"The Sarbanes-Oxley Act and its Impact on Corporate America"

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Introduction

This capstone Senior Honors Project, focused on the Sarbanes-Oxley Act of 2002, consists of sections detailing various elements that comprise this influential legislation. Throughout the paper, aspects such as motivation for the act, regulations, current issues regarding the act, as well as costs and benefits for complying corporations are analyzed. The following gives a brief overview of the Sarbanes-Oxley Act.

Overview

When the media-crazed scandals of Enron and other major corporations occurred, several repercussions followed. Primarily, the level of confidence that the public held in corporate America faltered. In response, the Sarbanes-Oxley Act of 2002 was introduced and passed by the United States Congress. Essentially, this act requires the upper-management of publicly traded companies to personally be responsible for all financial information and statements. This was intended to make senior management police the information so that the American public to regain trust in corporate governance. The Act passed in Congress states that Sarbanes-Oxley is designed to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and other purposes" (www.teamplate.com).

Sarbanes-Oxley requires the corporate board to validate each and every financial statement or information of their company. Since the act focuses on the accuracy of financial information, it also requires the strengthening of internal controls over financial reporting. Due to the fact that security is a main issue, it requires open communication

between upper-management and security staff. The board of a corporation will have to play a more "hands-on" role in their firm. This leads boards to engage in micro-management of the firm and blurs the traditional distinction between management and the board. All of these factors obviously make the Sarbanes-Oxley Act a strong force in a company. Many changes are necessary to meet the demands and requirements mandated by this Act.

Some of the major changes that many corporations are undergoing rely on technology. New systems are required in order to meet the requirements of Sarbanes-Oxley. Most of these systems can be very expensive, but are necessary. Since the act is extremely complex, structured technology is a major asset. However, many companies, through the use of technology, training, and outside expertise, are able to cut unnecessary costs.

While these particular costs do affect a business, there are benefits to complying with the Sarbanes-Oxley Act. Like previously mentioned, security of internal controls will be intact. Also, adherence to the regulations will promote the corporation to the public in a positive light, gaining trust not only for the firm, but also for corporate governance as a whole. Compliance will be vital for the reputation of the public firm. Unfortunately, costs and stringent requirements have forced several publicly traded firms to retract to the private sector.

Obviously, the Sarbanes-Oxley Act is a very influential piece of legislation that forces corporations to be proactive, rather that reactive. The creators of the bill were Senator Paul Sarbanes, (D-Maryland), the Senate Banking Committee Chairman, and U.S. Representative Michael G. Oxley (R-Ohio), Chairman of the House Financial

Services Committee. The bill was originally designed in the wake of the Enron scandal, and then pushed through Congress after the occurrence of other scandals, such as WorldCom. (www.cnn.com).

Enron Corporation was one of the largest energy companies in the world, marketing primarily electricity and natural gas. Additionally, Enron also provided financial and risk management services to its customers worldwide. Formed in 1985, the corporation expanded into European markets in 1995, and eventually became an e-commerce business in 1999. In 2000, the reported revenues exceeded $101 billion. (www.cnn.com) However, Enron's eventual crash began in 1997, when it bought out a partner's stake in a company, JEDI, and in turn sold that stake to another company, Chewco, which was created, owned, and operated by Enron. This began the multifaceted strategy of transactions that allowed the company to hide debts. (www.time.com)

Successive events led to the downfall of Enron, eventually concluding on January 9, 2002, when a criminal investigation was launched. Beforehand, on November 8, 2001, Enron admitted to accounting errors, which reported their income in an excess of $586 million since 1997 (www.time.com). Obviously, these major errors were the focus of the scandal, which also led to the downfall of their accounting firm, Arthur Anderson, for the lack of accurate reporting. Public confidence in corporate governance was greatly shaken after the Enron debacle, but was nearly shattered after the WorldCom scandal that followed.

WorldCom, a telecommunications group, was the combination of WorldCom Group, which offered mostly international services, and MCI Group, which focused

primarily on local and long distance services. With reported revenues of $36 billion in 2001, WorldCom was a leading provider in its industry. (www.vault.com) However, after a federal investigation, it was discovered that discrepancies in WorldCom's accounting records incorrectly credited $3.8 billion over five quarters, making the company appear much stronger and financially sound than it was in reality. (www.cnn.com)

The WorldCom incident is strikingly similar to the Enron scandal. First and foremost, Arthur Anderson, LLP, the same accounting firm involved with Enron, also signed off on WordCom's books. In June 2002, President Bush, infuriated by the events, challenged corporate leaders to "...live up to higher ethical standards" instead of trying to "fudge the numbers" (www.cnn.com). One of the main issues argued was the lack of documentation from auditors and accounting firms.

Enter the Sarbanes-Oxley Act of 2002. Designed to prevent future scandals, upper-management is now personally responsible for authorization of all financial documents. The bi-partisan bill successfully formed independent oversight boards to keep a close check on the auditors of publicly traded companies, which are intended to deter any more financial scandals similar to Enron and WorldCom to occur. The government hopes to restore the American confidence in corporate governance through the enactment and compliance of Sarbanes-Oxley. However, the government was unable to determine whether or not the problem was widespread, therefore implementing Sarbanes-Oxley punished public firms that were acting ethically.

Section 302

When the Sarbanes-Oxley Act was passed in 2002, public corporations across the nation scurried to meet compliance deadlines. With numerous sections and

regulations to review, implement, and satisfy, Sarbanes-Oxley became one of the most expensive and time-consuming pieces of legislation in the history of corporate America.

Section 302 of the act requires that both Chief Executive Officers and Chief Financial Officers certify all quarterly and annual financial reports. These certifications must guarantee that all financial reports issued do not contain any false statements of relevant information. Additionally, these reports must accurately represent the current financial condition and outputs of the corporation. Misleading facts or figures should not be contained within the report. By certifying these documents, the government and public can evaluate the current financial status of all public corporations, as well as monitor actions taken by the lead directors of the organization. (www.fei.org)

Due to the act, one of the newest terms to enter the corporate world is "disclosure controls and procedures". Defined as the specifics surrounding the actual disclosure of the financial reports, the CEO and CFO are responsible for establishing the correct procedures for this action, which guarantees that all material information is disclosed efficiently and in a timely manner. Evaluations are also in place to ensure that the procedures in place are the most effective manner of disclosing the financial documents. Executives can determine if the documents are being completed and reported in proper accordance to the time period to which the report corresponds. (Badawi and Fitzsimmons)

Section 302 also requires that the executives disclose all relevant information to auditors and the board of directors. Relevant information includes both the design and operation of internal controls relating to financial reporting. This allows the audit committee to identify any weaknesses in the operation or design. Additionally,

management and executives can be evaluated using this process. This includes evaluating the employee's role in the financial reporting procedure. Executives must notify the audit committee of any significant changes that may have altered the financial reporting process. The Securities and Exchange Commission also requires that issuers of financial reports disclose an overall system of disclosure procedures in adherence to Exchange Act Rules 13a-15 and 15d-15. (www.soxlaw.com)

Section 302 has proven to be the primary focus of most public corporations in the fall immediately following the passing of Sarbanes-Oxley. The traditional first step taken by corporations in the implementation process was formalizing disclosure procedures. The best way to analyze implementation of Section 302 is breaking down one corporation's actions. For example, Coca-Cola Co. began formalizing their review procedures by drafting a formal charter for its newly established disclosure committee. Then, the company proceeded in implementation by requiring the manager of each operating unit to submit a formal written report that was in accordance to their external auditor's form letters. These reports made the certification process smoother and more accurate, as well as adding more depth to each report. The unstructured reports submitted prior to the new regulations could skim the surface without detailing pertinent information. The newly established disclosure committee can highlight discrepancies and weaknesses and make any necessary alterations to the reporting procedures of each particular unit. (www.fei.org)

A vital element that Coca-Cola quickly learned was that proactive communication with employees is necessary. The company informed all relevant employees of the new requirements that Section 302 entailed, allowing the entire company to be focused on

accurate and complete compliance with Sarbanes-Oxley. The international divisions of Coca-Cola were also updated of new regulations, enforcing the importance of compliance within the entire company. The management of Coca-Cola intends for this emphasis to be an ongoing process, not relenting to provide constant compliance. (www.fei.org)

With so many regulations and rules, the process of complying with Section 302 can be both time-consuming and costly. For example, Coca-Cola's newly established disclosure committee has strict administrative time and expenses attached to their actions. From meetings to reports, the committee is a completely separate unit of the company. Documenting and compiling the financial reports, followed by the certification process by the executives, then finally completed with the evaluation and audit committee, Section 302 has proven to be extremely costly, in both time and money.

Section 404

Sarbanes-Oxley Act of 2002 requires many entities to carefully examine their internal controls and financial reporting practices. While the entire act is extremely important, one of the most significant areas causing concern is Section 404. This section mandates internal control reports in conjunction with the annual report to the Securities and Exchange Commission (SEC). Three areas are required: management's responsibility for internal control structure, an assessment of the effectiveness of the internal controls, and a statement that the company's public accountants have confirmed the management's assessment and report (www.fei.org). These three sections will be covered in the following paragraphs, but first, an analysis of those affected by these requirements is beneficial.

The Sarbanes-Oxley Act mandates that any companies that file under either Section 13(a) or 15(d) with the Securities and Exchange Commission must comply with Section 404, the internal control report. If a public company has a nonpublic subsidiary, it must review and evaluate the nonpublic entity's internal controls. It is not required to issue a separate report, but must include the evaluation in the parent company's report. In addition to these entities, foreign issuers must comply with Section 404, as well as unlisted companies that have accumulated public debt. However, investment companies are not required to meet the demands of Section 404, but they do comply with Section 302 of Sarbanes-Oxley, which requires CEO and CFO certification of financial reports. Not-for-profit entities are not affected by Section 404 either, but are encouraged to evaluate their internal control structure. (www.fei.org).

The first area of the internal control report that Section 404 requires is a description of 'management's responsibility to establish and maintain adequate internal controls and procedures for financial reporting" (www.cooley.com). Basically, this can be termed as *internal controls over financial reporting*. This section will list detailed responsibilities for each upper-management member. The SEC believes that the tone of the environment is vital, and must be set by the board and top-management in order to run an effective company. (www.cooley.com)

The second area covered by Section 404 is the management's assessment of the effectiveness of the company's internal controls over financial reporting (www.fei.org). These evaluations must be assessed quarterly, and included in the quarter and annual report. In this section, management records any changes that have occurred during the period of time covered in the evaluation. The design of the internal

control structure must also me evaluated. Various tests, depending on the company, may be administered by non-management personnel to aid in the evaluation. (www.cooley.com)

While any framework that is suitable will work for evaluation, the SEC has recommended the COSO (Committee of Sponsoring Organizations) framework, which combines its definition of internal control with the five components for effectiveness. Internal control is defined by COSO as "a process, affected by people, providing reasonable assurance regarding the achievement of categories of objectives" (www.cooley.com). The five interrelated components that must be assessed for an evaluation of effectiveness include: control environment, risk assessment, control activities, information and communication, and monitoring. (Romney, p. 197)

The final area that must be included in the annual report under Section 404 is an attestation report from the company's public accounting firm. This requires additional work by the auditors, but will be able to evaluate the management's assessment efficiently after gathering sufficient data. An opinion is then expressed by the auditor's whether the management has correctly and sufficiently evaluated its internal controls over financial reporting. (www.fei.org)

Section 404 is a vital component of the act. Companies that fall under Section 404 jurisdiction must comply with its regulations. The implementation of Section 404 can be a huge and complex undertaking. Implementation of Section 404, even as just one portion of a complex piece of legislation, can be quite costly. When first announced, most executives expected the majority of costs to only be financial in

nature. However, it is now evident that most corporations find a large budget dedicated towards financial, operation, and IT costs (www.line56.com)

The Sarbanes-Oxley Act of 2002 is perhaps the most important legislation regarding corporate governance. In particular, Section 404 has had a tremendous effect on the American corporate world. Implementation of Section 404 is time-consuming and costly. With an effective implementation of Section 404, the company will be able to go above and beyond the necessary compliance, and embrace the intended spirit of the law. This will result in higher ethical values, stronger morals, and reliable reporting of financial documents. The key to implementing Section 404 successfully is starting with the end in mind. The management must know where they are headed before beginning compliance, and keep one thing in mind throughout the entire process – the objective is to reach reliable financial reporting for the company (www.fei.org).

Before any changes or implementation can occur, the first step necessary is to organize the project by establishing a foundation. The management must be able to agree upon methods of approaching this project, defining the parameters of the project, and determining objectives that should be included within the project. After a strong foundation is set and agreed upon, the next step is an assessment of current internal controls and risks. Management must be able to recognize gaps within their organization and see where new or updated controls are needed. Full documentation of this process, as with all steps in implementation, is critical. (www.fei.org)

Following the assessment of the current controls and risks, the next step towards implementation is designing new solutions for the gaps that were previously found in the

current system. Obviously, along with designing new solutions is implementing these new remedies. This process can be very long and tedious, considering that an ample amount of time is necessary for both the design and implementation. The key to this step is testing and monitoring, which should be conducted continuously, and documenting all test results. In the design phase, the management must refer to the gaps in the current system to see what improvements, changes, and/or additions could be made. After this is designed and implemented, the testing is critical to see if additional alterations are necessary. Very few designs are right on target the first time, and only after extensive testing and redesigning are solutions often found. These two steps, designing and implementing new solutions, are the capstone of the full implementation of Section 404. (www.fei.org).

The final step of implementation is compiling a report of the previous steps. All current internal control gaps, new designs, and testing results should be documented and then compiled into a final report. This summary will allow the independent auditors to finalize their assessment as required by Section 404. (www.fei.org)

To most companies, the entire concept of compliance with Sarbanes-Oxley may seem like a daunting task. However, the most prominent concern has been the cost of implementing Section 404, as maintaining strong internal controls and documentation after the deadline for compliance. Surveys conducted by Financial Executives International have shown that estimated costs in January 2004 were nearly double by July 2004. Corporations have been consumed with compliance of Sarbanes-Oxley, and to satisfy these requirements completely, a massive cost must also be absorbed.

However, every stakeholder in any complying company should want nothing less, because with complete compliance comes strong internal controls.

Obviously, the size of the corporation in discussion will affect the total cost for implementation of Section 404. The ratio of cost to revenues is steady throughout all sizes of companies. However, this does not make it any easier for smaller companies to implement this new regulation. Financial Executives International conducted the same poll at two different points in time – January 2004 and July 2004. This survey asked over 220 companies about estimated and actual costs, in both time and money, for Section 404 implementation. The two surveys show tremendous differences in estimated and realized costs at the two time periods. For example, the average Total "Year One" Costs jumped from around $2 million to $3 million for smaller companies, and doubled for companies with revenues over $5 billion, to $8 million. (www.fei.org)

Major cost areas can be broken down into the following areas: internal hours and costs, external consulting and software, and additional audit attestation report. This Financial Executives International survey also showed that estimations nearly doubled from January to July in these categories as well. Estimated internal hours jumped from over 12,000 to nearly 26,000 hours. The need for an increase in these areas was discovered mainly when companies were well into their documentation process. Software expenses can vary for each company, depending on size, needs, and preferences. However, some external software and consulting vendors can easily charge over $2 million, especially for large corporations. (www.fei.org)

As for the audit attestation report that is required of all public companies to comply with Section 404, the average price for all companies was $823,200, with larger

companies obviously paying much more (www.fei.org). The *Wall Street Journal* found that over 132 million total hours have been dedicated to Section 404 implementation, including both public companies and external auditors, primarily the Big Four auditing firms. A rough estimation of this cost in money runs between $10 billion to $13 billion. (www.wsj.com)

While costs are large, eventually the benefits reaped will hopefully outweigh the costs. Companies will have stronger internal controls, more confident investors, and more efficient operations. Obviously, it is difficult for some companies to see the light at the end of the tunnel when up-front costs are so large. However, while there will be some costs that are associated with maintaining internal controls, documentation, and training of employees, these costs will not be as high as initial costs. Eventually, costs and benefits, for most companies, should not be as burdensome.

Total Cost Effect

Since its passage in 2002, the Sarbanes-Oxley Act has forced public corporations to spend millions of dollars in order to comply with its regulations. The numerous requirements that the legislation enforces place an expensive burden on all companies, regardless of size. Some companies estimated costs accurately, others have not, and some companies have been forced to terminate its public status and become private. Regardless, every public company has struggled to minimize costs while meeting the requirements of the act.

In "A Rock and a Hard Place", *CIO Insight*'s Debra D'Agostino analyzes the primary problem facing companies: compliance costs have steadily increased and they have yet to see the end of the tunnel. She interviews Bob Travatello, the CIO of Blue

Rhino Corp., America's largest independent supplier of propane gas cylinder exchange for backyard grills, on his thoughts of Sarbanes-Oxley. Initially, Travatello admits that Blue Rhino felt confident in their preparation in complying with Sarbanes-Oxley. Compliance reigned as a top priority for the medium-size company and was not anticipating any negative financial consequences (www.cioinsight-ziffdavis.com)

In just under two years later, Travatello feels much differently. Like most other American companies, Blue Rhino underestimated compliance costs and overspent their predicted budget. Compliance also took much longer than expected, which contributed to the overspending. Additionally, the company hoped that it would benefit overall from Sarbanes-Oxley when, in reality, it hurt their bottom line. Both net earnings and their stock price dropped in 2004. With all of these factors taken into consideration, Travatello questions if the money that Blue Rhino spent on compliance was worth it. (www.cioinsight-ziffdavis.com)

It is indisputable that there is a need to decrease the current costs of compliance. Currently, there are two options that most corporations follow. First, they can continue to depend on audit teams to ensure compliance. This can be costly because internal and external audit committees can easily conflict in both their characterization of compliance and how to achieve it, which often results in costly and time-consuming disputes. Audit fees have increased over 35% since the introduction of Sarbanes-Oxley. (www.cioinsight-ziffdavis.com)

The second option is to turn to the often overworked IT department to purchase software that effectively manages compliance. Some companies have already seen improvement by purchasing software that can automate vital processes, such as testing

controls to make sure they are working properly. Companies are just now beginning to realize that incorporating compliance efforts into the continuous business processes will eventually reduce overall costs. (www.cioinsight-ziffdavis.com)

Both options, turning to either audit committees or the IT department, can be costly if they are inaccurately managed. Eighty percent of public companies report that they will have instituted a Chief Compliance Officer by 2006, which indicates the importance of ongoing compliance. As of 2004, only 41% of public companies are found to have compliance budgets, but this number is guaranteed to have increased in 2005. Currently, of their available compliance budget, 42% is dedicated to internal labor, 29% is granted to non-IT outsourced services, and technology is accredited to 28%. The remaining 1% is designated as 'other'. As time goes on, analysts predict compliance budgets to increase, as well as allocation of these budgets. Technology costs will increase, as software becomes more advanced, accurate, and necessary. Within the next 1 or 2 years, public companies will be able to recognize a reduction in their compliance costs, if effectively managed. (www.cioinsight-ziffdavis.com)

It is difficult for many companies to accurately estimate their compliance costs for the year. Costs are dependent on existing procedures, design, and technology for each company; therefore, initial cost estimation is a case-by-case basis. A typical company, depending on size, will spend an average of $4.6 million on compliance. With this stated, it has been shown that accurate compliance is more valuable in the long-run. While there may be a chance of overcompliance, it is more beneficial than having to redo documentation that had not been correctly recorded initially. (www.baselinemag.com)

With the costs that public companies now face with compliance regulations, it is no surprise that there is an increasing number of public companies that are going private in order to avoid the compliance costs. These businesses realize that their costs of compliance exceed the benefits of being a publicly traded company. Private corporations are less regulated than its public counterparts, thereby attracting companies to cross the private barrier. Unexpected costs range from providing the required "financial expert" that serves on the audit company, insurance premiums that have increased 25-40%, and higher director fees due to increased activity required of audit committees. In 2004, 114 companies went private and 44 of these 114 cited increased compliance costs as an issue. The 44 companies accumulated Sarbanes-Oxley compliance costs of an 149% increase and lost an average of $3.2 million per firm. (http://ssrn.com/abstract=672761)

For companies with revenues under $1 billion per year, costs for Sarbanes-Oxley compliance increased 33% from 2003 to 2004. Total average costs have increased nearly $2.4 million in 2004 since the requirements were installed. Additionally, being a public company in the United States has become much more costly. This cost alone is over $14.3 million in 2004, resulting in a 45% increase from the previous year. (www.corporatecompliance.org)

Sarbanes-Oxley, with its complex regulations, has become a financial burden on many publicly traded corporations. It may be several years before cost-efficient solutions become available, but until then, companies have to manage their current assets and technology to the best of their ability, all while meeting compliance standards.

Scripps Networks

The Sarbanes-Oxley Act of 2002 has proved to be a major element in the corporate world since its inception. Public companies across the nation are struggling to meet deadlines, acquire adequate software, and make necessary alterations to its operations. All companies, regardless of size, financial resources, and consulting needs, are faced with astonishing costs and compulsory modifications. According to Mr. Ken McNamee, Vice-President of Compliance, Scripps Networks, Sarbanes-Oxley has forced many companies to restructure their Compliance and Information Technology departments.

E.W. Scripps Company, founded in 1878 by Edward W. Scripps, has skyrocketed to one of the nation's top media conglomerates since its establishment. Initially, Scripps entered the newspaper industry with "The Penny Press" in Cleveland, Ohio. Today, Scripps consists of 21 newspaper markets, resulting in over 1.4 million daily subscribers nationwide. Several comic strips, including Peanuts™ and Dilbert™, are licensed by a subsidiary of E.W. Scripps Company. After early success in the newspaper business, Scripps eventually added broadcasting, first with radio, then acquiring television stations by the 1940's. Scripps now owns 10 television stations, including several ABC and NBC affiliate stations. Additionally, Scripps has acquired four different cable networks, including Home & Garden Television, as well as entering the retail television industry. With all entities included, Scripps Company will have revenues just under $2 billion in 2005, and employs over 9,000 individuals. (www.scripps.com)

Scripps Networks, which is the cable network division of the E.W. Scripps

Company, is headquartered in Knoxville, Tennessee. This division was greatly affected by the Sarbanes-Oxley Act, as was the entire corporation. Guidance from their auditors, Deloitte, and additional consulting from Ernst & Young has helped Scripps sail through this rigorous transition period as smoothly as possible. Fortunately for Scripps, many strong internal controls were already in operation, resulting in minimal expenditure implementing new controls. The main focus for the entire company was standardization across all operations, including Knoxville and offices in Los Angeles, Cincinnati, and New York. Along with the requirement of documentation of all activities, this theory of standardization has aided Scripps in cross-training its employees. Each and every procedure that occurs in Scripps is fully documented. "If it isn't documented, then it didn't happen," is the theory that Scripps Networks follows, according to Mr. Ken McNamee, Vice-President of Compliance. Employees are able to acquire the necessary skills for different positions much easier than before, and this also assists in training new employees. This will eventually cut down expenditures on training employees. (McNamee Interview)

Since many internal controls were already intact for Scripps, only 20 new positions have been added to the company. This number is relatively small considering the size of both the company and the undertaking of Sarbanes-Oxley compliance. All of these positions are necessary for implementation, but it is estimated that only one-half of these new positions will be needed once the initial alterations occur. Therefore, the number of employees who are dedicated toward Sarbanes-Oxley compliance will be reduced in the next 3 years. The combination of new employees, consulting fees, and implementation costs has resulted in expenditures exceeding $3

million for Scripps. New software has been purchased by Scripps Networks, a large, one-time expenditure. The yearly, ongoing cost for Sarbanes-Oxley compliance is expected to be $2 million. While this may seem like an enormous cost, this is only equal to one-tenth of one percent of revenue that Scripps generates each year. This ratio shows that this cost is minimal in regard to the benefits it brings to the company. Mr. McNamee agrees that this is a small price to pay to reap several benefits. (McNamee Interview)

The implementation of Sarbanes-Oxley has allowed Scripps Networks to become a stronger, better-rounded company. By maintaining the newly- established internal procedures and control environment, Scripps will be more efficient in all operations. After this rigorous transition period, costs will generate more benefits for a company the size of Scripps Networks. However, Mr. McNamee realizes that this may not be the case for many companies since smaller companies may have to absorb more consulting fees, training costs, and implementation expenses. Scripps was very fortunate in having a strong foundation to build upon, as well as having strong guidance from both Deloitte and Ernst & Young, two of the top accounting firms in the nation. (McNamee Interview)

Scripps Networks, a corporation generating billions in revenue each year, has witnessed the benefits of Sarbanes-Oxley first-hand. While external auditors do visit the headquarters more often than before, and initial expenditures have been high, the company is able to see its future with Sarbanes-Oxley. The benefits will soon greatly outweigh any cost incurred by maintaining Sarbanes-Oxley compliance procedures.

Corporate America: Before & After Sarbanes-Oxley

Sarbanes-Oxley has forever changed corporate America. Compliance regulations, affiliated costs, and implementation procedures have made a monumental impact on all public corporations. While most changes are viewed as beneficial, there are, as with any new requirements, negative consequences that corporations must overcome to fully comply with Sarbanes-Oxley.

Claudia Imhoff of Intelligent Solutions pinpoints four significant consequences that the implementation of Sarbanes-Oxley has placed on corporate America. One of the most prominent changes that has occurred is reduction of international companies perform an initial public offering in America. These companies do not feel that they can comply with the stringent requirements that Sarbanes-Oxley places on publicly traded companies. Therefore, there has been a decrease in interest of international companies turning public in American trading. (www.dmreview.com)

Section 409 of Sarbanes-Oxley forces public companies to report all material information to its shareholders and the public. This includes research and development (R&D) projects, regardless of their success. Public companies are hesitant to report their failed projects, which has caused a decline in innovation by public companies. This responsibility has fallen on the shoulders of private companies, which are restricted by less capital and fewer resources. (www.dmreview.com)

Imhoff also describes that many public companies are contemplating returning to a private corporation. This entails the company to buy back their stock, which decreases the opportunities for American investors and can leave the now private company with large debt. (www.dmreview.com)

Public companies are not the only entities affected by Sarbanes-Oxley. Private companies must also take into consideration the new rules and regulations, especially if they plan to go public in the future. Additionally, if there is a slight possibility that they may be acquired or merge with a public company, compliance is a necessity. Government contracts can also require compliance with Sarbanes-Oxley. It is vital that private companies do not overlook the regulations or underestimate the importance of compliance. (www.dmreview.com)

Roderick M. Hills, former SEC Commissioner, has made several observations about the positive and negative consequences of Sarbanes-Oxley. A support of the act, Hills believes that the result of compliance will be a more ethical corporate America. This may require some changes to be made to the current state of the regulations, but overall, the act has been positive. However, Hills has noted some problems that need to be evaluated in order for Sarbanes-Oxley to be completely effective. For example, the Financial Accounting Standards Boards (FASB) has reacted to Sarbanes-Oxley by enacting stricter standards. Also, audits have become more of a product as opposed to a service. Corporations hire accountants based on price as opposed to quality of work. (www.fei.org)

While Sarbanes-Oxley has produced some negative consequences, compliance will eventually be a positive outcome. One of the most important facts to keep in mind, however, is the origin of this legislation. It was engendered due to the unethical business practices in regard to financial reporting. While procedures and regulations are now closely monitored by corporate executives, the corporate environment has not been altered in the correct manner. Executives need to evaluate the behavior that

brought about Sarbanes-Oxley to begin with, then compliance will be easier to attain. When this is goal is met, Sarbanes-Oxley will have accomplished its mission.

Conclusion

Sarbanes-Oxley Act of 2002 is one of the most complex, intricate pieces of legislation to come out of the United States Congress. Obviously, there are many elements of Sarbanes-Oxley that have not been discussed. However, Sections 302 and 404 are two aspects of Sarbanes-Oxley that are most expensive and time-consuming for companies. Combined, public companies, auditing firms, and other entities have spent billions of dollars on implementation costs, consulting fees, and employee training expenditures. While costs vary due to several factors, such as company size, benefits should eventually outweigh costs. The integration of technology into compliance efforts has shown an increase in efficiency and a decrease in costs. One of the purposes of this legislation was to create more ethical, efficient companies. While it is difficult to change corporate culture that so long allowed unethical behavior, it is apparent that compliance procedures allow for companies to meet these high expectations.

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