Sarbanes-Oxley: Five Years Later

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SOX: Five Years Later

- What happened?
- Why did it happen?
- What are the effects?
- What *might be* the effects?
- What are suggestions for improvement?
Oct. - Nov. Enron reports $100s MM losses, restatements of earnings, $1.2B reduction in SH equity; SEC inquiry.

Enron files for Chapter 11 Bankruptcy $63B (12/2)

SOX signed into law (7/30)

Interim Report of CCMR (11/30)

Bloomberg & Schumer Report (1/7)

Worldcom BK (7/21)  $103B

Adelphia BK (6/25)

Global Crossing (1/28) $30B

Conseco BK (12/18)  $61B

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302 Rules

SEC Passes 404 Rules

Congressional Hearings on Two Year (Report 1/22)

SEC Rountable on IC Implementation (4/5)

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SEC Advisory Committee Report; GAO Report on Small Business (4/6)

SEC Issues 404 Guidance; PCAOB Revises AS2 11/26

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Theory of Corporate Governance and Regulation

- Why have securities regulation and corporate governance?
  - Problem: separation of ownership from management
  - Corporate governance vs. agency costs
  - Solutions to the problem
  - CG, disclosure and company value

- Framework for Evaluation Regulation
  - Costs versus benefits
  - No such thing as perfection
  - Many imperfections are predictable
What is Sarbanes-Oxley?

- Components
- In one sentence: better monitoring (internally and by gatekeepers), better controls and disclosures, more penalties
- Internal Monitoring through independence
- Gatekeeper monitoring
  - Auditors and attorneys
- Better reporting through internal control
- Increased criminal and civil liability
Ripple Effects of SOX

- Compliance costs
  - 2004 (1st year): avg. $4.36MM
  - Total $6 billion; 20% of total regulatory compliance; $6.2 billion by 2008
  - auditor fees and time
  - Increased board costs
  - Turning compliance into value?

- Increased use of private bonds
- Subcertifications
- Higher D&O insurance
- Heavier burden on small business
...Ripple Effects of SOX

- Impact on CFOs
  - Higher turnover; higher salary
  - Better financial statements and controls
Ripples of SOX?

- Impact measured by firm valuation
  - Controversy on how investors valued SOX
  - Other corporate governance rules are valued
- SOX and U.S. Competitiveness
  - General considerations
  - Decreased IPOs in U.S.?
Decreased IPOs in U.S.?

Percentage of global IPOs listed in a U.S. exchange (NYSE, NASDAQ, AMEX). An IPO is defined as global if a company goes public in a market other than its domestic market, regardless of whether the company was already public in the home market or not. The source of the data is Dealogic.
...Impacts of SOX?

- Decreased cross-listing
- Increasing importance of London
- Increased significant of private equity markets
- Increased cost of capital in U.S.

**Figure 2 – U.S. Cross-listing Valuation Premium**

(Source: Doidge, Karolyi, and Stultz, The Valuation Premium for Non-U.S. Stocks Listed in U.S. Markets (2005))
Reforms and Reform Proposals

- Reforms
  - Delays for small companies
  - SEC’s 404 Guidance; PCAOB AS2 Revision
- Proposals to Preserve Status Quo.
- Proposals to add more.
- Proposals to tweak.
- Proposals to exempt or repeal.
SOX: 5 Years Later

- Corporate Governance continues to be important.
- SOX unduly burdened small business, but too early to be sure about net effect.
- SOX had some impact on U.S. competitiveness, but not clear how much or even if significant.
- Proposals for reform vary greatly.