**ACCT 331/531 – Financial Accounting II**

**Spring 2016**

The impact of the Sarbanes-Oxley Act on corporate financial reporting

Name: Zixin Wang

Instructor: Ling Lisic

G number: 01003298

**Introduction**

In this day and age, we are living in a highly developing world, and with the development many problems have come out to us, especially the economic issue. Finance plays an important role in our daily lives, and most things need currency to transact. Hence, it is easier to trigger a problem of people, company or market. There is a company, Enron Corporation, which was one of the world’s top energy companies. However, because of corruption and fraud, the company had to go into bankruptcy (Vakkur & Herrera-Vakkur 2012). This incident not only led to related corporations paying the huge cost, but also had a strong impact on the American and British governments. In order to avert another mistake, the government would set up many acts to perfect management systems. There is an act which was promulgated in 2002 after the Enron event, the Sarbanes-Oxley Act, which is mainly about strengthening the supervision of internal accounting of enterprises, compulsory external audits, and increasing punishment levels for criminal fraud (Hoyle, Schaefer, & Doupnik, 2011). This act is one of the most far-reaching pieces of American reform. In the meantime, it also makes a great impact on corporation financial reporting.

**Impact**

The SOX Act signally improves the reliability of financial reporting. As the stipulation of the Sarbanes-Oxley Act, the company is asked to provide the true financial report and annual report to the SEC (Griffin, 2005; Donaldson, 2005). Thus, the corporation would pay more attention to correct the error before the Act was set. For example, Griffin (2005) expounds that the company could find the old system has a loophole. To be up to the SOX Act standard, the company has to perfect their fundamental IT system and the process of internal governance. The company management becomes more efficient and consummate than before. As a result, these improving would lead the investor to have more dependable information which can impact the investment decision (Gibson, 2012). All of these would be a positive impact on the future development of the market. Although the SOX Act has many benefits for public or government, it also has a disadvantage for the corporation, that is the cost of financial reporting improvement is huge (Allison, 2003). It is obvious that the spend of building a new system or repairing a system is enormous. Furthermore, the corporation also needs to invest the money and time to file an annual report (Gibson, 2012). Therefore, in the long run, even though there is a problem about cost, the investment in the complete financial reporting system is worthy. It would not only improve the reliability of financial reporting, but also increase the reliance of investors which can attract more financial support.

The SOX Act increases the transparency of financial reporting for investors or the public. The reliability is the basis for the process of complete supervision. It is a more far-reaching effect that the Act requests the company to enhance their financial report disclosure, such as off-balance sheet transactions, off-balance sheet transactions, material current events and internal management (Clark, 2012; Donaldson, 2005). These various of disclosures could cause the fraudulent activities decrease such as inflated stock prices, misused of capital reserves and changed in earnings management (Cohen & Dey & Lys, 2007; Iliev, 2010). In addition, the supplementary information would raise the alertness of administrator, auditor, and investor than before (Cohen & Dey & Lys, 2007). Whereas the transparency of financial reporting provides many advantages for the investor, there is a disadvantage for them too. Some corporations abide by SOX Act law, but they would keep these disclosures as a quiet restatement which is difficult for investors to find (Burks, 2011). Hence, there is also much insufficient need to be completed in the future evolution.

**Conclusion**

As a general view, the Sarbanes-Oxley Act is successful for the capital market. In the meantime, it also is a thruster for many Acts’ establishing. The SOX Act not only makes the financial reporting becomes more credible, but also boosts the disclosure of financial reporting. Meanwhile, the SOX Act also improves the investor’s confidence with these public companies. Nevertheless, the system is not perfect now, we should continue to pay attention to enhancing it to avoid the cheating activity happened. (*Words* 700)

**Reference list**

Griffin, J. (2005). Life after sarbanes-oxley compliance.*DM Review, 15*(3), 10. Retrieved from <http://search.proquest.com.mutex.gmu.edu/docview/214673906?accountid=14541>

Vakkur, N. V., & Herrera-Vakkur, Z. (2012). Ripple effects: Sarbanes oxley's impact upon investor risk in a global economy.*Review of Accounting & Finance, 11*(2), 184-205. doi:http://dx.doi.org.mutex.gmu.edu/10.1108/14757701211228219

Donaldson, W. H. (2005). Testimony Concerning the Impact of the Sarbanes-Oxley Act. *U.S. Securities and Exchange Commission.* Retrieved from <http://www.sec.gov/news/testimony/ts042105whd.htm>

Hoyle, B. J., & Schaefer, T. F., & Doupnik, T. S. (2011). Advanced accounting (10th ed.). *New York: McGraw-Hill Irwin.*

Gibson, C. H. (2012). Financial Reporting and Analysis. *Cengage Learning.*

Cohen, D. A., & Dey, A., & Lys, T. Z. (2007). Real and Accrual-Based Earnings Management in the Pre- and Post-Sarbanes Oxley Periods. *AAA 2006 Financial Accounting and Reporting Section (FARS)* Meeting Paper.

Allison, F. (2003). One Year Later, The Impact of Sarbanes-Oxley. Retrieved from http://www.forbes.com/2003/07/22/cz\_af\_0722sarbanes.html

Ugrin, J. C., & Odom, M. D. (2010). Exploring Sarbanes–Oxley’s effect on attitudes, perceptions of norms, and intentions to commit financial statement fraud from a general deterrence perspective.*Journal of Accounting and Public Policy,* 29(5), 439-458.

Clark, K. N. (2012). The Effects of Sarbanes Oxley on Current Financial. Retrieved from http://digitalcommons.liberty.edu/cgi/viewcontent.cgi?article=1303&context=honors

Iliev, P. (2010). The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices. *Journal of Finance*, 65(3), 1163-1196.

Burks, J. (2011). Are Investors Confused by Restatements after Sarbanes-Oxley? *The Accounting review.* 86 (2), p. 507 - 539.