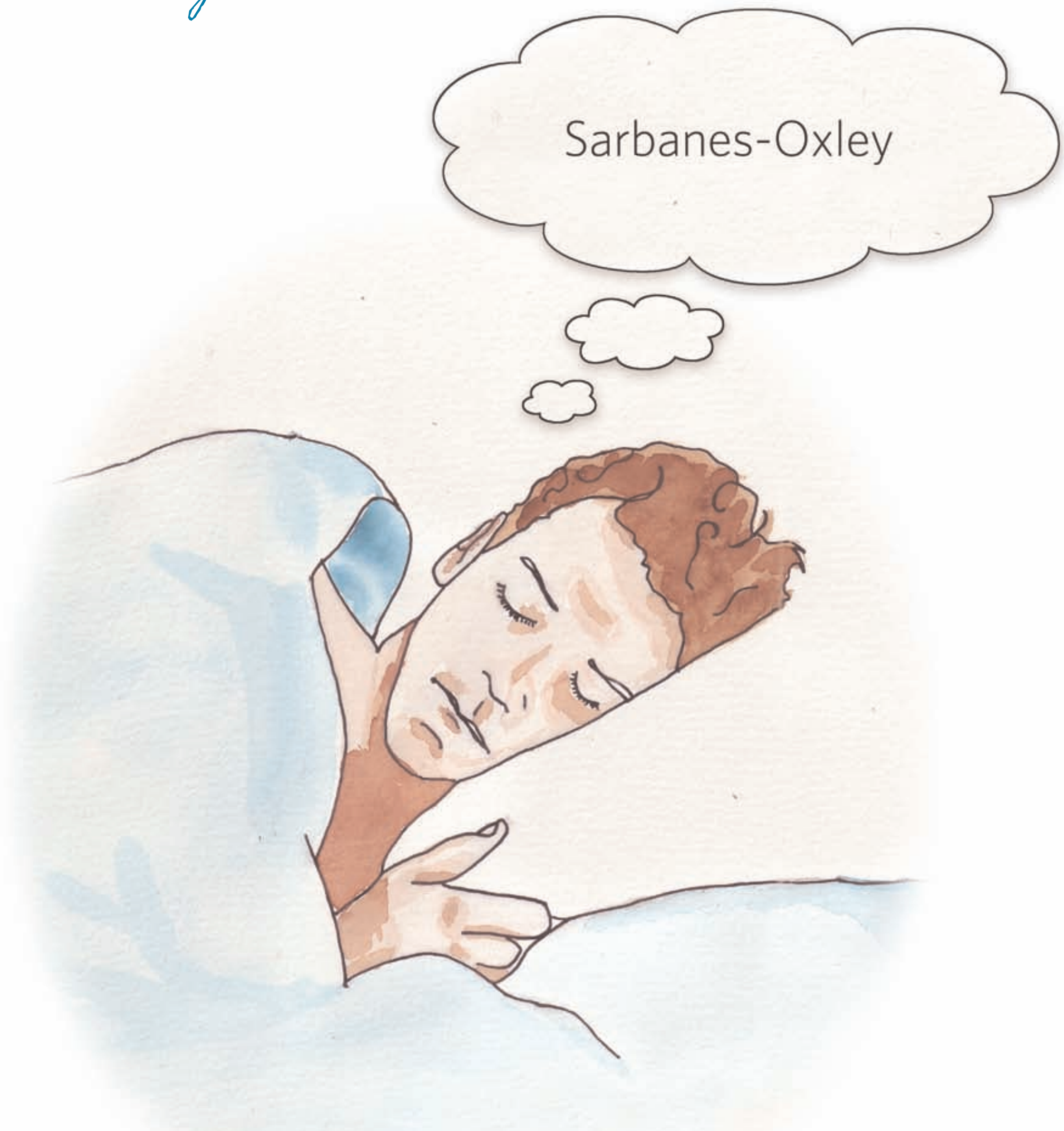
you'll manage | BY CHRIS ALLISON



Get some sleep with SOX

The pain of more paperwork is worth the peace of mind

For managers of public companies and their shareholders, the Sarbanes-Oxley Act of 2002 has done for business what the Department of Homeland Security has done for air travel. It's a necessary work in progress that makes us feel more secure. But for frequent fliers, such as CEOs, CFOs and their audit firms, taking your shoes off all the time can become a pain.

When I was running a public company and first heard about this new set of regulations, my managers and I all looked like a bunch of squirrels trying to swallow peach stones. We weren't at all sure what was going to happen but knew it could be painful down the road.

Sarbanes-Oxley was Congress' effort to soothe their financially wounded constituents after the stock-market crash of 2000.

Most people realized too late that stock speculation is inherently risky, but what really made them cranky was the feeling that that some corporate chieftains were less than forthright about what was under

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illustration by **CATHY RUBIN**

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their kilts.

Everyone knows the poster children of the post-bubble perp walk: Enron's late Kenneth Lay, Jeffrey Skilling, and Andrew Fastow; Dennis Koslowski from Tyco; Bernard Ebbers and Scott Sullivan of Worldcom and, closer to home, John and Timothy Rigas of Adelphia. These companies simply weren't making the money these CEOs said they were making, and they lost billions in market value.

NEED A REGULATION REFILL?

Created in 2002 by Sen. Paul Sarbanes (D-Md.) and Rep. Michael Oxley (R-Ohio), Sarbanes-Oxley or "SOX" mandates tight financial controls for public companies. To make sure this is happening, every year a company's accounting firm gives the company what amounts to a financial lower GI. With a fine-toothed comb, auditors review every critical financial control, see that it's documented and make sure people understand how these controls work. They also make sure management teams are stating in the King's English the health of a company in public disclosure documents such as 10-Qs and 10-Ks, as well as presenting future risks to the company.

SOX forces CEOs and CFOs to sign a statement that the financial results reported to shareholders are accurate. It also makes public-company boards, most notably their audit committees, more responsible for policing themselves.

Certifying financial statements have one main purpose besides accuracy. They are designed to scare the bejesus out of executives and board members.

If they certify financial statements that they know are incorrect, the guys with the badges, long leather coats and the guns pay a visit. And if you're really bad, you get to visit Club Fed for a vacation. And if you're really, really bad, you end up an extra in Oz.

Interestingly, all of the big name CEOs going to jail were prosecuted under pre-SOX rules. And the biggest name CEO prosecuted under SOX, Richard Scrushy of HealthSouth, was found innocent in his fraud counts during his first case. A lot of folks in Birmingham think that his acquittal was a result of his local philanthropic largesse rather than the merits of the case.

FAUX LAMENTATIONS

In "Hamlet," Shakespeare showed how full of it Queen Gertrude was with the line, "The lady doth protest too much, methinks."

I have a theory that most CEOs complain up and down about SOX, but they sure don't mind the sense of security it gives them that the numbers they report to shareholders are right.

Many CEOs say the requirements are too onerous and don't make dishonest people honest. They claim that it forces public company CEOs to pay huge sums of money to their auditors. They also lament that SOX creates mind-numbing bureaucracy.

With that said, many a CEO has stared at the bedroom ceiling at night wondering if some overzealous sales person decided to cloud the facts of a sale to make a big commission, or if someone didn't follow a quality procedure thus creating a big recall.

If there are problems with financial statements certified by a CEO and CFO, the SEC, state attorneys general and Justice Department come after the big fish, not the minnows. And CEOs and CFOs have the most to lose in prestige, employability and personal wealth. So I'll bet they don't mind the fear of Eliot Spitzer and all like him being passed down through the organization. Improvements in financial controls and financial certifications that extend down into the bowels of the corporation are like Ambien to a CEO.

In defense of auditors, costs related to Sarbanes-Oxley should be viewed more like Y2K information technology costs back in the late 1990s. Getting one's house in order was expensive the first year, but those costs tend to trail off in successive years.

Financial Executives International, an industry group, found that small public companies expect to spend an average of $824,000 on SOX compliance and that costs across all public companies average $4.3 million.

From a control standpoint, few public company managers would be hard pressed to say that SOX has not improved things, albeit expensively.

IN THE HEADLIGHTS

Some claim that the act has made entrepreneurial companies less nimble. In my mind, a few more controls can't impact one's urgency nor one's search for innovation. In fact, it may make managers think more thoroughly about business decisions.

But there is a latent effect of SOX on our economy in terms of new business creation, as well as the amount of risk that a management team is willing to take. For new business creation, it boils down to an elimination of ways a venture investor can cash in on an investment.

Venture capitalists invest in entrepreneurs, who build companies that are sold or go public. Entrepreneurs — being bold business people who like the journey as much as the reward — take their newfound wealth and either start or invest in new businesses.

If fewer companies go public because the management doesn't want to spend the money it takes to be public, or become more inefficient because of SOX rules, then less wealth is created. Also, if a venture capitalist is negotiating the sale of a company and he doesn't have the option of an IPO in his quiver, he has less leverage during a negotiation.

According to Thomson Venture Economics and the National Venture Capital Association, 264 venture-backed companies went public in 2000.

In 2005, that number was less than 50. Granted, the equity markets have stunk until last year, but SOX may have some impact on it.

On the management side, executives

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may not be as bold as they once were. Coming soon to a board room near you will be a new entity called a "risk committee," which will be able to commiserate with all the brave souls sitting on audit committees. They will be evaluating the risks the company faces down the road and making sure that dangers are communicated to shareholders.

Here's hoping the rock star CEOs of the past don't turn into Don Knotts.

SMOKE AND MIRRORS

Here is the reality: Sarbanes-Oxley is good for shareholders and companies. Eating a lot of fiber for breakfast is good for you, too. Bran muffins aren't as fun as a bacon, egg and cheese from Mickey D's, but it cleans out the bad stuff.

It costs a little more money, but down deep, top executives don't mind spending a little more dough for the piece of mind of knowing that they won't be playing pinochle with Bernie Ebbers.

Sarbanes-Oxley is good for shareholders because Joe Bagadoughnuts investor gets more accurate financial information. And management teams of public companies are less likely to engage in puffery when commenting about their company's outlook.

Finally, companies of late have not been resisting IPOs due to costs and the increased scrutiny of SOX. The market from 2000 to 2005 hasn't been that hot. As the public markets continue to improve, the number of IPOs will increase. And you'll see more merger deals of hot young tech companies.

Let's face it. For all its benefits, running a public company is one big pain in the rump. It always has been. It always will be. For my money, I'd trade the cost and the piece of mind any day knowing that I could prevent a visit from the SEC and Justice Department down the road.

So for investors and, if truth be told, for CEOs and CFOs, there's nothing better than a little good SOX. PQ

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