The Positives and Negatives of the Sarbanes-Oxley Act of 2002

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Preliminary observations:

Apart from its length and complexity, a challenge posed by the Research Proposal is that it requires the student to constantly be mindful of the persona they have to project to the reader. Since the audience of a Research Proposal is the organization or person that may fund the research (and facilitate its very existence), the student should imagine that they are in the position to impress this audience. They have to do this in two ways: first, by demonstrating that their chosen topic is worthy of research because it is feasible and has a clear benefit to humanity and/or a specific field; and secondly, by making it clear to the reader that they are the right person to do this research. These two aspects permeate all the sections of a Research Proposal:

1. The “Literature Review” section is necessary not only because it contextualizes the gap which the student has found in the existing literature on a general topic and which is the basis for the specific research they are proposing, but also because it shows that they are knowledgeable about their topic and therefore the person qualified to undertake this research.

2. The “Methodology” section should go into the nuts and bolts of how exactly the research will be undertaken. In so doing, it shows both that the project is feasible and that the researcher has a very clear idea of what exactly they will be doing to find an answer to their research question and therefore that they are the right person for the job.

3. The “Discussion” section includes 3 rhetorical moves. It starts by detailing the benefits of the research project to humanity and/or a field, and thus demonstrates that the topic is worthy of research. It continues by discussing the limitations of the project and thus paints a picture of the researcher as a true professional who is unwilling to exaggerate the benefits of their project or to downplay its limitations for the sake of getting funding. The researcher, therefore, appears as the right person to undertake this research. The section ends with a reiteration of the most significant benefits of this project (“the big picture”). This reiteration is necessary because the Research Proposal must end on a positive note (rather than with a discussion of the limitations of the project) in order to further persuade the reader that the project is worthy of funding.

The Introduction of the Research Proposal contains elements of all of these 3 sections. This is meant to anticipate the content of the Research Proposal (which is typical of the introduction of any paper) and to make it abundantly clear to the reader from the very beginning that the project is worthy of research and that the person proposing it is the right individual for the job.

The author of this particular sample did a great job writing this Research Proposal.

More comments below.

Abstract

In this paper, I am proposing a study that will determine if the positive effects of the Sarbanes-Oxley Act of 2002 outweigh the negative effects or vice-versa. In all the past research individuals have identified all the different positive and negative effects, and mention the importance of determining whether the positives outweigh the negatives or vice-versa. With that being said, there is currently no definitive answer to this question. So, I propose a study that will utilize interviews and the analysis of financial statement data to determine an answer to this question.

**Introduction:**

The Sarbanes-Oxley Act (SOX) is the most important legislation affecting corporate financial reporting enacted in the United States since the 1930’s. Its purpose is to improve the accuracy and reliability of accounting information that is reported to investors (Li et al. 2008). However, the U.S. stock market and U.S. corporations have witnessed both positive and negative effects after the passage of SOX. This means that legislation passed by the government that was intended to improve different aspects of the business world has imposed adverse effects as well. By examining the significance of these effects, it could help us determine the status and effectiveness of the Sarbanes-Oxley Act of 2002. In addition, with this finding it could possibly lead to changes regarding the act that could benefit the economy tremendously.

There have been various studies and articles published that discuss the positive and negative effects associated with SOX regarding the U.S. stock market and U.S. corporations. For example, research has been published that suggests that the act positively affected the U.S. stock market by increasing stock returns (Jain and Zabihollah, 2006; Li et al., 2008). On the contrary, research has also indicated that the act negatively affected the stock market by decreasing stock returns (Hammersly and Myers, 2007; Zhang, 2007). In addition, research has discovered that there have been negative and positive effects on U.S. corporations following the act as well (Valenti, 2008; Li et al., 2008; Sherman and Chambers, 2009; Bargeron and Zutter, 2010). However, it seems that research has been generally aimed at just discovering these positive and negative effects.

I would like to take a closer look at the significance of these positive and negative effects, rather than just identifying them. I noticed that a majority of studies mentioned the importance of determining whether or not the positives of the act outweigh the negatives or vice-versa. With that being said, there is no type of hard data or articles discussing an answer to this specific question.

This research study will examine whether the positive effects of the Sarbanes-Oxley Act outweigh the negative aspects that have been created as a result of the legislation. Through the analysis of different types of data, I believe that the answer behind this question will be uncovered.

**Literature Review:**

In the literature review we will be looking at past work that has been done to determine the different positive and negative effects associated with SOX on the U.S. stock market and U.S. corporations. We will be first looking at the past research that has suggested that SOX has positively affected the stock market and corporations.

**“**The Sarbanes-Oxley Act of 2002 was enacted in response to numerous corporate and accounting scandals. It aims to reinforce corporate accountability and professional responsibility in order to restore investor confidence in corporate America” (Jain & Zabihollah, 2006). According to Jain and Zabihollah, the research question that they proposed to answer was, whether or not the passage of SOX has had a positive effect on stock returns. Through different types of analysis using a derived regression model, which is based on cross sectional variables, the two were able to come to a conclusion based off of their results. At the end of their experiment they came to the conclusion that the market saw an increase in stock returns as a result of the passage of SOX. In addition, Jain and Zabihollah exclaim that, “This suggests that the Act created an environment that promotes strong market-place integrity, and investors considered its enactment as good news” (Jain et al., 2006). Similarly, to the work done by Jain and Zabihollah, research done by Li et al. (2008) attempts to find the same exact answer to the question of whether SOX has increased stock returns. They approached the question by designing an experiment that would examine the correlation between the passage of SOX and stock returns. After utilizing several different statistical methods to help determine the correlation between the two variables Li et al. (2008) were able to come to a conclusion.

Li et al. (2008) study found the following:

There are significantly positive stock returns associated with subsequent SOX events, including (1) issuance of the House-Senate Conference Committee’s report, which resolved uncertainty about the act’s provisions and revealed that they would include the most demanding reforms Congress had been considering, and (2) SEC actions signaling rigorous enforcement of the act. These results are consistent with investors expecting the provisions and enforcement of SOX to have a net beneficial effect.

Valenti asserts that, “A major concern echoed by several governance observers was that corporate boards had fallen short of their monitoring and control responsibilities in allowing falsification of financial records” (2008). SOX requires that corporations must create an audit committee that encompasses at least one financial expert. Valenti sets out to answer the question of whether or not corporations have begun restructuring their boards differently than in the past in response to the act. He begins his research by looking at different industries and the way in which their boards are composed before and after the passage of SOX. After gathering the data and running ANOVA tests to determine the significance, he determined that they have in fact restructured their boards differently since its enactment. He states that, “Substantive changes such as separation of CEO and chair position and appointment of accounting experts to audit committees should signify a long-term commitment to achieving more balance between management and the board” (2008). This work done by Valenti indicates that SOX has been effective in a positive manner by creating a type of checks and balances system within U.S. corporations. In addition, Li et al. (2008) provided further support that SOX has positively affected U.S. corporations. According to Li et al. (2008) SOX has changed the ways in which firms are able to employ earnings management by creating guidelines. They also explain that explain that earnings management is the utilization of accounting techniques to portray an overly positive view of financial statement information. Li et al. (2008) concludes that by restricting the usage of earnings management, it has enhanced the quality of financial statement information. Not only would this increase confidence for investors, but it would positively affect the image of the corporation.

On the other hand, there has been research that suggests the act has had a negative impact on the stock market and corporations as well. Below is a discussion of the different studies that have been done that make this claim. In a study done in mid 2007, Hammersly and Myers set out to answer the question of whether section-302 of SOX has negatively affected U.S. stock returns. Under section-302 of SOX, the CEO and CFO are required to disclose any type of material weaknesses that may be associated with the internal control of the company. These weaknesses could possibly include the design of the internal control process or the overall effectiveness of the process (Hammersly and Myers, 2007). After conducting their research using multiple regression and other statistical models, they determined that stock returns were negatively affected as a result of section-302 of SOX. According to Hammersly and Myers, “We find that size-adjusted returns on the day that the weaknesses are disclosed are significantly negative, suggesting that investors’ aggregate beliefs about firm value are revised downward” (2007). In addition, in 2007 Ivy Zhang completed a study that attempted to determine if SOX as a whole affected U.S. stock returns in a negative manner. Zhang began by creating a statistical model using multiple regression that allowed her to test her hypothesis. After extensive analysis of the results Zhang concluded that U.S. stock returns decreased because of SOX. According to Zhang,” I find that the cumulative stock returns of U.S. firms complying with SOX are negative and statistically significant (2007). SOX has created an unthinkable amount of new regulations that publicly traded corporations are required to follow. With these new guidelines, Sherman and Chambers (2009) state that operational costs for these corporations have skyrocketed. Sherman and Chambers have done an extensive amount of research and found that in 2005, on average companies would spend 3.8 million dollars alone in compliance costs, and 2.9 million dollars in 2006 (2009). Additionally, the implementation of SOX has affected U.S. corporations negatively in other ways. In a study done by Bargeron and Zutter (2010) they attempted to answer the question of whether corporate risk-taking declined after the adoption of SOX. After analyzing their data that they gathered by using statistical methods, the two were able to determine the answer to their question. They concluded that, “This paper finds that adoption of the Sarbanes-Oxley Act of 2002 is associated with a significant subsequent reduction in risk-taking by publicly traded U.S. companies” (Bargeron and Zutter, 2009). More specifically, they found that corporations reduced research and development expenditures tremendously because of SOX. Although, researchers have identified the different positive and negative effects associated with SOX on the stock market and corporations, it is still unknown whether these positive aspects outweigh the negatives or vice-versa.

I propose a research study that will hopefully determine whether these positive effects of the Sarbanes-Oxley Act outweigh the negative effects or vice-versa. It will first look at various financial statements from different major corporations in order to find any correlation to its passage. Then, certain individuals from major stock brokerage firms and major corporations will be interviewed in order to get their perspective of the situation.

**Methodology:**

As I just briefly mentioned above this research study will attempt to answer the question of whether the positive effects of SOX outweigh the negative effects or vice-versa. First, I will be examining the financial statements of a select group of major corporations within the United States. In addition, I will also be interviewing certain individuals from major stock brokerage firms and individuals from the group of corporations whose financial statements I analyzed, to understand their perspective of the act and how it has affected their job.

I will begin by analyzing the financial statements of General Motors, Verizon, General Electric, Exxon Mobil, and Apple. I have chosen these specific companies because it will allow me to see a variety of industries, and determine how significantly the act has affected these firms positively and negatively from a financial standpoint. For example, by using these companies I will be able to look at the auto industry, the telecommunications industry, a conglomerate, the oil and gas industry, and the electronics industry. More specifically, I will be analyzing the financial statements of these corporations that were released in 2000 and in 2003. I have chosen the statements in 2000 because it is pre-SOX and the statements in 2003 because it is post-SOX. In addition, I will be using the statements in 2003 instead of the most recent statements because I believe that the statements in 2003 are the most accurate representation of the values in 2000 because of inflation. During my analysis, I will be looking for any fluctuations in sales and any type of expenses that may have been created as a result of SOX.

I will also be conducting an interview session to find an answer to my research question. This interview session will be broken down into two different parts and will include a discussion between employees at Charles Schwab, TD Ameritrade, and E-Trade, and with employees in the accounting and finance departments at the corporations whose financial statements I analyzed. This list includes General Motors, Verizon, General Electric, Exxon Mobil, and Apple. I have chosen to use these stock brokerage firms because they are some of the largest and most powerful firms in the United States, and I have chosen these corporations because I will be familiar with their business after conducting my prior research. More specifically, I will be interviewing 20 employees from each brokerage firm that were with the firm pre-SOX and post-SOX to understand their perspective of the act. See page 11 for a list of the questions I will be asking the employees at the brokerage firms. In addition, I will be interviewing 20 individuals that have been with the company since before the passage of SOX and after the passage of SOX in the accounting and finance departments from each of the corporations that I have selected. It is important that the individuals in both interviews have experience with the company before and after the passage of SOX to have a thorough understanding of its effects on their profession. See page 11 for a list of questions I will be asking employees at these corporations.

**Discussion:**

There are numerous different potential results/benefits that could arise because of this study. First, by discovering an answer to this question I will be contributing new knowledge to the field of business in general and more specifically the field of accounting. As I have mentioned throughout this proposal there is no current research concerning my question, so it would be groundbreaking new knowledge. In addition, it would be extremely beneficial to answer the question of whether the positive effects of SOX outweigh the negatives or vice-versa. For example, if I find that the positive effects of the act outweigh the negatives then it could possibly lead to the government strengthening the act and potentially benefiting the economy. In addition, if I find that the negative effects outweigh the positives it could possibly lead to deregulation of the act and benefit audit firms, corporations, and the economy. However, there are some other factors that aren’t accounted for in this study.

As with every study, there are limitations associated with the specific study in which I am proposing. The first limitation associated with this study is the small sample size of the corporation’s financial statements that I am analyzing, and of the individuals that I am interviewing from these corporations and from the stock brokerage firms. I am only looking at 5 corporations and interviewing 20 people from each corporation and brokerage firms. It could be possible that I would be making a very large assumption based off the results of such a small sample size. In addition, as I explained I will be interviewing 20 individuals from each corporation and brokerage firm. The fact that I am interviewing employees that have been positively and negatively affected by the legislation leaves me with a dilemma. Since there are two different perspectives of the act, I could possibly be given a bias answer by the interviewee. This could also cause me to make a false assumption based off my results. Lastly, I am only looking at the financial statements of large U.S. corporations. With that being said, I could perhaps look over important data from financial statements associated with smaller corporations which could lead to an incorrect conclusion.

The increase in knowledge of whether the positive effects of the Sarbanes-Oxley Act outweigh the negative effects or vice-versa would be a major step towards finding an answer to my research question. In addition, with this discovery it could lead to changes regarding the act that could possibly enhance the stability of the economy, and determine the current effectiveness of the act. However, more studies concerning the topic would need to be done in order to solidify the conclusion, but this is definitely a step in the right direction.

**Questions:**

Questions for the employees at the brokerage firms:

1. When did you begin working with the firm?
2. Have you seen any effects with the passage of the Sarbanes-Oxley Act on the stock market?
3. If so, have these effects been negative or positive? Give examples. In your opinion how significant have these effects been?
4. Has SOX affected any of your day to day operations? If so, please give examples.

Questions for the employees at the corporations:

1. When did you begin working for …?
2. Has the passage of SOX created any fluctuations in sales for the company? If so, please explain.
3. Has the passage of SOX created any additional costs for the company? If so, please explain.
4. In your opinion how significant have these effects been?
5. Has SOX affected your job in any way? If so, please give examples.

References:

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