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Sarbanes Oxley Act

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The Sarbanes Oxley Act (SOA) is a law that requires all publicly-traded companies to report internal accounting controls to the Securities and Exchange Commission. Certain provisions of the act apply to private companies as well. Important items to consider when examining the SOA are the history of the act, what led to its implementation, and the effects of the act thus far.

The Sarbanes Oley Act was enacted in July 2002. It is named after its sponsors, U.S. Senator Paul Sarbanes and U.S. Representative Michael Oxley (Sarbanes Oxley 101). The overall goal of the act was to make corporate accounting more transparent (AccountingWeb). It is meant to restore investors' confidence in the financial markets and close loopholes that allowed public companies to defraud investors (Blokhin). There are many requirements placed upon companies under this act. The first being that all financial reports must include an Internal Controls report to show that the company's financial data are accurate, and that adequate controls are in place to safeguard financial data (Sarbanes Oxley 101). So, what are internal controls? Internal controls are defined as "the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud" (Investopedia). One example would be separation of duties. A case of this could be something like the accounts payable clerk preparing a voucher, which is then forwarded to the treasurer's office for approval along with the supporting documentation. Since there are different people handling the documents, there is less of a chance of any single employee committing fraudulent acts. Besides implementing internal controls, companies must also prepare year-end financial disclosure reports. Finally, a SOX auditor is required to review controls, policies, and procedures. Now that we know what the SOA is, let's move on to why it was needed in the first place.

The SOA was enacted in response to many corporate scandals involving widespread fraud that took place from 2000-2002 (Peavler). The predominant cause for the act was fraud within the publicly traded company Enron. Enron was a U.S. energy-trading and utilities company whose executives employed accounting practices that falsely inflated the company's revenues (Peavler). They did so by excluding huge debts from the balance sheets. Once they were caught, the company filed for Chapter 11 bankruptcy in 2001. Because of this, shareholders lost $74 billion, thousands of employees and investors lost their retirement accounts, and many employees lost their jobs ("The 10 Worst Accounting Scandals of All Time"). While the Enron scandal was one of the first big-name accounting scandals, it was followed by the uncovering of fraud at other companies as well such as WorldCom, Tyco International, and HealthSouth (Peavler). Now let's inspect the effects and consequences of fraud with the Sarbanes-Oxley Act in place.

There are three basic types of fraud: asset misappropriation, bribery and corruption, and financial statement fraud. Asset misappropriation is the most common, happening in over 91% of fraud schemes (Coenen). This may be because it includes less complex things like check forgery, money or inventory theft, and payroll fraud. Asset misappropriation can have very serious consequences from imprisonment to fines and probation and even a permanent criminal record (Coenen). The severity of the punishment may be determined by the value of the property affected and previous criminal record. Bribery and corruption is the next most common type of fraud, which is part of about 35% of fraud that is exposed (Association of Certified Fraud Examiners). This can include kickbacks, bribes to influence voting or decision-making, substitution of inferior goods, and more.

Conviction of a single count of bribery can result in fines of up to triple the amount of the bribe, as many as 15 years in prison, and a sanction disqualifying the defendant from holding public office in the future (HG Legal Resources). Lastly, financial statement fraud occurs in only 10% of all fraud cases; however, it is easily the most expensive (Coenen). It includes overstating assets, revenues, and profits and understating liabilities, expenses, and losses (Fraud Magazine). The average case of financial statement fraud costs a company around $2 million (Coenen). Executives who approve inaccurate documentation now face fines of up to five million dollars and jail time of up to 20 years (Sarbanes Oxley 101).

Now that the SOA is in enacted, it is much harder for companies to commit, and get away with fraud. It also imposes harsher punishment for companies that are caught taking part in fraudulent activities. The Sarbanes Oxley act plays a very important role in accounting and auditing today and is generally credited with reducing fraud and protecting investors. It is important to learn about the history of the act, what led to its implementation, and the effects and consequences of the act, in order to make educated conclusions about the act as a whole.

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