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SOX, Lay and Videotape

Rules of conduct, whatever they may be, are not sufficient to produce good results unless the ends sought are good. – Bertrand Russell

Ken Lay died earlier this week. The former chief of Enron died of an apparent heart attack while awaiting an appeal of his recent conviction for conspiracy and fraud during his tenure at the helm of the former energy trading behemoth. Later that day, in an ironic twist, crude oil hit a new all time high.

Mr. Lay's death started me thinking about all the new regulations that were largely the result of the meltdown of Enron. Sarbanes Oxley (formerly known as SarbOx, now SOX), a.k.a. the Public Company Accounting Reform and Investor Protection Act of 2002, represents the latest attempt to clean up American corporations and reign in accounting firms.

The results so far have been spotty at best - a lot of near misses, unintended consequences, and rules created after the fact. In the unintended consequences category, accounting firms, a primary target of the bill, have seen their profits soar as the cost of understanding and implementing these new regulations has increased their billable time substantially.

Implementation and documentation of the new rules has been expensive. So expensive in fact that a surprising number of public companies are now seriously considering buying back enough of their own stock from public shareholders so as to qualify as privately held, and therefore not subject to the onerous requirements.

Some of the new rules seem so ridiculously self-evident that you wonder what was going on prior to the act. For example, the new rules *expressly* state that accounting firms that provide audit services to a company cannot also perform any of the following: bookkeeping or other services related to the accounting records or financial statements, management functions, investment advise or investment banking services, legal services and expert services unrelated to the audit. In other words, an audit firm should not review its own work. Duh.

Another new rule requires that the CEO and CFO sign a statement declaring that the financial statements are correct, and can face prosecution for knowingly and intentionally misrepresenting material facts. You might think, based on this legislation, that CEO's (who collectively earned $5.1 billion at the 500 largest U.S. companies - up from $3.3 billion the year before, according to Forbes) haven't already had this responsibility. Of course they have. Mr. Lay was prosecuted based on law that existed prior to the enactment of SOX.

Of course there is good news for some. Many of the same law firms that bled the tobacco and asbestos manufacturers are now into new deep pockets, and this time they have a target rich environment. Instead of only a few tobacco or asbestos related companies, the new law effects *all* publicly traded corporations. Class action suits against companies that have experienced a significant loss of share value have mushroomed. Unfortunately, not much of the money recovered from these suits will end up in the hands of the shareholders after the expenses and fees charged by these firms.

With Mr. Lay's death, the case against him is now in jeopardy. In prior decisions by the 5th Circuit Court of Appeals (where the appeal was to be heard), a person who dies prior to his appeal is completed cannot be considered convicted. This may also end the prosecutors' efforts to seize Mr. Lay's remaining assets as he may no longer be considered a felon. There is good news though. The lead prosecutor on the case, Leslie Caldwell, has already found new employment with the law firm of Morgan Lewis for a cool $1 million. Ain't life grand?