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**Sarbanes-Oxley Act (SOX)**

The Sarbanes-Oxley Act of 2002 is a federal law that established sweeping auditing and financial regulations for public companies.

Lawmakers created the legislation to help protect shareholders, employees and the public from accounting errors and fraudulent financial practices.

The legislation, commonly referred to as SOX, sought to both improve the reliability of the public companies' financial reporting as well as restore investor confidence in the wake of high-profile cases of corporate crime. Former U.S. President George W. Bush, who signed the act into law on July 30, 2002, called the act "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt."

SOX primarily sought to regulate financial reporting and other business practices at publicly traded companies. However, some provisions apply to all enterprises, including private companies and not-for-profit organizations.

**Benefits of SOX**

On the other hand, some business leaders acknowledged the need for improvements and felt SOX could spur better financial practices that would benefit companies and their stakeholders.

Indeed, even some of those skeptical of SOX when it was first passed later acknowledged its benefits as the law was fully implemented in subsequent years.

Specifically, proponents of the law acknowledged that SOX helped businesses improve their financial management by strengthening controls, standardizing processes, improving documentation and creating stronger board oversight.

Studies also have found that SOX increased investor confidence.

**Major elements[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=2)**]**

1. **Public Company Accounting Oversight Board (PCAOB)**
Title I consists of nine sections and establishes the Public Company Accounting Oversight Board, to provide independent oversight of public accounting firms providing audit services ("auditors"). It also creates a central oversight board tasked with registering auditors, defining the specific processes and procedures for compliance audits, inspecting and policing conduct and quality control, and enforcing compliance with the specific mandates of SOX.
2. **Auditor Independence**
Title II consists of 9 sections and establishes standards for external auditor independence, to limit conflicts of interest. It also addresses new auditor approval requirements, audit partner rotation, and auditor reporting requirements. It restricts auditing companies from providing non-audit services (e.g., consulting) for the same clients.
3. **Corporate Responsibility**
Title III consists of eight sections and mandates that senior executives take **individual responsibility** for the accuracy and completeness of corporate financial reports. It defines the interaction of external auditors and corporate audit committees, and specifies the responsibility of corporate officers for the accuracy and validity of corporate financial reports. It enumerates specific limits on the behaviors of corporate officers and describes specific forfeitures of benefits and civil penalties for non-compliance. For example, Section 302 requires that the company's "principal officers" (typically the [Chief Executive Officer](/wiki/Chief_Executive_Officer) and [Chief Financial Officer](/wiki/Chief_Financial_Officer)) certify and approve the integrity of their company financial reports quarterly.[[6]](/l)
4. **Enhanced Financial Disclosures**
Title IV consists of nine sections. It describes enhanced reporting requirements for financial transactions, including [off-balance-sheet](/wiki/Off-balance-sheet) transactions, pro-forma figures and stock transactions of corporate officers. It requires internal controls for assuring the accuracy of financial reports and disclosures, and mandates both audits and reports on those controls. It also requires timely reporting of material changes in financial condition and specific enhanced reviews by the SEC or its agents of corporate reports.
5. **Analyst Conflicts of Interest**

Title V consists of only one section, which includes measures designed to help restore investor confidence in the reporting of securities analysts. It defines the codes of conduct for securities analysts and requires disclosure of knowable conflicts of interest.

 **6. Commission Resources and Authority**

Title VI consists of four sections and defines practices to restore investor confidence in securities analysts. It also defines the SEC's authority to censure or bar securities professionals from practice and defines conditions under which a person can be barred from practicing as a broker, advisor, or dealer.

 **7. Studies and Reports**

Title VII consists of five sections and requires the [Comptroller General](/wiki/Comptroller_General_of_the_United_States) and the SEC to perform various studies and report their findings. Studies and reports include the effects of consolidation of public accounting firms, the role of credit rating agencies in the operation of securities markets, securities violations, and enforcement actions, and whether investment banks assisted [Enron](/wiki/Enron), [Global Crossing](/wiki/Global_Crossing), and others to manipulate earnings and obfuscate true financial conditions.

 **8. Corporate and Criminal Fraud Accountability**

Title VIII consists of seven sections and is also referred to as the *"Corporate and Criminal Fraud Accountability Act of 2002*". It describes specific criminal penalties for manipulation, destruction or alteration of financial records or other interference with investigations, while providing certain protections for whistle-blowers.

 **9. White Collar Crime Penalty Enhancement**

Title IX consists of six sections. This section is also called the *"White Collar Crime Penalty Enhancement Act of 2002"*. This section increases the criminal penalties associated with [white-collar crimes](/wiki/White-collar_crime) and conspiracies. It recommends stronger sentencing guidelines and specifically adds failure to certify corporate financial reports as a criminal offense.

 **10. Corporate Tax Returns**

Title X consists of one section. Section 1001 states that the [Chief Executive Officer](/wiki/Chief_Executive_Officer) should sign the company tax return.

 **11. Corporate Fraud Accountability**

Title XI consists of seven sections. Section 1101 recommends a name for this title as *"Corporate Fraud Accountability Act of 2002"*. It identifies corporate fraud and records tampering as criminal offenses and joins those offenses to specific penalties. It also revises sentencing guidelines and strengthens their penalties. This enables the SEC to resort to temporarily freezing transactions or payments that have been deemed "large" or "unusual".

**Implementation of key provisions[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=9)**]**

**Sarbanes–Oxley Section 302: Disclosure controls[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=10)**]**

Under Sarbanes–Oxley, two separate sections came into effect—one civil and the other criminal. [15 U.S.C.](/wiki/Title_15_of_the_United_States_Code) [§ 7241](https://www.law.cornell.edu/uscode/text/15/7241) (Section 302) (civil provision); [18 U.S.C.](/wiki/Title_18_of_the_United_States_Code) [§ 1350](https://www.law.cornell.edu/uscode/text/18/1350) (Section 906) (criminal provision).

Section 302 of the Act mandates a set of internal procedures designed to ensure accurate financial disclosure. The signing officers must certify that they are "responsible for establishing and maintaining [internal controls](/wiki/Internal_control)" and "have designed such internal controls to ensure that material information relating to the [company](/wiki/Company) and its [consolidated subsidiaries](/wiki/Subsidiary) is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared". [15 U.S.C.](/wiki/Title_15_of_the_United_States_Code) [§ 7241(a)(4)](https://www.law.cornell.edu/uscode/text/15/7241#a_4). The officers must "have evaluated the effectiveness of the [company](/wiki/Company)'s internal controls as of a date within 90 days prior to the report" and "have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date". *Id.*.

The SEC interpreted the intention of Sec. 302 in Final Rule 33–8124. In it, the SEC defines the new term "[disclosure](/wiki/Corporation#Financial_disclosure) controls and procedures," which are distinct from "[internal controls](/wiki/Internal_control) over [financial reporting](/wiki/Financial_reporting)".[[36]](/l) Under both Section 302 and Section 404, Congress directed the SEC to promulgate regulations enforcing these provisions.[[37]](/l)

External auditors are required to issue an opinion on whether effective internal control over financial reporting was maintained in all material respects by management. This is in addition to the financial statement opinion regarding the accuracy of the financial statements. The requirement to issue a third opinion regarding management's assessment was removed in 2007.

A *Lord & Benoit* report, titled '**Bridging the Sarbanes-Oxley Disclosure Control Gap'** was filed with the SEC Subcommittee on internal controls which reported that those companies with ineffective internal controls, the expected rate of full and accurate disclosure under Section 302 will range between 8 and 15 percent. A full 9 out of every 10 companies with ineffective Section 404 controls self reported effective Section 302 controls in the same period end that an adverse Section 404 was reported, 90% in accurate without a Section 404 audit. <http://www.section404.org/UserFiles/File/Lord_Benoit_Report_1_Bridging_the_Disclosure_Control_Gap.pdf>

**Sarbanes–Oxley Section 303: Improper influence on conduct of audits[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=11)**]**

a. Rules To Prohibit. It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

b. Enforcement. In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

c. No Preemption of Other Law. The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

d. Deadline for Rulemaking. The Commission shall—1. propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and 2. issue final rules or regulations required by this section, not later than 270 days after that date of enactment.[[1]](http://taft.law.uc.edu/CCL/SOact/sec303.html)

**Sarbanes–Oxley Section 401: Disclosures in periodic reports (Off-balance sheet items)[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=12)**]**

The bankruptcy of [Enron](/wiki/Enron) drew attention to [off-balance sheet](/wiki/Off-balance_sheet) instruments that were used fraudulently. During 2010, the court examiner's review of the [Lehman Brothers bankruptcy](/wiki/Lehman_Brothers_bankruptcy) also brought these instruments back into focus, as Lehman had used an instrument called "Repo 105" to allegedly move assets and debt off-balance sheet to make its financial position look more favorable to investors. Sarbanes-Oxley required the disclosure of all material off-balance sheet items. It also required an SEC study and report to better understand the extent of usage of such instruments and whether accounting principles adequately addressed these instruments; the SEC report was issued June 15, 2005.[[38]HYPERLINK \l "[39]](/l) Interim guidance was issued in May 2006, which was later finalized.[[40]](/l) Critics argued the SEC did not take adequate steps to regulate and monitor this activity.[[41]](/l)

**Sarbanes–Oxley Section 404: Assessment of internal control[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=13)**]**

Further information: [SOX 404 top-down risk assessment](/wiki/SOX_404_top-down_risk_assessment)

The most contentious aspect of SOX is Section 404, which requires management and the external auditor to report on the adequacy of the company's internal control on financial reporting (ICFR). This is the most costly aspect of the legislation for companies to implement, as documenting and testing important financial manual and automated controls requires enormous effort.[[42]](/l)

Under Section 404 of the Act, management is required to produce an "internal control report" as part of each annual Exchange Act report. *See* [15 U.S.C.](/wiki/Title_15_of_the_United_States_Code) [§ 7262](https://www.law.cornell.edu/uscode/text/15/7262). The report must affirm "the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting". [15 U.S.C.](/wiki/Title_15_of_the_United_States_Code) [§ 7262(a)](https://www.law.cornell.edu/uscode/text/15/7262#a). The report must also "contain an assessment, as of the end of the most recent fiscal year of the [Company](/wiki/Company), of the effectiveness of the internal control structure and procedures of the issuer for financial reporting". To do this, managers are generally adopting an internal control framework such as that described in [COSO](/wiki/Committee_of_Sponsoring_Organizations_of_the_Treadway_Commission).

To help alleviate the high costs of compliance, guidance and practice have continued to evolve. The [Public Company Accounting Oversight Board](/wiki/Public_Company_Accounting_Oversight_Board) (PCAOB) approved [Auditing](/wiki/Audit) Standard No. 5 for public accounting firms on July 25, 2007.[[43]](/l) This standard superseded Auditing Standard No. 2, the initial guidance provided in 2004. The SEC also released its interpretive guidance [[44]](/l) on June 27, 2007. It is generally consistent with the PCAOB's guidance, but intended to provide guidance for management. Both management and the external auditor are responsible for performing their assessment in the context of a [top-down risk assessment](/wiki/SOX_404_top-down_risk_assessment), which requires management to base both the scope of its assessment and evidence gathered on risk. This gives management wider discretion in its assessment approach. These two standards together require management to:

* Assess both the design and operating effectiveness of selected internal controls related to significant accounts and relevant assertions, in the context of material misstatement risks;
* Understand the flow of transactions, including IT aspects, in sufficient detail to identify points at which a misstatement could arise;
* Evaluate company-level (entity-level) controls, which correspond to the components of the [COSO](/wiki/Committee_of_Sponsoring_Organizations_of_the_Treadway_Commission) framework;
* Perform a fraud risk assessment;
* Evaluate controls designed to [prevent or detect fraud](/wiki/Fraud_deterrence), including management override of controls;
* Evaluate controls over the period-end [financial](/wiki/Finance) reporting process;
* Scale the assessment based on the size and complexity of the company;
* Rely on management's work based on factors such as competency, objectivity, and risk;
* Conclude on the adequacy of internal control over financial reporting.

SOX 404 compliance costs represent a tax on inefficiency, encouraging companies to centralize and automate their financial reporting systems. This is apparent in the comparative costs of companies with decentralized operations and systems, versus those with centralized, more efficient systems. For example, the 2007 [Financial Executives International (FEI)](/wiki/Financial_Executives_International_%28FEI%29) survey indicated average compliance costs for decentralized companies were $1.9 million, while centralized company costs were $1.3 million.[[45]](/l) Costs of evaluating manual control procedures are dramatically reduced through automation.

**Sarbanes–Oxley 404 and smaller public companies[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=14)**]**

The cost of complying with SOX 404 impacts smaller companies disproportionately, as there is a significant fixed cost involved in completing the assessment. For example, during 2004 U.S. companies with revenues exceeding $5 billion spent 0.06% of revenue on SOX compliance, while companies with less than $100 million in revenue spent 2.55%.[[46]](/l)

This disparity is a focal point of 2007 SEC and U.S. Senate action.[[47]](/l) The PCAOB intends to issue further guidance to help companies scale their assessment based on company size and complexity during 2007. The SEC issued their guidance to management in June, 2007.[[44]](/l)

After the SEC and PCAOB issued their guidance, the SEC required smaller public companies (non-accelerated filers) with fiscal years ending after December 15, 2007 to document a Management Assessment of their Internal Controls over Financial Reporting (ICFR). Outside auditors of non-accelerated filers however opine or test internal controls under PCAOB (Public Company Accounting Oversight Board) Auditing Standards for years ending after December 15, 2008. Another extension was granted by the SEC for the outside auditor assessment until years ending after December 15, 2009. The reason for the timing disparity was to address the House Committee on Small Business concern that the cost of complying with Section 404 of the Sarbanes–Oxley Act of 2002 was still unknown and could therefore be disproportionately high for smaller publicly held companies.[[48]](/l) On October 2, 2009, the SEC granted another extension for the outside auditor assessment until fiscal years ending after June 15, 2010. The SEC stated in their release that the extension was granted so that the SEC's Office of Economic Analysis could complete a study of whether additional guidance provided to company managers and auditors in 2007 was effective in reducing the costs of compliance. They also stated that there will be no further extensions in the future.[[49]](/l)

On September 15, 2010 the SEC issued final rule 33-9142 the permanently exempts registrants that are neither accelerated nor large accelerated filers as defined by Rule 12b-2 of the Securities and Exchange Act of 1934 from Section 404(b) internal control audit requirement.[[50]](/l)

**Sarbanes–Oxley Section 802: Criminal penalties for influencing US Agency investigation/proper administration[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=15)**]**

Section 802(a) of the SOX, [18 U.S.C.](/wiki/Title_18_of_the_United_States_Code) [§ 1519](https://www.law.cornell.edu/uscode/text/18/1519) states:

Whoever 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 of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

**Sarbanes–Oxley Section 806: Civil action to protect against retaliation in fraud cases[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=16)**]**

Section 806 of the Sarbanes–Oxley Act, also known as the whistleblower-protection provision, prohibits any "officer, employee, contractor, subcontractor, or agent" of a publicly traded company from retaliating against "an employee" for disclosing reasonably perceived potential or actual violations of the six enumerated categories of protected conduct in Section 806 (securities fraud, shareholder fraud, bank fraud, a violation of any SEC rule or regulation, mail fraud, or wire fraud).[[51]](/l) Section 806 prohibits a broad range of retaliatory adverse employment actions, including discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against a whistleblower.[[51]](/l) Recently a federal court of appeals held that merely "outing" or disclosing the identity of a whistleblower is actionable retaliation.

Remedies under Section 806 include:[[51]](/l)

(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

(B) the amount of back pay, with interest; and

(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

Prevailing SOX whistleblowers have received significant jury verdicts, including:

•$11 million jury verdict to a former Bio-Rad Laboratories Inc. General Counsel who was terminated after reporting potential violations of the Foreign Corrupt Practices Act;

•$6 million jury verdict to a former Playboy accounting executive who alleged that her employment was terminated in retaliation for disclosing to her former employer's Chief Financial Officer and Chief Compliance Officer concerns about accruing discretionary executive bonuses without Board approval; and

•$5 million jury verdict to a former senior manager at Progenics Pharmaceuticals, Inc. who was terminated in retaliation for his disclosure to executives that the company was committing fraud against shareholders by making inaccurate representations about the results of a clinical trial.

A claim under the anti-retaliation provision of the Sarbanes–Oxley Act must be filed initially at the Occupational Safety and Health Administration at the U.S. Department of Labor. OSHA will perform an investigation and if they conclude that the employer violated SOX, OSHA can order preliminary reinstatement.

**Sarbanes–Oxley Section 906: Criminal Penalties for CEO/CFO financial statement certification[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=17)**]**

§ 1350. Section 906 states: Failure of corporate officers to certify financial reports

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

(b) Content.— The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of [1] 1934 (15 U.S.C. 78m or 78o (d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

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

(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both. [[2]](https://www.law.cornell.edu/uscode/18/1350.html)

**Sarbanes–Oxley Section 1107: Criminal penalties for retaliation against whistleblowers[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=18)**]**

Section 1107 of the SOX [18 U.S.C.](/wiki/Title_18_of_the_United_States_Code) [§ 1513(e)](https://www.law.cornell.edu/uscode/text/18/1513#e) states:[[52]](/l)

Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any federal offense, shall be fined under this title, imprisoned not more than 10 years, or both.

**Clawbacks of executive compensation for misconduct[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=19)**]**

One of the highlights of the law was a provision that allowed the SEC to force a company's CEO or CFO to [disgorge](/wiki/Disgorgement_%28law%29) any executive compensation (such as bonus pay or proceeds from stock sales) earned within a year of misconduct that results in an earnings restatement. However, according to [Gretchen Morgenson](/wiki/Gretchen_Morgenson) of [*The New York Times*](/wiki/The_New_York_Times), such clawbacks have actually been rare, due in part to the requirement that the misconduct must be either deliberate or reckless. The SEC did not attempt to claw back any executive compensation until 2007, and as of December 2013 had only brought 31 cases, 13 of which were begun after 2010. However, according to Dan Whalen of the accounting research firm Audit Analytics, the threat of clawbacks, and the time-consuming litigation associated with them, has forced companies to tighten their financial reporting standards.[[53]](/l)

**Criticism[**[**edit**](/w/index.php?title=Sarbanes%E2%80%93Oxley_Act&action=edit&section=20)**]**

Congressman [Ron Paul](/wiki/Ron_Paul) and others such as former Arkansas governor [Mike Huckabee](/wiki/Mike_Huckabee) have contended that SOX was an unnecessary and costly government intrusion into corporate management that places U.S. corporations at a competitive disadvantage with foreign firms, driving businesses out of the United States. In an April 14, 2005 speech before the U.S. House of Representatives, Paul stated[[54]](/l)

These regulations are damaging American capital markets by providing an incentive for small US firms and foreign firms to deregister from US stock exchanges. According to a study by a researcher at the Wharton Business School, the number of American companies deregistering from public stock exchanges nearly tripled during the year after Sarbanes–Oxley became law, while the New York Stock Exchange had only 10 new foreign listings in all of 2004. The reluctance of small businesses and foreign firms to register on American stock exchanges is easily understood when one considers the costs Sarbanes–Oxley imposes on businesses. According to a survey by [Korn/Ferry](/wiki/Korn/Ferry) International, Sarbanes–Oxley cost Fortune 500 companies an average of $5.1 million in compliance expenses in 2004, while a study by the law firm of Foley and Lardner found the Act increased costs associated with being a publicly held company by 130 percent.

A research study published by Joseph Piotroski of Stanford University and Suraj Srinivasan of Harvard Business School titled "Regulation and Bonding: Sarbanes Oxley Act and the Flow of International Listings" in the [Journal of Accounting Research](/wiki/Journal_of_Accounting_Research) in 2008 found that following the act's passage, smaller international companies were more likely to list in stock exchanges in the U.K. rather than U.S. stock exchanges.[[55]](/l)

During the [financial crisis of 2007–2010](/wiki/Financial_crisis_of_2007%E2%80%932010), critics blamed Sarbanes–Oxley for the low number of Initial Public Offerings (IPOs) on American stock exchanges during 2008. In November 2008, [Newt Gingrich](/wiki/Newt_Gingrich) and co-author David W. Kralik called on Congress to repeal Sarbanes–Oxley.[[56]](/l)

A 2012 Wall St. Journal editorial stated, "One reason the U.S. economy isn't creating enough jobs is that it's not creating enough employers... For the third year in a row the world's leading exchange for new stock offerings was located not in New York, but in Hong Kong... Given that the U.S. is still home to the world's largest economy, there's no reason it shouldn't have the most vibrant equity markets—unless regulation is holding back the creation of new public companies. On that score it's getting harder for backers of the Sarbanes-Oxley accounting law to explain away each disappointing year since its 2002 enactment as some kind of temporary or unrelated setback.