THE SOX EFFECT

THE SARBANES-OXLEY ACT WAS MEANT TO RESTORE INVESTOR CONFIDENCE BUT THE ACT'S CHIEF EXECUTIVE **RICHARD RAEBURN** DISCOVERED THAT MEMBERS HAVE SERIOUS RESERVATIONS.

The US Congress passed the Sarbanes-Oxley Act (SOx) in July this year, in the expectation that it would serve to restore investor confidence and underwrite the integrity of financial information. The legislation has the potential to have a profound impact on the governance and behaviour of any business with a US listing.

Some of the key implications of the Act are:

- extraterritorial reach beyond the US;
- criminal sanctions for senior management in breach of certain clauses;
- enhanced disclosure based on rigorous internal controls reporting and certification by senior management;
- strict limitations on auditor provision of non-audit services; and
- independence requirements for audit committee members.

In September, we held a symposium to discuss the Act. I subsequently participated in an event organised by the *Financial Times* and, as part of the preparation for this, a group of our members, in senior positions with UK companies that have US listings, were asked to respond to a set of questions about the impact of the Act. The views of these members were summarised in the presentation I made that follows.

The questions to members were grouped into three main areas:

WHAT WILL BE THE IMPACT OF SOX ON LISTINGS BY UK COMPANIES IN THE US? Our members felt, for the most part, that there would not be a significant withdrawal from existing US listings, or a material reluctance to arrange new listings. There is a feeling US compliance has always been burdensome and that this is part of the price to pay for access to US capital markets. It is also recognised that there is an element in SOx that represents a move to create governance standards in the US that begin to approach levels already reached in the UK.

HOW FAR WILL INTERNAL PROCESSES NEED TO CHANGE TO ALLOW COMPLIANCE WITH SOX? There is a general expectation that internal sign-off procedures will immediately be formalised further, to support certification by CEOs and CFOs as to the integrity of their company's financial reporting (recognising the criminal sanctions that will now be in place for the individuals responsible for certification).

SOx introduces a requirement for an internal control report, including a statement about the effectiveness of controls, as part of the annual report. This is seen as going further than UK governance standards, with the need to apply qualitative judgement as to effectiveness rather than simply reporting factually on the existence of controls. The extent to which SOx's certification requirements are new relative to UK standards was summarised in terms of the introduction of personal liability, the need for enhanced formality in internal procedures and the challenge of attesting to the effectiveness of controls.

WHAT WILL BE THE IMPACT ON THE AUDIT PROFESSION? SOx introduces mandatory audit partner (but not audit firm) rotation. This is widely welcomed by the members involved in our discussions. However, SOx is also draconian in its requirement for a bar on all non-audit services. There is some feeling that this reflects an over-reaction: companies feel they are capable already of dealing with the issue and also that, in some cases, such as tax compliance work, the SOx bar on use of auditors will create unnecessary inefficiencies.

With the Act passed into law, the SEC in the US has been charged with establishing a set of rules for its application. At the time of writing, this process is still underway. What was clear from the SEC participation in the London event is that it is having to grapple with the requirement to document rules that are faithful to the intent of SOx, while recognising that the Act's impact on non-US companies could be highly damaging. For instance, under the terms of the Act, the presence of employee representatives on a German company's supervisory board, normal in the local context, would render the company in breach of the Act should that company have a US listing.

That the UK is much less affected by Sarbanes-Oxley (as broadly reflected in the responses made by our members) is testimony to the state of corporate governance in this country compared in particular with the US, but also to many other key economies. As we argued in the Association's submission to the Higgs consultation process, we look in the UK for some important improvements in governance (especially in a rigorous understanding of what independence means for non-executive directors) but do not consider there are glaring deficiencies in our systems. Sarbanes-Oxley will put further burdens on companies with US listings but should not dramatically change the playing field for those in the UK aiming to match best practice in standards of governance.

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