IDEAS -- OUTSIDE SHOT
By Annette L. Nazareth

Keeping SarbOx Is Crucial

Some U.S. critics call it burdensome, but other nations are adopting similar laws

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As memories of catastrophic frauds such as WorldCom and Enron begin to fade, critics have gained traction with assertions that Congress overreacted when it enacted the Sarbanes-Oxley Act of 2002. I disagree. The Sarbanes-Oxley Act has been the most important and influential single piece of securities legislation since the landmark Securities Exchange Act of 1934.

It has promoted investor confidence, improved transparency, and increased corporate accountability. Although some fine-tuning around the edges undoubtedly is necessary, we have everything to gain by keeping SarbOx in place.

Just consider the breadth of improvements accomplished by the act. CEOs and CFOs are now required to certify the accuracy and completeness of their companies' financials. Insider trading reports must be filed electronically, giving investors quicker and easier access to this key data. Listing standards have enlarged the responsibilities of independent audit committees. For the first time, public accounting firms are inspected by an independent body, the Public Company Accounting Oversight Board. SarbOx also made it possible to distribute civil monetary penalties to compensate defrauded investors.

Many have ignored these benefits, preferring instead to focus on a single provision: Section 404. Under it, public companies must include an assessment of their internal controls over financial reporting in their annual reports. The reports also must include an auditor's opinion of the assessment.

Some complain that compliance is too costly. But many large companies have been complying with Section 404 for nearly three years. Their experience tells us two things: First, the cost burden during the first year was indeed significant, although it has decreased markedly. Second, there were palpable benefits from compliance, including improved efficiencies, better financial reporting, and enhanced detection and prevention of problems. A Lord & Benoit study even concluded that compliance with Section 404 was positively reflected in companies' stock prices.

Still, the initial costs and responsibilities of complying were admittedly troubling, and the Securities & Exchange Commission is working to address those issues. In December we will propose new guidance to management regarding assessment of internal controls. The PCAOB is

also crafting significant amendments to Auditing Standard No. 2 that will be less prescriptive and more focused on increasing the cost-effectiveness of the audit process.

We must also craft guidance for the flexible, scalable application of Section 404 to smaller public companies, for which the costs of compliance could be disproportionate. However, a wholesale exemption of smaller businesses, as some have suggested, is not appropriate. There is no second tier for the integrity of a public company's internal controls.

Some believe the costs of complying with Section 404 have deterred companies from listing on U.S. exchanges. Contrary to that common misperception, companies listed in the U.S. still have a competitive advantage because they have access to the deepest capital pool in the world at the least expense. Individual investors represent a crucial component of that pool. Indeed, America has the highest percentage of individual investor participation in the world. These shareholders must have confidence in our markets, which SarbOx, including Section 404, has helped to restore.

Some have pointed to a drop in U.S. initial public offerings as proof that Section 404 has harmed American markets. In reality, U.S. IPOs have slipped due to a lower-interest-rate environment, the availability of private equity capital in the U.S., and the changing nature of businesses going public: Many are international companies or privatized state-owned entities that have chosen, for a variety of reasons, to tap foreign markets for their IPOs. The U.S. share of worldwide IPOs actually has increased since 2001.

It's noteworthy that other countries are adopting rules similar to SarbOx. Provisions roughly equivalent to Section 404 are in place in France and Japan, while both China and Canada are implementing similar safeguards. This suggests that SarbOx has not harmed our ability to compete but rather is viewed by other countries as providing valuable investor protections.

With the discrete refinements to Section 404 that are on the horizon, we can look forward to the promise of Sarbanes-Oxley being realized in a more cost-effective and efficient manner. America's investors deserve no less.

Annette L. Nazareth has been a commissioner on the Securities & Exchange Commission since 2005. Her views are her own