

# Roll Back Burdensome Sarbanes-Oxley Accounting Rules

“How can we have these levels of fictions in financials after Sarbanes-Oxley?” asks Jim Cramer, the colorful host of CNBC’s “Mad Money.” Maybe because Sarbanes-Oxley (known as Sarbox) is an inherently flawed law: costly to entrepreneurs and investors, and 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.

Sarbox was rushed through Congress in 2002 following the Enron and WorldCom scandals. In the last two years, the law has come under criticism from all sides. House Speaker Nancy Pelosi (D-Calif.) has criticized aspects of the law and said that she supports revising it, to mitigate its “unintended consequences.” Similarly, Sen. John Kerry (D-Mass.), now chairman of the Senate Small Business and Entrepreneurship Committee, laments the law’s disproportionate effect on small business.

Congress should heed this call. Today, more than ever, it is essential for mid-size companies to have access to the equity markets, as the debt markets have dried up. 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 di-

rect compliance costs, according to the American Electronics Association. And it adds 35,000 extra man-hours for the average public firm, according to Financial Executive International. Congress should relieve this heavy regulatory burden by doing the following:

- Adopt the Securities and Exchange Commission’s (SEC) advisory committee recommendation that smaller public companies be exempt from Sarbanes-Oxley’s Section 404 and other SEC rules. A letter from seven Democratic members of the House Small Business Committee, including now-Chairman Nydia Velazquez, notes that 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. And the 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 standard-setters accountable to the President and Congress. Sarbanes-Oxley created this agency to enforce its accounting rules. Congress designated the

board as a private non-profit corporation appointed by the SEC—a structure that violates the Constitution’s Appointments Clause, which reserves such appointment power to the President or to the head of a cabinet department. The PCAOB 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. The PCAOB’s constitutionality now faces a court challenge, but regardless of that case’s outcome, 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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