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Final Project Paper

The Sarbanes-Oxley Act

I. Act Background Information

a. Why the Act was needed

The Sarbanes-Oxley Act was passed into law in 2002 when it was approved by the House, the Senate and President George W Bush. According to W. Dough Creech, the Sarbanes-Oxley Act was "enacted by the US Congress in response to financial reporting scandals at Enron, Tyco, and WorldCom, among others" (Creech, "Sarbanes-Oxley and Cost Engineering"). The financial reporting scandals of Enron, WorldCom and others are very well known throughout this country because of the devastating toll they took on the security market. Because of the decisions made by these companies to falsify, omit or elude information on their financial statements, investors lost billions before this act was passed in 2002.

Edward Nusbaum, CEO of Grant Thornton, LLP is glad that the Sarbanes-Oxley Act was passed as he feels the general mindset is in the accounting world is "if the rulebook does not specifically forbid it, it must be ok" (Nusbaum, "Sarbanes-Oxley Act Oversight). Nusbaum believes that this mindset is what caused the majority of the problems our country faced before the Sarbanes-Oxley Act was passed. It is because of people like the leaders of Enron, Tyco, and Adelphia that change was needed. If this change means that there is further regulation on publically traded companies, but consumer and investor confidence is restored, then the Sarbanes-Oxley Act has fulfilled its purpose.

b. Who is impacted by the Act

The Sarbanes-Oxley Act was created so that the scandals that occurred at companies like Enron, WorldCom, and others would not be able to occur, at least not at the same magnitude, again. J. J. Keller states, "The Sarbanes-Oxley Act of 2002 applies to companies that are

publicly traded, and also to private subsidiaries of publicly-traded companies" (Keller, "Sarbanes-Oxley Act of 2002"). It is obvious that Congress felt the need to impose additional controls on all publicly traded companies to ensure that investors would once again feel secure. Of course, all publicly traded companies were already required to report their financial statements to the SEC; however, the Sarbanes-Oxley Act now provides additional checks and balances that all publicly traded companies must adhere by.

As with any new change in legislation, publicly traded companies are not the only group impacted by this Act. Nusbaum states, "government regulators, the new Public Company Accounting Oversight Board, the accounting profession, corporate America, and all other stakeholders must work together to accomplish the objectives of this Act" (Nusbaum). Not only are all publicly traded companies impacted by this Act, the government itself also now has an increased responsibility to verify the information that publicly traded companies are providing as the Public Company Accounting Oversight Board (PCAOB) reports directly to the Securities and Exchange Commission. Additionally, accounting audit companies, now more than ever, have a responsibility to ensure the information they are auditing is prepared in such a way that they would have no dilemma defending the information in whatever way necessary.

II. The SEC Role in the Act

The SEC plays a vital role in the Sarbanes-Oxley Act. Creech illustrates this when he asserts "the Securities and Exchange Commission has specific oversight and enforcement authority over the [Public Company Accounting Oversight] Board […] it is a non-profit corporation, consisting of five members, to oversee the audit of public companies that are subject to the securities laws of the U.S." (Creech). While the SEC itself will not be investigating and disciplining publicly traded companies, the Public Company Accounting Oversight Board

(PCAOB) will do just that. The primary goal of this board is to ensure that the financial statements provided by publicly traded companies are accurate and true. The Board itself is free to perform day to day activities as necessary to ensure compliance among publicly traded companies, but the five members who were appointed by the SEC report directly to the SEC.

In addition to the PCAOB, the SEC works directly with whistleblowers who want to report suspected illegal activities in the company that employs them. This can be witnessed in, "it protects employees who report conduct which violates the laws of the Securities and Exchange Commission, which involves fraud against shareholders […] it is illegal to discriminate or retaliate against an employee in response to that individual's reporting of illegal financial activity" (Keller). This is a major advantage for employees that were formerly scared of retaliation from their employer. Previously, if an employee felt that the company was violating one or multiple laws of the SEC, and the employer told the employee not to say anything if he/she wanted to keep their job, the employee might have felt fear, hesitation, and uncertainty in how to respond. After the Sarbanes-Oxley Act was passed, this is no longer the case. If an employee does report illegal financial activity to the SEC, the Occupational Safety and Health Administration (OSHA) will fight to protect the employee and ensure they are treated fairly.

III. Company Roles & Responsibilities

As a direct result of the Sarbanes-Oxley Act, there are now many increased responsibilities for companies perform. One new responsibility is that "both the Chief Executive Officer and Chief Financial Officer must certify the accuracy of financial statements that are filed with the SEC" (Keller). This is a major change! In the past, the Chief Financial Officer (CFO) was the only person required to certify the accuracy of the financial statements. Now, the

Chief Executive Officer (CEO) is also required to sign off on the accuracy of the financial statements provided to the SEC under punishment of fines or imprisonment for certifying false documents. Along those same lines, "the SEC requires CEOs to back up the [state of their internal control systems] with a signature and actual evidence" (Nusbaum). The main goal behind both of these changes in SEC reporting requirements is to ensure that the CEO actually knows what is going on in the company. Before, many CEOs received reports about how things were being done (i.e. internal controls, accounting methods, etc. But now, the CEO is placing not only his own career on the line, but also risking imprisonment by certifying false documents. As a result, the CEO will want to witness firsthand that the information being provided to the SEC is accurate.

In addition to the CEO and CFO, the board of directors must also ensure they are providing accurate information and also guarding the interests of their shareholders. This is observed in, "boards [of directors] can no longer blindly rubber-stamp the actions of management. They must now work side-by-side with the auditors to ensure the shareholders interests are protected" (Nusbaum). The primary responsibility of the board of directors has been, and should always be, to protect its shareholders. Because the board of directors is comprised of members elected by the shareholders, the board of directors must not only provide a direction for the company as a whole, but also make certain that management of the company is following all rules and regulations governing their industry. The SEC believes that if a company's board of directors feels more responsibility for what happens at a company, they are more likely to guarantee the accuracy and information of financial statements.

IV. Penalties

Because of the damage caused from the corporate scandals of companies like Enron and Arthur Anderson, the Sarbanes-Oxley Act provides more strict punishment for violations of the Act than previously. The Act, "incorporates the Corporate and Criminal Fraud Accountability Act of 2002, which makes it a felony to knowingly destroy or create documents to impede, obstruct, or influence a federal investigation […] including hefty fines and imprisonment up to 20 years for tampering with records" (Keller). White collar crimes are no longer a matter to be taken lightly, and they definitely are not a victimless crime. Because these crimes can destroy a company, cost investors billions of dollars, and leave many people unemployed or without any savings (as was the case in Enron), the SEC has increased the fines and consequences associated with such a crime. Today, if someone wants to commit a white collar crime by altering the company's financial statements, for example, they do so at great risk.

The law now also provides strict penalties for violations of the Employee Retirement Income Security Act of 1974 (ERISA). This can be found in, "Sarbanes-Oxley increases the maximum term of imprisonment from one year to ten years, the maximum fine for natural persons from $5,000 to $100,000, and the maximum fine for other persons from $100,000 to $500,000" (Klubes 7-6.16). Congress believes that by increasing the punishment for violating ERISA, it is less likely that someone will in fact violate ERISA. While simply increasing the punishment of committing a certain act may be a deterrent in and of itself for some people, others will not view it this way. The combination of increased punishment and the PCAOB should, however, deter more people because PCAOB is reviewing publicly traded companies and there is an increased change of being caught when doing something wrong.

V. Conclusion

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The Sarbanes-Oxley Act, enacted into law in 2002, was designed as a means of further regulation on all publicly traded companies. As a result of all of the corporate scandals of major firms (i.e. Enron, Arthur Anderson, WorldCom, etc.), the government passed this Act in hopes of preventing further scandals as the public was beginning to lose confidence in investing thru the public sector. This Act gave the SEC the ability to create the PCAOB to monitor all of the publicly traded companies in the U.S. The PCAOB has the responsibility to oversee the auditors of publicly traded companies. Companies that violate any part of the Act are now subject to extensive fines and their CEOs, CFOs, and anyone involved in financial statement preparation that provides false information could be subject to lengthy imprisonment.

The Act was created not so that the government could further regulate the business sector of the economy, but rather because there had been several examples of companies that abused their powers by providing falsified information to its employees and stockholders that caused countless people to lose their jobs and lose billions in investments. This Act seems to be doing what it was designed to do. Companies such as Enron and Tyco used to be in the news on a constant basis while their corporate scandals were exposed and top company executives were being charged with crimes. Today, these companies are no longer the source of media attention. And, according to certain studies, confidence is being restored in publicly traded companies. Overall, this Act seems to have had a positive impact on the investment market.

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