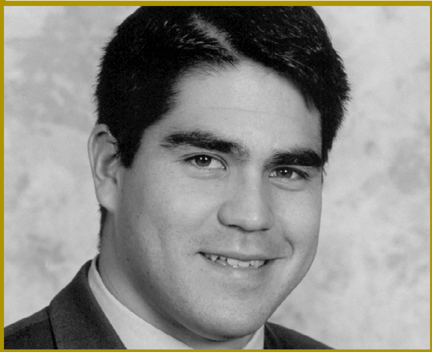
Progress, but at a price

New regulation improves reporting, but costs hit hard.

The Sarbanes-Oxley Act of 2002 plays the role of a persistent, curious financial father. Public companies no longer can sweep financial records under the rug or turn in muddy reports. Legislation calls for buttoned-up accounting practices, whistle-blower protection, corporate governance and infrastructure that demands the truth. These regulations are in response to national corporate fraud cases and stakeholders' growing interest in accurate financial practices.

"We are already seeing faster, better and more complete disclosure of financial and other company information," acknowledges Michael Jordan, a partner with Schottenstein, Zox & Dunn in Columbus. "While there will always be problems when companies undergo such sweeping changes [in their systems], at the end of the day, despite all the negativity about the perceived overreaching nature of the act, Sarbanes-Oxley is a good thing."



While the legislation mostly addresses public companies, large, privately owned corporations and various nonprofit entities also are considering ways to instill some of the Sarbanes-Oxley principles into their own corporate structures. Here, Jordan provides information and addresses concerns surrounding Sarbanes-Oxley.

Q: What regulations does Sarbanes-Oxley impose on corporations?

Sarbanes-Oxley was a reactionary piece of legislation that was a direct result of the corporate and accounting failures of the early 2000s, the goal being to further protect investors by increasing financial disclosure and transparency both on a timely and quality/quantity basis and to increase corporate accountability.

Public companies were required to put systems in place that fell in three major arenas: corporate governance; financial reporting and disclosure; and Section 404, which is to ensure adequate internal control systems over financial reporting.

Q: What companies does it affect?

So far, Sarbanes-Oxley has most affected public companies the SEC calls "accelerated filers." These are companies that now have to file periodic financial disclosures more quickly than smaller public companies. Accelerated filers are required to comply with the Section 404 requirements generally a full fiscal year ahead of non-accelerated filers.

Q: What Sarbanes-Oxley principles apply to all businesses?

Although most of the act applies only to U.S. public companies, there are a couple of provisions of Sarbanes-Oxley that apply to everyone, regardless of an entity's public or private nature. One is on record-keeping and destruction of records. There are enhanced criminal penalties for the alteration, falsification or destruction of records, particularly in light of a government investigation. Because this prohibition applies broadly, all companies should revisit their records retention and destruction policies. And if a company does not have any such policies, it should seriously consider adopting them.

Also, there are two different whistle-blower protection clauses of Sarbanes-Oxley. One is limited only to public companies, but the other is more broad-based, protecting whistle-blowers who report suspected illegal activities within the company. Procedures for the proper handling of employee complaints and safeguards to prevent retaliation should be adopted.

Further, we are seeing many nonprofit entites adopting certain Sarbanes-Oxley principles; for example, we have worked with many nonprofit companies to create audit committees, adopt independent board member requirements and prepare and adopt codes of ethics and conflicts of interest policies. Because many of these nonprofits are charitable organizations and therefore accountable to the public at large, we expect that all of their stakeholders want to know that the financial information [the organization] discloses is full, accurate, timely and complete.

Q: What challenges are associated with defining financial reporting processes?

Across the board, there has been an incredible increase in both internal and external costs. Internally, companies have had to hire additional internal accounting personnel. Externally, audit fees are the source of the highest increase. A recent study said that auditing fees for the 100 largest U.S. companies increased 45 percent to $13 million. Some of my clients have seen audit fee increases closer to 80 percent to 100 percent.

The debate has shifted in recent months as to whether costs will diminish in coming years, with many thinking they will decrease more than 40 percent. Surely, there will be a decrease in costs in coming years, as implementing Sarbanes-Oxley, is to a large extent, front-loaded work. However, the question still remains as to whether the act's perceived benefits outweigh the impact of compliance.

Another issue challenging public companies is the lack of practical implementation and compliance guidance. This is all new, and without better direction from the appropriate sources it will continue to be a challenge. For example, how do companies decide what is a material weakness in internal controls and what is not? Fortunately, this guidance issue is being addressed at several levels. In fact, COSO (The Committee of Sponsoring Organizations of the Treadway Commission) is in the middle of developing practical guidelines for smaller companies on how to implement Section 404.

MICHAEL JORDAN is a partner in the law firm Schottenstein Zox & Dunn. His practice is concentrated in securities, corporate finance and mergers and acquisitions. He can be reached at (614) 462-2283.

sponsored by

SPECIAL ADVERTISING FEATURE

© 2005 Smart Business Network Inc. Reprinted from the June 2005 issue of *Smart Business Columbus.*