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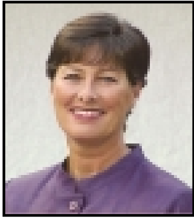


CLAUDIA IMHOFF

The Year of Compliance, Part 3

Sarbanes-Oxley – The Unforeseen Consequences

There is still much confusion regarding the ultimate requirements and the impact Sarbanes-Oxley (SOX) legislation will have on corporate America. Even with this uncertainty, it is guaranteed that the environments and even cultural milieu of these corporations will be forever changed. I predict four significant consequences of SOX legislation compliance and one remaining roadblock to corporate compliance in general.

Many non-U.S. companies have completed a public offering of their companies in the U.S. stock markets (e.g., NYSE or NASDAQ). The offerings bolster these markets in the eyes of the international investing public and also give U.S. investors access and insight into international companies. Unfortunately, many international companies are reassessing their desire to perform a U.S. initial public offering (IPO), and several have already stated that they have decided to forego the IPO because they cannot comply with SOX. One clear example is the German automaker, Porsche, who canceled its U.S. IPO because its supervisory boards and audit committees have employee representatives. According to SOX rules, the company would be in violation of SOX because these types of board representatives are not independent.

We pride ourselves on having very innovative corporations in America. Many of these are public companies that spend significant amounts of money on research and development (R&D) projects. According to people who understand Section 409 of the SOX legislation, a failed R&D project could be considered a material event. If this is the case, it must be reported to the public, to the company's shareholders, competitors and the world in general – nothing like airing your dirty laundry in public! It seems a logical leap that these companies will be much less willing to invest in innovation if they are required to report failures (if this is what compliance dictates). Innovation would be left to private companies who may have fewer resources to invest.

A public company may have to spin off the innovative part of their company into another, privately held company, or invest in a private company with the idea of bringing the spin-off back in house or acquiring the private company when the innovation pays off. Not the best scenario in any case.

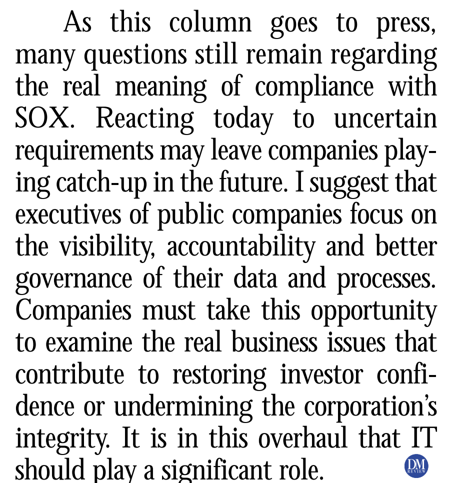
To avoid any non-compliance problems, some currently public companies are considering buying back their stock and going private again. Not only does this remove investment opportunities from the public, it can also deplete the coffers of the public company – leaving it with significant debt or reduced capital that could otherwise be reinvested in the company.

While it is true that private companies were not the intended target of the SOX legislation, it does not mean that they can completely ignore the act. In fact, private companies should pay close attention to the legislation if they:

- Plan to go public. If the company has visions of an IPO in their future, they better study this act and its implications.
- May be acquired by or merged with a public company. The public company will do more due diligence of a private firm before purchasing it to ensure that there are no SOX skeletons in the closet.
- Have government contracts that require compliance. This is an interesting twist that may not be understood by private companies.

To provide assurances that a private company is in compliance, I recommend they: add independent directors to their board; create an independent audit committee; review internal accounting procedures; educate directors, officers and employees on requirements pertaining to reporting of misconduct; provide education on fraud prevention; and enlist the help of data-auditing solution providers.

Thus far, we have discussed the unforeseen – and perhaps unfortunate – consequences of the SOX Act. However, there is still one very real and very difficult hurdle to overcome – corporate culture itself. In the go-go days of the 1990s, we created and even promoted a corporate culture in which any behavior, ethical or otherwise, was acceptable as long as the shareholder value increased. Even today, after Enron, WorldCom and HealthSouth have been "caught," do you think a company would be investigated if its stock maintained a good price? I am not sure it would. It seems to me that executives of public companies are focusing a great deal of attention on the mechanics of compliance but not on changing the culture that fostered unethical behavior in the first place. Changing corporate culture may be the most difficult task of all.



As this column goes to press, many questions still remain regarding the real meaning of compliance with SOX. Reacting today to uncertain requirements may leave companies playing catch-up in the future. I suggest that executives of public companies focus on the visibility, accountability and better governance of their data and processes. Companies must take this opportunity to examine the real business issues that contribute to restoring investor confidence or undermining the corporation's integrity. It is in this overhaul that IT should play a significant role.

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