

# Sarbanes-oxley

Business, Management



Securities Exchange Commission is the highest authority which administers and monitors the audit of U. S Listed Companies at NYSE, NASDAQ and Dow Zones. All U. S. Listed Companies which get traded at U. S. bourses, have to comply with the FASB rules and practice GAAP standards of accounting. Non-compliance to any of the auditing rules prescribed by GAAP would be seriously viewed. U. S. Federal Government works in the interest of public investors and it expects all public companies to work in a transparent method by disclosing fair transactions in annual financial statements of all public companies.

Particularly, with the collapse of Enron, which is the world's largest corporation, which shocked the entire corporate world, with the clean opinion of company's auditor. , Arthur Anderson. The emphasis here is more on auditing committees and board of directors of the company who must participate and work without any prejudicial interest, with the fact that Board of Directors are the fiduciary officers of a company who work and intermediate between shareholders and management of the company whereas Auditors are the representatives of public investors who must in all respects protect and safeguard the investments of public.

In spite of highly qualified CFOs, COOs and CEOs, who are penalized for falling part of the non-compliance, officers also invite criminal charges. In order to prevent future scandals in corporate America and also to protect all the investments of investors, President Bush signed the law of SOX on 30th July, 2002 and it was passed through Congress for unanimous support. For the common investor, SOX is a great saver and also enables complete transparency about a public listed company. Further this is also in the

interest of Federal Government whose responsibility to safeguard the international businesses and nation's economy.

Discrepancies found in Enron that laid foundation to SOX Enron filed bankruptcy in the year 2001 and the company's share dropped down from \$ 90 per share to \$ 0.30 cents per share. Fortune magazine named Enron as "America's most innovative Company". Enron had nearly \$ 101 billion revenues prior to the filing of bankruptcy and it was the most successful company in United States in supplying electricity and natural gas.

Surprisingly, all the credit rating agencies viz. , S&P, Moody's Investors Service, Fitch Rating have given all good credit ratings until Enron filed Chapter 11.

According to SOX reporting standards , some of the discrepancies found in Enron are viz. , successive resignations of management, inaccurate and unreliable financial statements, CEO stock sales during blackout period, nondisclosure of earlier CEO stock sales, off-balance sheet transactions to hide losses, destruction of documentation and rigging of ratings. After three months of collapse of Enron, another giant Internet company Global Crossing Ltd. , filed its bankruptcy indicating its financial condition.

WorldCom followed by Tyco went completely bankrupt indicating disability to run the companies any longer. One common factor in all of the above companies, is either mismanagement or non-practice of professional accounting procedures which yielded the companies to its last stage of fate and certainly, this could have been prevented by methodical and professional accounting procedures particularly with the authentication and

certification of Auditors who in all probability are relied upon by the SEC and Federal Government.

Therefore, the emphasis here is that auditors have to be free and fair in certifying the financial statements and in order to thoroughly screen the public companies, without leaving any scope for fraudulent account procedures, U. S. Government has initiated SOX law in the year 2002. (Jill Gilbert Welytok Sarbanes-Oxley for Dummies) Literature Review What is SOX law? Sarbanes-Oxley Act of 2002 also called as SOX is mandatory for all organisations including large and small.

This legislation is aimed at enforcement of financial practices, regulations and to ensure corporate governance. Sarbanes-Oxley is named after Senator Paul Sarbanes and Representative Michael Oxley, who were main designers in setting number of deadlines for the compliance of legislation. SOX is arranged in eleven titles. Some of the most importance sections with regard to the compliance are sec. 302, 401, 404, 409, 802 and 906. Compliance through SOX has to be performed methodically, through proper analysis and study.

After a thorough work, SOX leaves no scope for any fraud or misrepresentation of facts and figures and by far, it recommends all the organisations to act in a credible manner stating that “ don’t put off until tomorrow what can be done today! ” in order to save companies and also refraining from adverse consequences caused by lenient views either by audit committees or by the management of the companies. SOX has helped many companies to draw benefit from the compliance of regulations as it

provides a clear picture of financial status of the company and to those who would like to have access to the information about a particular company.

Further, this also helps the U. S Government to keep a watchful eye on the financial status of companies and keeps a vigilance on the financial system of companies. (A guide to the Sarbanes-Oxley Act 2002) Methods Section 302 of SOX This section is listed under Title III of the Act and details about “ Corporate Responsibility for Financial Reports”. Section 302 states that periodic filing of statutory financial reports should be certified by the signing officers who must review the report. The report must not contain any untrue or false statements or omissions or misleading statements.

The financial statements must state only related information which is fairly presented and must also reflect on the financial condition of the company and must also details the results of all material facts and aspects. The signing officers are responsible for all internal controls and must evaluate these internal controls within previous 3 months and must have reported on the findings. A list of all deficiencies if any found, in the internal controls or any fraud information that involves the employees of the company who are involved in internal activities must be stated.

Any significant change or observation made by the signing officers, within internal controls which can negatively impact must be reported by the officers. All the provisions of this Section cannot be avoided by transferring or reincorporating the activities of a company outside United States.

Whether company is operating within United States or outside United States, must comply with this Section as a registered company under Securities

Exchange Commission. (A guide to Sarbanes-Oxley Act 2002, summary of section 302) Section 401 of SOX

This section is listed under Title IV of the Act and discusses about “ Disclosure in Periodic Reports”. Financial statements published must be accurate and must not contain any incorrect statements or admit the fact that material information is stated. Financial statements apart from regular Profit & Loss Account and Balance Sheet, also include off-Balance Sheet liabilities, obligations or any transactions. To this effect, the Commission would study and report with a complete analysis of off-Balance Sheet transactions and to what extent these are transparent.

The Commission has also to decide whether GAAP principles or any other regulations are resulting in its reporting. Section 404 of SOX This section is listed under Title IV of the Act and discusses about “ Management Assessment of Internal Controls”. All Annual Reports of companies have to publish information about the scope and adequacy of the internal control structure and other procedures with regard to financial reporting. This statement must also confirm the effectiveness about internal controls and procedures.

A registered accounting firm can also attest and report on the assessment and about effectiveness of the internal control procedures for financial reporting. Section 409 of SOX This section is listed under the Title IV of the Act and details about “ Real Time Issuer Disclosures”. Issuers are required to provide information on material changes pertaining to financial conditions or changes. Public must have access to information on urgent basis and no

delay can be made. These disclosures have to be presented in an easy and understanding manner and the information should be qualitative with graphic presentations as required.

Section 802 of SOX This section is listed in Title VIII of the Act and pertains to the “ Criminal Penalties for Altering Documents”. This section states that penalties and fines or imprisonment up to 20 years is levied on the persons who are responsible for altering, destroying, concealing, falsifying records or documents or tangible objects. This act done either with an intention to obstruct, impede or to influence a legal investigation is seriously viewed by the SOX officers.

Further this section also imposes penalty or fine or imprisonment up to 10 years on any accountant who knowingly or willfully violates the provisions of this section or violates the maintenance of audit or review of papers for a period of 5 years. Discussion SOX is divided into many parts and each part carries certain specific rules and regulations which are prescribed for easy understanding of corporates. SEC-Rules states about SOX SEC Rules and Regulations, which states that officers have to certify about the maintenance, regularity and establishment of effectiveness of the issuer’s internal controls.

IC-Primer states about internal control framework, risk control, assessments, audit programs relating to Sections 302 and 404 regarding Certification of Disclosure and Managements’ Internal Controls and Procedures. This framework established by COSO/SAS-78. SOX Act 2002 is aimed at to improve the quality and transparency in financial reporting, independent

audit and accounting services for public companies and also to create a Public Company Accounting Oversight Board, to work towards setting up of standards for best accounting practices and also to strengthen the independence of audit firms who audit public companies.

Further SOX is aimed at to increase the corporate responsibility and the useful advantages of financial disclosure, to protect the independence of securities analyst and also to improve the Securities and Exchange Commission resources for all purposes. SOA-Manual lists all the key dates and timetable, self-assessment questionnaires, definitions relating to Titles II and III regarding Auditor Independence and Corporate Responsibility.

Forms have to be prepared independently or by the assistantship of a practitioner who is engaged to perform accounting compliance services. (Sarbanes-Oxley Act 2002, Financial and Accounting Disclosure Information) According to Pricewaterhouse Coopers Report 2006, “ Audit Committees Effectiveness, what works best” focus and emphasis is more on financial statements, compliance and ethics, relationship with external auditors, risk management and internal control which discuss as to how effective practice of auditing can be conducted in organizations.

There is also an emphasis about external auditing and internal auditing which is conducted periodically within the internal environment by internal audit committees and whose report can reveal much accounting information about the recording of business transactions of organizations. After the year 2002, which witnessed the unfortunate events in U. S. corporate sector, the



entire corporate world, stood up for more accuracy and correct presentation in financial statements.

A quote which states “ prevention is better than cure” which is applicable in health, is also now applicable to corporate sector with the fact that, companies would never reach to the last stage of liquidation or bankruptcy, if the companies had been properly conducting internal audits and external audit, and thoroughly complying with the auditing procedures and has been GAAP accounting practices, worst state-of-affairs could have been prevented and many companies could be saved.

Another development in the corporate sector that is to be noted is, loss making companies or companies that are performing low in business, are finding many potential ways to save the companies by mergers or acquisitions. In the recent years, throughout the world there have many mergers and acquisitions (M&A). For example Daimler-Benz is now called as DaimlerChrysler, JP Morgan & Chase Co. , purchased Bank One Corp, CitiCorp purchased Travelers Group, AT&T Inc purchased Bell South Corporation.

It can be stated here that, M&A activity saved many companies in the past decade and even saved jobs of many people. Apart from M&A activity, SOX Act is equally protecting companies and public investments and there can be absolute assurance about the compliance of SOX regulations. This is due to the fact SOX aims at checking the fraudulent working of organizations. From another angle, SOX Act credibility is also being questioned by the legislative authorities and another alternative is also being looked for future business regulations.

According to the authorities, who believe that the advantages of SOX would never last long which is why another source of compliance is being searched. (How Does The Sarbanes-Oxley Act Impact American Business? ) However, the Federal Government continues to update SOX mandates and in the year 2007, U. S. Securities and Exchange Commission (SEC) approved new auditing standard for internal controls. In order to bring more awareness about auditing, SEC and PCAOB are encouraging auditors to undertake risk-based approach in the evaluation of internal controls on financial reporting of public companies.

There are many benefits from SOX compliance such as findings can be used in evaluations, it would reduce the costs associated with risk assessment, it would also reveal the risks that an organization is confronted with and the remedial measures available to manage risk, help companies to begin groundwork for risk assessment and to introduce more regulations and specifications and further a risk management program can be developed through SOX compliance.

As stated above the success of SOX is quite benefiting to both American companies as well U. S. Federal Government with the fact that SOX identifies assets and activities, monitors the activities and ensures accuracy in financial statements which is the most important activity in checking the health of a listed company. Access to data wherever required demonstrates and indicates the practice of Accounting Standards according to FASB Rules and it reveals complete business transactions of a company.

SOX can also retrieve entire events, records, commands given to data server and find out whether there is any mismanagement, forgery or fraudulent activity in the accounting procedures. SOX also generates audit reports which gives a full length of information about each and every company. The information that is provided by SOX enables Government to take necessary steps to issues notices or memos to U. S companies to make necessary corrections wherever required and can also provide plans for remedial measures to save the companies from liquidation.

SOX is a wake up call for many American businesses and also to all those foreign companies which are venturing into business with American companies. Conclusion SOX continues to keep the companies under check and investigation about the compliance of accounting procedures as laid in FASB Rules and also about the compliance of auditing procedures in internal controls. It is very difficult for American companies to evade any procedures which come under the purview of SOX and therefore, there is expected to be a neat and clean organizations with excellent auditing committees.