consider any circumstances that arose after the loss or damage occurred or the odds that the company could successfully claim damages from other responsible parties. Any such agreement is required by Section 538 to be disclosed in the company's annual statements or directors' report ("Companies Act 2006").

IV. *Comparison of Legislation*

Because of the shared legal history between the United States and United Kingdom, we can compare the provisions for personal liability for the commission of fraud under the Sarbanes-Oxley Act of 2002 and the Companies Act of 2006 by the magnitude of their penalties, scope of their provisions, and the intent of the legislators.

The Sarbanes-Oxley Act of 2002 sets high limits for the areas of corporate malfeasance it addresses: 25-year prison sentence maximum for securities fraud, 20 years for mail and wire fraud, 20 years for the destruction of documents, a fine and 20 years for doctoring or destroying evidence, a fine and ten years for audit document retention, a $5 million fine and 20 year sentence for making false or misleading statements in SEC fillings, and a $100,000 or $500,000 fine and a 10-year sentence for ERISA violations. These limits are either increases from prior penalties or entirely new liabilities, but whether they are new or updates, they all indicate the American Congress's intent to inflict serious penalties upon individuals who engage in fraudulent corporate behavior.

The Companies Act of 2006 sets limits for some of the liabilities that it creates. Penalties for false or misleading statements in a directors' report are limited to the damage to the company. Director failure to keep accounting records carries a limited fine or imprisonment, and directors are subject to a limited fine for not complying with their duties related to the company's register of members. Fraudulent trading also has a limited penalty, a maximum sentence of ten years imprisonment.

However, the 2006 Act has unlimited fines for directors convicted of violating conflict of interest regulations and for auditors who write a faulty report. Though the scope of these unlimited penalties is narrow, unlimited penalties are a stringent punishment and pose a serious professional risk to directors and auditors alike.

Summarizing the penalties created by the Sarbanes-Oxley Act of 2002 and the Companies Act of 2006 helps outline their respective scopes and focuses. In creating new statutes governing the roles of auditors, the Sarbanes-Oxley Act emphasizes auditor independence and procedures auditors should take in completing a financial audit. The 2006 Act places its focus for auditing professionals on auditor liability for reports and related liability agreements. The 2006 Act goes on to address director liability and record keeping, but the Sarbanes-Oxley Act creates new provisions for a much broader scope of activity, such as mail fraud, wire fraud, destruction of evidence, and obstruction of justice, topics for which the Companies Act did not create similar personal liabilities. The Sarbanes-Oxley Act also addresses the statute of limitations, ordered studies on personal liability that would assist in further legislative action, and areas of individual punishment which the Companies Act of 2006 did not specifically address.

Attempting to compare the new provisions in the Sarbanes-Oxley Act of 2002 and the Companies Act of 2006 brings to light their essential difference: that while both are remarkably broad and sweeping in their coverage of topics, Sarbanes-Oxley has a keener focus on the creation of new penalties for individuals for the commission of fraud. The discrepancy could be explained by the difference in the purposes of these laws: while Sarbanes-Oxley was a legislative reaction to widespread corporate frauds and bankruptcies, the Companies Act of 2006 was in large part a compilation and restatement of previously existing legislation. The intent of the legislators directly impacts the variance in scope of the laws and the magnitude of the penalties they create.

V. *Conclusion*

Because of the differences in the intent and scope of the two laws, it is difficult to definitively conclude which law more strictly punishes fraudulent behavior. This paper has attempted to answer this question by assessing the difference for the individual committing securities fraud in the United States compared to his or her colleague in the United Kingdom. Though the Companies Act of 2006 allows for a few unlimited fines, the broader scope of provisions in the Sarbanes-Oxley Act of 2002 ultimately makes it a greater risk to practicing professionals.

For these reasons, it is my conclusion that the Sarbanes-Oxley Act of 2002 creates broader and stricter punishments for the commission of fraud and thus deals with corporate fraud more stringently than does the Companies Act of 2006.

However, it does not follow that the Sarbanes-Oxley Act of 2002 will necessarily push more talent away from the accounting profession than will the Companies Act of 2006. Though Sarbanes-Oxley has wider categories of personal liability provisions, it also provides extensive guidance on procedures auditors can follow to avoid such liabilities. In addition, though the Companies Act allows unlimited penalties for auditors, the proper performance of due professional care should adequately protect auditors from these unlimited fines, even if the auditor is unsuccessful in catching fraudulent plots.

The effect of these laws' stringent punishments on the profession depends upon professionals' depth of understanding of the meaning of and wariness of being subject to such penalties. Because accounting professionals are required to achieve and maintain certification standards, they must seek continuing education and training in their field. The more time that passes from the enactment of accounting law, the less likely it becomes that professionals would be wholly unaware of the risk attached to their professional practice.

VI. *Recommendations for Further Research*

Further research could continue this study by examining the second arm of risk: probability. Once there is a sufficient database of finalized court sentences, a statistical analysis of how often prosecuted cases render penalties could reveal the probability of being assigned a consequence for fraudulent misconduct. The data should reflect final rulings once all appeals have been exhausted, and could measure either the same time period in both countries or the same set of time in each country, such as Year 1 through Year 5 after the passage of the relevant legislation.

Alternatively, further research could be conducted into the accounting profession's assessment of the risk in their industry and their reaction, if any. The industry will adjust to the new statutes and increased magnitude of risk, and there will likely be a few high-profile cases of auditors and directors serving jail time. As accounting professionals and university students reassess the risk of a career in accounting, a study of whether the accounting profession is leaking talent to less risky fields could be very telling. Such research could indicate whether legislation has gone too far in punishing misconduct by scaring away talented potential accounting professionals and industry leaders.

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Education

The Pennsylvania State University, Smeal College of Business, University Park, Pennsylvania

- Master of Accounting (August 2009 – December 2010)
- Bachelor of Science in Accounting (August 2005 – December 2010)
- Minors in the Legal Environment of Business and International Business
- Schreyer Honors College Scholar
- Intermediate proficiency in Spanish and beginner's proficiency in American Sign Language
- Honors Thesis: *The Magnitude of Professional Risk Created by the Sarbanes-Oxley Act of 2002 and the Companies Act of 2006*
  - Evaluating the statutes containing penalties for individuals who engage in fraudulent behavior in the United States and the United Kingdom to determine which jurisdiction generally punishes professional malfeasance more stringently

The Institute for the International Education of Students (IES), IES Study London (Spring 2008)

- Studies with international emphasis, including European Union business and management

Work Experience

KPMG, Assurance Intern, Philadelphia, Pennsylvania (June – August 2008; January – March 2010)

- Worked on financial statement audits for asset management, real estate, and banking clients
- Participated on large and small engagement teams for year-end audits and a quarterly review
- Performed and documented substantive and control testwork on source documents
- Interacted directly with clients for documentation requests and interviews

Smeal College of Business, Department of Accounting, Teaching Assistant (January – May 2009)

Smeal College of Business, Department of Economics, Grader (September 2006 – December 2009)

Allegheny County Controller's Office, Intern, Pittsburgh, Pennsylvania (May 2006 – August 2006)

- Performed substantive testwork in hotel occupancy tax audits
- Updated database formats to facilitate performance of airport car rental audit

Smeal College of Business, Department of Supply Chain, Teaching Intern (January – May 2006)

Valley News Dispatch, Student Columnist, Tarentum, Pennsylvania (November 2003 – August 2005)

- Selected to communicate with the five-county region through monthly column

Leadership and Activities

IES Class Representative (Spring 2008)

- Facilitated student feedback with Program Director and faculty

Campus Crusade for Christ (Cru) Community Team Leader and Executive Board (Spring/Fall 2007)

- Led team of 15 people in planning two events each week for 50 to 200 members

KMPG National Audit Case Competition (Spring 2007)

- Planned the audit of transfers of mortgage loans by a fictitious client, which had continuing involvement through a recourse obligation and a retained interest, including assessing materiality and risk of material misstatement and planning the necessary substantive and control procedures
- Researched and wrote the audit team's opinion on the appropriate accounting under FAS 140
- Evaluated the sufficiency of disclosures under FAS 140, FIN 45, and FAS 5

Operation Appreciation (Spring 2006)

- Founded and led a letter-writing campaign for overseas soldiers

Mock Trial (Fall 2005)

- Acted as a key witness on the champion team in of a PSU tournament and was cross-examined by the opposing team's counsel in front of a jury and audience