The Sarbanes-Oxley Act of 2002: a five-year retrospective

Steven T. Petra and Gerasimos Loukatos

Steven T. Petra is Associate Professor based at the Frank G. Zarb School of Business, Hofstra University, Hempstead, New York, USA. Gerasimos Loukatos is based at the Frank G. Zarb School of Business, Hofstra University, Hempstead, New York, USA.

Abstract

Purpose – *The Sarbanes-Oxley Act has celebrated its fifth anniversary. This paper aims to discuss the effectiveness and usefulness to the accounting profession and the investing community of the reforms set forth in the Act.*

Design/methodology/approach – *Various components of the Sarbanes-Oxley Act of 2002 are explored in detail, predominantly those dealing with corporate governance and internal controls. Discussions with practicing certified public accountants along with opinions from other professionals in the investing community are used to gain insight into the Act's effects on those who work its provisions on a daily basis.*

Findings – *Differing opinions exist as to the effects of the reforms on the accounting profession, financial reporting, capital markets, and ultimately, investor confidence. Some experts feel the reforms are helping to restore investor confidence in issuer's financial statements while others feel the cost of compliance with the Act's reforms exceed the benefits.*

Practical Implications – *Implementation of the Act's reforms are not without controversy. This paper highlights the need for investors to understand the nature and issues surrounding the reforms to help increase investor confidence in the financial markets.*

Originality/value – *This paper reviews the origins of the Act's reforms and their intended purpose. A better understanding of the reforms and discussions with experts in the business community allows investors to determine the effectiveness and usefulness of the Act.*

Keywords *Corporate governance, Accounting, Internal control, Laws and legislation*

Paper type *General review*

Introduction

The business community ushered in the twenty-first century with accounting fraud, questionable practices of corporate governance, insider trading and accusations of limited financial disclosure. Perhaps the most noticeable and widely publicized example of corporate fraud was the demise of the Enron Corporation.

Approved by the United States House of Representatives by a vote of 423:3 and by the US Senate by a vote of 99:0, the Sarbanes-Oxley Act of 2002 (the Act), was signed into law on July 30, 2002 by President George W. Bush in response to accounting and corporate governance scandals. Its purpose is to ''protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes'' (USC 7201). The Act, more commonly referred to as SOX was named after its sponsors, Senator Paul Sarbanes and Representative Michael Oxley. The fundamental groundwork of the Act is to provide investors and the public with increased trust in accounting and financial reporting. Throughout this review various components of the Sarbanes-Oxley Act of 2002 are explored in greater detail, predominantly those dealing with corporate governance and internal controls. Discussions with practicing certified public

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accountants along with opinions from other professionals in the investing community help to assess the effectiveness and ultimate usefulness of the Act's fundamental objectives.

Named by *Fortune* magazine as ''America's most innovative company'' from 1996 to 2000, Enron Corporation was one of the leading electricity, natural gas and communications companies in the world. The company was featured on *Fortune*'s popular ''100 best companies to work for in America'' list in 2000, when it declared revenues of $111 billion. With shocking speed, the company came crashing down. Enron filed for bankruptcy on December 2, 2001 when it was revealed that its financial position was generated by accounting fraud (Greer, 2002). The company's stock price quickly dropped from 90 dollars to 30 cents on the dollar sending shock waves throughout the investing community.

Enron's stock had been able to thrive for years because the company's financial statements did not include debts and losses that were incurred by special purpose entities or SPEs which it controlled. Special purpose entities were initially intended to isolate financial risk and provide organizations with less expensive financing (Soroosh and Ciesielski, 2004). Special purpose entities do not enlist in business activities other than the ones they were initially created for.

The intended benefit of SPEs is derived from the protection afforded creditors. Creditors are shielded from the risks of the borrower's operations outside of the SPE thus reducing the borrower's cost of borrowing. One corollary benefit of special purpose entities lies in their ability to remove debt from the borrower's balance sheet. SPEs operate autonomously from their creators and are not required to be consolidated into the creator's other operations. Accounting Research Bulletin No. 51 (1959), Consolidated Financial Statements, requires consolidation of entities controlled through a majority voting interest. Typically, the creator of the SPE owns little or no stock in the SPE thus avoiding consolidation. In January 2003 the Financial Accounting Standards Board (FASB), responded to the Enron crisis by issuing Interpretation 46, Consolidation of Variable Business Entities, an Interpretation of ARB 51. Interpretation no. 46 was revised in December 2003 (FIN 46(R)), (FASB, 2003).

FIN 46(R) does not restrict the use of SPE's but hopes to improve financial reporting by enterprises involved with variable interest entities. The FASB has established a second model for consolidated financial statements. FASB believes, absent a majority voting interest, the variable interest entity should be consolidated with the borrower where the borrower is the primary beneficiary of the variable interest entity. The objective of FIN 46(R) is to insure that companies, such as Enron, will not be able to abuse off balance sheet financing to obscure the true financial condition of the company.

Arthur Andersen & Company, one of the largest and most respected accounting firms in the world faced intense scrutiny because of its affiliation with Enron. The Chicago, Illinois firm performed audit, tax and consulting services for Enron. In 2002, Andersen was convicted of obstruction of justice when David Duncan (a lead partner on the Enron account) and Nancy Temple (of Andersen's legal team) shredded supporting documents produced from their audit of Enron (Stephens, 2002). Consequently, the firm surrendered its licenses in 2002, which ended its operations.

The Act

In response to criticisms levied at the accounting profession's failure to monitor and control its members, the Act created the Public Company Accounting Oversight Board (PCAOB). The PCAOB was created as a non-profit corporation to administer the audit of public companies for the purpose of protecting investors. The Board is responsible for setting guidelines for the preparation of accurate and independent audit reports for those companies whose stock is publicly traded. The Board's duties include registering all public accounting firms that engage in audits of financial statements. Their role is to also create ''auditing, quality control, ethics, independence and other standards that may relate to the preparation of audit reports'' (USC 7201). The Board also has been empowered to conduct inspections of public accounting firms and administer disciplinary hearings for the purpose

of promoting superior professional standards. The Board is made up of five members who have demonstrated allegiance to investors. Only two members of the Board are permitted to be or have been certified public accountants. Furthermore, each member is to be employed by the Board on a full time basis.

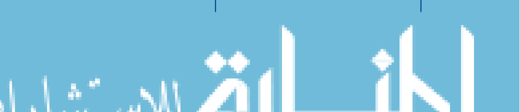
In response to criticisms levied against Arthur Andersen & Co's failure to maintain proper audit work papers, the Act requires audit work papers be prepared in substantial detail to support the conclusions attained and be kept for no less than seven years. Each audit report conclusion is to be supported by a second partner and ''concurring approval ... by a qualified person associated with the public accounting firm, other than the person in charge of the audit'' (USC 7201).

The Act addresses the need for stricter guidelines and practices to achieve auditor independence. The Securities and Exchange act of 1934 has been amended to include prohibited activities by registered pubic accounting firms. It is unlawful for a registered public accounting firm to provide non-audit services to a client while simultaneously providing audit services. Non-audit services include: bookkeeping services, financial information systems design, appraisal or valuation services, actuarial services, internal audit services, outsourcing services, human resource services, management services, investment banking services and legal services or expert services unrelated to the audit. A registered public accounting firm may provide other non-audit services not listed such as tax services provided that the services have been approved in advance by the client's audit committee (USC 7201).

Senator Sarbanes argues that the purpose of SOX ''was to get auditors to start being auditors again''. He claims that audit firms were too focused on generating consulting work from their existing clients and lost sight of their central mission (Nocera, 2005). A partner at a midsize registered public accounting firm based in New York City, disagrees with the Senator's statement. He does however agree to a need for greater auditor independence. ''If an accounting firm assists in the implementation and design process of an accounting system it would be difficult for them to opine on the effectiveness of this system, should some internal control problems arise. As such, they are not truly independent of the client''. However he does not feel that auditors had lost sight of their central mission. He says that if auditors concentrated more on the essence of transactions rather than meeting the technical guidelines, investors would have been better served. A senior manager at a midsize accounting firm also disagrees with the Senator's statement. He claims that at most mid-size accounting firms, the financial audit is the primary service provided. He feels that a credible firm would not compromise their independence for the sake of additional consulting fees. A partner with ''Big Five'' experience agrees with the Senator. He feels that accounting firms found ways to shorten audit procedures to concentrate on consulting work. ''Big Five'' refers to the five largest public accounting firms in the United States, of which, Arthur Andersen & Co. was a member.

In conducting an audit, each registered public accounting firm is to report findings to the client's audit committee. These reports should include: accounting policies to be used, alternative treatments of accounting principles that have already been discussed with management, the consequences of using those treatments, and the practices that the registered public accounting firm prefers and any other written documents between the firm and the client (USC 7201).

SOX also attempts to mitigate potential conflicts of interest between registered public accounting firms and the issuers of financial statements. If a chief executive officer, controller, chief financial officer or other person in an equivalent position was employed by the registered public accounting firm and participated in any audit related activities for the issuer during a one year period preceding the date of the current audit, the registered public accounting firm cannot perform any audit services for that issuer. Additionally, a registered public accounting firm may not provide auditing services to a client if the lead audit partner who is primarily responsible for the engagement or the partner who is responsible for



reviewing the audit has provided auditing services for the client in the last five consecutive years. Thus accounting firms are now required to rotate partners responsible for their audit engagements.

SOX also mandates the Comptroller General of the United States to present an analysis of the effects of requiring a mandatory rotation of registered public accounting firms. The mandatory rotation implies a limit on the accounting periods in which a registered public accounting firm may audit the financial statements of the issuer (USC 7201). The fundamental issue is whether long term relationships between client's and their accounting firms might ultimately impair auditor independence and compromise audit quality. The study by the Comptroller General concluded that the benefits of mandatory firm rotation were inconclusive. More experience with the Act's other policies is needed. Currently, 99 percent of the Fortune 1000 companies have no formal public accounting firm rotation policy (Arel *et al.*, 2005). The lack of a formal rotation policy may be due to the limited number of large registered public accounting firms that are capable of handling complex and large audits of financial statements.

In an attempt to avoid another Enron situation where corporate officers and directors claimed to be unaware of fraudulent accounting practices, SOX established corporate responsibility for financial reports. Now, the chief executive officer and the chief financial officer must affirm, in a management letter, certain responsibilities over financial reporting and internal control. The officers must sign this letter acknowledging that they have reviewed the report that accompanies the annual financial statements or other quarterly reports that are filed. They must also attest that the report does not contain any material false statements or that any material information has been omitted. Congruent with the signing of the report, the officers maintain that the information they are presenting fairly represents the financial condition and results of operations of the company for the periods contained in the statements.

SOX prohibits an issuer from influencing, coercing, manipulating or misleading a public accountant or auditor engaged in auditing the financial statements of the issuer. If an issuer is found to be materially non-compliant or acting in misconduct and is required to restate financial statements SOX presumes the chief executive officer and chief financial officer personally liable to the issuer. Should any financial restatements need to be prepared under the preceding circumstances, the officers are liable to repay any bonuses, incentive-based or equity-based compensation they received. Also, any profits received from the sale of securities are to be repaid. Subsequently, the SEC may ''seek equitable relief that may be appropriate or necessary for the benefit of investors'' (USC 7201).

SOX includes provisions designed to ensure the accuracy and reliability of financial statements presented by issuers. The Act mandates that financial statements include any adjustments that have been identified by registered public accounting firms. To further the protection of investors and the public, all financial reports filed with the SEC should disclose any off-balance sheet transactions and obligations with any entities that are not consolidated in the issuer's financial statements. The issuer is also required to provide a separate explanation of its off-balance sheet transactions in a subsection of Management's Discussion and Analysis (SEC, 2002). The information should include the total amount of assets and liabilities of the off-balance sheet obligations, amounts receivable, expenses or revenues from the arrangement and any other contingent guarantees that may require future obligations. These provisions are intended to enhance the transparency of financial information and improve the standards of off-balance sheet transactions.

The Committee of Sponsoring Organizations (COSO) has developed common criteria to evaluate and define internal control. Internal control is ''a process, effected by the entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations'' (COSO, 1992).

The Act requires both management and the registered public accounting firm to provide reports on the issuer's internal control structure. Section 404, as it is commonly referred to, requires each report filed with the SEC to contain an internal control report that requires management to:

1. acknowledge responsibility for establishing and monitoring an adequate internal control structure; and
2. assess the effectiveness of the internal control structure and procedures as of the end of the most recent fiscal year.

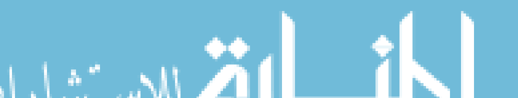
The Act requires the registered public accounting firm to report on and attest to the assessments made by management (USC 7201).

The Foreign Corrupt Practices Act has required companies to have adequate internal control structures since the late 1970s. Public accounting firms have been expected to test internal controls before signing off on any financial statements. In fact, auditors determine the level of audit risk for a particular engagement based on the effectiveness of the issuer's internal control structure. Section 404 now requires the auditor and management to attest that the controls are effective against allowing any material misstatements in financial statements. This ensures that management is held accountable for issues that may arise in the future. ''The fact that companies are having difficulty complying, after controls have been in federal law for 25 years, doesn't speak well for the quality of their controls'' says one high ranking regulator (Henry *et al.*, 2005).

Section 404 requires public issuers to assess, evaluate and, when needed, improve internal controls. The registered public accounting firm that conducts the audit of the issuer's financial statements is no longer permitted to perform consulting functions for the issuer. Issuers now have to retain a different registered public accounting firm to evaluate their internal control structure or conduct the evaluation internally. Once this one-time undertaking is complete, results are updated yearly.

Management's responsibility is to identify its controls and test their effectiveness for preventing material misstatements in financial reporting. Management's testing sample is based on the COSO framework of internal control previously discussed. Three deficiencies may arise from management's testing including: a control deficiency, a significant deficiency and a material weakness. A control deficiency arises when the design of a specific control does not allow management or employees to detect misstatements. A significant deficiency is a control deficiency that prevents management from reporting financial information in accordance with US GAAP. Finally, a material weakness is a combination of significant deficiencies that result in ''more than a remote likelihood that material misstatements . . . will not be prevented or detected'' (Whittington and Pany, 2006). If any deficiencies are discovered, management must communicate the information to the audit committee who then communicates the information to the registered public accounting firm. It is in management's best interest to correct any deficiencies before they become part of the public record accompanying their annual financial statements. If management asserts that there are no material weaknesses in their system of internal control, a letter is issued stating that the issuer maintained effective internal control over financial reporting.

Section 404 of SOX now requires the registered public accounting firm to not only conduct an audit of the issuer's financial statements but to also conduct a similar concurrent audit of management's assertion of internal controls. Similarly with planning an audit of financial statements, the registered public accounting firm must plan the engagement to audit the issuer's assertion of internal controls. The audit of an internal control structure focuses on whether internal controls are effective at a point in time. This might involve performing tests of internal controls and other traditional audit procedures for a period of time usually less than one year. Next, the registered public accounting firm must evaluate management's assessment process. The auditors must determine whether management has tested controls over all significant accounts and disclosures. Also, the auditors must determine



whether the documentation of internal control reasonably supports management's assertion. Next, the registered public accounting firm must obtain an understanding of internal control. This is accomplished by physically performing internal control tests, inspecting documents and observing the application of actual controls. The most common practice is referred to as a walk-through. This involves actually tracing a transaction through the issuer's accounting information system until it appears on the financial reports. The auditors are also required to recognize and test significant accounts, significant processes and major classes of transactions. Next, the auditors must test and evaluate the design and the operating effectiveness of the issuer's internal controls. The last step in attesting to management's assertion of internal controls is to form an opinion on the effectiveness of those controls. When no material weaknesses have been detected, the registered public accounting firm will issue an unqualified opinion on the internal control structure.

Section 404 has generated controversy within the business community. Critics argue that the cost of implementing section 404 exceeds the benefits while others justify the additional implementation costs. The average total cost of compliance for the first year of section 404 implementation was $4.36 million per company, which is 39 percent greater than the expected amount based on a Financial Executives International survey conducted in 2004. A majority (55 percent) of the companies surveyed believed that section 404 gives investors and other external users added confidence. Conversely, nearly all of the respondents (94 percent) believe that the costs exceed the benefits. The companies surveyed proposed recommendations to improve the efficiency of the internal control process, which included, allowing for a more risk-based audit approach, reducing the degree of documentation, providing flexibility for remediating control problems, and increasing the judgment allowed in aggregating deficiencies (*The CPA Journal*, 2005).

Foley & Lardner, a national law firm based in Chicago, IL, conducts an annual study regarding SOX compliance costs. Their research indicates the average cost of being a public company has increased 171 percent (54 percent) for firms with revenues less (more) than $1 billion, with Section 404 compliance responsible for most of the increase.

A partner with ''Big Five'' experience believes costs are only high for the first year of compliance. He also feels these costs are only justifiable for larger companies. However, a partner in a mid-size accounting firm does not believe these costs are justifiable. He believes holding management to a higher standard would have accomplished similar results. A senior manager with a mid-size accounting firm agrees that smaller issuers should be held to a less stringent standard. He says ''the one size fits all approach is terrible''.

According to the Foley & Lardner study (2007), audit fees in the second year of Section 404 compliance are lower than the initial year of compliance. For companies with less (more) than $1 billion in revenue, the cost of SOX compliance dropped by 19 percent (8 percent) in the second year.

Nearly, one in four respondents of the Foley & Lardner study are considering going private in response to Sarbanes-Oxley reforms. Additionally, nearly one third of respondents are considering selling or merging with another company. A senior manager with a mid-size accounting firm indicates that he has experience with clients delisting from public stock exchanges because of the costs of compliance.

However, Harvey Goldschmid, a law professor at Columbia University and former SEC commissioner views SOX as a ''great success in terms of the effect it has had on improved corporate governance'' (Nocera, 2005).

Staples, the office superstore has spent between seven and ten million dollars implementing SOX. John J. Mahoney, Staples' Chief Financial Officer feels the expense was worth the benefits. The compliance process has offered Staples an opportunity to more closely examine and improve their processes. Other companies are acknowledging the positive effects that resulted from section 404 compliance. Pitney Bowes Inc. is a mail and document technology company based in Stamford Connecticut. Pitney Bowes incurred expenses of 12

million dollars in 2004 to review its internal control policies. The company planned to save about five hundred thousand dollars in 2005 by combining operational logistics. Pitney Bowes viewed the testing of internal controls as an opportunity to assess practices that may need altering but that is hard to accomplish otherwise (Borrus, 2005). Cisco Systems Inc. spent a staggering 50 million dollars and two hundred and forty thousand hours during its audit of internal controls. As with Pitney Bowes, management at Cisco discovered ways to streamline and connect the ordering process with the customer service process. Other companies have begun using the byproducts of section 404 compliance to improve training and orientation programs. Hub Group Inc, a transportation management company in Downers Grove, Illinois is using the documentation outlining internal controls as training manuals (Borrus, 2005).

The accounting and investing communities have expressed contrasting views regarding SOX, specifically the implementation of Section 404. Created in a direct response to the accounting and corporate governance scandals that emerged at Enron, WorldCom and other multinational issuers, critics argue that SOX wouldn't prevent another Enron. The number of companies that have reported potential weaknesses in internal controls was 586 during the first quarter of 2005 compared with 313 for all of 2004 (Borrus, 2005). Issuer's are criticizing the additional work and costs involved with compliance because only a small percentage of public companies have compromised internal controls. A partner with a mid-size accounting firm agrees that 404 compliance would not have detected fraud at Enron. He says that ''management erred by intentionally misrepresenting the results using approved GAAP procedures. I do not believe that 404 compliance would have changed that result. That is now only happening due to the litigation that is making more executives aware of the importance of not misleading investors''. A partner with ''Big Five'' experience disagrees and claims that 404 compliance has changed the attitude and thinking of management.

According to Moody's Investor Service, approximately seven percent of all US companies have reported material weaknesses over internal control. The authors have extended Moody's report by cross referencing companies with internal control weaknesses with their audit opinions and the name of the registered public accounting firm. An abridged view is depicted in Table I below with the complete table included in the Appendix.

Issuers that reported numerous internal control weaknesses were included in the sample to highlight the apparent disparity between this admittance and the issuance of an unqualified audit opinion on the issuer's financial statements. Of the companies included in Moody's Report only three (CNA Financial Corporation, Dura Automotive and PetsSmart Inc.) received an unqualified opinion with an explanatory paragraph. However, that explanatory paragraph was unrelated to material weaknesses in internal control but related to changes in accounting principle adopted by the companies.

The framework of internal control is intended to provide reasonable assurance regarding the achievement of objectives such as the reliability of financial reporting. When an issuer admits to deficiencies or material weaknesses in internal control it seems counterintuitive that a registered public accounting firm can issue an unqualified opinion regarding the representation of their financial statements. A partner with a mid-size accounting firm explains ''effective internal controls may not exist over financial reporting but these control weaknesses may not be material enough to cause inappropriate financial reporting. If a material deficiency or weakness were detected the auditor could design auditing procedures that would determine if the weakness caused a misstatement in the financial statement. The scope of the audit would need to be adjusted to give comfort to the auditor. Once the additional testing is complete the auditor could still issue an unqualified opinion assuming the results corroborated the expectations''. A partner with ''Big Five'' experience adds, the financial statements can in fact be accurate even though controls over financial reporting might not be adequate. However, he says that if the issuer has a

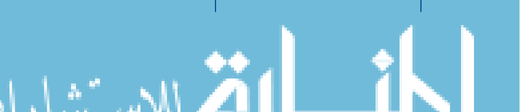


Table I

Issuer	*Nature of control weakness identified*	*Financial statement opinion*	*Registered accounting firm*
Aspen Technology	Ineffective personnel, Revenues and related receivables, Pervasive ineffective processes, Income Tax accounting, Cash accounting	Unqualified	Deloitte & Touche
Central Parking Corp.	Tone at the top, Ineffective personnel, Accounts payable and accrued liabilities, Revenues and related receivables	Unqualified	KPMG
CSK Auto Corporation	Lease Accounting, Accounts Payable and Accrued Liabilities, Inventory accounting, Ineffective personnel	Unqualified	
	PriceWaterhouseCoopers		
Danka Business Systems PLC	Technology and data access controls, Revenues and related receivables, Income Tax accounting, Inventory accounting	Unqualified	KPMG
Interpublic Group of Companies, Inc.	Tone at the top, Fraud-detection controls, ineffective personnel, Acquisition accounting, Revenues and related receivable, Lease accounting, Income Tax accounting, Accounts payable and accrued liabilities, Intercompany accounts	Unqualified	
	PriceWaterhouseCoopers		
Navarre Corporation	Income Tax accounting, Consolidation accounting, Compensation accounting	Unqualified	Ernst & Young
NDCHealth Corp.	Revenues and related receivables, pervasive ineffective processes, Income Tax accounting	Unqualified	Ernst & Young
OM Group, Inc.	Financial information accumulation, Income Tax accounting, Investment accounting	Unqualified	Ernst & Young
Pantry, Inc.	Pervasive ineffective processes, Accounts payable and accrued liabilities	Unqualified	Deloitte & Touche
Stillwater Mining	Ineffective personnel, Pervasive ineffective processes, Inventory accounting, Revenues and related receivables	Unqualified	KPMG

Notes: The above is a partial listing of companies identified by Moody's Investor Service as having several material control weaknesses, the nature of the control weaknesses, the type of financial statement audit opinion received, and the name of the registered accounting firm issuing the opinion. The complete listing is contained in the Appendix

significant internal control weakness the financial statements might be, in fact, materially misstated.

Conclusion

The Sarbanes Oxley Act contains many reforms intended to protect investors by raising corporate governance standards designed to increase the accuracy and reliability of corporate disclosures. There are differing views as to whether SOX, in general, and Section 404, in particular, have resulted in increased investor confidence in financial statements. A partner in a mid-size accounting firm was uncertain if management's acknowledgement of their responsibility over internal controls has increased investor confidence. He does say that it will help in overall internal control. Because Section 404 makes management more accountable than they had once been, they will want to make sure that proper internal controls exist. A senior manager in a mid-size accounting firm believes that management's acknowledgement will increase investor confidence only if investors are aware of the provision of the Act. A partner with ''Big Five'' experience feels that management's acknowledgement will increase investor confidence, but only for larger companies. All three practicing accountants however, agreed that the independent auditor's attestation on management's assertions over internal control should increase investor confidence. The senior manager says that ''the auditor's approach to the client has a more skeptical side to it than ever before''. The partner with ''Big Five'' experience

also agrees that there is a greater level of scrutiny involved in the audit process. The partner with the mid-size accounting firm says that the average investor does not have the knowledge required to determine whether internal controls have any impact on financial reporting. He says that ''the media has created an environment where skepticism abounds''. In contrast, he believes educated investors may have more confidence because they may feel that more independent overviews are being accomplished.

According to Moody's Investors Service, reporting on internal control under SOX has helped restore investor confidence in financial reporting. They claim that information regarding control problems benefits creditors by helping assess reporting risk. Also, it is believed that investors are less likely to make bad investment decisions because this new focus on internal controls has reduced the risk of misleading financial statements (Jonas *et al.*, 2006).

Mark Taylor, PhD, Professor at Creighton University, completed a one year fellowship with the Securities and Exchange Commission analyzing corporate compliance with the Sarbanes-Oxley Act. According to Taylor, registered public accounting firms are taking a ''back-to-basics approach to auditing . . . focusing on the fundamentals of independence, professional skepticism, and rigorous appropriate testing and documentation''. Taylor emphasizes that there has not been a corporate scandal the likes of Enron or WorldCom since implementation of SOX but acknowledges there are ''other market effects that dampen that optimism''. Taylor discusses other corporate governance and accounting issues such as options back-dating and financial statement restatements. He points out that corporate restatements doubled in 2005 when 10 percent of all companies in the United States filed restatements (Taylor, 2007).

The Act appears to have had an effect on capital markets. Stock prices of companies that disclosed material weaknesses in internal controls declined 5-10 percent (Jonas *et al.*, 2006). According to a study by the Stanford Law School, those companies that provided detailed disclosures regarding the material weaknesses experienced a significantly smaller decline in their stock prices as compared with companies that did not disclose details (Agami, 2006).

Securities and Exchange Commissioner Annette L. Nazareth believes Section 404 has increased investor confidence despite its implementation costs. Nazareth supports SOX implementation and points out that other countries such as France, Japan, China and Canada are implementing similar policies, which might be viewed as valuable investor protections. (Nazareth, 2006).

Hubbard, Dean and Professor of Finance at Columbia Business School and Thornton, former president of Goldman Sachs argue that ''a cost benefit analysis would enhance the efficiency of our capital markets and strengthen investor protection at the same time'' (Hubbard and Thornton, 2006).

The jury is still out on whether implementation of the Sarbanes-Oxley Act of 2002 has achieved its objectives. Although the Act has celebrated its fifth anniversary, differing opinions exist as to the effects of the reforms on the accounting profession, financial reporting, capital markets, and ultimately, investor confidence. Some experts feel the reforms are helping to restore investor confidence in issuer's financial statements while others feel the cost of compliance with the Act's reforms exceed the benefits. For now analysts can agree to disagree.

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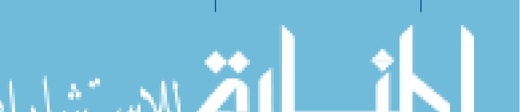

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Appendix

The following is a listing of the companies identified by Moody's Investor Service as having material control weaknesses, the nature of the control weakness, the type of financial statement audit opinion received, and the name of the registered accounting firm issuing the opinion (Table AI).

Table AI

Issuer	*Nature of control weakness*	*Financial statement opinion*	*Registered accounting firm*
Agilent Technologies, Inc	Income tax accounting	Unqualified	PriceWaterhouse Coopers
Alpharma, Inc	Income tax accounting	Unqualified	BDO Seidman
American International Group, Inc.	Ineffective processes, Derivative accounting, income tax accounting	Unqualified	PriceWaterhouse Coopers
Americredit Corp.	Cash flow statement presentation	Unqualified	PriceWaterhouse Coopers
Ameritrade Corp.	Derivative accounting	Unqualified	Deloitte & Touche
Aspen Technology	Ineffective personnel, revenues and related receivables, Pervasive ineffective processes, Income tax accounting, cash accounting	Unqualified	Deloitte & Touche
Blyth, Inc.	Income tax accounting	Unqualified	PriceWaterhouse Coopers
Central Parking Corp.	Tone at the top, ineffective personnel, accounts payable and accrued liabilities, Revenues and related receivables	Unqualified	KPMG
Central Vermont Public Service	Pervasive ineffective processes	Unqualified	Deloitte & Touche
Ceridian Corporation	Ineffective personnel	Unqualified	KPMG
Chattem, Inc.	Inventory accounting	Unqualified	Grant Thornton
Chesapeake Corp.	Income tax accounting	Unqualified	PriceWaterhouse Coopers
CKE Restaurants, Inc.	Fixed assets, lease accounting	Unqualified	KPMG
CNA Financial Corp.	Discontinued operations accounting, cash flow statement presentation	Unqualified w/ explanatory paragraph unrelated to internal control	Deloitte & Touche
Conagra Foods Inc.	Income tax accounting	Unqualified	Deloitte & Touche
Constar International	Ineffective personnel, Income Tax accounting, inventory accounting	Unqualified	PriceWaterhouse Coopers
CSK Auto Corporation	Lease accounting, accounts payable and accrued liabilities, Inventory accounting, Ineffective personnel	Unqualified	PriceWaterhouse Coopers
Danka Business Systems PLC	Technology and data access controls, revenues and related receivables, income tax accounting, inventory accounting	Unqualified	KPMG
Dollar Generation Corporation	Lease accounting	Unqualified	Ernst & Young
Dura Automotive	Income tax accounting	Unqualified w/ Explanatory paragraph unrelated to internal control	Deloitte & Touche
Dynegy Incorporated	Income tax accounting	Unqualified	PriceWaterhouse Coopers
Eastman Kodak Company	Income tax accounting	Unqualified	PriceWaterhouse Coopers
Epicor Software	Revenues and related receivables	Unqualified	Deloitte & Touche
Exide Technologies	Pervasive ineffective processes, Income tax accounting	Unqualified	PriceWaterhouse Coopers
GCI, Inc.	Revenues and related receivables	Unqualified	KPMG
General Growth Properties	Ineffective personnel, income tax accounting	Unqualified	Deloitte & Touche
General Motors Corporation	Cash flow statement presentation, impairment accounting	Unqualified	Deloitte & Touche
General Motors Acceptance Corporation	Cash flow statement presentation	Unqualified	Deloitte & Touche
Genesco, Inc.	Lease accounting	Unqualified	Ernst & Young
H&R Block, Inc.	Income tax accounting	Unqualified	PriceWaterhouse Coopers

(*Continued*)

Table AI

Issuer	*Nature of control weakness*	*Financial statement opinion*	*Registered accounting firm*
Ikon Office Solutions, Inc.	Revenues and related receivables	Unqualified	PriceWaterhouse Coopers
Ingles Markets, Inc.	Pervasive ineffective processes, Technology and data access controls	Unqualified	Ernst & Young
Integrated Alarm Services Group, Inc.	Revenues and related receivables	Unqualified	PriceWaterhouse Coopers
Interpool, Inc.	Ineffective personnel, pervasive ineffective processes, Technology and data access controls	Unqualified	KPMG
Interpublic Group of Companies, Inc.	Tone at the top, fraud-detection controls, ineffective personnel, Acquisition accounting, Revenues and related receivable, lease accounting, income tax accounting, Accounts Payable and accrued liabilities, intercompany accounts	Unqualified	PriceWaterhouse Coopers
Jo-Ann Stores, Inc.	Lease accounting	Unqualified	Ernst & Young
Kellwood Co.	Accounts payable and accrued liabilities	Unqualified	PriceWaterhouse Coopers
Kroger, Co.	Income tax accounting	Unqualified	PriceWaterhouse Coopers
Leap Wireless	Ineffective personnel, income tax accounting	Unqualified	PriceWaterhouse Coopers
Lennox International	Derivative accounting	Unqualified	KPMG
Loews Corp.	Discontinued operations accounting, cash flow statement presentation	Unqualified	Deloitte & Touche
Longview Fibre Co.	Ineffective personnel, inventory accounting, accounts payable and accrued liabilities	Unqualified	PriceWaterhouse Coopers
Magellan Health Services	Income tax accounting	Unqualified	Ernst & Young
Markwest Energy Partners	Pervasive ineffective processes, Derivative accounting	Unqualified	KPMG
Movie Gallery Inc.	Pervasive ineffective processes, ineffective personnel, fixed assets, inventory accounting	Unqualified	Ernst & Young
MTR Gaming Group	Various significant deficiencies constituting a material weakness	Unqualified	Ernst & Young
Navarre Corporation	Income tax accounting, Consolidation accounting, Compensation accounting	Unqualified	Ernst & Young
NDCHealth Corp.	Revenues and related receivables, pervasive ineffective processes, income tax accounting	Unqualified	Ernst & Young
Odyssey Re Holdings	Finite reinsurance arrangements	Unqualified	PriceWaterhouse Coopers
OM Group, Inc.	Financial information accumulation, income tax accounting, Investment accounting	Unqualified	Ernst & Young
Oneok, Inc.	Derivative accounting	Unqualified	KPMG
Pantry, Inc.	Pervasive ineffective processes, Accounts payable and accrued liabilities	Unqualified	Deloitte & Touche
Paxson Communications Corporation	Income tax accounting	Unqualified	PriceWaterhouse Coopers

(*Continued*)

Table AI

Issuer	*Nature of control weakness*	*Financial statement opinion*	*Registered accounting firm*
Petco	Accounts payable and accrued liabilities	Unqualified	KPMG
Petsmart, Inc.	Income tax accounting	Unqualified w/ Explanatory paragraph unrelated to internal control	Deloitte & Touche
Polo Ralph Lauren Corporation	Income tax accounting	Unqualified	Deloitte & Touche
Pope and Talbot, Inc.	Income tax accounting	Unqualified	KPMG
Popular Inc.	Cash flow statement presentation	Unqualified	PriceWaterhouse Coopers
Progressive Gaming International	Revenues and related receivables	Unqualified	BDO Seidman
Radiologix, Inc.	Lease accounting	Unqualified	Ernst & Young
Residential Capital Corporation	Cash flow statement presentation	Unqualified	PriceWaterhouse Coopers
Ryerson, Inc.	Ineffective personnel, inventory accounting	Unqualified	PriceWaterhouse Coopers
South Financial Group	Derivative accounting	Unqualified	KPMG
Stewart Enterprises, Inc.	Revenues and related receivables	Unqualified	PriceWaterhouse Coopers
Stillwater Mining	Ineffective personnel, pervasive ineffective processes, inventory accounting, revenues and related receivables	Unqualified	KPMG
Sun Microsystems	Income tax accounting	Unqualified	Ernst & Young
Susquehanna Bancshares	Cash flow statement presentation	Unqualified	PriceWaterhouse Coopers
SVB Financial Group	Ineffective personnel, pervasive ineffective processes	Unqualified	KPMG
TRM Corporation	Revenues and related receivables, fixed assets, accounts payable and accrued liabilities	Unqualified	PriceWaterhouse Coopers
United Rentals North America, Inc.	Pervasive ineffective processes	Unqualified	Ernst & Young
Visteon Corporation	Accounts payable and accrued liabilities	Unqualified	PriceWaterhouse Coopers
Wynn Resorts, LTD	Derivative accounting	Unqualified	PriceWaterhouse Coopers

About the authors

Steven T. Petra is an Associate Professor at the Frank G. Zarb School of Business at Hofstra University in New York. He holds a PhD degree in accounting and is a Certified Public Accountant. His research interests include corporate governance and the role of boards of directors in improving public confidence in corporate earnings numbers. Steven T. Petra is the corresponding author and can be contacted at: actstp@hofstra.edu

Gerasimos Loukatos is a graduate student at Hofstra University's Frank G. Zarb School of Business. He received his Master of Science degree in Accounting in 2007. He is presently working in public accounting and is pursuing his Certified Public Accountant licensure.

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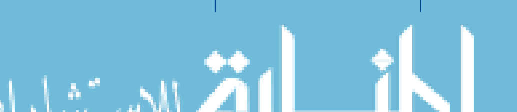

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