Sarbanes Oxley Compliance Professionals Association (SOXCPA)
1200 G Street NW Suite 800, Washington DC, 20005-6705 USA
Tel: 202-449-9750 Web: www.sarbanes-oxley-association.com

Sarbanes Oxley News, October 2023

Dear members and friends,

The Public Company Accounting Oversight Board (PCAOB) has adopted a new standard to strengthen and modernize the requirements for the auditor's use of confirmation – *the process that involves verifying information about one or more financial statement assertions with a third party*.

The new standard reflects changes in technology, communications, and business practices since the interim standard was first adopted by the PCAOB in 2003 after being issued by the AICPA in 1991.

The updated standard will better protect investors by strengthening procedures that enhance an auditor's ability to identify fraud in certain circumstances and improving overall audit quality.

"The new standard will help auditors detect fraud and better protect investors. By replacing a confirmation standard that had not changed significantly since faxes were a regular form of communication, the Board has taken an important step in modernizing our standards to effectively protect investors in today's world," said PCAOB Chair Erica Y. Williams.

"The Board thanks the many commenters whose thoughtful input helped to shape this new standard on the auditor's use of confirmation, and we look forward to monitoring the new standard's implementation and impact."

Key Provisions of the New Standard

Touching nearly every audit, the confirmation process involves an auditor selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

The new standard establishes principles-based requirements designed to stay relevant as technology evolves by applying to all methods of confirmation, including electronic and paper-based communications. In addition, the new standard better integrates with the PCAOB's risk assessment standards. Among its key provisions, the new standard:

- Includes a new requirement regarding confirming cash and cash equivalents held by third parties or otherwise obtaining relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source;

- Carries forward the existing requirement regarding confirming accounts receivable, while addressing situations where it is not feasible for the auditor to perform confirmation procedures or otherwise obtain relevant and reliable audit evidence for accounts receivable by directly accessing information maintained by a knowledgeable external source;

- States that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence;

- Emphasizes the auditor's responsibility to maintain control over the confirmation process and provides that the auditor is responsible for selecting the items to be confirmed, sending confirmation requests, and receiving confirmation responses; and

- Identifies situations in which alternative procedures should be performed by the auditor.

The adoption of the new confirmation standard was informed by input from an extensive notice-and-comment process, including issuance of a concept release and two proposing releases.

Information on the history of this project, including historical documents and comments received, can be found in Rulemaking Docket 028 and the related Standard-Setting Project page at:

https://pcaobus.org/oversight/standards/standard-setting-research-projects/confirmations

The new standard will apply to all audits conducted under PCAOB standards.

Subject to approval by the Securities and Exchange Commission, the new standard will take effect for audits of financial statements for fiscal years ending on or after **June 15, 2025.**

To read more: https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket_028/2023-008_confirmation-adopting-release.pdf?sfvrsn=e18cef74_2

The Auditor's Use of Confirmation, and Other Amendments to PCAOB Standards

PCAOB Release No. 2023-008
September 28, 2023

PCAOB Rulemaking
Docket Matter No. 028

PCAOB Issues Proposal to Strengthen Accountability for Contributing to Firm Violations

To better protect investors, the proposal would update a nearly 20-year-old rule to allow the PCAOB to hold associated persons accountable when they negligently, directly, and substantially contribute to firms' violations.

The Public Company Accounting Oversight Board (PCAOB) issued for public comment a proposal to amend PCAOB Rule 3502, Responsibility Not to Knowingly or Recklessly Contribute to Violations. The rule, originally enacted in 2005, governs the liability of associated persons who contribute to registered public accounting firms' violations of the laws, rules, and standards that the PCAOB enforces.

PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

1666 K Street NW
Washington, DC 20006

Office: 202-207-9100
Fax: 202-862-8430

www.pcaobus.org

PROPOSED AMENDMENTS TO PCAOB RULE 3502 GOVERNING CONTRIBUTORY LIABILITY

PCAOB Release No. 2023-007
September 19, 2023

PCAOB Rulemaking
Docket Matter No. 053

The proposal: https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/053/pcaob-release-no.-2023-007-rule-3502-proposal.pdf?sfvrsn=7d49cc51_9

Through the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), Congress established the Board in the wake of a series of high-profile corporate collapses that laid bare auditor misconduct and the need for a new type of oversight of the public accounting industry.[1] As part of its comprehensive, multipronged approach to such oversight, Congress authorized the Board to investigate, bring charges against, and sanction (when appropriate) registered public accounting firms and associated persons[2] thereof for violations of the laws, rules, and standards that Congress charged the Board with enforcing.[3] That enforcement authority covers a wide array of auditor conduct, including negligent conduct.

The deadline for public comment on the proposal is November 3, 2023.

"This proposal is simply updating PCAOB rules to match what investors already expect: that auditors act with reasonable care whenever they are performing their duties – and when an auditor's negligence results in firm violations that can put investors at risk, the PCAOB has tools to hold them accountable," said PCAOB Chair Erica Y. Williams.

Rule 3502's purpose is to enable the Board to hold accountable associated persons of PCAOB-registered firms who directly and substantially contribute to violations committed by registered firms.

Today's proposal better protects investors with two key updates:

1. It strengthens accountability for those who put investors at risk by updating the threshold for liability:

Auditors are already required to exercise reasonable care anytime they perform an audit – and failure to do so constitutes "negligence."

The current Rule 3502, however, only allows auditors to be held liable for firms' violations when they "recklessly" contribute to those violations – which represents a greater departure from the standard of care than negligence.

This means even when a firm commits a violation negligently, an associated person who directly and substantially contributed to the firm's violation can be sanctioned only if the PCAOB shows that the associated person acted recklessly.

The proposal, if adopted, would update Rule 3502's liability standard from recklessness to negligence, aligning it with the same standard of reasonable care auditors are already required to exercise anytime they are executing their professional duties.

Similarly, the U.S. Securities and Exchange Commission already has the ability to bring enforcement actions against associated persons when they negligently cause firm violations.

The proposal maintains the requirement under the current version of Rule 3502 that an associated person must have contributed to the firm's violation both "directly and substantially" in order to be held liable.

2. It clarifies the relationship between the contributory actor and the primary violator:

To be held liable under the current Rule 3502, an associated person who contributes to a firm's violation must be an associated person of that particular firm.

Given the increasing complexity of arrangements among firms and the constantly evolving nature of technology, the proposal clarifies that associated persons of any firm can be held liable as long as their conduct at least negligently, and directly and substantially, contributes to any firm's violation, not just violations by a firm with which they are associated.

Throughout the proposal, the Board requests comments on specific aspects of the proposed amendments. Readers are encouraged to answer the Board's questions, to comment on any aspect of the proposal, and to provide reasoning and relevant data supporting their views.

The public can learn more about submitting comments on PCAOB proposals at the Open for Public Comment page. Learn more about the PCAOB's rulemaking agenda on the PCAOB website.

To read more: https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-issues-proposal-to-strengthen-accountability-for-contributing-to-firm-violations

PCAOB Chair Williams Delivers Remarks at 2023 PCAOB Conference on Auditing and Capital Markets

Thank you, [Dr. Martin C. Schmalz, PCAOB Chief Economist and Director, Office of Economic and Risk Analysis].

And thank you to everyone here with us today and to those watching online. It is great to be back with you in person.

Before we begin, I must issue the standard disclaimer that the views that I express here are my own and are not necessarily the views of the other Board Members or the PCAOB staff.

I hope the presentation this morning left you feeling excited about working with the PCAOB to protect investors.

Even in D.C. – which is a town full of wonks – there aren't many rooms that would be energized by fun facts about auditing at 9:30 in the morning. But you all know better.

You understand that beyond the jargon and the data, auditing is fundamentally about people.

Whether it's workers saving for retirement, parents saving to put their kids through college, or anyone who depends on the soundness of our capital markets to invest and build their own version of the American dream – quality audits protect people.

And that's why we are here.

When we came together a year ago, the Board had recently released our five-year strategic plan, and I shared with you our three key pillars:

1. Modernizing our standards,
2. Enhancing our inspections, and
3. Strengthening our enforcement.

We have been hard at work executing on all three.

Standards

Under this Board, we laid out the most ambitious standard-setting and rulemaking agendas in PCAOB history.

The projects on our agenda address more than half of our standards in one way or another.

Nearly all of the standards we are considering are so-called 'interim standards,' which the PCAOB first adopted in 2003 based on standards set by the profession on what was intended to be a temporary basis. Yet, they have not been significantly updated in at least 20 years.

I don't have to tell you that our capital markets don't stand still. They evolve constantly. Practices change. Technology advances relentlessly. And new risks emerge.

To keep investors protected, our standards must keep up.

Since this Board took over less than two years ago, we have issued proposals in five standard-setting projects and one rulemaking project and adopted two new standards and related amendments.

The Board unanimously voted to adopt a new standard and related amendments on the confirmation process just last week. And the Board finalized a new standard that strengthens requirements that apply to audits involving multiple audit firms last year.

The confirmation process touches nearly every audit. The new standard will help auditors detect fraud and better protect investors now and into the future. Subject to approval by the SEC, the new standard will take effect for audits of financial statements for fiscal years ending on or after June 15, 2025.

The new standard and amendments to requirements involving other auditors will require audit firms to ensure that lead auditors sufficiently plan, supervise, and evaluate the work of other auditors. The amendments take effect for audits of financial statements for fiscal years ending on or after December 15, 2024.

This summer we issued a proposal on a rulemaking project that would hold associated persons accountable when they negligently, directly, and substantially contribute to firms' violations.

We also proposed amendments to give auditors additional direction addressing specific aspects of designing and performing audit procedures that involve technology-assisted analysis of information in electronic form.

And we proposed a new standard on noncompliance with laws and regulations, or NOCLAR.

When sanctions, fines, and civil settlements directly affect a company's bottom line, or reputational damage causes a company's stock value to decline, investors pay a price.

The proposed NOCLAR standard aims to better protect investors by strengthening the requirements for auditors to identify, evaluate, and communicate information that may indicate a company's noncompliance with laws and regulations.

In March, we issued proposed changes to modernize a suite of standards that address core auditing principles and responsibilities, including reasonable assurance, professional judgment, due professional care, and professional skepticism – known as AS 1000.

The proposed changes will center investors by making clear that auditors have a fundamental obligation to protect them.

Finally, late last year, the Board issued a new quality control (QC) standard for public comment. I called it a watershed moment for the PCAOB, because QC systems lay the very foundation for how firms approach everything they do, including performing audits.

As much progress as we are making on standards, there is still much work ahead of us, and it will require high-quality economic analysis to ensure we get it right.

Inspections

At the same time, our Inspections division has been hard at work on pillar number two: enhancing our inspections.

Our teams inspect roughly 800 audits in more than 30 jurisdictions around the world each year.

Last year we expanded the PCAOB's reach even further by securing access to inspect completely in China for the first time in history.

In May, we released the inspection reports for a firm located in mainland China and another firm headquartered in Hong Kong, which were both inspected in 2022.

The deficiencies we found during those inspections are unacceptable. And we are using every tool we have to hold the firms accountable for fixing them, including shining a light through our public reports and referring inspection findings to our enforcement team where appropriate.

If enforcement violations are found, we will not hesitate to order sanctions, including imposing significant money penalties and barring bad actors from performing future audits.

The fact that our inspectors found these deficiencies is a sign that the inspection process worked as it is supposed to.

Of course, last year was only the beginning of our work. Firms in China and Hong Kong are in the process of being inspected this year and will be inspected on a regular basis going forward.

The two firms we inspected in 2022 audited 40% of the total market share of U.S.-listed companies audited by Hong Kong and mainland China firms, and we are on track to hit 99% of the total market share by the end of this year.

We are continuing to demand complete access with no loopholes and no exceptions. Should People's Republic of China (PRC) authorities obstruct or otherwise fail to facilitate the PCAOB's access – in any way and at any time – the Board will act immediately to consider the need to issue a new determination.

This is just one aspect of our busy inspection work. Our team likes to say that "the sun never sets on PCAOB inspections," because at any given moment odds are an inspection is taking place somewhere around the world.

In May, we announced enhancements to make our inspection reports more transparent with a new section on auditor independence and a range of other improvements to make more relevant, reliable, and useful information available for investors, researchers, and others.

In July, we rolled out new features on our website to help users compare inspection report data.

This was just the beginning of our work to increase transparency and make PCAOB data more accessible.

Transparency is one of the most powerful tools the PCAOB has to improve audit quality. Sharing our inspection results empowers audit committees and boards of directors – which are responsible for hiring auditors of public companies – to hold audit firms accountable directly.

That is more important than ever, as we are seeing audit quality for both domestic and international firms trend in the wrong direction for the second year in a row.

When inspection reports are finalized later this year, PCAOB inspectors expect that approximately 40% of the audits they reviewed in 2022 will have had one or more deficiencies where the audit firm failed to obtain sufficient appropriate evidence to support its opinion.

That is up 6 percentage points from 2021, which was already 5 points higher than the deficiency rate in 2020.

This means audit opinions were signed without completing the audit work required to verify the accuracy of the financial statements. That is a serious problem at any rate, and 40% is completely unacceptable.

I have challenged auditors to sharpen their focus and called on audit committees to hold their firms accountable.

Enforcement

Of course, as our third pillar of strengthening enforcement suggests, the PCAOB has not hesitated to bring enforcement cases against auditors when appropriate.

Last year we doubled the number of enforcement orders compared with 2021 and imposed the highest total penalties in PCAOB history.

We are making sanctions count. We are expanding how we identify cases. And we are expanding the types of cases we are pursuing.

Each of these three pillars is supported by high-quality economic analysis.

Economic analysis informs every standard and rule on our agenda.

To stay effective, our inspections team must constantly adjust to new and emerging risks around the world, which requires data, analysis, and high-quality economic research.

And our enforcement team relies on data and analysis to help develop a list of risk factors to focus on.

We are thrilled that Dr. Martin Schmalz joined the PCAOB in August to lead that work as Chief Economist and the Director of the Office of Economic and Risk Analysis.

Martin is a tenured Professor of Finance and Economics at the University of Oxford, Saïd Business School, serving as the Academic Area Head for the Finance, Accounting, Managerial Science, and Economics faculty group.

Martin also serves as the Academic Director of the Blockchain Strategy Program, and co-director of the Open Banking and AI in Finance Program. Outside Oxford, he serves as a Director of Global Corporate Governance Colloquia.

Martin is the author of The Business of Big Data - a book on the economics of machine learning and AI that is accessible to non-technical audiences. He has published nine articles across all top finance journals as well as the journal of political economy, has edited a volume in a law journal, and serves as associate editor of the review of corporate finance studies.

Martin holds a graduate degree in mechanical engineering from the University of Stuttgart and a Ph.D. in economics from Princeton University.

Martin brings extraordinary expertise to the great work Michael Gurbutt and the team in our Office of Economic Risk and Analysis are doing. And I know he is excited to work with all of you.

We depend on our Office of Economic and Risk Analysis for evidence-based analysis that helps ensure our decision-making is infused with the best available data, information, and research. And they depend on you, the broader academic community, to expand our knowledge and understanding of the economic impact of auditing and audit regulation on our capital markets.

The team mentioned our fellowship program at the beginning of today's program. I encourage you to get involved. We'd love to work with you.

I know Martin is looking at ways to make it even more attractive for you to work with the PCAOB. I encourage anyone who is interested in working with the PCAOB to talk with Martin or a member of his team over the next two days. I know they have a long list of research questions waiting to be answered.

You have an exciting two days ahead of you filled with brilliant speakers, interesting research, and plenty of data.

As you take it all in, I ask you to remember what it's all about: protecting people.

As U.S. Senator Paul Sarbanes said shortly after he helped create the PCAOB more than 20 years ago: "If you don't protect the interests of the investors, it deals a major blow to the workings of the economic system…Investors, after all, make the whole thing work."

Thank you, and please enjoy the conference.

To read more: https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-delivers-remarks-at-2023-pcaob-conference-on-auditing-and-capital-markets

PCAOB 2023 Conference on Auditing and Capital Markets Attracts 359 Participants From Across Academia

The Public Company Accounting Oversight Board (PCAOB) concluded its two-day 2023 Conference on Auditing and Capital Markets, held in Washington, DC. Open to academics and Ph.D. students, the research conference attracted 359 participants this year.

"Whether it's workers saving for retirement, parents saving to put their kids through college, or anyone who depends on the soundness of our capital markets to invest and build their own version of the American dream, quality audits protect people – and that's why we are here," PCAOB Chair Erica Y. Williams told the conference.

"Our work to protect investors relies on high-quality economic analysis, and we depend on the academic community to expand our knowledge and understanding of the economic impact of auditing and audit regulation on our capital markets."

Established by the PCAOB in 2014, the Conference on Auditing and Capital Markets is designed to foster rigorous economic research on audit-related topics (including the economic impact of auditing and audit regulation on capital markets), inform the academic community about PCAOB activities and developments, and obtain input from the academic community on topics of interest to the PCAOB.

At the 2023 conference, academics presented research during panels focused on the following topics:

- Audit Partner Accountability, Reputation, and Repercussions
- Auditor Expertise and Team Dynamics
- Diversity, Equity, and Inclusion in the Auditing Profession
- Modeling Assisted Decision Making in Auditing and Audit Regulation
- Critical Audit Matters

In addition to these panels and sessions featuring PCAOB speakers, participants heard keynote remarks from Jennifer R. Joe, the John E. Peterson Professor in the Accounting and Information Systems Department of the Pamplin College of Business at Virginia Tech and the President of the Auditing Section of the American Accounting Association; and Karthik Ramanna, Professor of Business and Public Policy at the University of Oxford's Blavatnik School of Government and a fellow at St. John's College.

"We thank all the participants in this year's Conference on Auditing and Capital Markets," said Dr. Martin C. Schmalz, the PCAOB's Chief Economist and the Director of its Office of Economic and Risk Analysis.

"Their insights and perspectives build understanding of opportunities and challenges facing not just the auditing world, but also the broader economy."

Learn more about the PCAOB's work related to economic analysis at: https://pcaobus.org/oversight/standards/economic-analysis

To read more: https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-2023-conference-on-auditing-and-capital-markets-attracts-359-participants-from-across-academia

SEC Enhances Rule to Prevent Misleading or Deceptive Fund Names

The Securities and Exchange Commission has adopted amendments to the Investment Company Act "Names Rule," which addresses fund names that are likely to mislead investors about a fund's investments and risks.

The amendments modernize and enhance the Names Rule and other names-related regulatory requirements to further the Commission's investor protection goals and to address developments in the fund industry in the approximately 20 years since the rule was adopted.

"As the fund industry has developed over the last two decades, gaps in the current Names Rule may undermine investor protection," said SEC Chair Gary Gensler. "Today's final rules will help ensure that a fund's portfolio aligns with a fund's name. Such truth in advertising promotes fund integrity on behalf of fund investors."

Typically, a fund's name is the first piece of information that investors receive about a fund, and fund names offer important signaling for investors in assessing their investment options.

The Names Rule currently requires registered investment companies whose names suggest a focus in a particular type of investment to adopt a policy to invest at least 80 percent of the value of their assets in those investments (an "80 percent investment policy").

The amendments to the Names Rule will enhance the rule's protections by requiring more funds to adopt an 80 percent investment policy, including funds with names suggesting a focus in investments with particular characteristics, for example, terms such as "growth" or "value," or certain terms that reference a thematic investment focus, such as the incorporation of one or more Environmental, Social, or Governance factors.

The amendments will also include a new requirement that a fund review its portfolio assets' treatment under its 80 percent investment policy at least quarterly and will include specific time frames – generally 90 days – for getting back into compliance if a fund departs from its 80 percent investment policy.

FACT SHEET

Final Rules: Amendments to the Fund "Names Rule"

The Securities and Exchange Commission adopted amendments to rule 35d-1 under the Investment Company Act of 1940, the fund "Names Rule." The amendments will better serve the Commission's mission of investor protection by:

- Improving and broadening the scope of funds that must comply with the current requirement to adopt a policy to invest at least 80 percent of their assets in accordance with the investment focus the fund's name suggests;
- Providing enhanced disclosure and reporting requirements related to terms used in fund names; and
- Establishing additional recordkeeping requirements.

Why This Matters

The name of a registered investment company or business development company ("BDC") communicates information about the fund to investors and is an important marketing tool for the fund. The purpose of the Names Rule is to prevent fund names from misrepresenting the fund's investments and risks. Typically, a fund's name is the first piece of information that investors receive about a fund and fund names offer important signaling for investors in assessing their investment options. However, because of developments in the fund industry since the adoption of the Names Rule in 2001 – including the increase in fund assets under management and the proliferation of diverse fund strategies, such as those with thematic and environmental, social, or governance ("ESG")-related objectives – the Commission is modernizing and enhancing the Names Rule and other names-related regulatory requirements to further its investor protections goals.

What's Next

The rule amendments will become effective 60 days after publication in the Federal Register. Fund groups with net assets of $1 billion or more will have 24 months to comply with the amendments, and fund groups with net assets of less than $1 billion will have 30 months to comply.

The amendments will include enhanced prospectus disclosure requirements for terminology used in fund names, including a requirement that any terms used in the fund's name that suggest an investment focus must be consistent with those terms' plain English meaning or established industry use.

The amendments will also include additional reporting and recordkeeping requirements for funds regarding compliance with the names-related regulatory requirements.

The rule amendments, adopted at a Commission open meeting on Sept. 20, 2023, will become effective 60 days after publication in the Federal Register.

Fund groups with net assets of $1 billion or more will have 24 months to comply with the amendments, and fund groups with net assets of less than $1 billion will have 30 months to comply.

To read more: https://www.sec.gov/sec-enhances-rule-prevent-misleading-or-deceptive-fund-names

https://www.sec.gov/news/press-release/2023-188

The Commission sends request for information to X under the Digital Services Act

The European Commission services has formally sent X a request for information under the Digital Services Act (DSA).

This request follows indications received by the Commission services of the alleged spreading of illegal content and disinformation, in particular the spreading of terrorist and violent content and hate speech.

The request addresses compliance with other provisions of the DSA as well.

Following its designation as Very Large Online Platform, X is required to comply with the full set of provisions introduced by the DSA since late August 2023, including the assessment and mitigation of risks related to the dissemination of illegal content, disinformation, gender-based violence, and any negative effects on the exercise of fundamental rights, rights of the child, public security and mental well-being.

In this particular case, the Commission services are investigating X's compliance with the DSA, including with regard to its policies and actions regarding notices on illegal content, complaint handling, risk assessment and measures to mitigate the risks identified.

The Commission services are empowered to request further information to X in order to verify the correct implementation of the law.

Next Steps

X needs to provide the requested information to the Commission services. Based on the assessment of X replies, the Commission will assess next steps. This could entail the formal opening of proceedings pursuant to Article 66 of the DSA.

Pursuant to Article 74 (2) of the DSA, the Commission can impose fines for incorrect, incomplete or misleading information in response to a request for information. In case of failure to reply by X, the Commission may decide to request the information by decision. In this case, failure to reply by the deadline could lead to the imposition of periodic penalty payments.

Background

The DSA is a cornerstone of the EU's digital strategy and sets out an unprecedented new standard for the accountability of online platforms regarding disinformation, illegal content, such as illegal hate speech, and other societal risks. It includes overarching principles and robust guarantees for freedom of expression and other users' rights.

On 25 April 2023, the Commission had designated 19 Very Large Online Platforms (VLOPs) and Very Large Online Search Engines (VLOSEs) on the ground of their number of users being above 45 million, or 10% of EU population. These services need to comply with the full set of provisions introduced by the DSA since the end of August 2023.

To read more:
https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4953

The Role of Research, Data, and Analysis in Banking Reforms

Governor Michelle W. Bowman, Board of Governors of the Federal Reserve System, at the 2023 Community Banking Research Conference sponsored by the Federal Reserve System, the Conference of State Bank Supervisors, and the Federal Deposit Insurance Corporation, St. Louis, Missouri

It's a pleasure to be back in St. Louis for the annual Community Banking Research Conference. I am grateful for the continued partnership between the Federal Reserve, the Conference of State Bank Supervisors (CSBS), and the Federal Deposit Insurance Corporation (FDIC), and I would like to thank the conference organizing committee for putting together this important forum, now in its 11th year.

This conference provides an excellent opportunity for policymakers to pause and reflect on the Impact of current U.S. bank regulatory policies on the financial system. At the same time, we should also consider how alterations to these policies will influence the future of the broader banking system.

We get a view into these questions—the effectiveness of past policy choices and insights that can help shape future policy reforms—from several aspects of this conference, including, of course, the research that will be presented and from the results of the CSBS Annual Community Bank Survey.

We also gain insight from the experience and perspectives of our participants: your questions and commentary throughout the next few days can provide important context about the intended and unintended consequences of past policy decisions.

And the combined perspectives from the wide range of experts gathered here—the researchers, regulators, policymakers, and bankers—will provide us with valuable insights into how to better establish and calibrate bank regulatory and supervisory policy in the future.

Research, data, and analysis are essential to thoughtful bank regulatory reform. These tools can be used to identify issues that must be addressed or remediated; they can help us evaluate which elements of the current bank regulatory framework may be effective or ineffective, and they can help us craft reforms with a clearer understanding of the intended and unintended consequences.

Together, these tools can help us develop and implement appropriate regulatory reforms that do not impair the long-term health or impede the future growth of our diverse U.S. banking system, enabling us to avoid the pitfalls of reforms that fail to accomplish these important goals.

Today I will begin by discussing some of the research around community banks and the role they play in the U.S. banking system.

I will then discuss how this research can inform policy, including by helping us be more sensitive to the unintended consequences of reform, and discuss how this perspective can be applied to the evaluation of bank mergers and acquisitions. Finally, I will mention a few additional areas where I think research could be valuable as an input to the rulemaking process.

The Role of Research, Data, and Analysis in Rulemaking

Good research leads to good policy. This statement will likely sound familiar to many of you, as it was how Jim Bullard, the former president of the Federal Reserve Bank of St. Louis, would describe one of the key purposes of this conference in past years.

Over the years, many of the conference speakers and presenters have echoed that same sentiment since this conference first launched in 2013.

In my remarks today, I will discuss the importance of using an evidence-based approach to bank regulatory policy, which has been a long-standing theme and goal of this conference.

While research can provide valuable insights to inform revisions to bank regulatory policy, research is particularly important when it comes to regulatory efforts that directly affect community banks, including changes to modernize the Community Reinvestment Act regulations, or reforms to the supervisory standards and expectations for community banks.

Research also plays an important role in helping us understand policy reforms that affect community banks indirectly, such as the potential that regulatory requirements designed to apply only to larger banks could eventually be pushed down to smaller and community banks.

Research and evidence-based rulemaking can insulate the banking system from wide swings in policy over time. The banking system faced significant challenges this year, triggered by the failures of three large banks in the early spring.

As I noted at the time, the policy choices made in responding to these failures will have important, long-term consequences for the U.S. banking system.

The potentially far-reaching consequences of policy choices we make during this time highlight the importance of clearly identifying the problems we are attempting to address using data to craft solutions that are effective, targeted, and efficient.

Bank failures demand scrutiny, but bank failures alone do not justify wholesale revisions to the bank regulatory framework. Before we undertake reforms intended to address issues that led to bank failures, we need to develop a comprehensive understanding not only of those root causes, but also of the costs and unintended consequences of potential reforms.

Research can protect against over-reactive regulation, especially that which is not efficient, calibrated and tailored to address the actual risks and challenges facing the banking system.

My insistence upon being guided by evidence does not imply that I am opposed to regulatory reforms, but rather that policymakers should be expected to show their work.

The banking system is not perfect, and policymakers should continually ask themselves if there are ways to improve regulation and supervision.

I am always open to considering evidence-based proposals that address known deficiencies and shortcomings in our regulatory and supervisory framework, but any such proposals must stop short of interfering with or stepping into the role of managing the financial institution.

I am very pleased that this research and policy conference has continued to thrive and grow over the 11 years since its inception. The research work you all do, especially your efforts to develop data and analysis to inform policy, is a critical input to the rulemaking process.

While research is a foundation of prudent regulatory policy, the community banks that operate under this framework are the reason we are gathered together at the Saint Louis Federal Reserve Bank.
So, let's build upon that foundation to highlight the role of community banks in the U.S. banking system.

To read more:
https://www.federalreserve.gov/newsevents/speech/bowman20231004a.htm

2023 FSB Annual Report

Executive summary

The banking turmoil in March 2023 highlighted issues for financial stability.

1. Swift and decisive actions by the US and Swiss authorities were taken to deal with the failures of US regional banks and of Credit Suisse respectively earlier this year.

2. The already implemented Basel III reforms helped shield the global banking sector and real economy from a more severe banking crisis. The events underscored the importance of completing the implementation of the outstanding Basel III standards.

3. A striking feature of the bank failures was the unprecedented speed and scale of deposit runs. The FSB is assessing vulnerabilities from asset-liability and liquidity mismatches and exploring whether technology and social media have changed deposit stickiness.

4. Banks' risk management and governance arrangements remain the first and most important source of resilience.

   The Basel Committee on Banking Supervision (BCBS) is prioritising work to strengthen supervisory effectiveness and is pursuing follow-up work to assess the performance of specific features of the Basel Framework, such as liquidity risk and interest rate risk in the banking book.

5. The FSB's review of the lessons to be learnt for the operation of the international resolution framework concludes that recent events demonstrate the soundness of the framework.

   While the review identifies several areas for further analysis and improvements in the operationalisation and implementation of the framework, the review upholds the appropriateness and feasibility of the framework, rather than presenting issues that would question the substance of the Key Attributes themselves.

Vulnerabilities in the global financial system continue to be elevated…

1. The effects of the post-pandemic rise in interest rates are increasingly being felt. The cost of financing has risen substantially, at a time when debt is at very high levels across the government, corporate and household sectors. This is likely to lead to credit quality challenges that may affect both banks and non-bank investors.

2. High interest rates and an uncertain growth outlook also create the potential for higher volatility in asset prices. This could generate significant spikes in collateral and margin calls, inducing fire sales of assets. Liquidity mismatches in non-bank financial entities could also amplify shocks if they lead to simultaneous asset sales across markets.

… while vulnerabilities from structural change continue to emerge.

1. Exposure to climate-related vulnerabilities is becoming more evident. A manifestation of physical risks, as well as a disorderly transition to a low carbon economy, could have destabilising effects from increases in risk premia and falling asset prices.

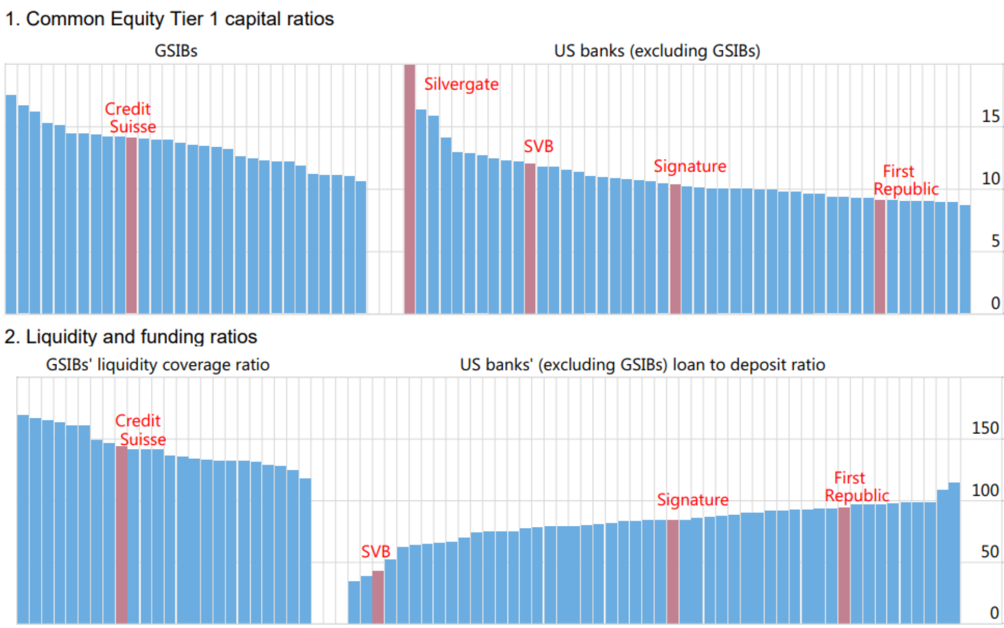
2. Cyber incidents continue to grow in frequency and sophistication. A successful cyberattack on parts of the financial system, including third-party service providers, could interrupt the supply of financial services and damage confidence.

3. Crypto-asset markets are rapidly evolving and, while financial stability risks appear contained at present, recent incidents underscore the need for vigilance and oversight.

   If these markets were to grow and become more interconnected with the traditional financial system, they could reach a point where they represent a threat to global financial stability.

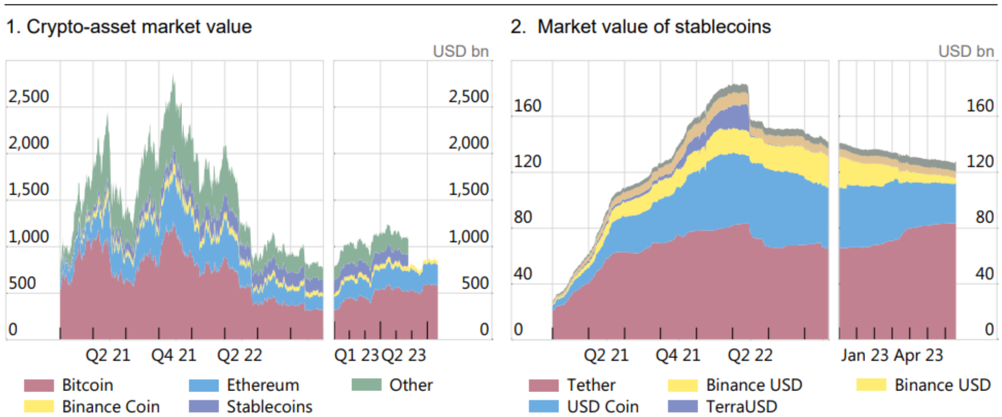
The banks that failed were not outliers in terms of capital or liquidity ratios — **Graph 2**

In per cent as of 2022:Q4



Sources: S&P Capital IQ; FSB calculations.

Crypto-asset market capitalisation remains well below its peak — **Graph 5**



Sources: CoinGecko; CCData; FSB calculations.

To read more: https://www.fsb.org/wp-content/uploads/P111023.pdf

FSB FINANCIAL STABILITY BOARD

Promoting Global Financial Stability

2023 FSB Annual Report

Financial Stability in Uncertain Times

Governor Michelle W. Bowman, at the Reinventing Bretton Woods Committee and Policy Center for the New South Marrakech Economic Festival, Marrakech, Morocco

It's a pleasure to join you today to discuss the role of central banks and financial regulators in effectively promoting a stable and resilient global financial system.

Before I begin my remarks, let me first take a moment to express my deepest sympathies to those who have been impacted by last month's earthquake.

I especially wish to recognize the Moroccan authorities for their efforts to host this important gathering under such challenging circumstances. We are grateful for your determination and inspired by your resilience and hospitality.

Today, I will discuss some of the financial system vulnerabilities and risks that I see as most salient. These risks and vulnerabilities are top of my mind but are by no means exhaustive of those monitored by the Federal Reserve.

I will then offer some thoughts on how the Federal Reserve, and other financial regulators and central banks, may be able to address and mitigate these financial system vulnerabilities and risks so that monetary policymakers are able to continue to pursue their monetary policy mandates.

The recent macroeconomic experience has presented both monetary policy and financial stability challenges for central banks. In many economies during the pandemic, supply chain disruptions coupled with strong demand as economies emerged from pandemic restrictions acted as catalysts pushing inflation up to very high levels.

Aggregate demand was also supported by accommodative monetary and fiscal policies, which served to bolster the balance sheets of households, businesses, and local governments; increased excess savings; and contributed to very tight labor markets.

Many central banks facing these dynamics have tightened monetary policy in an effort to bring demand and supply into better balance and to bring inflation back down to their targets.

In the United States, over the past year and a half, the Federal Open Market Committee (FOMC) has increased the federal funds target range by 5-1/4 percent and has been reducing the Federal Reserve's securities holdings, which had increased substantially during the pandemic period.

We have seen some progress on lowering inflation over that time. However, inflation remains well above the FOMC's 2 percent target.

Domestic spending has continued at a strong pace, and the labor market remains tight.

This suggests that the policy rate may need to rise further and stay restrictive for some time to return inflation to the FOMC's goal.

As they have confronted price stability challenges, central banks have also faced new financial stability risks, with some related to the sizable moves in interest rates in an environment with persistent, elevated inflation.

The recent experience has also highlighted how geopolitical tensions can pose financial stability risks, for example, through greater financial market volatility or, more indirectly, through their possible effects on economic activity and inflation.

Financial System Vulnerabilities and Risks

Like many other central banks, the Federal Reserve continually monitors for a wide range of emerging risks and vulnerabilities in the financial system.

It is critical to acknowledge that we need to be responsive to changing conditions in our assessment of and response to financial stability risks.

As a case in point, in recent years, it seemed that many underappreciated interest rate risk and yet, it was poor management of this risk that created significant disruptions in the financial system this spring.

With that in mind, I will discuss in more detail the financial stability risks and vulnerabilities on which I am currently most focused.
Banking sector

Starting with the banking sector, the events of earlier this year have underscored the strength and resilience of the overall U.S. banking system.

The vast majority of U.S. banks are adequately managing their interest rate and credit risk and maintaining prudent capital and liquidity positions.

While the banking sector is expected to experience higher funding costs and some deposit outflows as a result of tighter monetary policy and higher interest rates, these outcomes can create vulnerabilities for some banks.

Banks relying on more expensive deposits and that also have large holdings of long-term assets like longer-dated loans or securities with low, fixed rates will likely continue to experience a drag on earnings, especially if interest rates stay higher for longer.

Should a bank be forced to sell long-term assets, the realized losses can negatively impact regulatory capital. A rising interest rate environment may also erode the credit quality of bank loan portfolios should economic activity and incomes soften, posing an additional source of risk to bank earnings and capital.

It is important to monitor these evolving risks, and if necessary, take action to minimize the possible spillover effects on the wider banking and financial system.

In the United States, the Federal Reserve's recent stress test of the largest banks' capital positions featured a scenario with extreme declines in asset valuations and a steep rise in unemployment. All banks subject to this test passed.

In March of this year, we saw a run on the deposits of Silicon Valley Bank and other related banking sector stresses which highlighted banking system vulnerability to an erosion of confidence.

This erosion of confidence—even when it starts at a single institution with its own unique and isolated issues—can pose risks to a larger set of institutions based on, among other things, similarities in size, business model, or customer base.

As we have seen in the past, an erosion of confidence can lead to sudden large deposit outflows. Today, social media and technology can accelerate the spread of fear among depositors and bank investors, exacerbating contagion risk.
To read more:
https://www.federalreserve.gov/newsevents/speech/bowman20231011a.htm#:~:text=A%20stable%20and%20resilient%20financial,bring%20inflation%20back%20to%20target

SEC Approves Revised Privacy Act Rule

The Securities and Exchange Commission approved a rule to revise the Commission's regulations under the Privacy Act, which is the principal law governing the handling of personal information in the federal government.

The rule: https://www.sec.gov/files/rules/final/2023/34-98437.pdf

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting amendments to the Commission's regulations under the Privacy Act of 1974, as amended ("Privacy Act"). The amendments revise the Commission's regulations under the Privacy Act to clarify, update, and streamline the language of several procedural provisions.

The final rule clarifies, updates, and streamlines the Commission's Privacy Act regulations. In addition, the final rule revises procedural and fee provisions and eliminates unnecessary provisions. The final rule also allows for electronic methods to verify one's identity and submit Privacy Act requests.

"I was pleased to support this adoption because it will update the Commission's rules with respect to this important law," said SEC Chair Gary Gensler. "These amendments will provide more clarity on how the public can access their records maintained by the Commission and request amendments."

The Commission last updated its Privacy Act rules in 2011. The revisions approved today will codify current practices for processing requests made by the public under the Privacy Act. This provides greater clarity regarding the Commission's process for how individuals can access information pertaining to themselves.

Due to the scope of the revisions, the final rule replaces the Commission's current Privacy Act regulations in their entirety. The final rule is published on SEC.gov and will be published in the Federal Register. The final rule becomes effective 30 days after publication in the Federal Register.

To read more: https://www.sec.gov/news/press-release/2023-189

Blumenthal & Hawley Announce Bipartisan Framework on Artificial Intelligence Legislation

RICHARD BLUMENTHAL
U.S. SENATOR FOR CONNECTICUT

U.S. Senators Richard Blumenthal (D-CT) and Josh Hawley (R-MO), Chair and Ranking Member of the Senate Judiciary Subcommittee on Privacy, Technology, and the Law, announced a bipartisan legislative framework to establish guardrails for artificial intelligence.

The framework lays out specific principles for upcoming legislative efforts, including the establishment of an independent oversight body, ensuring legal accountability for harms, defending national security, promoting transparency, and protecting consumers and kids.

The announcement follows multiple hearings in the Subcommittee featuring witness testimony from industry and academic leaders, including OpenAI CEO Sam Altman, Anthropic CEO Dario Amodei, and Microsoft President and Vice Chair Brad Smith who will testify before the Subcommittee on Tuesday.

“This bipartisan framework is a milestone—the first tough, comprehensive legislative blueprint for real, enforceable AI protections. It should put us on a path to addressing the promise and peril AI portends,” said Blumenthal.

“We’ll continue hearings with industry leaders and experts, as well as other conversations and fact finding to build a coalition of support for legislation. License requirements, clear AI identification, accountability, transparency, and strong protections for consumers and kids—such common sense principles are a solid starting point.”

“Congress must act on AI regulation, and these principles should form the backbone,” said Hawley. “Our American families, workers, and national security are on the line. We know what needs to be done—the only question is whether Congress has the willingness to see it through.”

Specifically, the framework would:

Establish a Licensing Regime Administered by an Independent Oversight Body. Companies developing sophisticated general purpose AI models (e.g.,GPT-4) or models used in high risk situations (e.g., facial recognition) should be required to register with an independent oversight body, which would have the authority to audit companies seeking licenses and cooperating with other enforcers such as state Attorneys General. The entity should also monitor and report on technological developments and economic impacts of AI.

Ensure Legal Accountability for Harms. Congress should require AI companies to be held liable through entity enforcement and private rights of action when their models and systems breach privacy, violate civil rights, or cause other harms such as non-consensual explicit deepfake imagery of real people, production of child sexual abuse material from generative AI, and election interference. Congress should clarify that Section 230 does not apply to AI and ensure enforcers and victims can take companies and perpetrators to court.

Defend National Security and International Competition. Congress should utilize export controls, sanctions, and other legal restrictions to limit the transfer of advanced AI models, hardware, and other equipment to China Russia, other adversary nations, and countries engaged in gross human rights violations.

Promote Transparency. Congress should promote responsibility, due diligence, and consumer redress by requiring transparency from companies. Developers should be required to disclose essential information about training data, limitations, accuracy, and safety of AI models to users and other companies. Users should also have a right to an affirmative notice when they are interacting with an AI model or system, and the new agency should establish a public database to report when significant adverse incidents occur or failures cause harms.

Protect Consumers and Kids. Consumers should have control over how their personal data is used in AI systems and strict limits should be imposed on generating AI involving kids. Companies deploying AI in high-risk or consequential situations should be required to implement safety brakes and give notice when AI is being used to make adverse decisions.

A copy of the bipartisan framework can be found at:
https://www.blumenthal.senate.gov/imo/media/doc/09072023bipartisanaiframework.pdf

To read more:
https://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-and-hawley-announce-bipartisan-framework-on-artificial-intelligence-legislation

CFPB Issues Guidance on Credit Denials by Lenders Using Artificial Intelligence

Consumers must receive accurate and specific reasons for credit denials

cfpb Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) issued guidance about certain legal requirements that lenders must adhere to when using artificial intelligence and other complex models.

The guidance describes how lenders must use specific and accurate reasons when taking adverse actions against consumers.

This means that creditors cannot simply use CFPB sample adverse action forms and checklists if they do not reflect the actual reason for the denial of credit or a change of credit conditions.

This requirement is especially important with the growth of advanced algorithms and personal consumer data in credit underwriting.

Explaining the reasons for adverse actions help improve consumers' chances for future credit, and protect consumers from illegal discrimination.

"Technology marketed as artificial intelligence is expanding the data used for lending decisions, and also growing the list of potential reasons for why credit is denied," said CFPB Director Rohit Chopra. "Creditors must be able to specifically explain their reasons for denial. There is no special exemption for artificial intelligence."

In today's marketplace, creditors are increasingly using complex algorithms, marketed as artificial intelligence, and other predictive decision-making technologies in their underwriting models.

Creditors often feed these complex algorithms with large datasets, sometimes including data that may be harvested from consumer surveillance.

As a result, a consumer may be denied credit for reasons they may not consider particularly relevant to their finances.

Despite the potentially expansive list of reasons for adverse credit actions, some creditors may inappropriately rely on a checklist of reasons provided in CFPB sample forms. However, the Equal Credit Opportunity Act does not allow creditors to simply conduct check-the-box exercises when delivering notices of adverse action if doing so fails to accurately inform consumers why adverse actions were taken.

In fact, the CFPB has confirmed in a circular from last year, that the Equal Credit Opportunity Act requires creditors to explain the specific reasons for taking adverse actions.

CFPB Acts to Protect the Public from Black-Box Credit Models Using Complex Algorithms

Companies relying on complex algorithms must provide specific and accurate explanations for denying applications

MAY 26, 2022

You may visit: https://www.consumerfinance.gov/about-us/newsroom/cfpb-acts-to-protect-the-public-from-black-box-credit-models-using-complex-algorithms/

This requirement remains even if those companies use complex algorithms and black-box credit models that make it difficult to identify those reasons. Today's guidance expands on last year's circular by explaining that sample adverse action checklists should not be considered exhaustive, nor do they automatically cover a creditor's legal requirements.

Specifically, today's guidance explains that even for adverse decisions made by complex algorithms, creditors must provide accurate and specific reasons. Generally, creditors cannot state the reasons for adverse actions by pointing to a broad bucket.

For instance, if a creditor decides to lower the limit on a consumer's credit line based on behavioral spending data, the explanation would likely need to provide more details about the specific negative behaviors that led to the reduction beyond a general reason like "purchasing history."

Creditors that simply select the closest factors from the checklist of sample reasons are not in compliance with the law if those reasons do not sufficiently reflect the actual reason for the action taken.
Creditors must disclose the specific reasons, even if consumers may be surprised, upset, or angered to learn their credit applications were being graded on data that may not intuitively relate to their finances.

In addition to today's and last year's circulars, the CFPB has issued an advisory opinion that consumer financial protection law requires lenders to provide adverse action notices to borrowers when changes are made to their existing credit.

CFPB Issues Advisory Opinion on Coverage of Fair Lending Laws

Equal Credit Opportunity Act continues to protect borrowers after they have applied for and received credit

MAY 09, 2022

You may visit: https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-advisory-opinion-on-coverage-of-fair-lending-laws/

The CFPB has made the intersection of fair lending and technology a priority.

For instance, as the demand for digital, algorithmic scoring of prospective tenants has increased among corporate landlords, the CFPB reminded landlords that prospective tenants must receive adverse action notices when denied housing.

The CFPB also has joined with other federal agencies to issue a proposed rule on automated valuation models, and is actively working to ensure that black-box models do not lead to acts of digital redlining in the mortgage market.

To read more: https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-guidance-on-credit-denials-by-lenders-using-artificial-intelligence/

The U.S. Federal Bureau of Investigation (FBI) about dual ransomware attacks targeting the same victims.

Ransomware attacks against the same victim occurring within 10 days, or less, of each other were considered dual ransomware attacks. The majority of dual ransomware attacks occurred within 48 hours of each other.

Summary

The Federal Bureau of Investigation (FBI) is releasing this Private Industry Notification to highlight emerging ransomware trends and encourage organizations to implement the recommendations in the "Mitigations" section to reduce the likelihood and impact of ransomware incidents.

Threat

As of July 2023, the FBI noted two trends emerging across the ransomware environment and is releasing this notification for industry awareness. These new trends included multiple ransomware attacks on the same victim in close date proximity and new data destruction tactics in ransomware attacks.

The FBI noted a trend of dual ransomware attacks conducted in close proximity to one another.

During these attacks, cyber threat actors deployed two different ransomware variants against victim companies from the following variants: AvosLocker, Diamond, Hive, Karakurt, LockBit, Quantum, and Royal. Variants were deployed in various combinations.

This use of dual ransomware variants resulted in a combination of data encryption, exfiltration, and financial losses from ransom payments.

Second ransomware attacks against an already compromised system could significantly harm victim entities.

In early 2022, multiple ransomware groups increased use of custom data theft, wiper tools, and malware to pressure victims to negotiate.
In some cases, new code was added to known data theft tools to prevent detection.

In other cases in 2022, malware containing data wipers remained dormant until a set time, then executed to corrupt data in alternating intervals.

Preparing for Cyber Incidents

1. Maintain offline backups of data, and regularly maintain backup and restoration. By instituting this practice, the organization ensures they will not be severely interrupted, and that backup data will be accessible when it is needed.

2. Ensure all backup data is encrypted, immutable (that is, cannot be altered or deleted), and covers the entire organization's data infrastructure. Ensure your backup data is not already infected.

3. Review the security posture of third-party vendors and those interconnected with your organization. Ensure all connections between third-party vendors and outside software or hardware are monitored and reviewed for suspicious activity.

4. Implement listing policies for applications and remote access that only allow systems to execute known and permitted programs under an established security policy.

5. Document and monitor external remote connections. Organizations should document approved solutions for remote management and maintenance, and immediately investigate if an unapproved solution is installed on a workstation.

6. Implement a recovery plan to maintain and retain multiple copies of sensitive or proprietary data and servers in a physically separate, segmented, and secure location (that is, a hard drive, other storage device, or the cloud).

To read more: https://www.ic3.gov/Media/News/2023/230928.pdf

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