# LEADERS DISCUSS IMPACT OF SECTION 404

The Sarbanes-Oxley Act, which Congress passed in 2002 in response to a cascade of corporate accounting scandals and bankruptcies, was the most far-reaching corporate governance legislation enacted in more than 50 years. Its provisions include requirements that chief executive officers sign off on corporate earnings and that a majority of the board of directors be independent.

One of the most important components of the act is Section 404, which requires companies to develop a system of internal controls and then to issue annual reports attesting to the effectiveness of those controls. One year after the implementation of Section 404, NYU Stern's Vincent C. Ross Institute of Accounting Research convened leaders from academia and from the investment, legal, and accounting industries to discuss the impact of Section 404 – its costs, benefits, and impact on public companies, corporate governance, and consumer confidence. NYU Stern Accounting Professor Seymour Jones moderated the panel discussion.

NYU Stern Accounting Professor Eli Bartov noted that establishing and maintaining adequate internal control structures and procedures for financial reporting is an enormously costly enterprise. But he wondered: "Will Section 404 prevent or even reduce deceptive behavior by top management or financial statement fraud?"

Lynn Turner, former chief accountant at the Securities and Exchange Commission, acknowledged that the initial costs of complying with 404 are steep. But he suggested they will fall over time. What's more, they're a drop in the bucket when compared to the costs of financial accounting fraud.

Alan Annex, a partner at the New York law firm Greenberg Traurig, LLP, highlighted another benefit. Companies, who would rather be "more safe than sorry," are reporting any and all accounting deficiencies – even if they are not considered material weaknesses.

Douglas Carmichael, chief auditor of the Public Company Accounting Oversight Board, discussed the history behind Section 404. He emphasized that while it was established to reduce the probability of fraud, it can not entirely eliminate risk.

Mark Lilling, CPA, of Auditing Committee Consulting Team LLC, outlined Section 404's requirements. And Raymond Beier, a partner at PricewaterhouseCoopers, and Thomas Knudsen, a partner at Ernst & Young, described the effect of Section 404 on corporate governance. There has been greater involvement of audit committees and boards with respect to financial reporting and insuring that the numbers companies report are accurate. Marti Subrahmanyam, professor of finance and economics at NYU Stern, and a member of several corporate boards, noted that he had already seen the positive impact Section 404 has had on corporate governance.

Abby Joseph Cohen, chief US portfolio strategist at Goldman, Sachs & Co., noted that Section 404 has helped restore consumer confidence. Most Goldman Sachs clients, she noted, said they saw immediate benefits to 404 – either because they discovered problems they were able to fix before they became larger problems, or because 404 provided a spur to redesign their accounting systems.

In a sign that management of all types of companies are taking Sarbanes-Oxley to heart, panelist James Feely, director and chief financial officer at TDI Transistor Services, discussed why TDI, a private company, was considering complying with Sarbanes-Oxley now – in case management decided to go public in the future.