

Directorship

The aftermath of Sarbanes-Oxley:

If CEOs aren't running our companies, then who is?

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New corporate governance laws enacted during the last two years are reshaping the role of the CEO and other upper-level corporate executives and are shifting the balance of power far beyond the boardroom.

This shift in power can be largely attributed to the implementation of the Sarbanes-Oxley Act, which was created to increase the reliability and accuracy of corporate reporting, accounting and audit practices. According to a recent Pricewaterhouse Coopers Management Barometer survey, the act has resulted in significant changes in controls and compliance practices at approximately 85 percent of large US multinational companies.

However, the potential danger lies not in the fact that changes are being made but in who is directing these changes and how they are being executed within a company. The regulators empowered by the act—the SEC, the IRS and the Public Company Accounting Oversight Board—have been put in a position where they could easily overstep their boundaries, to the point where they are almost running America's companies through stringent regulation and legislation.

For example, Sarbanes-Oxley requires that audit committees be comprised solely of directors who are independent, which the act defines as “receiving no salary or fees from the company other than services as a director.” It also states that CEOs, who are now forced to take responsibility for the validity of earnings statements, have no say in the hiring of an auditor. According to the regulations, the hiring, supervision and compensation of the auditor must be decided solely by the audit committee, and the auditor must report directly to that committee, not company management.

Unfortunately, Sarbanes-Oxley regulations appear to be punishing thousands of executives and accountants who are not—and never will be—corrupt, based upon the actions of a few who have been indicted over the last few years.

Just five years ago, corporate leaders such as Andrew and Lea Fastow of Enron and Richard Scrushy of HealthSouth were praised as heroes of America's then-thriving economy. When Enron, WorldCom, Tyco and others began to fall from grace, public skepticism began to grow around closed-door boardroom activities.

When the pressure to react and ease the public's concern fell squarely on the shoulders of the government, Sarbanes-Oxley seemed to be an obvious solution. However, a growing number of experts feel this reaction might have been too hasty.

While the bill passed the Senate 99-0 and cleared the House with only three votes against it, critics note this factor as a negative more than a positive. In fact, many would argue that any bill that passes almost unanimously is bad legislation because it signals that no one has taken the time to read it. If the aftermath turns out to be negative, there is always a crowd to fall back on because everyone voted for it and true ownership and accountability are lost.

Whether or not Sarbanes-Oxley is the remedy for what ails corporate America remains to be seen. According to the PwC survey, only one-third of the executives who are actually running companies believe the new law will restore investor confidence in the capital markets or aid their companies' ability to create shareholder value. In fact, 53 percent of those executives surveyed said the new law simply codifies much of what their companies have been already doing to ensure good corporate governance.

Many experts do agree, however, that Sarbanes-Oxley has already changed several facets of business including: the way leaders now view the executive suite; the way honest, hard-working CEOs view their role; and the way scandal-weary boards operate and make decisions.

For example, in the event that a hostile takeover succeeds, the new board may cross over into management's territory so aggressively that it not only causes friction but creates an environment of "Who's on first, who's on second?" Chaos ensues. Or a board member could impose his or her own agenda to the extent either that decisions remain at an impasse or getting things done takes far too long and affects the company's ability to compete.

Additionally, CEOs and CFOs are not the only executives whose roles are changing as a result of these new standards. Although not specifically mandated to do so by Sarbanes-Oxley, many companies are requiring certifications of financial results by their division presidents, department heads and other senior management in an effort to comply with the latest corporate governance controls.

As is generally the case with governmental intervention in the affairs of business, Sarbanes-Oxley has many unintended side effects. And with champions of the legislation comparing it to FDR's New Deal, one has to wonder whether the regulatory reforms of this legislation are too far-reaching.

Ironically, Representative Oxley, one of the bill's authors, has become concerned that the US is becoming too risk-averse as a result of growing regulation and legislation, which could hamper the nation's ability to compete effectively in the global business arena.

The uncertainty surrounding the legislation's impact has had a paralyzing effect on operations in boardrooms across the US. Leading decision-makers at companies are in many cases so intently focused on legislative issues they have been distracted from fully focusing efforts on their businesses' primary operations and on creating shareholder value. As the process continues to filter down the ranks, simply complying with these laws could end up costing shareholders more than they ever thought possible.

Sarbanes-Oxley passed on the heels of WorldCom's \$104-billion bankruptcy, the largest case in history at that time. But for every WorldCom, there are thousands of good, ethical companies that don't need this type of regulation to maintain sound business practices and good corporate governance. The question becomes whether well-intended regulations for good governance could have gone overboard in their requirements, thus creating a negative impact.

Imagine a doctor conducting a physical exam with a pitchfork. With a tool that size, even the least amount of poking and prodding could end up killing the patient he intended to heal. Sarbanes-Oxley is a broadly sweeping regulatory scythe, and regulators should be wary of how they wield it.

When asked for their overall assessment of Sarbanes-Oxley, 42 percent of senior executives polled in the PwC survey said the bill was "a well-meaning attempt, but will impose unnecessary costs on companies." And 71 percent believe these costs will increase over the long term. A study conducted for the Financial Executive International organization last year concluded that the average Fortune 500 company will pay \$4 million–\$9 million initially and thereafter spend \$3 million–\$8 million annually for compliance with the new regulatory regime (*Directorship*, May 2003).

Twenty months after passage of this historic legislation, the only certainty is that corporate America is still unsure of the total impact—positive or negative—that Sarbanes-Oxley will have. But many stakeholders would agree that the costs of compliance may not be the best use of corporate funds.

Ambiguity in the boardroom post-Sarbanes-Oxley will certainly continue as the fear of over-arching legislation persists. Will firms be willing to stick their necks out and propose sweeping internal changes before the legislation has been properly interpreted? We must hope that new legislation will gradually move requirements more toward the middle of the road as businesses, regulators and shareholders begin to experience the unintended consequences resulting from over-regulation and legislation.

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