SARBANES-OXLEY ACT AND ITS EFFECTS ON CORPORATE GOVERNANCE Sarbanes-Oxley (SOX) Act was passed by congress in July 30, 2002 after spectacular failures of the once highly respected companies, Enron and WorldCom. Not only is SOX a basic change in law, but it is also a departure in the regulation mode where it introduces a vast array of corporate governance initiative into federal securities law. Before SOX, the federal regime comprised disclosure requirements instead of substantive corporate government mandates, which were deemed to be states’ area of jurisdiction and accordingly left to state corporate law (Romano 2005). SOX changes this mechanism by making explicit provisions and directions for the SEC. However, many of the governance provisions regulated in SOX are not really innovations to alleviate problems of deficiencies in the business environment. Practitioners and academics put a high expectations on SOX to revamp unsound governance practices and to embark on enhanced bonding and monitoring mechanisms in corporate governance. Meanwhile, benefits reaped by complying with SOX provisions may stem from stronger governance structures, particularly more aware shareholders and more active market for corporate control in the wake of Enron’s demise, rather than form SOX provisions.

The Sarbanes-Oxley Act also known as “Public Company Accounting Reform and Investor Protection Act” (in the senate) and “Corporate and Auditing Accountability, Responsibility, and Transparency Act” (in the house) and more commonly called Sarbanes-Oxley, Sarbox or SOX, is a United States federal law that sets new or expanded requirements for all U.S. public company boards, management and public accounting firms. A number of provisions of the Act also apply to privately held companies, such as the willful destruction of evidence to impede a federal investigations.

BACKGROUND

In 2002, Sarbanes-Oxley was named after bill sponsors U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Micheal G. Oxley(R-OH). As a result of SOX, top management must individually certify the accuracy of financial information. In addition, penalties for fraudulent financial activity are much more severe. Also, SOX increased the oversight role of boards of directors and the independence of the outside auditors who reviews the accuracy of corporate financial statements.

The bill, which contains eleven sections, was enacted as a reaction to a number of major corporate and accounting scandals, including those affecting Enron, Tyco international, Adelphia, Peregrine Systems, and WorldCom. These scandals cost investors billions of dollars when the share prices of affected companies collapsed, and shook public confidence in US securities.

The Act contains eleven titles, or sections, ranging from additional corporate board responsibilities to criminal penalties, and requires the Securities and Exchange Commission (SEC) to implement rulings on requirements to comply with the law. Harvey Pitt, the 26th chairman of the SEC, led the SEC in the adoption of dozens of rules to implement the Sarbanes-Oxley Act.

COST BENEFITS OF SARBANES-OXLEY

A significant body of academic research and opinion exists regarding the costs and benefits of SOX, with significant differences in conclusions. This is due in part to the difficulty of isolating the impact of SOX from other variables affecting the stock market and corporate earnings. Section 404 of the act, which requires management and the external auditor to report on the adequacy of a company’s internal control on financial reporting, is often singled out for analysis. Conclusion from several of these studies and related criticism are summarized below:

* FEI Survey (Annual): Finance Executives International (FEI) provides an annual survey on SOX Section 404 costs. These costs have continued to decline relative to revenues since 2004. The 2007 study indicated that, for 168 companies with average revenues of $4.7 billion, the average compliance costs were $1.7 million (0.036% of revenue). The 2006 study indicated that, for 200 companies with average revenues of $6.8 billion, the average compliance costs were $2.9 million (0.043% of revenue), down 23% from 2005.
* A 2011 SEC study found that Section 404(b) compliance costs have continued to decline, especially after 2007 accounting guidance.
* Foley & Lardner Survey (2007): This annual study focuses on changes in the total costs of being a U.S public company, which were significantly affected by SOX. Such costs include external auditors fees, directors and officers (D&O) insurance, board compensation, lost productivity, and legal costs. Each of these costs categories increased significantly between FY2001 and FY2006. Nearly 70% of survey respondents indicated public companies with revenues under $251 million should be exempt from SOX Section 404.

SARBANES-OXLEY REPORTING TOOLS

Close scrutiny of corporate governance and greater responsibility placed on directors to vouch for the reports submitted to the SEC and other federal agencies, have resulted in the growth of software solutions aimed at reducing the complexity, time and expense involved in creating the reports. This trend accelerated in 2008 with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Software as a service (SaaS) products allow corporate directors and internal auditors to assemble and analyze financial and other relevant data-including unstructured data –and create the needed reports quickly and without the need of an outside vendor.