Chapter 8 Sarbanes-Oxley

Chapter Objectives

This chapter will discuss:

- How the internet scandals of the late 1990s and early 2000s led to Sarbanes-Oxley (SOX),
- What SOX is;
- The consequences of violating SOX,
- Risk management and data auditing as a key to gaining SOX compliance,
- Due diligence with members of the company's extended enterprise,
- Document retention, and
- The cost of compliance and possible mid-course corrections for outside auditors.

8.1 Scandal Leads to Regulation

With the massive amounts of fraud in the U.S. during the Internet boom, of which the Enron scandal is the most obvious case in point, political pressure was exerted on politicians to ensure this kind of scandal would not occur in the future. The result was the Sarbanes-Oxley Act of 2002 (SOX), which mandates financial accountability for publicly traded companies. This chapter describes the law and then discusses its relevance to compliance and an organization's business objectives as a whole.

8.2 SOX Described

SOX, while brief, established a major financial responsibility on organizations, especially their senior executives. Wagner and Dittmar (2006) highlight three sections of the statute:

- Section 302- Corporate Responsibility for Financial Reports. This section requires CEOs and CFOs personally

attest to the accuracy of all financial statements and disclosures made by the company.

- Section 906- Corporate Responsibility for Financial Reports. This section requires CEOs and CFOs to affirm that submitted reports comply with government reporting requirements with substantial penalties for failing to do so.

- Section 404- This section, the one most relevant to this book, requires a yearly audit to evaluate the internal controls in place to ensure financial reporting is accurate. This is what Dittmar and Wagner (ibid) refer to as a "control environment." They summarize the section as follows:

> "This section calls for an annual evaluation of internal controls and procedures for financial reporting. Like Section 302, Section 404 requires CEOs and CFOs to periodically assess and vouch for their effectiveness.
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> "Section 404 also obliges companies to include an internal-control report in their annual report. Although the SEC has not spelled out all of the elements of the internal-control report, it has indicated that the document should contain the following:
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> "- a statement acknowledging responsibility for establishing and maintaining adequate internal control over financial reporting
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> "- a statement identifying the internal-control framework used to evaluate the effectiveness of internal control over financial reporting
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> "- an assessment of the effectiveness of the company's internal control over financial reporting as of the end of the most recent fiscal year
>
> "- disclosure of any material weaknesses in the company's internal control over financial reporting (if any material weaknesses exist, then internal control over financial reporting is deemed ineffective)