# Sarbanes-oxley act essay

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Officially named as Public Company Accounting Reform and Investor Protection Act of 2002, the Sarbanes-Oxley Act (SOX or Sarbox) became so controversial that it took America's famous companies in their own industries, shook and even collapse as what happened to Tyco and Worldcom. As one 1writer noted, SOX was the " biggest overhaul of U. S. securities regulations. " America could probably been one of the most attractive investment areas for businessmen as evidenced by hundreds of thousands of them who lost millions of dollars when Tyco and Worldcom collapse and more are threatened with the ongoing litigation of Enron.

SOX could have been really powerful, if not that considered effective, in trying to dig into the irregularities within a billion-dollar-company that it was able to run after the most powerful people behind the said American business tycoons. In one issue of the Times Magazine (online), featuring the Sarbanes-Oxley Act, it stressed that it was because of the provision of SOX that Bernie Ebbers of Worldcom was convicted in March 2005 for an accounting fraud amounting to $11 billion (Kay, Joseph 2002).

It was the same law which proven Dennis Kozlowski and Mark Swartz guilty beyond reasonable doubt in June of the same year. Kozlowski and Swartz were convicted for stealing $150 million from Tyco (Summers, Jeremy, 2005). It is no doubt that SOX is the biggest hindrance, and probably the worst nightmare for the executives of Enron and Global Crossing, who were now on the spot, bare and exposed, for a corporate scandal linked with " failed corporate governance, accounting abuses, and outright greed" (Moberg, Dennis and Edward Romar 2002).

Due maybe to the embarrassment of the American political and business society, the United States of American government did not hesitate to pass the Sarbanes-Oxley in order to save the American economic integrity and at the same time, the nation's ethical image. SOX, aside from its effects on the American business and economics as a whole, had its several significant effects in the accounting principles and current practices. This is especially true with internal audit practices including the use of more rigid internal control systems.

" The Sarbanes-Oxley Act created new standards for corporate accountability and established new penalties for acts of wrongdoing. " It particularly holds the company's heads (CEOs and CFOs) responsible for their financial statements and through several provisions stating new reporting responsibilities and internal controls. Sarbanes-Oxley Act requires the mandatory disclosure of CEO and CFO compensation and profits which is not usually required as per accounting principles. The act also provides that these people are held primarily responsible for financial reports.

Aside from provisions mentioned above, the executive officers of the company are no longer allowed to solicit nor accept loans from their own companies. This in effect would limit their control over the company's financial matters especially with money taken out and recorded as their loans. SOX also require that internal audits be done on an annual interval and that these audits must be certified by external auditors. This measure would consequently make its hard, if not completely impossible, for company controllers to manipulate results of internal audits by possibly controlling the auditors themselves.

The said law also has significant effect on the auditing principles and current auditing practice because it requires that requires all financial reports include an internal control report. Internal control reports are not required as with auditing standards set before SOX. Aside from this, audit firms are no longer allowed to provide consulting, legal or actuarial services to their client companies, or the companies they have audited. Based on previous auditing practice, this provision is not expressed nor implied.

This provision however is beneficial if it comes with audit integrity because audit firms and the companies to which they are connected (as in audit firm-client relationship) can hardly make it possible to connive in intentionally misstating the company's financial statements. What is probably being contested with this law is its provision, known as SOX 404 compliance, which requires the establishment of internal financial controls and that these controls are to be annually audited by outside firms.

It is estimated that SOX 404 compliance would cost a company, especially the big ones, an average of $4. 3 million. On the part of the company, SOX could have been really expensive and too demanding as with documentation and internal control systems. However the said law is undoubtedly beneficial to the investors, and potential investors including other stakeholders such as the company's employees because of the fact that SOX give them the assurance that their interest and their money are safe and would eventually make considerable returns.

There are basically three concepts integrated in the Sarbanes-Oxley Act that has significant effect on accounting principles and consequently have caused

changes on traditional audit practices. First, SOX requires the formalization and the strengthening of internal checks and balances with corporations. Although internal checks and balances is the main purpose of auditing, traditional audit practice do not require the internal control reports as rigid as the requirements of the SOX. Second, SOX ensures stakeholders that financial reporting complies with full disclosure.

This means that selective account reporting can no longer be made possible since the law also provides that intentional misstatement of financial statements are punishable. Lastly, it requires that corporate governance be implemented with complete transparency. This writer assumes that transparency here both points to transparency with the major stakeholders and the government. This provision then limits and hopefully would eliminate company practices for maintaining one book (separate book for government reporting, for internal purposes especially companies with active labor unions, for investor reporting and the real financial books).

Let us take for example the case of Worldcom relative to malpractices on financial reporting which was discovered and became a turning point for the American business society through the SOX. In one analysis made by Moberg, he stated that the company intentionally misstated its financial statements, that is contrary to accounting practices, by including in the cost of its acquired assets the expected income and expenses in the future (Moberg, Dennis and Edward Romar 2002).

Moberg's analysis pointed out that this practice would in effect make the financial statements appear to be impressive by having higher losses in the

current quarter and higher earnings in the future quarters. Aside from this, Worldcom also misapplied (whether intentionally or intentionally) the valuation principles on goodwill by which they had this spread out in decades contrary to what is supposed to be applied by spreading the cost of the intangible assets over the years of its prudently assessed value.

Through the strict provisions of SOX and the mandatory compliance of all its provisions and its punishments for whosoever failed to comply, the accounting profession and its current practices would eventually have a radical change. This is primarily because accounting practices will now be strictly backed up with laws especially with auditing practices. I would say that the accounting profession will gain higher integrity in the future since the confidence of investors and stakeholders of all companies will now rely on the integrity of the audit results and the people working on it.

Based on the experiences of Tyco, Worldcom, Enron and other companies who are being rigidly audited and have been audited, the accounting professionals will earn the respect of the American society, especially the investors around the world for having been instruments of implementing complete transparency in reporting the company’s financial statements. In the near future, the American economy and the world as well, would rely on the integrity of accounting professionals for taking part of the smooth, clean and ethical internal controls practiced by every company.