Sarbanes-Oxley Act

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1. **Act Background Information**

In the fall of 2001, Enron shocked investors, stockholders, and the public by falsifying financial statements to hide debt and overstate its profits. Days prior to filing bankruptcy, Enron revealed their $690 million debt and their stock plummeted below $1. Thousands of employees were laid off and stockholders were robbed (The Associated Press, 2006). The American public thought they were outraged at the blind sighting of the Enron scandal, but this, as they quickly learned, was not an isolated incident. Less than a year later, Tyco’s CEO and CFO are accused of enterprise corruption of stealing over $170 million from the company and acquiring $430 million by fraudulently selling Tyco shares (The Associated Press, 2005). Concurrently, WorldCom is investigated for misleading its financial health and misrepresenting over $3.8 million in expenses (USA TODAY, 2005).

Amidst such financial scandals and economic turmoil, the United States Senator, Paul Sarbanes, and Congressman, Michael Oxley, separately presented bills to help prevent and control future corporate corruption. In 2002, a combined bill bearing both names was passed, nearly unanimously. George W. Bush signed the bill into law thus making the Sarbanes-Oxley Act effective on July 30, 2002 (Thomas, 2012). The provisions of the Act required publicly-traded companies to be appointed an oversight board, establish internal audit committees, maintained and keep audit records for seven years, cooperate with CPAs and investigations, and have annual inspections (New York, 2009).

1. **Why the Act was Needed**

The Sarbanes-Oxley Act was driven by the need to protect investors and stockholders against corporate fraud. Nearly months after the World Trade Center devastation, corporate investors felt attacked by the company fraud and misleading financial statements. Retirements vanished, unemployment rates spiked, and a recession was on the horizon. This bill was vital to restoring the public trust and rebuilding the country’s economic health (Independent Sector, 2012).

In addition, the trending nature of CEO and CFO involvement was alarming to congress. It was undeniable that such guidelines to establish accuracy and reliability of financial statements would be needed. Congress recognized that the utmost accountability would need to be held of the CEOs and deniability would no longer be an option. Finally, an overwhelming need of external auditors was identified for purposes of financial verification. Overall, the Sarbanes-Oxley Act was in the best interest of the public and the health of the economy (All Business, 2012).

1. **Who was Impacted by the Act?**

First and foremost, the Sarbanes-Oxley Act affects publically traded companies of any size, the employees, owners, and their officers. In addition, attorneys, brokers, dealer, financial analysts and investment bankers who work or have as clients are also impacted by the provisions of this bill. Interested parties are required to comply with and are held accountable to the ethical nature of financial reporting and their respective responsibilities thereof (107th Congress, 2002).

While private companies and non-profits are not directly addressed in the Sarbanes-Oxley Act, such organizations are strongly encouraged to voluntarily adhere to those applicable provisions. Every company, despite status, has ethical and fiduciary responsibilities to financial reporting. In demonstrating good faith in accounting practices, such organizations should participate in guidelines established for publically-traded companies. For example, external audits are recommended of both private companies and non-profits as it is in best interest of the organization, establishes accuracy, and demonstrates reliability to consumers (Independent Sector, 2012).

Finally, the Sarbanes Oxley Act of 2002 establishes protections for corporate whistleblowers. In the event an employee, investor, or an interested party may suspect corporate fraud and financial misrepresentation, they may report it to the internal audit committee. Laws regarding whistleblower retaliation for any type of organization were amended making such actions criminal and also punishable as a violation of the Securities Exchange Act of 1934. Finally, the law also requires attorneys to blow the whistle on their client in specific circumstances (Kohn, 2012).

1. **The SEC Role in the Act**

The Securities and Exchange Commission has several roles in the Sarbanes-Oxley Act. Their first responsibility is to regulate accounting firms, accountants, and those involved with accounting firms for the purpose of financial reporting. The primary responsibility of such parties is to ensure honest and ethical accuracy of accounting. The SEC also appoints each publically-traded company a Public Company Accounting Oversight Board to register accounting firms and oversee compliance of the law (107th Congress, 2002).

Additionally, the SEC sets standards for accounting, auditing, and preparation of audit reports. Standardizing reports can help minimize fraudulent reporting, misrepresentation of incomes and expenses, and misleading by the corporation. In the event criminal activity or violations of the Sarbanes-Oxley Act may occur, the SEC is also responsible for taking legal or disciplinary action on the associated party (107th Congress, 2002).

1. **Act Penalties**

The Securities and Exchange Commission has established severe penalties for participating in criminal activity or violations of the Sarbanes Oxley Act despite an individual’s knowledge of wrongdoing. For anyone who may falsify financial records or mislead parties of interest will be given a substantial fine of $1,000,000 and up to 10 years of imprisonment. Any accountant that fails to conduct and maintain required audits or refuses to submit relevant records or documentation to the SEC can also be fined up to $1,000,000 and should expect up to 10 years in jail (Thomas, 2012). Comparative penalties will be given for securities fraud, mail and wire fraud, and violations of employee retirement. Additional penalties can include: suspension of registration, suspension from the bar, suspension from involvement in activities, functions, or business operations, additional professional education, and any other penalty within the scope of the board’s jurisdiction (Thomas, 2012).

While penalties may seem steep for unknowingly committing crimes, those offenders with intentional conduct face more severe consequences. For anyone who knowingly destroys, alters, fabricates, or tampers with records while under investigation or undergoing bankruptcy can receive up to a $5,000,000 fine and up to 20 years imprisonment. Additionally, performing any type of retaliation against whistleblowers or informants will be fined and can receive up to 10 years in jail (Thomas, 2012).

1. **Company Roles and Responsibilities to the Sarbanes-Oxley Act**

M3H Consulting is a small, private contracting company with only 31 employees. The company opened for business seventeen months ago hiring only its second employee one year ago. M3H won its first contract last December adding an additional 29 bodies to its staff. The company employees provide a service, thus it has very little overhead, few items of equipment, and no inventory. While M3H is not a publically traded company, it still adheres to the applicable provisions of the Sarbanes-Oxley Act of 2002. In the spring of 2012, M3H decided to hire both a contracted attorney and an accountant to ensure the business practices were solid and 2011 taxes were calculated correctly.

Upon hiring an accounting firm, M3H Consulting scheduled an initial audit. They have created a secure filing system to ensure financial records would be kept for seven years both with the accountant and at the office. The company also created a separation of duties for payroll and benefit allocation. The company established roles in which one person on site would ensure hours logged on time cards were accurate while another approved timecards and issued paychecks.

1. **Recommendations for Company Management**

M3H Consulting is currently displaying good faith in accounting practices for a small company. I would recommend ensuring this is a constant practice for the company. I would recommend that they ensure their external accounting firm is registered with the Securities and Exchange Commission and check on that status annually. Additionally, I would suggest to the company that they hire a qualified Human Resource staff to eliminate these duties from upper management. This would allow time for management to focus on operating activities, generating more revenue, and getting the best use out of the accountant.

Further, if M3H Consulting anticipates becoming a publically-traded company in the next ten years, I would recommend they ensure compliance of all required provisions of the Sarbanes-Oxley Act. For example, the company should establish internal audit committees and plan annual inspections of their financials. This would best prepare the company for a transition, ensure financial reporting was always accurate, and establish the company as ethically sound.

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