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Newsmaker: Michael G. Oxley, SOX cosponsor

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Michael G. Oxley

A generous economic boom comes to a sudden and dramatic end, massive financial scandals shake public confidence in the nation's markets and the government begins working on legislation to address oversight weaknesses.

The year at hand is not 2008 but 2001. The popped bubble? Dot-com stocks. The financial scandals? Enron and WorldCom. And the legislation that was crafted in response? The Sarbanes-Oxley Act (SOX), a landmark bill that would dramatically change the shape and culture of financial reporting and underscore the importance of auditor independence and objectivity.

The bill, signed into law by former President George W. Bush on July 30, 2002, turned 10 this year, prompting many within the financial world to reflect on its regulatory successes and flaws. But for former Congressman Michael G. Oxley (R-Ohio), who, along with former Sen. Paul Sarbanes (D-Md.) created the legislation, it has had exactly the effect he'd hoped for: In the decade since the law was enacted, public companies have seen the rise of the independent audit committee, the creation of the Public Company Accounting Oversight Board (PCAOB) and new emphasis on internal controls. Oxley spoke with *Trusted Professional* writer Chris Gaetano on SOX's legacy and its future.

What misconceptions about SOX do you find yourself constantly deflating?

Two things: first, that it was passed in haste. It was nine months from the time we had our first hearing to when the president signed the bill, but some people will lead you to believe it was a matter of weeks. While nine months, admittedly, is quick by congressional standards, the bill was not rushed through. We had almost no opposition—the only opposition came from the accounting firms. The business sector simply did not fight it, and so as a result, it went through as it did. The second misconception is that it was controversial. But when you get 98-0 in [the] Senate and 423-3 in the House, either way you cut it, the bill was not controversial.

What was it like putting SOX together—negotiating the finer points of the bill's language, interacting with the industry and getting other members of Congress on board?

We had the first hearing on Enron in my committee, the Financial Services Committee, in December 2001, which was the month that Enron filed for bankruptcy. The Enron board ordered an investigation by a select committee of outsiders, headed up by William C. Powers Jr., who, at the time, was dean of the University of Texas's law school, and William R. McLucas, who had been chief of enforcement at the SEC before he went into private practice. Their committee reported directly to us early in 2002, and the gist of their report was that the gatekeepers for Enron each had failed in their job—and by that we mean the accountants, the attorneys, the analysts, the board and the credit rating agencies. Trying to correct what had gone wrong in each of those instances with the gatekeepers became the building blocks for the legislation.

Then it went over to the Senate, and the Senate basically passed its version after WorldCom, whose bankruptcy was, of course, four times larger. I chaired the conference committee to iron out the differences between the House and Senate.

And how did the reconciliation process go? Were there conflicts?

It went very smoothly. We were under a lot of pressure from the White House to get it to the president's desk, which was advantageous because we were able to, for example, add in the Fair Fund, which provided a receptacle for the SEC for fines and disgorgements. That subsequently amounted to billions of dollars and went directly to compensate investors who lost money, so it was a worthwhile addition. We also closed a loophole in backdating stock options, which had become quite prevalent back then, where insiders would simply backdate the value of their options to their benefit and only to their benefit, not the public's.

Did anything unexpected arise during the course of its implementation? Some unintended effect, either good or bad, that you didn't anticipate?

The biggest complaint was the cost of compliance with Section 404(b), probably because no one anticipated that the death of Arthur Andersen would mean that you had far less competition in that space. When I was elected to Congress in 1981, there were eight nationally recognized accounting firms, but then, with the consolidation, it became five. And then with a stroke of a pen, we saw Arthur Andersen, which had been the gold standard, disappear. All of a sudden, a lot of companies had to scramble and find another auditor, which drove up costs. I think the PCAOB, which we created in the act, and the SEC were under enormous pressure timewise to write the regulations and, to some extent, they were probably overly strict and therefore compliance was overly expensive. I think over the years, we've seen the costs come down and, in some cases, quite dramatically, but that's taken some time and effort by the SEC and PCAOB.

The 404(b) requirements were kind of one-size-fits-all, and in retrospect we should have given the SEC and PCAOB more flexibility in dealing with smaller- to medium-sized companies, because of the fact that their costs would be proportionately higher than some of the larger companies.

Some legislators assail SOX as excessive government control over business. How do you respond to that argument?

Well, the idea was to really provide more transparency and accountability. Part of the problem with Enron was that they were able to do a lot of off-the-books accounting without the full knowledge of the investors, and as the result, there were thousands of jobs lost. We lost some $8 trillion in market cap, so it was obviously a problem that needed fixing, and that was how we saw our role. It's amazing, the number of critics out there who never had anything negative to say at all during the process, during those nine months, and they had plenty of time to study it. But no one in the business community wanted to be seen as opposing those reforms because of the public outrage that occurred with Enron, WorldCom and others.

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Looking back, did SOX have the impact you wanted it to have?

We wanted to make sure we never had a macroeconomic meltdown, like we had with Enron and WorldCom, and of course, 10 years later, we've not had that. That would be a pretty good indicator that the law does work.

What's your take on financial regulations since SOX, particularly the Dodd-Frank Wall Street Reform and Consumer Protection Act? Would you say it's the SOX of its own crisis?

The Dodd-Frank Act was 2,300 pages long; ours was about 450. I think, in comparison, our bill stands up pretty well. But we're talking about two different things, two different problems, two different approaches. I will say SOX was passed by large bipartisan majorities, while Dodd-Frank was passed on a partisan basis. It may reflect the times more than anything else, but ours was a huge bipartisan success passed by a large margin in a Republican House and Democratic Senate and signed by a Republican president. Dodd-Frank was passed by a Democrat House and Senate, and signed by a Democrat president. So from the standpoint of bipartisanship, I think ours stands the test of time.

The JOBS (Jumpstart Our Business Startups) Act has created a new category for "emerging growth companies" that are not required to undergo internal controls audits. Do you think smaller companies can stand to have this exemption, or are they more at risk?

I think the jury's still out. It's interesting that Manchester United, the soccer team in Great Britain, [went] public as an emerging company, when they've been around for more than 100 years and won't create one job in the U.S. I think that stands the whole JOBS Act concept on its ear. We'll see. I think investors over the last 10 years have come to expect reliable accounting information from corporations that wish to go public, and it'll be interesting to see how they will react to the failure of these companies to provide that kind of information. It may well be that the market rejects that. It may well be that some people will seek to invest in these companies, and when they fail, the industry will probably blame the regulators or SOX or something else, but we'll see how that happens. But if I were an investor today, knowing I could get solid information from other companies outside that category, I'd feel a lot more comfortable investing my money into those, as opposed to the newer ones.

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