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Yes, You Do Need to Know about Sarbanes-Oxley

By Karen Berman and Joe Knight
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You've heard others talk about it, you've read about it in the newspaper and your senior leadership has probably discussed it with employees during a recent quarterly or annual review. Sarbanes-Oxley, sometimes called Sarbox or just SOX, is the law passed by Congress in response to the financial fraud that occurred in the late 1990s and early 2000s, and continues today. It has more than likely been a big focus in some of your key departments such as finance and accounting and IT and, of course, with your senior leadership team. But as executives and managers, why do you need to know about it? Because you are as responsible for cultivating and ensuring a fraud-free environment in your area of responsibility in your organization.

Sarbanes-Oxley addresses codes of ethics, financial reporting and procedures and processes. But it is also about becoming financially transparent, an approach to leading and managing that is one of the best ways you can personally prevent financial fraud in your organization. You may not be in a position to discover the kind of fraud that occurred at companies like Enron, but you do influence how the company is managed, and how people work. That influence is critical to creating an organization that is ethical, accountable, and financially intelligent.

Let's start with a brief overview of what Sarbanes-Oxley is and why it came about. Then we'll get to how your actions can lead to a financially transparent and responsible organization.

What Is Sarbanes Oxley?

Sarbanes-Oxley (SOX) was the government's response to financial fraud. Named after the two congressmen who wrote the law, it is the most important legislation affecting corporate governance, financial disclosure and public accounting since the U.S. securities laws were enacted in the 1930s, laws that were in response to the stock market crash and subsequent depression. In its essence, SOX was designed to improve the public's confidence in the financial markets by strengthening financial reporting controls and the penalties for noncompliance. It addresses codes of ethics (amazingly, Enron's Board of Directors gave its "approval to set aside its ethics statements...!"), financial reporting procedures and the responsibilities of CEOs and CFOs and all other employees. Here are just a few elements:

- * There must be procedures for employees to confidentially tip off directors to fraudulent accounting.
- * CEOs and CFOs must attest that the financial statements don't contain misrepresentations. (Some CEOs have used the "I didn't know" defense in court with varying degrees of success.)
- * Management is responsible for maintaining adequate documentation of internal controls and procedures in financial reporting. This is the one ruling you've probably heard the most about, given the impact on documentation from finance and accounting.

Why Did SOX Come About?

The financial fraud that caused Congress to write and pass SOX came in several varieties. But in the end, in every case, senior management hid the true performance of its business from the public, including shareholders, analysts, bankers and employees. Many of those leaders, by their actions, made themselves rich. Enron did it by creating partnerships that allowed management to move things off, and then back on, the balance sheet, making the balance sheet look healthier; Worldcom did it by inappropriately moving expenses from the income statement to the balance sheet (called capitalizing expenses); and Xerox did it by counting sales when they really shouldn't have.

Your Role

If we step back for a moment from the specifics of SOX, and look at the big picture, you can see the essence of the law is financial transparency. Financial transparency is the exact opposite of what Enron, Worldcom and others did. They hid the actual performance of their companies from the public. Financial transparency means that a reasonable investor, shareholder and/or employee can review the financial statements of a business and really know what is going on. A financially transparent company wants all those interested to understand its financial position because it believes that making things clear in the financial statements leads to a stronger business. Managers and leaders in today's organizations are on the frontline of creating financial transparency. It is mandated by law, and it is good business practice.

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Let's make it clear that financial transparency isn't just about numbers. It is also about ethics and accountability, and about communication and education. Below are two questions that incorporate the essence of financial transparency inside a company:

1. To what extent do employees trust that management is telling them the truth?
2. Is there a common language used throughout the organization to talk about the business?

Financial transparency is the answer to both of these questions. When employees, managers and leaders understand how the company makes money, how it measures financial success and its current results and goals, trust increases and communication improves. Employees see that their work makes a difference, and managers and leaders have the opportunities to talk about the current situation and how their department or area of responsibility can make a difference in improving the results. Financial transparency, which consists of educating everyone about the numbers and then sharing the numbers on a regular basis, creates a trusting environment and a common language. Ethical conduct increases, accountability increases and the environment in which fraud flourishes disappears.

OK, So What Can I Do?

Here are some first steps to creating financial transparency in your organization:

- * Learn about your company's numbers. Be sure you understand the financial statements, and how your department contributes.
- * On a weekly or monthly basis, discuss results with your staff. Share the current situation and how they can focus their efforts on the company's goals.
- * Keep educating and sharing, in good times and bad. If you stop after a few months, you've done more harm than good. In good times, everyone knows they participated in that success. In bad, everyone pitches in because they know how their job makes an impact.

Not only do these simple steps take you a long way to your responsibility when it comes to financial transparency, you'll find there are lots of benefits, too, like:

- * You'll manage better. When you know the financial situation and goals of the company, you'll make better decisions.
- * You'll see a change in your employees. They will work better as a team and be more focused on what is important.
- * You'll see a change in your organization. As you do your part, others will follow, and your principles will contribute to the ethical foundation of your company.

Financial transparency truly does mean there is less likelihood of another Enron debacle. It is interesting to note that virtually all of the corporate scandals were uncovered by an employee inside the company, someone who understood finance and accounting, saw that something was wrong and spoke up.

Author Bios:

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