



Fallout from Enron, WorldCom, Tyco and others...You may be At Risk

By Richard A. Diamond ■ *Stradivarius Associates*

No one built an empire by playing it safe. Risk is the price of entry. Business leaders accept this. What often keeps them up at night is not knowing which risks to focus on. Is it the risk of implementing a new technology? Of security threats? Of losing intellectual property? Of alienating customers? Of making off-strategy investments? In this new column Broadband Properties identifies, sources, measures, prioritizes, and helps you manage the risks that stand between you and your business goals.

The groundbreaking Sarbanes-Oxley Act signed into law by President Bush in July 2002 will forever be remembered as the legislation spurred by corporate corruption, crooked CEOs and creative accounting. The Sarbanes-Oxley Act is a direct response to the deterioration in public confidence in financial governance institutions and recent scandals involving prominent public companies. Observers have referred to Sarbanes-Oxley as the most comprehensive reform of US securities law since the passing of the Securities Exchange Act in 1934.

The legislation is broad in scope and includes a number of important changes to the financial regulatory requirements of US based, publicly traded companies. Provisions set out in the Act are being implemented by the Securities and Exchange Commission

(SEC), which is now in the process of setting rules. "The Act adopts tough new provisions to deter and punish corporate and accounting fraud and corruption, ensure justice for wrongdoers,



and protect the interests of workers and shareholders," stated President Bush.

In reality, the accounting industry has been heading toward a major reform for many years. Now that it's here,

financial executives find themselves at a crossroads, facing the daunting task of implementing major changes in day-to-day operations, while at the same time quickly educating their staff on the sweeping changes brought on by proactive – but also reactive – legislation.

Current government and public questioning of business practices, values and standards of corporate America is placing the responsibility for ethical operations on management with little room for compromise.

The Sarbanes-Oxley Act of 2002 requires a new level of accountability around reporting a company's financial performance. While the certifying officers have always been responsible for and have been exposed to liability associated with financial and public reporting, Sarbanes-

Oxley has raised the stakes. The risks are higher and the consequences are more significant. The Act requires that CEOs and CFOs of publicly held companies:

- Certify the accuracy of financial statements and financial information issued by their companies
- Certify that "internal controls and procedures for financial reporting" have been designed and are in place
- Certify that "disclosure controls and procedures" are in place to ensure that all material information relating to

the company and its financial condition is made known to them

- Report that the controls and procedures for financial reporting and disclosure are effective (or identify material weaknesses)

Major Provisions of the Sarbanes-Oxley Act, specifically, the new law:

1. Establishes an independent auditing oversight board under the SEC;
2. Beefs up penalties for corporate wrongdoers;
3. Requires faster and more extensive

financial disclosure; and

4. Creates avenues of recourse for aggrieved shareholders.

Be the best you can be, or pay the price

Being a chief executive officer (CEO) of a company in today's business environment may not be as enviable a position as it once was. With these recent corporate scandals, the Sarbanes-Oxley Act requiring CEOs to sign off on financial statements, and penalties including jail time, forfeiture of bonuses and any profits realized from the sale of company securities, the role of the CEO has taken on a new dimension.

In the past five years, one in 10 public companies

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made financial restatements due to accounting irregularities, according to a report released on Oct. 23, 2002, by the U.S. General Accounting Office (GAO).

In explanation of the restatements, the GAO report cites weaknesses in corporate management and the restating companies, including auditors and boards of directors failing in their roles and securities analysts and credit rating agencies that did not find problems in time.

CEOs today need a clear understanding of the accounting policies applied to major transactions within their companies. The first step they should take is to meet with the CFO and the audit committee to ensure that they understand the processes that result in their quarterly statements.

The CFO, audit committee, and the company's independent auditors are key players that can provide the CEO with insights into how the company handles its transactions. And, the CEO's new responsibility to vouch for a company's financial statements creates a new paradigm in the corporate world.

Sarbanes-Oxley has been, in essence, a relief act for CFOs. Historically, the CEO was the one pushing the CFO in the direction of stretching the numbers. Now that CEOs must certify the financial statement, they can no longer say they weren't aware of the accounting practices taking place within the company, ignorance is not an alibi.

Restructuring the audit committee

The CEO's relationship with the audit committee is also evolving. In the past, the CEO would hand pick audit committee members who were compensated with company benefits, including stock options. Now, under Sarbanes-Oxley, audit committee members must be independent, which is defined

as not receiving, other than for service on the board, any consulting, advisory, or other compensatory fee from the company; and not being affiliated with

the purpose of Sarbanes-Oxley is congruous with the mission of the conscientious CEO and CFO – to maintain an open and honest relationship with the shareholders of the corporation. Responsible corporate directors and officers share an equal interest with the SEC in maintaining an open and honest relationship with investors.

While admittedly onerous, Sarbanes-Oxley is simply a much-overdue tool to help the directors and officers of the public corporation do the job they have been hired to do – the job they want to do on behalf of their shareholders.

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the company. These new rules will force audit committees to more effectively deal with the company's financial affairs, including involvement with the external accounting firm.

Trickle-down effect: Private Companies, Be prepared

While the provisions of the Sarbanes-Oxley Act apply specifically to public companies, honesty and integrity in financial reporting is required of public and private companies alike. Private companies are captured in the environment that the business world at large functions under, and are not insulated from the provisions of Sarbanes-Oxley.

In response to the act's provisions, management teams of private companies should establish an action plan that could be put into effect, if the company is ever required to meet some or all of the requirements of Sarbanes-Oxley.

It is also envisioned that the effects of Sarbanes-Oxley may trickle down to loan agreements, where banks may require private companies to provide certifications that are comparable to Sarbanes-Oxley. There will be some spillover into the private sector, but the jury is still out on how much.

The Sarbanes-Oxley Act of 2002 appears to make the jobs of the CEO and CFO of public corporations much more demanding, and complex. But

About the Author

Richard A. Diamond is the President & CEO of Stradivarius Associates which specializes in business strategy consulting for public and private companies around the world. He can be reached via email at rdiamond@stradass.com.

