

The impact of the sarbanes-oxley act on community bank governance essay sample

[Business](#), [Corporate Governance](#)



Introduction

This paper aims to discuss the Sarbanes-Oxley Act and the impact that it has had, and will continue to have on the financial industry, in particular the field of community bank governance. In order for the paper to successfully do this, a definition of the Sarbanes-Oxley Act and of governance, both good and bad, is necessary. It is also necessary to look at what position community bank governance found itself in before the passing of the Sarbanes-Oxley Act and the position it is in after the passing of the Sarbanes-Oxley Act to assess the changes and impacts that it has had.

For the purposes of supplying additional and supporting information, this paper also gives a general discussion of the Sarbanes-Oxley Act, the background and history of it, and the impact the passing of it has had on corporate governance in general, because I believe that it is important to understand this aspect of it in order to understand the full importance, relevance and implications of the impact of the Sarbanes-Oxley Act on community bank governance. The Act has had a profound impact both on community bank governance as a whole and on suppliers to the bank as well as individual staff members employed by the bank, and indirectly the customers of the bank.

What is the Sarbanes-Oxley Act?

In order to correctly define the Act, let's read what John T Bostelman, author of "The Sarbanes-Oxley Deskbook" (2003, 2004), has to say. He explains it clearly and concisely in the following manner:

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The Sarbanes-Oxley Act gives new legal rights to employees of public companies who claim that they were retaliated against for providing information, assisting an investigation, or participating in a proceeding concerning alleged violations of US Federal securities or anti-fraud laws”.

In other words, the Sarbanes-Oxley Act provides protection to employees of public companies and minimizes the risk that they are going to be discriminated against after trying to hold up United States Federal securities or anti-fraud laws.

The Act was passed on June 30 2002 (Miller and Jentz, 2004) after a number of high profile scandals such as the much publicized Enron scandal (to explain this briefly, there were rumors of mismanagement and fraud in the company, and subsequently the Houston based energy company collapsed, bringing shame for the accounting firm with which it was associated, Arthur Anderson and unleashing scandal for large companies in just about every sector of the “ New Economy” – Axelrod and Phillips, 2004).

Named after its architects, Representative Michael Oxley and Senator Sarbanes the Sarbanes-Oxley Act has had a large and important impact on many related aspects of finance including auditing and the revolution of risk management. It has in fact been one of the sole factors responsible for the revolutionizing of corporate governance which has taken place in the last few years. This being the case we can see how important it is that we as individuals have correct and complete understanding of the Act.

Let's analyze what governance means to us within the scenario we are discussing in this paper.

Governance

Governance in the sense that we are referring to it here is in essence the way or manner in which an organization or a company is run. Governance of a company can be done in a good, mediocre or a bad way - therefore, there are the terms good, mediocre and bad governance. The manner in which an organization is governed can have a direct impact on the success or failure of that organization - very frequently, bad governance is the reason that a company will fail. Because of the Sarbanes-Oxley Act, corporate governance compliance has come to the fore in a way that has not occurred previously - it has now become an essential management tool (FinWeek, 2005).

There are many players, both internal and external, in the governance of a company - accountants, auditors, directors, etc, and governance applies to all aspects of the running of a company.

Community Bank Governance pre Sarbanes-Oxley

In their book "Corporate Governance", 2004, Monks and Minow inform us that the importance of corporate governance was made suddenly and unmistakably clear. In recent years, the loss of shareholder wealth to the tune of billions of dollars, the criminal investigation of many executives, a record number of filings of bankruptcies and a huge rise in unemployment

were all as a result of corporate catastrophe, including fraud and other forms of corporate disaster.

Donald Rowland, 2005, in a publication entitled “ Re-inventing your Bank via Sarbanes-Oxley” points out that for the past seventy years, the protection of the investing public was centered mainly upon the way in which results were reported - the main aim was to provide the public with fair, transparent and financial results - this was to enable them to understand the results and make fully informed decisions.

Community Bank Governance post Sarbanes-Oxley

Rowland goes on to state that Sarbanes-Oxley focuses on process - so in addition to accuracy and transparency, banks must now deliver focus driven results too. These processes must be analyzed and evaluated to ensure that they comply with what is required of them completely.

Parts of the Sarbanes-Oxley Act relate to analyst conflicts of interest which have induced investment banks to separate in a much stricter way than before between investment banking and research divisions (Kulpman, 2004). Therefore internal controls and systems must be drawn up strictly, adhered to and maintained.

In his article about Sarbanes-Oxley's application to Banks, Christopher Gallagher, 2004, states that:

“ Lately community bankers have had to put much emphasis on internal controls, supportive systems and elevated supervisory expectations for top banking staff, including managers, directors, etc.”

Gallagher further goes on to state that a recent discussion of the applicability of Sarbanes-Oxley to community banks that have assets that do not total \$500 million may have implied to community bankers that there is some hope of relief from the rather dire implications of the new regulations. He goes on to ask whether such hope as this is justifiable, and tells us that he wrote his article for a number of reasons, including to:

“ clarify this recent regulatory commentary, to place it in the broader context of today’s examination procedures and to warn community bank officials, especially directors, that they still should expect to be held to higher standards of effective oversight of their bank’s compliance structures, including the standards established in Sarbanes-Oxley”

According to Gallagher, in the August 3 2004 issue of “ American Banker”, John Reich, Vice President of the FDIC, stated that “ Sarbanes-Oxley did not apply to non-public institutions under \$500 million”, and instructed bankers to call him if they felt that the Act required them to make any changes. Gallagher believes that bankers who ignore Sarbanes-Oxley do so at their peril, and it is significant that no other high up players in the banking field have supported Reich’s view.

Sarbanes-Oxley also holds a number of implications for individual staff members within an organization. People must be made fully aware of the

Act, the meaning of it and the implications that it holds for their particular position, implying that some level of staff training is required. In addition, there are employment implications to particular positions within companies - for example for the person who holds the position of accountant within the company, the following implications would need to be taken into consideration, according to AICPA, 2005:

Board Composition: . Two of the five Board members must be or must have been CPAs. The remaining three members of the Board must not be and cannot ever have been CPAs. The Chair may be held by one of the CPA members, but he or she must not have practiced accounting during the five years preceding his or her appointment to the Board.

Standard Setting . The Board will issue standards or adopt standards set by other groups or organizations, for audit firm quality controls for the audits of public companies.

Investigative and Disciplinary Authority . The Board is empowered to regularly inspect registered accounting firms' operations and will investigate potential violations of securities laws, standards, competency and conduct in order to ensure that these are done properly.

International Authority . Foreign accounting firms that " prepare or furnish" an audit report involving U. S. registrants will be subject to the authority of the Board and the conditions imposed as such.

As well as CPAs, other staff members are also impacted - most notably amongst these are auditors and bookkeepers.

There are other, more commercial impacts that must be directly dealt with. For example, a company in the financial field must now ensure that it is Sarbanes-Oxley compliant. As stated by Remenyi (2004) in "Proceedings of the 11th European Conference on Information Technology", although the Act is essentially financial legislation, Information Technology will be greatly used as part of the company's system, and therefore IT controls must be incorporated into the internal control systems of the company. Remenyi goes on to say that this is of vital importance for the achievement of financial transparency, because internal controls allow important aspects of the company to be evaluated. IT systems must therefore be strengthened and this ties in with the assessment and recording of corporate internal controls that the Sarbanes-Oxley Act perpetuates.

Rowland believes that this requires a significant shift in the thinking that surrounds banking. He states that this type of process analysis is ambiguous, objective and non-linear, and that the practical implications of complying with this requirement are very demanding and overwhelming - it will be a number of years before the implications are fully understood, and therefore it will be some time before we can hope to get it right - at the moment there is rather a lot of trial and error in the restructuring of systems.

Expertise from a large number of sources is required to put into place what Sarbanes-Oxley requires. In some manner or means these can only be

obtained at a cost, and this needs to be weighed up. Let's look at the two options Rowland suggests that banks have today to comply with Sarbanes-Oxley:

The first is that banks can enlist auditing firms for outside assistance. These auditors supplement the internal staff and help with the streamlining of the reviewing, analyzing and recording of the controls that are already in place. They understand the elements of financial reporting and this expertise can help to analyze, improve and record processes and procedures which are responsible for the production of the bank's reports.

The second option is as follows: Bankers with vision are turning to banking consultants to obtain advice. These people have internal control expertise as well as expertise within the field of banking and can give exceptional insight into how best to make the change. They can make recommendations and the changes that they suggest can be immediately implemented for the good of the bank. Thereafter, once it is tried and trusted, the process or procedure can be documented. There are a number of benefits to this type of approach, including the fact that managers and consultants can understand dependencies between banking, operations and accounting functions.

Neither of the options presented above will come without heavy financial cost. One tangible example of how costs have increased after the Sarbanes-Oxley legislation is the fact that the fees of auditing have increased worldwide (FinWeek, 2005). The financial aspect is therefore one thing that

stands in opposition to the successful implementation of the Act and it is unsurprising that it is very haltingly that some companies embark upon the reform, if they do so at all.

Conclusion

In this paper I have discussed the impact of the Sarbanes-Oxley Act on community bank governance by looking at and breaking down aspects of the Act itself which have the greatest impact on this segment of the professional world.

Furthermore, the paper has analyzed and discussed amongst other things the reasons why the Sarbanes-Oxley Act was brought in, what implications it holds for banks, how banks were governed in the past and the dramatic changes to their corporate governance those banks with assets over \$500 million are going to have to make now. In the paper I also made the point, based on supplementary information, that banks with assets under \$500 million may have been given reason to think that the Act does not apply to them, but they should not ignore the Act - to do so would be to their peril. It discusses the implications that the Act holds for various individual staff members within an organization, and further, it goes on to give options as to how community banks can make the change. In addition, it supplies supporting information that I believes may be of value and of interest to the reader of this work.

We can conclude that although the implementation of Sarbanes-Oxley Act in 2002 was necessary in order to stamp out corruption, fraud, etc, the success of it in the financial industry is not going to come without a cost.

Supporting Information

1 A full copy of the Sarbanes-Oxley Act may be viewed at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_reports&docid=f:hr610.107.pdf

2 A compliance guide to Sarbanes Oxley can be found at <http://www.s-ox.com/>

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