

Free Smaller Companies to Go Public by Rolling Back Burdensome Sarbanes-Oxley Accounting Rules

In CEI's last Agenda for Congress, we recommended that "smaller public companies be exempt from Sarbanes-Oxley's Section 404." Indeed, despite the rampant fervor of the past Congress to reregulate, enough members of both parties in Congress were concerned about the impact of the Sarbox accounting rules on smaller firms that they permanently exempted firms with market valuation of \$75 million or below.

This was a significant step, but Congress needs to go much further to lift Sarbox barriers to business and job growth. For new firms to expand and create more jobs, they need to be able to go public. And right now, Sarbox is one of the biggest barriers to small and midsize firms going public.

Sarbox was rushed through Congress in 2002 following the Enron and WorldCom scandals. These costly rules did virtually nothing to prevent the careless risks taken with mortgage securities that led to the financial crisis. "How can we have these levels of fictions in financials after Sarbanes-Oxley?" asked Jim Cramer, the colorful host of CNBC's "Mad Money." The answer is because Sarbanes-Oxley is actually counterproductive at ensuring financial transparency. As the *Financial Times* noted, the inordinate amount of time boards of companies such as the former Bear Stearns spend on

Sarbox compliance came at the expense of their scrutinizing overall business risk.

Mid-size companies need access to equity markets. The Act's Section 404 requirement for accountants to sign off on vaguely defined "internal controls" is costing American companies \$35 billion a year in direct compliance costs, according to the American Electronics Association. And it adds 35,000 extra man-hours for the average public firm, according to Financial Executives International. Congress should relieve this heavy regulatory burden by doing the following:

- **Expand the modest relief for smaller companies in the Dodd-Frank financial reform law so that more firms are exempt from Sarbanes-Oxley's Section 404 and other SEC rules that are a drag on the economy.** As seven Democratic members of the House Small Business Committee have noted, senior managers at these smaller companies "now have to choose between spending their time on vital business development functions or Section 404 compliance."
- **Repeal the "internal control" rules of Section 404 or make them voluntary.** The term "internal controls" is undefined in the statute and has been broadly defined by regulators. The Securities and Exchange Commission (SEC) has found that internal

control practices are seldom a tip-off to fraud.

- **Abolish the unaccountable Public Company Accounting Oversight Board (PCAOB) and make accounting standard setters accountable to the President and Congress.** Although the Supreme Court put some limits on the authority of the PCAOB—it made the agency subject to at-will removal by the SEC—the PCAOB still wields tremendous power without accountability. It levies taxes on all public companies, it

can discipline and fine auditors, and it is responsible for the broad interpretation of Section 404’s “internal control” provision. And the PCAOB wields this power without any presidential supervision and minimal SEC oversight. Congress should abolish the Board—giving authority over accounting back to the presidential appointees at the SEC, where it was before Sarbanes-Oxley.

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