

Should SOX Be Changed?

The financial collapses of Enron, WorldCom and other high-profile companies, cost billions of dollars in lost investments, savings, retirement accounts, and pension funds. Thousands of workers lost jobs, medical insurance, and other benefits. In response, Congress passed the Sarbanes-Oxley Act of 2002 to impose new financial reporting requirements on publicly held corporations. But is SOX too burdensome?

After four years of SOX compliance, some business leaders propose changing SOX. The Committee on Capital Markets Regulation and the U.S. Chamber of Commerce lead the reform efforts. Both groups argue the costs of compliance with SOX exceed the law's benefits.

SOX's Costs: SOX's impact on U.S. corporations is undeniable. For example, the Act's Section 404 requires all publicly traded companies to develop, and verify the effectiveness of, extensive internal accounting controls. Section 404 compliance is expensive. A company with market capitalization under \$1 billion may spend an estimated \$1 million yearly on internal controls. A larger company may spend between \$2 and \$4 million yearly to comply with Section 404.

SOX's reporting standards demand chief executive officers (CEOs) and chief financial officers (CFOs) certify the accuracy of Securities and Exchanges Commission (SEC) filings. The certifications make CEOs and CFOs more vulnerable to shareholder lawsuits and criminal prosecutions. The reformers blame recent increases in CFO resignations on SOX imposed burdens. In 2005, 25% of CFOs resigned compared with 16% in 2004 and 13% in 2003.

Corporate directors also feel SOX's impact. The Act holds directors responsible for internal controls and developing ethical corporate cultures to detect and deter wrongdoing. Corporations are paying higher directors and officers (D & O) liability insurance premiums while getting less coverage.

SOX critics blame the legislation for reducing initial public offerings (IPOs) in the U.S. In the last two years, 33 of the 35 largest IPOs took place in overseas markets.

Proposed Changes: When writing this article, reformers had not released their specific proposals. Both groups were waiting until after the November elections. It is known, however, that SOX critics propose limiting shareholder class action lawsuits. They want corporations shielded from civil and criminal actions when a limited number of employees committed misdeeds. Let individuals be accountable for wrongdoing and not their corporate employers. Reformers urge greater liability protection for accounting firms.

Expect an effort to relieve smaller corporations from some SOX burdens. Reformers want companies with capitalized assets of \$750 million or less freed from SOX's internal controls and reporting requirements.

Obstacles to Changes: Regardless of need, reform will be difficult. The financial scandals of the 1990s remain fresh in many minds and legislators will be reluctant to weaken SOX. Recognizing that fact, reformers may try to make most changes through SEC rules and U.S. Department of Justice (DOJ) enforcement policies.

The growing scandal over backdating stock options makes it hard to argue that SOX is too tough. An estimated 135 companies are under investigation for backdating executives' stock options to coincide with low points in stock prices. The scandal has forced the resignations or firings of dozens of executives and board members. UnitedHealth Group Inc., CNET Networks Inc., McAfee, Apple, Zoran, and Monster WorldWide Inc. are some of the prominent corporations caught up in the scandal.

Conflicts issues exist about the reform groups' ties to the Bush administration. When President Bush signed SOX into law, he praised the legislation. Past and current Bush administration officials, however, are members of the groups pushing for reform. The Committee on Capital Markets Regulation is chaired by former White House economic adviser Glenn Hubbard. Donald Evans, President Bush's close friend and former Commerce Secretary is a committee member. Robert K. Steel, Treasury's current Undersecretary for Domestic Finances, previously headed the Chamber of Commerce's SOX reform efforts.

The DOJ insists that SOX effectively deters corporate wrongdoing and should not be weakened. In addition, investors, customers and lenders favor forcing corporations to develop strong internal controls and believe SOX improves financial reporting. Some business leaders view SOX as best business practices that make corporations more transparent and accountable. A healthy stock market also hampers changing SOX. Since 2002, the Wilshire 5000 index has increased from \$10.5 trillion to over \$16 trillion, a growth of 54%.

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