Cost of corporate fraud far outweighs cost of legal compliance

By Sen. Joe Biden

Several years ago, an epidemic of corporate accounting scandals at Enron, WorldCom and a host of other companies rocked the financial markets, wiped out investment accounts and pension plans, and threw workers into unemployment lines. Congress responded to the public outrage by passing the most comprehensive package of corporate reform legislation in decades -- the Sarbanes-Oxley Act of 2002.

Since then, many companies have restated their earnings to remedy accounting errors, crooked executives have been sent to jail, and the number of corporate scandals has waned. In 2006, the stock market closed out a record-breaking year, with the Dow Jones industrials topping 12,000 for the first time. Against this backdrop, some complain that the cost of compliance with Sarbanes-Oxley is too great and are calling for the act's repeal. This would be a huge mistake.

Sarbanes-Oxley helped restore confidence in American companies by holding corporate executives more accountable for their record-keeping and financial reporting, improving the quality of corporate auditing, and requiring greater transparency of companies' financial statements. And despite claims to the contrary, the evidence shows that Sarbanes-Oxley works. The number of companies restating their earnings has tripled, meaning companies are employing more rigorous accounting methods and the market is getting more accurate information on which to value those companies.

Both William Donaldson and Arthur Levitt, former chairmen of the Securities and Exchange Commission, have credited Sarbanes-Oxley with restoring investor confidence and improving corporate transparency and internal controls. Responsible business organizations, such as the Business Roundtable, also believe Sarbanes-Oxley contains important reforms. In addition, despite some recent high-profile cases, studies have shown that Section 403, which accelerates the reporting deadline for stock option grants, has reduced the abusive practice of backdating stock options to benefit corporate honchos at the expense of individual investors. And just last month, Bloomberg News attributed a decline in securities fraud suits to both more stringent corporate governance requirements and increased prosecutions. What's more, CFO Research Services (in conjunction with PricewaterhouseCoopers) recently interviewed 180 corporate financial executives who said that going through the exercise of compliance afforded them valuable insight about their companies that they didn't have before Sarbanes-Oxley.

Critics have complained that the cost of compliance has caused some companies to go private, abandon plans to go public, or list overseas rather than on an American exchange. But the recent growth in private equity acquisitions has been driven largely by the availability of cheap debt financing and by the promise of high returns in the private equity market. In addition, many fund managers have been lured into this sector by generous compensation packages offered by private equity firms. Those companies that have gone private to avoid regulation are mostly those with serious financial and corporate governance problems. They are precisely the kinds of companies that Sarbanes-Oxley seeks to discourage from trading publicly.

A company that cannot or will not institute and maintain the internal controls necessary to meet high standards of financial integrity and corporate accountability should not go public in the United States. Indeed, the loose accounting practices that were prevalent in the 1990s allowed countless public companies to report fantastic earnings, while they hid from the public evidence of their imminent financial collapse. If

American equities markets are going to maintain their reputation for unparalleled transparency and liquidity, then American laws must ensure the conditions that make that possible. Sarbanes-Oxley goes a long way toward achieving that end.

Furthermore, the increased number of companies listing on foreign exchanges is not due to American companies favoring more lax, overseas exchanges. Rather, the jump is almost entirely the result of more foreign companies going public and choosing to list on their own, domestic exchanges. Far from Sarbanes-Oxley causing a decline in new listings on Nasdaq, it was the burst of the Internet bubble in 2000 that caused a drop in new listings. And although companies are not listing on Nasdaq at the rate they were when the market was hot in the 1990s, listings on Nasdaq have increased since Congress enacted Sarbanes-Oxley, and the rate of new listings on the New York Stock Exchange is where it was immediately before the law was enacted.

Critics have also grumbled that requiring CEOs to attest to the accuracy of a company's financial statements and the soundness of its internal controls diverts the CEOs' attention away from other important business. But what could be more important to shareholders than the accuracy and integrity of a company's financial statements? Former Federal Reserve Board Chairman Alan Greenspan doesn't think it's burdensome for corporate executives to certify that they have not lied about or turned a blind eye to their company's financial health. He singled out this particular provision for praise.

There may be room to fine-tune and improve some of Sarbanes-Oxley's provisions. Congress should be open to that. But let's not turn back the clock to the uncertainty and dishonesty of the Enron era. Some may believe that the cost of financial integrity and corporate accountability is too high, but the cost of not demanding it would be catastrophic.

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