Best intentions

Sarbanes-Oxley: A law of unintended consequences **By Marc Morgenstern**

The corporate world was dramatically altered by The Sarbanes-Oxley Act. Intended to restore investor confidence, it increased public company financial statement transparency, management liability, and board involvement. Its unintended statutory consequences, however, created an unacceptable cost-benefit.

Direct costs for even small public companies range from $500,000 to $2 million annually, sharply contrasting with the SEC's $5,000 estimate. The costs directly decrease profits, since there is no offsetting revenue. Reduced net income yields a lower stock price and market capitalization. And time spent by mid-cap CFOs meeting with professionals hurts profitability.

The act also increases personal liability for directors, leading to lengthier board meetings designed more to evidence fulfillment of their fiduciary obligations than to achieve corporate goals. Financial statements are disproportionately emphasized over sales, growth and profitability; minimizing risks rather than maximizing rewards.

True investor confidence is created and sustained by profit and growth, and generated by marketing, technology, global sourcing, and economic and political sophistication. Broad operational experience permits a skill-balanced board to effectively shape corporate strategy and decisions.

Companies are appointing accountants to boards with increasing frequency. Potential directors with business talent (but without financial statement orientation) are reluctant to serve. Public companies are questioning the fundamental benefits of being public. Profitable private companies are remaining private or achieving corporate liquidity through business combinations with competitors. Smaller public companies are deregistering stock or selling.

Sarbanes-Oxley is a classic example of legislative overreaction reflecting political hysteria rather than reasoned analysis. Long term, the statute harms the marketplace and the investors it sought to help.

The governance issues raised statutorily need to be readdressed and modified, or public companies will be increasingly managed by directors with narrow skill sets incapable of achieving the congressional goal. The number of smaller public companies will further diminish. These results are unintended, undesirable, and unacceptable.

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a SMART BUSINESS NETWORK publication
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