Too Many Bells?  Too Many Whistles?  Corporate Governance in the Post Enron, Post WorldCom Era

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When the pendulum swings, it swings too far. The Enron debacle, both ending and beginning with a bankruptcy in December, 2001, and a perfect storm in governance terms, was the first to nudge the pendulum. WorldCom's bankruptcy, in July, 2002, resulted in loses for millions of investors, and caused the pendulum's swing to gather speed. By all accounts, the July 30, 2002, Sarbanes-Oxley legislation\(^1\) pushed the pendulum past the centerline, how far being the principal disagreement. Adelphia Communications, Tyco, HealthSouth, Global Crossing, Marsh & McCellan, Hollinger International, and other

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\(^{\text{1}}\) Pub. L. 107-204, 11 Stat. 745 (2002). The official popular name is the Public Company Accounting and Investor Protection Act of 2002. Popular appellations include SOA and SOXA, as well as SOX.
governance imbroglios have pushed the pendulum further.  

The pundits, law professors, corporate governance advocates, commercial providers, and other reformers, though, continue to write on, unaware that this reform is breaking real world backs. Their unstated assumption is that, in corporate governance, more is always better: more board meetings, more audit committee meetings, longer meetings, longer meeting still, more certifications, more internal controls, new often untried, documentation of those controls, added auditing devices, beefed up gatekeepers, new gatekeepers, separate counsel for independent directors - the list goes on, with few questions asked about the marginal utility of all this. The pendulum may have been pushed all the way, fully against the stops.

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This article’s purpose is threefold. First, the article attempts to give an insight into the costs of (but not detail) the legislatively mandated corporate governance reforms. Second, the article attempts to survey the reforms which reformers would have layered upon the reforms Sarbanes-Oxley dictates. No one has attempted a snapshot, let alone a comprehensive picture, of the cumulative toll all of this corporate governance reform poses. Third, the article makes some suggestions that may have the effect of pulling the pendulum toward the center line.

**Background.** A number of entities and individuals watch over the modern corporation and its performance. In modern parlance, those who earn their

livelihood doing so are “monitors.” The corporate governance “monitoring model” focuses on the board of directors, the subgroup of independent directors, and the committees of the board, most particularly the audit, nominating and compensation committees. With little effort, however, one can total up no less than 12-13 watchdogs or “monitors” of corporate performance, investors, whether public or private, aside:

- The board of directors.
- Independent directors.
- Committees of the board, including the audit committee.
- Debt rating agencies.
- Accounting firms.
- Lawyers and law firms.
- Securities brokers (“registered representatives”) and analysts.
- The NYSE or NASDAQ (self regulatory agencies).
- Specialized government agencies (for example, FERC or state PUCs).
- Financial press (television, magazines, and newspapers).

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Modern corporations cannot continue their existence as publicly held firms without the certification or approval of certain of these monitors, such as the board, independent directors, the audit committee, a public accounting firm, a multi-service law firm, the SEC, perhaps a specialized agency or two, both at the federal and at the state level. Those monitors whose certification is essential are “gatekeepers,” “reputational intermediaries who provide verification and certification services” both to corporations and investors. Without them, the corporation ceases to move forward.

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5. See, e.g., Douglas M. Branson, Enron - When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform, 48 Vill. L. Rev. 989, 996 (2003).

Certain monitors may be mere monitors to some corporations while they are gatekeepers vis a vis other companies. Debt rating agencies thus may be monitors with regard to some issuers of bonds, who regard their debt's rating interesting but not essential. The same agencies may be gatekeepers for other issuers for whom, like Enron, a high rating is essential for continued access to markets. Some commentators eschew the terminology as having “no analytical utility or legal significance.” Nonetheless, in the post Enron era the gatekeeper terminology has become ubiquitous.

Darwin's “survival of the fittest” seems to apply to gatekeepers' evolution and the roles they play in corporate governance. Over the years certain gatekeepers' influence ebbs while others' increases. As law morphed from a profession to a business, the attorney's role lessened from that of a deal guru and wise counselor to that of a technician that could be replaced by any of several others, many of whom might perform the task more cheaply. Public accounting, once universally regarded as a repository of integrity and probity, had become a commodity offered at prices which met or undercut those of competitors. By contrast, the financial press, arguably more a monitor than a gatekeeper,


gathered strength and prospered. Seemingly, each corporate earnings report has become the source of a news story while 20 or 30 years ago earnings were simply numbers the press reported in the back pages.

One widely used approach to SOX is to view it as an attempt by Congress to reverse this Darwinian slide, bolstering up certain of the gatekeepers. The statute takes “off the shelf” many, sometimes conflicting, structural devices that may help restore gatekeepers to their rightful positions. Other provisions put gatekeepers in positions that they have never occupied. Overall, a principal SOX focus is on “gatekeeper accountability.”


professionals ....") (footnotes omitted); John R. Kroger, Enron, Fraud and Securities Reform: An Enron Prosecutor’s Perspective, 76 Cl. L. Rev. 57, 59-60 (2005) (since the 1930s, our regime has relied on five sets of gatekeepers: “independent auditors, corporate boards of directors, private securities analysts ... securities regulators” and “prosecutors”).
A Selected SOX Reform or Two. Business and law articles and even entire treatises have devoted themselves to what SOX provides, criticisms of it, recommendations of how to implement it, and installation of structures and devices which, will not required by SOX, support SOX’s implementation.\(^1\) This article merely recounts one controversial “reform” measure SOX mandates to give flavor to and create context for the main subject, “beyond SOX,” or “SOX Plus,” and “just how much might all of this cost?”

SOX section requires that senior executives of public companies attest to the efficacy of internal accounting controls.\(^1^2\) They must also see to it that public accountants supply a similar attestation.\(^1^3\) Managers and accountants must do so in the lengthy, gray annual report public companies file with the SEC each year on SEC Form 10K.\(^1^4\)

\(^1^1\) See, e.g., MARC I. STEINBERG, ATTORNEY LIABILITY AFTER SARBANES-OXLEY (2005); Larry Ribstein, Sarbox: The Road To Nirvana, 150 Mich. St. L. Rev.1 (2004); Ribstein, Market v. Regulatory Approaches to Corporate Fraud: A Critique of Sarbanes-Oxley, 28 J. Corp. L. 1 (2002); articles cited supra note 2,

\(^1^2\) SOX § 404(a).

\(^1^3\) SOX § 404 (b)(accountants).

SOX also requires that firms file periodic reports with the SEC on an “accelerated” basis. Firms must file 10K’s within two, rather than three, months after their fiscal year closes.\textsuperscript{15} They must eventually file quarterly reports, which remain unaudited, within 35 days after a quarter closes.\textsuperscript{16} I include these more mundane SOX features only because thus was born the nomenclature, “accelerated filers,” which has come to loom large in the SOX section 404 attestation rule context.

Large teams of expensive accountants soon descended on public companies. These accountants examined each and every accounting control, or the deficiency or absence of controls. They required installation of new controls and documentation of each and every control.

Some of this exercise proved beneficial. Expert accountants define internal controls as devices which cause managers to “squeeze the numbers” as they ascend up through the corporate organization, eventually contributing to the numbers the corporation publishes on its financial statements. With adequate controls, senior managers have increased assurances that the final numbers reported reflect economic reality. Thus, for example, internal controls require that at each and every juncture managers certify revenues, costs and other

\textsuperscript{15} See SEC Release No. 33-8128 (Sept. 5, 2002).

accounting numbers, in a work center, at a plant, within a division, on up to a subsidiary, and on to the parent corporation's income statement and balance sheet, as those numbers percolate up through an organization.

Much has also proven to be trivial:

Examples of remedial actions pressed upon companies by auditors in connection with 404 reviews include the following: having the technical support “help desk” document every call it receives from employees; requiring employees to respond to thousands of emails to prove that they received them; proving that all the physical keys to an office in Europe have been accounted for since it opened in 1995; and requiring an auditor to attend a meeting to prove that it took place. More generally, since those items have a tendentious flavor, the section 404 attestation requirement is costly because it has pressed companies to document control processes much more fully and elaborately; to define and enforce restrictions on access to information technology systems; to separate accounting and financial functions, even in smaller offices ....


See also Honesty Is the Best Policy, Business Week, Oct. 27, 2005, at 100:

[M]anufacturers will have to prove that they can trace products from assembly line to customer. Temp agencies will have to show that the
A large portion of the expense stems from SOX section 404 requirements that corporations prove the negative, or demonstrate a higher certainty that such is the case.\textsuperscript{18}

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\textsuperscript{18} Bulkeley & Forelle, \textit{supra note}, for example report that recent corporate scandals show that at many companies “the process can still be ripe for manipulation”:

Employees can make false entries in the database, modify the dates of transactions or generate unauthorized expenditures.

Sarbanes-Oxley aims to curb these abuses. ... Companies need to demonstrate to auditors, for instance, that their programs are configured to reject bogus entries after the close of the quarter, or that they have a security system in place that would stop a rogue employee from writing himself a giant check.
An unintended consequence at accounting firms themselves is that many capable accountants, rather than be dragooned in section 404 compliance work, which often has to be performed on the road and away from home for days at a time, are leaving public accounting.\(^{19}\)

\(^{19}\) Conversation by the author with a departing Ernst & Young partner, Pittsburgh, PA, Oct. 8, 2005.
SOX put also into law restrictions the SEC had adopted in 1999 in the form of regulations.\textsuperscript{20} Public accounting firms may no longer perform 9 categories of “consulting services”\textsuperscript{21} ranging from in-house accounting and human resources to mergers and acquisitions and actuarial work or fairness opinions, at least for clients whose financial statements the accounting firm audits. For firms, auditing may no longer be offered as a loss leader but must stand on its own bottom. Section 404 attestation work, and the auditing and documentation that goes with it, have surpassed consulting as profit centers. For accountants, or at least many of the best and brightest of them, more and more they feel as though their specialties and seniority are being stripped away from them.

\textsuperscript{20} These are the so-called Leavitt reforms, mandating separation of auditing and consulting, which are in turn based upon the recommendations of an American Bar Association Blue Ribbon Committee on audit committee reform. See, e.g., 17 C.F.R. § 210.2-01(c)(4)(i)-(ix)(2002).

\textsuperscript{21} SOX § 201 (a)(requirements for “independence,” which still permits firms to undertake comfort letter writing in securities offerings and tax work). Of the 52 million Arthur Andersen billed Enron in 2000, 25 million represented auditing work while the rest represented consulting services. See, e.g., Branson, supra note 5, at 1010.
The SEC originally estimated that section 404 attestation would cost $91 thousand per corporation.\textsuperscript{22} At the outset of the exercise, the SEC estimated $2 million per firm.\textsuperscript{23} At nearly the same time, 217 “mid cap” companies estimated that the new procedure would add $3.14 million to per company compliance costs.\textsuperscript{24} The same companies reported average numbers at $4.36 million, or almost 40 percent more than estimates. They reported a 66 percent rise in external costs for consulting, software and the like, and a 58 percent rise in the fees they had estimated public accountants would charge. The number of person hours for 404 compliance averaged 26,758.7. Autodesk, a California company whose capitalization is $10.2 billion, reported spending $6 million and expending 28,000 person hours in the first year of section 404 attestation.\textsuperscript{25} The aggregate

\textsuperscript{22} SEC Release No. 33-8238, at n. 174 (June 11, 2003).


\textsuperscript{24} Rachel McTague, \textit{FEI Finds that Actual Costs of Compliance with SOX Section 404 Exceeds Estimates}, \textit{id.} No. 37-13, March 21, 2005, at 576 (Mar. 28, 2005). Although the definitions are imprecise, under one common formulation, a mid cap company would be one whose market capitalization exceeds $1 billion but is less than $5 billion.

\textsuperscript{25} \textit{Id.}, No. 37-8, Feb. 11, 2005, at 333 (Feb. 21, 2005). The large national law
cost SOX 404 imposes has been estimated at $35 billion per year.\textsuperscript{26}

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\textsuperscript{26} American Electronic Association Report, \textit{supra} note 17, at 2.
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In subsequent years, presumably, corporations will have lower compliance costs in order to obtain the needed section 404 attestations. Lower costs have not stopped the proliferation of SOX consulting firms and products. Two of Forbes's top 14 small cap stock picks for 2006, Corporate Executive Board, Inc., and Resources Connection, Inc., are SOX consulting firms. Large consulting firms such as IBM or Accenture and Bearing Point, the latter two consulting firms spun off from Big 4 (formerly Big 5) accounting firms, as well as smaller entities such as Mercer Delta Consulting, Hyperion Solutions, Inc., Movaris, and Shareholder.com, aggressively market SOX services, including section 404 attestations. All the software firms have SOX products as well, ranging from the bigs (Oracle and Microsoft) to the small (Paisley Consulting of Cokato,

27. *Fourteen Favorites*, Forbes, Oct. 31, 2005, 171, at 174. As of Nov. 12, 2005, the corporations had market capitalizations of $3.42 billion and $1.39 billion, respectively.

Projections are that corporations will spend $7.5 billion per year on SOX software.²⁹

Finally, with a stroke that will hold the line on corporations’ costs, a Federal District Judge held that, in enacting SOX, Congress had no intention whatsoever of creating a private right of action to investors allegedly aggrieved by violations of SOX.³¹ The holding is a death knell to class actions for damages in cases of SOX violations by corporations. At least corporations do not have to worry (for now) about liability to investors for SOX violations.

²⁹ Peter Loftus, Software for Sarbanes-Oxley, Wall St. J., April 25, 2005, at R-8 (also reviewing products and services of Browne & Co., EMC Corp., Steelent, Inc., Global Compliance Services, and Resources Connection, Inc.).


Praise and Criticism for SOX. Evidently believing that the SEC has been taking names, at least in their public pronouncements, public company officials have been timid in their criticism, or have praised SOX, albeit faintly so. The CEO of a small cap manufacturer of industrial products says that SOX requires “a lot more” documentation, makes it harder to recruit board members, and is “especially burdensome for small cap firms.”\(^\text{32}\) The Enron restructuring officer reports that SOX provides a “‘very helpful’ blueprint for reform.”\(^\text{33}\) The representative of a large institutional investor (the Ohio Public Employees Retirement System) thinks that SOX is “a step in the right direction.”\(^\text{34}\) A general counsel believes that “there is a lot more right than wrong” and a corporate governance watchdog says she “wouldn't make any ‘substantive changes.’”\(^\text{35}\) The chief accounting officer of a well know large cap corporation opines that “Sarbanes Oxley is working well.”\(^\text{36}\)


\(^\text{33}\) \textit{Id.} (remarks of Stephen Cooper).

\(^\text{34}\) \textit{Id.} (remarks of Cynthia Richson)(internal quotation marks omitted).

\(^\text{35}\) \textit{Id.} at R-9 (remarks of Logan Robinson and Nell Minow).

\(^\text{36}\) \textit{Id.} (remarks of Arnie Hanish at Eli Lily & Co.).
The more outspoken of SOX's sponsors, Representative Michael G. Oxley of Ohio, weighed in with comments that SOX's costs are “insubstantial” and “eminently reasonable.”\(^{37}\) In a speech at the World Bank on September 16, 2003, Representative Oxley pointed out that “retail investors came back to the markets after nearly two years of scandal and plummeting fortunes. ... [w]e had a small part in restoring that investor confidence.”\(^{38}\) The now former Chairman of the SEC, William Donaldson, touted SOX as a “valuable government intervention,” one which “helped to improve the ‘tone at the top’ of U.S. public companies.”\(^{39}\) The NASD’s President joined the chorus, stating that “[u]nlike some others on Wall Street, I support Sarbanes-Oxley. It’s a good thing ... serious legislation that struck a responsible


\(^{38}\) Richard Hill, Oxley Says Returning Investors Signal Renewed market Confidence, Success of Law, id., No. 35-37, at 1550 (Sept. 22, 2003).

\(^{39}\) Donaldson Cites Sarbanes-Oxley As `“Valuable Government Intervention,” id., No. 36-44, at 1969 (speech sponsored by Detroit Economic Club and the University of Toledo School of Law, Oct. 29, 2004)(Nov. 8, 2004).
compromise.”40 The God-like Alan Greenspan, Federal Reserve Chairman, found SOX “proving surprisingly effective,” revealing he had been “an early and passionate advocate in internal deliberations to make chief executives more accountable.”41


On the private side, a large public accounting firm took out a full page advertisement in a national newspapers, stating (without empirical support) that “to see the real impact of 404 - improved investor confidence evidenced by a better capital allocation process - will take more than a few months.”

For the most part, academics have been outspokenly scornful in their criticism of SOX. In an op-ed piece, one leading scholar questioned “strict enforcement of Sarbanes-Oxley in spite of mounting evidence that it is costly beyond any conceivable benefits.” The U.S. Chamber of Commerce President has been strident in his criticism. He calls the costs of section 404 to be “unjustified” and labels the SEC as “over-reaching” in its administration of the statute. In an earlier pronouncement, he expressed the conclusion that SOX

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produces a “risk averse economy,” “puts too much of a burden on executives and officers to be perfect,” and “has created enormous uncertainty.”

On its editorial page, the *Wall Street Journal* has been profuse, and colorful, in its criticism. Bemoaning the cost of section 404 compliance, the Journal editorial notes that SOX “did achieve one miracle. The accounting profession - reviled as the moral equivalent of porn merchants just two years ago - has been lofted to unexpected new heights of power and prosperity.” Big 4 accounting firms raised their audit fees 50 percent per year; the writer reports that the accountants expected to do the same in 2005 as well. *Fortune 100* corporations paid $6 billion in fees in 2003. Among the *Fortune 500*, the average fees individual firms paid for auditing rose from $2,930,000, in 2001, to $7,443,000, in 2004.48


Other critics have chosen to remain out of sight, or be lukewarm in their denunciations. Overall, among the public pronouncements, praises outweigh the criticisms.

**Calls for SOX II.** Extremely knowledgeable commentators have called outright for amendments to SOX 404, deleting the requirement for accountants’ attestations and possibly altogether for small cap and, possibly, some mid cap corporations.\(^{49}\) For those companies, section 404 is regressive. Corporations must pay out a large portion of the $2-3 million per year from a much smaller revenue base. Because their products may be unestablished or experimental, even before SOX many of these companies teetered on the brink of profitability.

Indeed, the cost of compliance may be much higher for many smaller corporations. For years, large companies have had in place internal accounting staffs which had, as a principal task, evaluation, implementation, and documentation of internal controls of the type SOX requires. Internal accounting functions barely exist at smaller corporations, if they exist at all. For practical purposes, with section 404 exercises, most small cap companies began from scratch, writing on a clean slate. On a relative basis, their costs are much higher.

\(^{49}\) Clark, *supra* note 9, at 29.
The one size fits all mind set also persists, forcing smaller companies to do, or feel that they must undertake, the same SOX tasks as larger companies, as for instance in the installation and verification of internal controls. In addressing the European Parliamentary Financial Securities Forum, SEC Commissioner Paul Atkins blames the PCAOB, which by its thick, gray Auditing Standard Number 2, notable for “sheer length and tone ... has contributed to an excess of caution and an emphasis on endless detail.”

Commissioner Cynthia Glassman is more colorful: “a company having 40,000 key [internal] controls is an oxymoron. How can they all be key?”


One growing category of small cap company had been foreign issuers who sought to have their shares listed on the NYSE or traded NASDAQ. As an example, Professor Jack Coffee point to the number of Israeli high tech firms that sought U.S. listings in 1999 and before.\textsuperscript{52} He has predicted a continued migration of listings to the U.S. which saw 750 foreign listings in 2000, compared to 170 in 1990, as firms sought to associate with stricter corporate governance regimes.\textsuperscript{53}

\textsuperscript{52} John C. Coffee, Jr., \textit{The Future As History: The Prospects For Global Convergence in Corporate Governance and Its Implications}, 93 Nw. U. L. Rev. 641, 675 (1999)(more than 100 Israeli firms, of which 70 are high tech, listed on NYSE, NASDAQ or AMEX).

\textsuperscript{53} Coffee, \textit{Race To the Top? The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance}, 102 Columb. L. Rev. 1757, 1770-71 (2002)(noting that by 2002, 17\% of the 3300 firms with NYSE listings were foreign).
Post SOX much of the discussion has been either solely rhetoric, or a combination of rhetoric with anecdotes, concerning withdrawal from U.S. markets. An editorial asserts “concern about the number of European and Asian companies delisting from, or not listing on, U.S. exchanges, to say nothing of a drastic decline in IPOs.”54 “Mexican Firms Leave NYSE" profiles the departures of conglomerate Desc SA and steel manufacturer Grupo Imsa SA but contains no statistics.55 Another piece outlines some of the reasoning, over and above the costs of SOX compliance. Capital markets in home countries tend to be much deeper and more liquid than they once were. With computerized trading mechanisms such as E*Trade and Charles Schwab, U.S. investors find it much easier to access those foreign markets. Large European companies, such as VNU, Roche, and Addidas-Solomon, think a U.S. listing to be “expensive and ... a


lot of extra work."\textsuperscript{56} For corporations on or close to the fence, the SOX compliance cost has been a tipping point against a U.S. listing.

The statistics demonstrate that delistings by foreign corporations are not as frequent SOX critics predicted. The NASDAQ had ten delistings in 2003. The NYSE had just two in 2003 and two in 2004. Delisting is difficult because the foreign firm must demonstrate that the number of U.S. resident holders of a class of its equities has fallen below 300, but, in December 2005, the SEC adopted new rule 12h-6, which makes it substantially easier for foreign firms, or those in good standing, to terminate their registrations.

Instead, what the numbers demonstrate is that, rather than deregistrations of firms already resident, the number of foreign corporations coming to U.S. shores, seeking listings, has gone from a robust stream to a mere trickle. From peaks of 63 in 1997, and 60 in 2000, the number of foreign firms seeking an

57. Greifeld, supra note 40, at A10.


59. See, e.g., David Epstein, Goodbye, Farewell Auf Wiedersehen, Adieu ..., Wall St. J., Feb. 9, 2005, at A10 (“the barriers to deregistration are formidable”).

NYSE listing has fallen to 16 in 2003 and 8 in 2004. Experts and firms themselves cite SOX compliance as the culprit.\textsuperscript{61}

\textsuperscript{61} Ascarelli, \textit{supra} note 58, C1, at C16.
Besides call for amendment or repeal of SOX section 404, at least for small cap companies, well respected commentators have called for and outlined SOX repeal or accommodations for foreign corporations.

**The SEC Response: Delayed Implementation.** In the eyes of some, the SEC response has been lukewarm. The first responses were that large corporations had to file 404 attestations on SEC annual report form 10K for fiscal years ending after June 15, 2004, or in the 10K for 2004 for calendar year reporters. Smaller corporations would have to do so for years ending after August 15, 2005, or in the 10K for 2005 for calendar year filers. The


64. Large Companies Expect to Spend Millions to Meet SOXA Internal Controls
Commission took a tough stance, noting that “improved corporate governance, improved financial reporting, [and] improved auditor performance is important for all companies, regardless of size.”

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Early the following year the SEC began to take a more middle-of-the-road, accommodating stance. The SEC delayed 404 filings for companies with a market capitalization less than $75 million until fiscal years ending after July, 2007. SEC Chairman Donaldson took note of that and of another delayed implementation for foreign corporations. He also publicized an SEC website the Commission had created so that “all interested parties can send us feedback on their experiences with Section 404.” Nonetheless, the SEC Chairman labeled cries for a partial repeal of SOX to be “short sighted.” The SEC also founded a 21 member Advisory Committee on Smaller Public Companies which held its first


meeting in April 2005.68

In September 2005, the SEC relented still further. It announced a three-tiered regulatory format, consisting of “large accelerated filers” (market cap over $700 million), “accelerated filers” (market cap under $700 million), and “non-accelerated filers” (market cap under $75 million). The latter category numbers over 6,000 public companies which will not have to comply until after mid 2007. The Commissioners also exempted the middle category from the accelerated annual 60 day and quarterly 35 day filing deadlines.

Critics of SEC accounting regulation were quick to speak out, “crying foul” over delayed implementation and what wags have termed “SOX Lite.” An accounting professor noted that approximately 75 percent “of companies that were the subject of fraud allegations ... in SEC enforcement releases from 1998 to 2003 had market capitalizations of less than $700 million.” “A good internal-control system within these companies would have prevented a good number of those,” stated another accounting teacher.

69. SEC Sets Meeting Date to Consider Extending Compliance Date for Internal Controls Rules, id., No. 37-37, at 1555 (Sept. 19, 2005)(amendments to the definition of accelerated filer in SEC Rule 12b-2).


71. Michela Rapoport, Watchdogs Frustrated by Sarbanes-Oxley Extension, Wall
Studies flatly contradict the latter. Fraud and accounting imbroglios come to light because of a tip (42.6 percent), by internal auditing (24.6 percent), through an accident (18 percent), by outside auditors’ discovery (16.4 percent) and, only last of all, by virtue of an internal control installed earlier (8.2 percent).  

Because of the costs involved, and their desperate attempts to hold the line on costs, smaller and other corporations are “outsourcing” SOX section 404 attestation work to India and other lower cost countries. 

Sun rosa, however, executives at a number of smaller cap public companies find themselves unable to obtain an accounting form to do SOX 404 attestations at all, or to do them at a price anywhere near what companies feel they can afford. The condition is so widespread that it has even taken on a name, “Sarbanes-Oxley limbo.” In Roman Catholic teachings, at least of the old fashioned kind, limbo is “a region believed to exist on the border of hell as the abode of souls barred from heaven through no fault of their own (as souls of ... unbaptized infants).” Corporations’ inability to comply at all may well have

72. Clark, supra note 9, at 28-29.

73. See, e.g, Eric Bellman, One More Cost of Sarbanes-Oxley: Outsourcing to India, Wall St. J., July 14, 2005, at C1 (SOX 404 costs of $5.5 billion in 2004 and $5.8 billion in 2005).

74. WEBSTER’S THIRD INTERNATIONAL DICTIONARY (Unabridged) at 1312
played a part in the SEC decision to delay implementation to mid 2007.

(2002) (secondary definitions include “a place or state of restraint or confinement ... [or] of neglect or oblivion”).
Beyond SOX (or SOX and Beyond). Despite the costs this article describes, at least in small part, corporate governance advocates and reformers layer added requirements over what SOX requires. There is a first generation of “best practices” blueprints in corporate governance. In the U.S., they include the General Motors 29 Points and the American Law Institute Principles of Corporate Governance and Structure. Elsewhere in the world sources include

75. GENERAL MOTOR BOARD OF DIRECTORS, GM BOARD GUIDELINES ON SIGNIFICANT CORPORATE GOVERNANCE ISSUES (rev. ed. 1995).

what is known as the Cadbury Report in England,\textsuperscript{77} the Vienot and Manzini Reports in France,\textsuperscript{78} the Bosch Report by the Institute of Corporate Directors in Australia,\textsuperscript{79} the Report in Italy,\textsuperscript{80} and many more.

\textsuperscript{77} COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, THE CODE OF BEST PRACTICE (London 1992). Cadbury was
followed by the Greenbury Report on officers’ and directors’ remuneration (1995), and the Hampel Report (1998) on corporate governance. Collectively, the three reports are also referred to as Cadbury and are re-published by the London Stock Exchange as the “Yellow Book.” They have recently been revised and re-issued as the Turnbull Guidance.


In the United States, second generation sources include the academics’ articles and other pronouncements.\textsuperscript{81} Perhaps attempting to mushroom large engagements into even larger ones, the consulting firms come up with lists of governance “add ons.” Other consultants, including no less than the venerable Standards & Poor Corporation, sell services which audit and then grade corporations’ compliance with scores of corporate governance metrics.\textsuperscript{82} In the


\textsuperscript{82} Institutional Shareholder Services uses a 61 point “Corporate Governance Quotient,” \url{http://www.isscgq/rating} criteria. The Corporate Library uses a similar system to rate “Board Effectiveness,” \url{http://www.thecorporatelibrary.com/productsandservices/boardeffectiveness-ratings}. See, also Clark, supra note , at 4 (listing Governance Metrics International, Moody’s and Standard & Poors’). In September, 2005, Standard & Poors’ ceased marketing its corporate governance ratings and services, which it had aggressively marketed at
larger corporate governance debacles, investigative committee of the board of directors render report and make good governance recommendations. Two of the leading reports were the Powers Report at Enron, by a committee chaired by Law Dean William Powers of the University of Texas,\textsuperscript{83} and the Wilmer Cutler & Pickering report at WorldCom, under the names of three expansion directors, but prepared by a leading Washington, D.C. law firm.\textsuperscript{84} The American Bar Association rendered a report, which has its own recommendation, via a committee chaired by James Cheek of Nashville, Tennessee.\textsuperscript{85}

\textsuperscript{83} WILLIAM C. POWERS, ET AL., REPORT OF THE INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORPORATION (2002).


THE AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY (July 16, 2002).
When bankruptcy follows a governance debacle, bankruptcy examiners render lengthy written reports. Neal Batson rendered the report(s) in Enron. Governor Richard Thornburgh, assisted by his law firm, rendered no less than three lengthy reports in WorldCom's bankruptcy.

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87. See Neal Batson, First Interim Report of Neal Batson, Bankruptcy Examiner, No. 01-16034 (Br. SDNY 2001); Batson, Second Interim Report, No. 01-16034 (Br. SDNY 2002); Batson, Third Interim Report, No. 01-16034 (Br. SDNY 2003); Examiner Named for Enron, N.Y. Times, May 23, 2002, at C4.

88. Richard Thornburgh, First Interim Report of Dick Thornburgh, Bankruptcy Examiner, in In Re WorldCom, Inc., No. 2-15533 (Br. SDNY, Nov. 4, 2002); Thornburgh, Second Interim Report of Dick Thornburgh, Bankruptcy Examiner, in In Re WorldCom, Inc., No. 2-15533 (Br. SDNY, June 9, 2003); and Thornburgh, Third and Final Report of Dick Thornburgh, Bankruptcy Examiner, in In Re WorldCom, Inc., No. 2-
15533 (Br. SDNY, Jan. 26, 2004).
Last of all, a new player, the “corporate monitor,” has come into existence. The first monitor report, by Richard Breeden, former Chairman of the SEC, entitled “Restoring Trust,” provided the beginning framework for this section of the article. “Restoring Trust” mandates installation of one hundred corporate governance “improvements” at WorldCom, now known as MCI, Inc. Mr. Breeden, and the consulting firm he has formed, have served as corporate monitor, and rendered reports, in several other high profile corporate governance cases, including Fannie Mae, Hollinger International, and KPMG.

The Board of Directors.

Old.

1. Board Meetings. Boards meet quarterly, often with one board meeting held as a “fly

89. Richard C. Breeden, Corporate Monitor, Restoring Trust, Report to Hon. Jed S. Rakeoff, United States District Judge, Southern District of New York, on Corporate Governance for the Future of MCI, Inc. Unless otherwise noted, recommendations in the following text originated in Mr. Breeden's report.

away meeting at a resort or in a more distant city. The corporation may have invited spouses.

The meeting was often held as a planning meeting or strategic retreat.

2. Meeting Duration. Meetings lasted 3-4 hours, often a morning or a morning and into the early afternoon.

3. Larger Boards. The group may have consisted of 18, 21, or 24 directors.\textsuperscript{91} With a very large number, a group of inside directors, although less than a majority, could control the agenda,

\textsuperscript{91} See, e.g., RALPH D. WARD, 21\textsuperscript{ST} CENTURY CORPORATE BOARD at 4 & 198 (1997).
due to collection action problems which prevented the majority of independent directors from networking amongst themselves.\textsuperscript{92}

\textsuperscript{92} See, e.g., Steve Lohr, \textit{Rubber Stamp Is Tossed Aside by General Motors Board}, New York Times, April 8, 1992, at A1 (lead by “lead” director John Smale, former CEO of Proctor & Gamble, Inc.).

\textsuperscript{93} Len Boselovic, \textit{Companies Split About Separating CEO, Chairman’s Jobs}, Pittsburgh Post-Gazette, Mar. 16, 2004 at C9 (opposition of Professor Charles Elson to separation of positions).
1. Board Meetings. The full board should meet at least ten times per year. On at least two of those occasions, the board should meet at a non-headquarters facility of the company.

2. Duration. Board meetings should last a full day, or even two days.

3. Smaller Boards. Mid cap company boards average 9 directors while Fortune 500 company boards average 10.9.98

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94. The courts have not recognized a mere social tie as negating a director's independence. See, e.g., Odyssey Partners, L.P. v. Fleming Cos., Inc., 735 A.2d 386, 409 (Del. Ch. 1999) (across the street neighbors). Accord: ALI CORP. GOV. PROJ., Comment to § 1.23 (definition of “Interested”), at 27 (“It is not intended that a person would be treated as subject to a controlling influence, and therefore interested, solely because of a long-time friendship or other social relationship ....”).

95. In Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971), the court found a prestigious law firm attorney actually to have been an insider for purposes of securities law due diligence analysis.


97. See ALI CORP. GOV. PROJ. § 3.05 (“Audit Committee in Large Publicly Held Corporations”) & §§ 3A.02-3A.05 (Audit, Nominating and Compensation Committees).

98. Average size today is 9.2 members overall and 10.9 members among
Fortune 500 companies. The range is from 3 to 31 members. *Board Basics, Wall St.*
J., Oct. 27, 2003, at R7 (Table).
4. **Board Composition.** A majority of all directors should be independent. While SOX mandates that only audit committee members be independent, SROs such as the NYSE and NASDAQ require that a majority be independent.

5. **Executive Sessions.** Each board meeting should have time reserved for an executive session at which no member of management, including the CEO, will be present.

6. **Side Jobs.** Experts opine that by acceptance of consulting and similar arrangement directors forfeit a portion of their independence. In the Senate Hearings on Enron, Professor Charles Elson of the University of Delaware testified that directors should have no financial ties

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99. Overall, 66 percent, and in the *Fortune 500* seventy two percent, are independent. Average tenure is 8.4 years, average age is 58.9 (59.9 in the *Fortune 500*), and 10 percent are women. *Board Basics, supra* note 97.

100. SOX § 301.
to the company whatsoever,” other than directors’ fees. “[I]f a director’s role is as a consultant, hire him as a consultant. If a director’s role is to be a director, hire him as a director. You cannot mix the two.”101

1. Yearly Strategic Planning Sessions. Corporations should have as mandatory evolutions a plenary board meeting at which directors review all major areas of the corporation's business.

2. Risk Management Committee. Corporations should have a board committee whose role is constantly to assess exposure the company may have, legal, regulatory, and other, from its various businesses and which sees that the corporation complies with the law.

3. Boot Camp. Corporate bylaws or governance guidelines must require that new directors attend and conduct refresher courses for all directors. Among others, several graduate schools of business, such as those at Stanford and Indiana Universities, conduct multiple day short courses for corporate directors.105

102. Enron directors, or their firms, received consulting fees of $70,000 to $493,914 annually. Enron made gifts of $500,000-600,000 to charities with which directors had close affiliations. Other side payments occurred in one form or another as well. See, id. at 51-52 (2002).

103. NYSE, NYSE LISTED COMPANY MANUAL § 303A.02(b)(ii)(Jan. 29, 2004); NASDAQ, Corporate Governance - Summary of Rule Changes (Rule 4200)(Nov. 4, 2003).


5. Independent Director Certification. Directors should undergo a training and testing process before they join boards. Schemes in Australia and in East Asia have initiated, or discussed, initiation of certification requirements.\textsuperscript{106}

\textsuperscript{106} Institute of Corporate Secretaries (Hong Kong), \textit{Professionalism or Incarceration - Will Future Directors Need To Be Accredited}, Company Secretary, July, 2004, at 6. In the U.S. the National Association of Corporate Directors (NCD) maintains a registry of potential directors but does not certify them. Blair & Bratton at 86 (comments of Dr. Richard Raber, President and CEO, NACD).
6. Term Limits. Boards should enact limits of ten years or so and provide that at least one new director should be elected annually. In the “old” days, board service of an individual lasting 20-25 years was not uncommon.107

7. Elimination of Trophy Directors.108 Directors and director candidates should serve on no more than 2 or 3 additional boards. Many corporate CEOs, long considered prime candidates for other corporations' boards of directors, no longer serve on any, or limit themselves to one, or are limited by contract, guideline, or bylaw, to one additional directorship.109

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107. Ward (long board service)


8. Shareholder Nomination. In 2005, SEC Chairman William Donaldson sought to have the Commission adopt a rule that would mandate authorization of nominations by institutional and similar large shareholders in cases in which given percentage of shareholders “withhold authority” for proxy votes, that is, for the corporate slate of directors. The history of that proposal is beyond the scope of this article. Some good governance checklists imply that, on their own, corporations should provide a system for shareholder nominations.

9. Resignations. Bylaws and employment contracts should provide that any resignation from a corporate office (CFO, COO) automatically constitutes a courtesy resignation from the board seat the corporate officer holds. In the WorldCom case, even after he had been revealed as the mastermind of a massive fraud and removed from his position as CFO, Scott Sullivan refused to resign his WorldCom board seat.

10. Independent Counsel. The independent directors should have present in the boardroom, and the corporation should pay the fees of, an attorney whose role it is to represent the board

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members in a day-to-day and meeting-to-meeting basis. 112

**Board Leadership.**

1. **Board Chair.** This position was an empty vessel into which various corporations poured various things. It had no legal status insofar as corporate statutes, old or new, as well as most corporate governance treatises, failed to mention it.113

2. **Honorary Position.** At many corporations, the position was, and remains, ceremonial, or largely so. The chair presides at board meetings only, or at shareholders’ meetings as well, or is also the primary liaison between directors and the corporation, or has charge of meeting agendas, or is the confidante of the CEO, or is both a right hand man and the confidante of the CEO.

Corporate bylaws may spell out some but rarely all of these varying responsibilities. At many


113. One of the few sources is Australian: HENRY BOSCH, A.O., CONVERSATIONS BETWEEN CHAIRMEN (Australian Institute of Company Directors 1999).
corporations, the CEO presides at shareholders' and even at directors' meetings.

3. Lead Directors. Worldwide the trend is separation of the offices of CEO and Board Chair, rising to 95 or 100 percent of the corporations in some countries. If the highest calling of modern boards is to evaluate and, if necessary, remove senior executives from office, most particularly the CEO, critics ask how a board can perform this function if the same person is both the CEO and calls the meetings and sets the agenda. The U.S. partial answer has been to appoint a senior or capable person on the board as lead director who has the power to convene board meetings as well. Although seemingly more corporations have separated the offices than discussion reveals, the formal U.S. answer remains appointment of a lead director.

New.

• Formal Responsibilities. Corporate bylaws or corporate governance guidelines should spell out in detail the Board Chair's duties.

• Minimum Responsibilities. They would include; control of the agenda for meetings (annual, regular, and special); chairing both shareholders' and directors' meetings; coordination of the work of board committees; board packet

responsibility; coordination of board visits to company facilities; reviews of corporate ethics programs; conduct of annual reviews of board members; and organization of the formal annual CEO review process.

Proposed.

3. Mandatory Leadership Rotation. The chair position should go to a new director at least every six years.

4. Office of Chairperson. The corporation should provide a physical office and a staff appropriate to the position and its responsibilities.

5. Annual Performance Reviews. Staff, managers and fellow directors must conduct annual 360 degree reviews of the Board Chair.

The Audit Committee.

1. Composition. Independent directors staff the committee. At least one member, and preferably more, have financial literacy, that is, they are familiar with financial statements, how they are prepared, and how outside accountants audit and certify them.¹¹⁵

2.

¹¹⁵ As has been seen, the NYSE added a requirement for an audit committee to its listing standards in 1977. See note 96 & accompanying text supra.
116 The committee is of the board, comprised solely of board members, and with its primary or only responsibility to the board.

The committee is one additional structural device assuring the integrity of the financial information reaching the full board and upon which it will evaluate the senior executives, officers, most particularly the CEO.

Meeting Frequency. The committee meets with the corporation's outside auditors before commencement of the annual audit, discussing the accountants' audit plan and pointing the auditors to problems areas or issues of which directors are aware. Later, the committee conducts an exit interview with the auditors, asking for assessments of internal accounting and its personnel, and asking several questions about conduct of the audit. 117 Acting as a focal point for


117 One schematic required committees to ask 4 questions of the auditors: (1) Did you receive complete cooperation from everyone at our company?; (2) Did anything occur which caused you to deviate from our agreed upon audit plan?; (3) Is there any matter that you believe the full board of directors should be advised about?; and (4) Are you- you personally - prepared to, and do you, endorse these audit results? See, e.g.,
discussion of accounting issues, the committee meets perhaps one or two other times per year.

2. Meeting Duration. Traditionally, audit committees conducted their meetings before the full board met, at, say, 7:00 or 7:30 AM if the full board were to convene at 9:00. Accordingly, many audit committee meetings would last between one and two hours.

HENRY BOSCH, AO, CONVERSATIONS WITH A NEW DIRECTOR at 43-45

(Australian Institute of Company Directors, 1997).
Composition. SOX mandates that the audit committee be comprised exclusively of independent directors, defined so as to exclude professionals or others whose firms derive any compensation from the corporation.

Expertise. At least one member must be a financial expert, the definition of which SOX delegates to the SEC. The SEC defines an expert as one who has hands-on experience in the auditing of publicly held companies.

Meeting Frequency. Committees are to meet more often than 3 or 4 times per year. In 2002, the year in which Congress enacted SOX, audit committees at Fortune 200 corporations met an average of 7.8 times, with both a median and a mode of 7 times.

Hotline Responsibility. SOX requires the audit committee to put in place and supervise mechanisms whereby anyone in the organization can report to and obtain the ear of those at the top regarding financial or accounting irregularities.120


119. Douglas M. Branson, The Board of Directors, WorldCom, Inc., supra note, Tab 20 (Aug., 2004). The related numbers for 2000 were a mean and a median of 5 times with a mode of 4 times, id., Tab 18, and for 2001 were a mean of 5.379, a median of 5.0, and a mode of 4, id., at Tab 19.

3. Reporting Up Receptacle. In addition to being a hotline receptacle, the audit committee acts as an alternative receptacle for attorney reports of evidence of "securities law violations and similar misconduct" within the organization. SOX section 307 reports that an attorney may make reports to the audit committee or full board, in lieu of reports to the Chief Legal Officer (CLO) or CEO.\footnote{SOX § 307.}

\textbf{Proposed.}

2. Meeting Frequency. The audit committee should meet at least eight times per year and more frequent meetings may be advisable.

3. Duration. One, two or perhaps even three hour meetings are insufficient. Meeting should last at least one half day, or longer.

4. Chair Rotation. The board should rotate the chair position on the committee at least once every three years.

5. Interested Director and Officer Transactions. The committee should review the documentation regarding such transactions, including, for example, flight logs and similar records to police director use of the corporation's personal and real property.\footnote{The ALI Corporate Governance Project provided that, in order to free up board members from such tasks, which can become mundane, the board (or shareholders) could pass a resolution and thereafter such tasks could be delegated to a corporate manager who would be free of all conceivable conflicts of interest in the matter. ALI CORP. GOV. PROJ. §§ 1.36 & 5.09 ("Standard of the Corporation" and "Effect of a Standard of the Corporation").}
6. Special Meetings. At least annually, the committee should meet with interested shareholders, securities analysts, and other observers for an accounting and “disclosure review.”

7. CFO Review. The committee is to conduct an annual review of the CFO’s performance as well as her personal finances and in order to be able to enforce an absolute prohibition on outside income or activities by the CFO (an Enron-Fastow provision).

8. Annual Training. Audit committee members must undergo an initial and then annual refresher training course. Such a course should cover accounting principles, auditing standards, ethical compliance, and the pronouncements of FASB and PCAOB. The courses should introduce students to nomenclature and analytical tools such as WACC (weighed average cost of capital) and EBITA (earnings before interest, taxes and amortization).

Accountants.

- Although the number ebbs and flows, almost on a daily basis,\textsuperscript{123} there are approximately 15,000 corporations which file periodic reports with the SEC. In 2002 Big 4 firms\textsuperscript{124} audited 79 percent of them and 97 percent of the companies with revenues which exceed $250, million, as follows: PriceWaterhouseCoopers, PriceWaterhouseCoopers, PriceWaterhouseCoopers, PriceWaterhouseCoopers.

\textsuperscript{123} As of adoption of SOX, approximately 16,200 public companies filed periodic reports with the SEC, see SEC, Framework for Enhancing the Quality of Financial Information, 67 Fed. Reg., at 44,999 (July 5, 2002), although the number constantly changes. See, e.g., ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW at 150 & n. 19 (2d ed. 2004).

\textsuperscript{124} Sometimes referred to as the “Final Four.” See Frank Partnoy, Strict Liability for Gatekeepers: A Reply to Professor Coffee, 84 B.U. L. Rev. 365, 368 (2004).
Eighteen other accounting firms (the “intermediate 18”), including some that are quite large, such as BDO and Grant Thorton, audit public companies. Some audit a few while others audit a number but no firm outside the Big 4 audits more than 100.

- SOX creates an independent, quasi governmental corporation, the Public Company Accounting Oversight Board (PCAOB), with which accountants must register if they audit one or more publicly held corporations. Under SOX, the PCAOB is to audit annually firms which audit more than 100 clients. It is to audit other accounting firms at least every 3 years. PCAOB also issues guidance to accountants as, for example, PCAOB did in Audit Standard No. 2, a voluminous guideline concerning installation and documentation of internal controls.

125. General Accounting Office, Report to the Senate Committee on Banking, Housing and Urban Affairs, “Public Accounting Firms: Mandated Study on Consolidation and Competition” (July 2003). See also SOX § 701 (Mandating the study and ensuing report to Congress).

126. SOX § 101.

The PCAOB has issued a number of question and answer publications and other forms of guidance for companies and for accountants.
• As of November, 2004, 1,378 accounting firms had registered with PCAOB, of which 499 are foreign based firms. One reason for the high number of registration is that each office of a large firm registers. Thus the Big 4 plus BDO and Grant Thorton alone account for approximately 232 registrations.¹²⁸

4. Registration. As aforesaid, accounting firms which audit so much as one public company must undergo screening and then have a registration accepted by the PCAOB.¹²⁹

5. Audits of Auditors. The PCAOB will conduct inspections of registrants.

6. Off Books Entities. SOX and the SEC require regulated corporations to make disclosures


¹²⁹ In the process, PCAOB rejected registrations by 3 accounting firms. Id. at 2078.
of off-balance sheet arrangements such as those Enron employed with its special purpose entities. Concurrently, the Financial Accounting Standards Board has tightened the rules, requiring financial statement disclosure on SPE's if the corporation is a “prime beneficiary” of the arrangement, however contrived. The change represents a shift from the bright line accounting rules under which Enron operated, requiring 3 percent of capital from an independent source and governance of the entity to be independent as well.

130. SOX § 401(a).

7. Cost. In addition to payment of $6-7 million in annual SOX 404 attestation and other costs, publicly held corporations must pay an annual levy to fund PCAOB. The formula is simple. Corporations are responsible for annual payments according to the fraction their market capitalization bears to the market capitalization of all firms. Large publicly held firms pay as much as $2 million annually.\(^{132}\)

Proposed.

1. Financial Statement Insurance. Corporations could obtain coverage after insurance companies conduct their own audit, or mini audit, in order to determine premium amounts. The insurer would then select the firm to do the audit.\(^{133}\) The proposal’s main feature is to eliminate the conflict of interest in which the company to be audited chooses and then pays the firm it selects to examine its financial statements. A disadvantage is the high premium that corporations might have to pay, the amount of which come more to light in the more recent Marsh & McLennan and AIG scandals.\(^{134}\)


\(^{134}\) See Diane Brady & Marcia Vickers, *AIG: What Went Wrong?*, Business
Another question is why insurances have not previously written such coverage into Director and Officer (D & O) policies.¹³⁵

¹³⁵. Former SEC Commissioner Joseph A. Grundfest has asked these questions. See Grundfest, Punctuated Equilibria in the Evolution of United Sates Securities Regulation, 8 Stan. J. L. Bus. & Fin. 1, 7-8 (2002)(“D & O insurers today could easily make retention of insurer approved auditors a condition of coverage. They could today also require an element of control over the audit process. Yet they don't”).

Week, April 11, 2005, at 32 (exorbitant premiums for “earnings insurance” and other coverages); Ian McDonald & Monica Langley, AIG Expected to Pay $1 billion-Plus to Settle Probes, Wall St. J., January 13, 2006, at A4.
2. Financial Statement Reliability Indexes. Corporations would have to disclose a numerical ranking, or the rank of the tranche in which evaluators had placed the company's financial statements. Moody's, Standard & Poors', and other rating agencies, which have made forays into corporate governance,¹³⁶ might compile such indexes. The existence of financial statement insurance might aid them. The index assigned might correlate closely with the amount of premium paid for, say, each $10 million in revenues.

¹³⁶ See note 80-81 & accompanying text supra.
3. Installation of Early Warning Accounting Systems. In truth, SOX, along with Auditing Standard No. 2, already incorporate an early warning system. “Traditional auditing begins with an auditor assessing a company’s internal control environment.” That task gives the auditor an early indication of the reliability of financial statements the client company has provided. By requiring auditors to undertake that process, and disclose the results to investors and others, SOX, auditors, and the section 404 attestation process combine to enable insiders and outsiders to gauge at an early point the reliability of financial statements.138


138. See AUDITING STANDARD No. 2, at app.¶ 6 ("[i]nformation on internal control over financial reporting is .. intended to provide an early warning to those inside and outside the company who are in a position to insist on improvements").
In performing the task, however, the auditor must speak out on the subject of internal controls. By doing so, he becomes a primary rather than secondary violator of the securities law. Since Central Bank of Denver eliminated aiding and abetting liability, plaintiffs encounter extreme difficulty in reaching secondary defendants, ... is absent in reaching the pockets of primary violators. To fine tune the early warning system, and to come closer to an adversarial audit, the law should develop safe harbor protections for forward-looking auditor statements regarding internal control ... that parallel existing safe harbors for issuers.


141. See Cunningham, supra note 136, at 1481.

142. Professor Cunningham also finds that the emphasis on internal controls only “partially succeeds as an early warning system.” Cunningham, supra note 136, at 1490.
SOX seems to regard internal controls as “an end in itself” when errors of judgment, estimation, or preparation may also render financial statements misleading. See generally id. 1487-90 (“A Different Warning: Control Worship”).
4. Choice of Auditors By Lot. In reality, the leading piece contains two different proposals, with the co-authors airing the differences between them and their proposals. They both address the same problem, namely, that the corporation which is responsible for financial statements, through its self-interested managers, selects and later compensates the accounting firm which is to vouch for the statements’ reliability. “It is as though baseball pitchers called their own balls and strikes and then hired umpires to verify their calls.”


144. Id. at 393. See generally Sean O’Connor, Be Careful What You Wish For: How Accountants and Congress Created the Problem of Auditor Independence, 45 B.C. L. Rev. 741 (2004).
Corporations could voluntarily make the relationship less cozy and more adversarial but they would have difficulty ... A public oversight board (the SEC, the PCAOB, or the like) would oversee the process, including fixing the auditor

The thrust of the program would be to reduce the extent to which auditors need to worry about pleasing the management of companies they audit.

The Lawson lottery proposal embraces contract, rather than a regulatory approach. The company would select at random from among the auditing firms that express a willingness to accept the engagement at a specified price.

If the posted price does not attract a critical mass, the company would have to raise its offering price. To the ... (for example, determining if the pool were a reasonable size), stock exchanges or other SROs would supply it.

In the past, there have been proposals that government should supply auditors. See, e.g., Mark A. Gullotta, The SEC’s Auditor Independence Rule: Missing the Boat on Auditor Independence, 42 Santa Clara L. Rev. 221, 224 (2001). See also Jenkins, supra note, at A17 (“[T]he SEC should contract directly with accounting firms to audit books of companies that want to raise money in the public markets”).

\[145\] Id. at 399-402.

\[146\] Id. at 414-17 (Donald Kahn is a co-author of the proposal(s)).

\[147\] Id. at 415

\[148\] Id. at 417 (Gary Lawson is the other co-author).

\[149\] In the past, there have been proposals that government should supply auditors. See, e.g., Mark A. Gullotta, The SEC’s Auditor Independence Rule: Missing the Boat on Auditor Independence, 42 Santa Clara L. Rev. 221, 224 (2001). See also Jenkins, supra note, at A17 (“[T]he SEC should contract directly with accounting firms to audit books of companies that want to raise money in the public markets”).
5. Mandatory Rotation of Auditing Firms. SOX requires that corporations rotate the “audit partner” and the “engagement partner” assigned to it at least every five years.\textsuperscript{150} Some original SOX proposals required a mandatory change of auditing firms, although the proposals did not survive in the final legislation. Nonetheless, commentators believe that best practices should dictate that firms change auditing firms at least every five years.\textsuperscript{151}

6. Contractual Liability Caps. In engagement agreements they sign with client corporations, accounting forms now include provisions for alternative dispute resolution (binding arbitration), elimination of punitive damages, and a cap on compensatory damages the auditor may be adjudged

\textsuperscript{150} SOX § 203. \textit{Cf.} John Plender, \textit{Don’t Be Fooled By the Rotating Audit Partner}, Financial Times, July 29, 2002, at 12. SOX also contains a “revolving door” provision which requires a one year minimum period before an auditor may assume an executive position (CEO, CFO, comptroller, etc.) with a corporation whose financial statements she has audited. SOX § 206.

\textsuperscript{151} \textit{See, e.g.}, John Kroger, \textit{Enron, Fraud, and Securities Reform: An Enron Prosecutor’s Perspective}, 76 Col. L. Rev. 57, 135-137 (2005). Fortune 1000 firms retain the same audit firm for 22 years, on average. GAO, “\textit{Public Accounting Firms; Required Study on the Effects of Mandatory Audit Firm Rotation},” GAO-04-216, at 6 (2003)
to owe the client.\textsuperscript{152} Post SOX, Big 4 accounting firms have been insistently on these type terms. The auditors' liability, or lack thereof, to third party investors remains unaffected, as the contract can only affect the relationship between the auditor and the client corporation.\textsuperscript{153}

7. Combinations. None of the proposals is mutually exclusive, except perhaps for the financial statement insurance proposal. A hypothetical corporation could purchase insurance, at least in some forms, choose its auditor by lot, agree to liability caps, install an early warning system, disclose a financial statement reliability index, and rotate its outside auditing firm periodically. The cost, while not insignificant, would not be prohibitive, or would not be prohibitive if the corporation omitted the purchase of financial statement insurance.


8. Strict Liability or Warranty Accounting. At present, absent contract, auditors may be liable to the auditing client for malpractice. Their liability to third parties, most particularly to investors, is more problematic. In most jurisdictions, the accountant will be liable to those who are the very “end and aim” of the transaction, and, under Restatement of Torts section 552, to foreseen but not to foreseeable parties. With the Supreme Court’s elimination of federal securities law aiding and abetting, investors have had difficulty holding accountants liable, although, as Professor Lawrence Cunningham has pointed out, this may change as accountants attest to the efficacy of internal controls under SOX section 404. In the post SOX era, a number of proposers seek to change all of this, replacing the scheme with potentially more expansive

154. Id.


156. See, e.g., Abrams Center Nat. Bank v. Farmer, Fuqua & Huff, P.C., S.W.3rd, 2005 WL 2806211 (TX App. at El Paso, Oct. 27, 2005)(accountants not liable because bank was merely a foreseeable rather than a foreseen user of financial statements); Branson, supra note 152, at 339-40.e

157. See note 138 & accompanying text supra.

158. Cunningham, supra note 136, at 1475.
accountants' liability.

9. Criminalize Accountant Negligence. Still another proposal retains liability based upon

\[159\] Coffee, supra note 8, at 349.


fault, but would criminalize a portion of it under “a new federal statute making [accountant misconduct] a misdemeanor, punishable by up to one year in jail.”\textsuperscript{163} The author, a former Enron prosecutor, points out that “[e]very legal system in world criminalizes at least some types of negligent conduct to protect important interests in life, limb and property.”\textsuperscript{164} He believes that criminalization is essential to create incentives for auditors to take reasonable care in the conduct in which they are paid to engage.

\textsuperscript{163} Kroger, \textit{supra} note , at 131 (footnote omitted).

\textsuperscript{164} \textit{Id.} at 130 (footnote omitted).
10. Fewer Criminal and Civil Proceedings. In its report, “Auditing: A Profession at Risk,” the U.S. Chamber of Commerce calls for diversion of all or most disputes to Alternative Dispute Resolution (ADR) and regulation of the ability to indict accounting firms in criminal matters.166

Attorneys.

• Reporting Up. SOX section 307 has as a trigger receipt of evidence of a “material violation of securities law or breach of fiduciary duty or similar violation by a company or any agent thereof.” Upon receipt, the attorney is to report up either to the Chief Legal Officer (CLO) or the CEO. Failing appropriate action by them, the attorney is to blow the whistle to either the audit committee, the independent directors, or the full board. The SEC may censure, suspend or revoke the privilege of practice before it of any attorney who fails to comply. Much has been written about the section, most of which is beyond the scope of this article.168

165. Available at http://www.uschamber.com (Last visited February 26, 2006)


167. SOX § 307.

168. See, e.g., Roger Cramton, Enron and the Corporate Lawyer: A Primer on Legal and Ethics Issues, 58 Bus. Law. 143 (2002); Richard Painter, Convergence and Competition in the Rules Governing Lawyers and Accountants, 29 J. Corp. L. 397 (2005); Susan Koniak See also Otis Bilodeau, Pinter's Putsch; Richard Painter Argued for Years
Past History. In SEC v. National Student Marketing,\textsuperscript{169} the SEC contended that, faced with suspicious accounting irregularities, lawyers from two prestigious law firms should have resigned and blown the whistle to the SEC. Instead, the lawyers accepted the explanations the clients proffered, closing the merger. Judge Parker found that the lawyers had violated the law but refused to grant the injunction the SEC requested. Many chalked National Student Marketing and the arguments for attorney whistle blowing up to SEC zeal and the Post Watergate morality which pervaded the country at the time.

A few years later, in a 2002 rules of practice disciplinary proceeding, the full Commission did uphold an internal whistle blowing requirement for lawyers who practice before the SEC. The lawyer must take further, more affirmative steps, such as a direct approach to the board of directors or one or more individual directors or officers.

170 Although the SEC never thereafter insisted upon whistle blowing by attorneys, internal or otherwise, presumably a percentage of them did so in one form or another. Proposed.

Qualified Legal Compliance Committees (QLLCs). SOX 307 set off a whirlwind of lawyer criticism. Experienced directors thought that boards and board committees were even less likely to welcome a lawyer into the room or make material disclosures to her knowing that the lawyer has a legal duty to report up any evidence of wrongdoing she might perceive to exist. One little noticed partial response has been to change the party to whom the lawyer must report. By rule, the SEC has authorized a third way, introducing the QLLC as a “mechanism for reporting, as well as investigating and responding to, misconduct.”

Board members may not perceive the QLLC as an answer. Even before SOX, many directors and students of governance felt that law and best practices blueprints combine to over burden board committees. Post-SOX, with overwhelming responsibilities imposed by law on audit committees and a welter of additional responsibilities proposed upon nominating,

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governance and other committees, as a matter of best practices, many believe that “this committee thing has gone too far.” Committees and committee responsibilities take directors away from monitoring and strategic planning exercises regarded as attorneys' highest and best uses, especially considering the part time nature of directors' positions. The QLLC is “just one more” (“yet another independent board committee”).174

Attorneys may have a opposing view, preferring creation and use of a QLLC. Bylaw or corporate governance guideline consignment of SOX section 307 reporting up responsibilities to a QLLC may relieve attorneys from over entanglement in possible wrongdoing. Lawyers, especially those from elite law firms, will be better able to concentrate on the “process” and “transaction” engineering they regard as their best use. “Attorneys, especially those at elite law firms, may refuse engagements with issuers who do not have QLLCs.”175

Despite the widespread belief that use of board committees has already extended far beyond its usefulness, the SEC affirmatively “encourages issuers to create [QLLCs] as a means of effective corporate governance.”176

Perhaps blissfully unaware of the burdens it is imposing, the SEC requires that one of the QLLCs three members also be a member of the audit committee.177

3. Noisy Withdrawals. Newly invigorated by SOX, some said, the SEC implemented SOX section 307 by including within its proposed rules provision for noisy withdrawals. Having

175. Fisch & Gentile, supra note 10, at 550-51.


177. Id. at 87,089.
reported evidence of wrongdoing, and determining that corporate officials had not taken appropriate action, an attorney could insulate himself by ceasing the representation and notifying others, including the SEC, that he had done so.178

To critics, the noisy withdrawal is tantamount to the whistle blowing responsibility the SEC attempted for foist upon attorneys in the 1976 National Student Marketing, at least by the back door. Due to the noise involved, in cases of withdrawal, onlookers, including prosecutors and regulators, would ask questions. Questions might well bring wrongdoing to light. The fact of withdrawal then might lead to prosecution or enforcement action.

Bending but not bowing to cries that the SEC had exceeded any authority SOX 307 had bestowed upon the Commission, the SEC did not include the noisy withdrawal safe harbor in the final version of Rule 205. The Commission, however, still keeps noisy withdrawal proposals, or narrower versions thereof, in its desk drawer.

Separate Counsel for Independent Directors. Two eminent academics have proposed that at major corporations, independent directors have their own lawyer going forward, and on a permanent basis.\textsuperscript{179} When academics pose structural improvements such as this,\textsuperscript{180} the considerable out-of-pocket cost aside, most business persons do not want to see lawyers as central players in the boardroom. Lawyers tend to see legal issues, often with potential liability, lurking in every nook and cranny. If an attorney acting alone tends to be too risk averse, two attorneys in the boardroom would compound the problem. In a sizeable subset of cases, attorneys would engage in one ups man ship, each attempting to demonstrate to the board that he has the right stuff. Such a rivalry would obfuscate rather than clarify legal aspects of doing business. On a more rarefied plane, at least in Delaware corporate jurisprudence, the standard of care and the business judgment rule, and the protection they afford to directors, make it unnecessary to have a second attorney, representing independent directors, in the boardroom.\textsuperscript{181}

\textsuperscript{179} Hazard & Rock, \textit{supra} note 111, at 1395-96.

\textsuperscript{180} See generally Hazard & Rock, \textit{supra} note 111, at 1406.

\textsuperscript{181} See E. Norman Veasey, \textit{Separate and Continuing Counsel for Independent Directors: An Idea Whose Time Has Not Come as a General Practice}, 59 Bus. Law. 1413, 1413-14 (2004). Former (Delaware) Chief Justice Veasey identifies six situations in which corporate provision of separate counsel would be appropriate, namely “where
The Nominating, or Governance, Committee.

Old.

(I) an independent committee, such as an audit or compensation committee, has a tradition of having its own regular, outside counsel ...; (ii) the [corporate] general counsel has a real or perceived conflict; (iii) the board or committee believes that has a need to explore independently something that appears questionable; (iv) a special investigation; (v) the need for a particular legal expertise; (vi) simply - to invoke a medical analogy - the board or committee seeks a “second opinion.”

Id. at 1417.
The primary purpose of such a committee was to take the process of developing board candidates out of the CEO’s hands, in which the power had traditionally been lodged. The committee thus would reinforce board independence. Creation of committee had as a corollary purpose encouragement of board diversity, that is, addition to the board of persons of color, women, and others historically under represented on the board.

Even after the nominating committee had become widespread, certain CEOs continued to subvert committees and their work. For example, CEOs Wayne Andreas at Archer-Daniels Midland (ADM) and Bernie Ebbers at WorldCom insisted upon CEO nominating committee membership. In Decatur, Illinois, according to wags, ADM referred to the board of directors, “All Dwayne’s Men.” In the 1980s and 1990s, in many instances (American Express, Sunbeam, Scott Paper, Archer Daniels Midland, Morrison Knudsen), CEOs were able to coopt or end run nominating committees, remolding or reshaping boards of directors themselves, thus postponing a comeuppance for CEO under performance or wrongdoing. A properly functioning governance and nominating committee would have prevented illicit board molding.

3. Nominations. The committee, and not the CEO, should be responsible for committee as well as board nominations.

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182 ALI CORP. GOV. PROJ., Comment to § 3A.04, at 124-25.
4. Rotation of Committee Chairs. Rotation should be mandatory. The nominating committee implements and enforces the provision.

5. Board Leadership. The Committee, and not the CEO, identifies and nominates persons for the board chair position.

6. Committee Charters. The nominating, or governance, committee oversees the adoption and the periodic updating of charters, which all board committees must have.

7. Organic Corporate Documents. The committee recommends and oversees the process of amendment of the articles of incorporation and bylaws.

   2. Separation of Offices. The committee should pull the laboring oar on the periodic discussion that offices of chair and CEO be separate and on appointment of a lead directors if the same individual remains both Chair and CEO.

3. Executive Sessions of the Board. Again, the enforcer should be the nominating, or governance, committee.

2. Risk Management Functions (assigned to a separate risk management committee on some corporate boards):

183 Chief Justice Veasey would assign 16 discrete responsibilities to the nominating, or governance, committee, including those discussed in text. See Veasey, supra note 178, at 1415-16.
- Develop and implement law compliance systems.
- Develop and insure compliance with a business code of ethics.

3. Periodically evaluate board schedules, quality of board meetings, and workloads of committees and individual directors.

4. Disclosure Documents. The committee superintends director responsibility for documents, or portions of them.

5. Conflicts of Interest. The committee has the responsibility to call attention to and deal with interested director, corporate opportunity, and other duty of loyalty issues.

6. Insider Trading. The committee has a similar responsibility with regard to these types of issues.

7. Succession Planning. The committee must have in effect plans not only for the CEO and for members of the board but for key corporate officers as well.

8. Evaluations. The committee maintains and is otherwise in charge of the evaluation process for directors, the board, and board committees.

9. Shareholder Relations. The committee is charged with oversight over effective shareholder relations and communications.

10. Electronic Town Meetings. The governance committee should establish and maintain a website on which any one percent shareholder would be entitled to post ideas and resolutions, but not be subject to screening of the type corporations currently undertake with shareholder public interest proxy proposals.¹⁸⁴

11. Disclosure Committee. The governance committee should set up a disclosure committee

¹⁸⁴ See SEC Rule 14a-8, Question 9 (i)(1-13)(possible exclusions from corporate proxy statements).
comprised of directors, members of senior management, and outside advisers, including, possibly, securities analysts.

**Compensation Committee**

This committee, comprised of independent directors, while becoming commonplace in corporations, generally has been acceded to be a failure.

CEO compensation has run rampant in the U.S. In 1990, Gref Crystal estimated CEO compensation to be 16 times that of the average worker in Japan, 21 times in Germany, and 160 times in the U.S. By 2000, Crystal put the number “north of 400 times and heading rapidly to 500 times.” The committee has not checked this rapid rise on compensation or otherwise worked well for several reasons.

One is that, advised by lawyers, and perhaps seeking the safe harbor protection of the business judgment rule, committees often hire compensation consultants. Consultants use a quartile method of

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185. ALI CORP. GOV. PROJ. § 3A.05 (“Compensation Committee in Large Publicly Held Corporations: Composition, Powers, and Functions”).


188. *See, e.g.*, In re Walt Disney Co. Derivative Litigation, 2005 WL 296661, Slip
comparison. Even though those type systems have had their obvious inadequacies highlighted, compensation committees and consultants continue to use them. The result, because four quartiles of companies almost all want their top executives’ compensation to be in the highest quartile, is an upward pressure on compensation.


189 See, e.g., RAKESH KHURANA, SEARCHING FOR THE CORPORATE SAVIOR: THE IRRATIONAL QUEST FOR CHARISMATIC CEOs at 167 (2002).
CEOs have also come to know how to game the system. They tend to appoint to the committee the newest, and likely to be most insecure, director. They then appoint a director who also is a sitting or former CEO, who has a vicarious interest, at least, in ever higher levels of CEO compensation.\footnote{WARD, supra note 90, at 219.}

Nonetheless, most corporate governance schematics continue to include a compensation committee of outside directors as a central element.

**New and Proposed.**

- The compensation committee charter should provide for semi-annual committee meetings with the director of human resources and the general counsel of the corporation to review related party transactions, human resources compensation levels, and complaints or disputes over benefits or other compensation levels.
- The compensation committee oversees the annual review of the human resources director.
• Agog at the sums CEOs receive, in January, 2006, the SEC rolled out proposed regulations which would treble the disclosures public corporations must make about CEO and other senior executives’ pay. Corporations will have to narrate how the board of directors goes about setting pay levels, and disclose the long term value of stock options, the value of executive perquisites, and quantify severance and retirement pay to be received under existing provisions.\textsuperscript{191} The SEC regulations are part of the growing dissatisfaction in the U.S. about the inordinate growth and high levels of CEO pay.\textsuperscript{192} When adopted, the SEC will add a new layer of responsibilities those compensation committees have traditionally had.

\textbf{Risk Management Committee.}

• Risk management is one of the newer ideas prevalent in certain corporate


governance circles. The committee's mission is to identify major risks in the corporation's businesses and their operations. The committee reviews the corporation's responses to manage and minimize those risks.

- The committee reviews risk disclosures or reports and employs experts, as necessary, to understand and clarify risk disclosures in documents the company files.
- Modern corporate governance schematics now call for as many as six committees of the board of directors: audit, nominating and governance, compensation, legal compliance (QLLC), disclosure, and risk management. Individual corporations may retain one or two first generation board committees, such as finance or capital expenditure, as well, bringing to total to 8 or so committees.

The Ethics Officer and the Code of Ethics.

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7. The Ethics Office. The board of directors should establish a formal ethics office which would function under the supervision of the CEO and the CLO but with regular written reports and briefings for, and periodic program reviews by, the board.

8. Ethics Pledge. In addition to overseeing signatures by employees on the code of conduct, the officer and officer must ensure that all new employees, as well as existing staff, swear to and sign an ethics pledge.

9. Annual Reviews. The full board of directors must meet with the CLO to review (I) the resources and leadership of the ethics office; (ii) the adequacy of ethics and ethics compliance programs; and (iii) contingent legal risks the corporation may face due to ethics failures.

10. Ethics Director. This should be a person with a substantial level of legal experience, ideally including direct regulatory or law enforcement experience.

11. Diversity. Through the ethics office and human resources, the board of directors should undertake a wide-ranging review of the corporation's diversity practices.

   Compliance Officer.
   • The suggestion has been made that corporations also recruit for upper level management a corporate officer whose task it to insure the corporation's compliance with regulatory and legal compliance. \(^ {194} \)

   In corporations in which a risk management committee exists, presumably such an officer would perform much of the day-to-day work of the committee.

Whistleblowers.

SOX adds an umbrella whistle blower provision of sorts to an existing patchwork of other federal protection provisions.\footnote{These include, for example, provisions in the Toxic Substance Control Act, 15 U.S.C. § 2605(a) (2000); Clean Water Act, 33 U.S.C. § 1367 (2000); and Energy Reorganization Act, 42 U.S.C. § 5851(a)(2000).} The provision creates a new cause of action for those who suffer adverse employment actions as a result of reporting corporate fraud.\footnote{SOX § 806. See generally Steinberg & Kaufman, supra note 119, at 448. The U.S. Court of Appeals for the First Circuit gave employers some relief when it affirmed Department of Labor and District Court conclusions that the whistleblowing provisions have no extraterritorial application, rejecting the claim of am employee of an Argentine subsidiary. Carnero v. Boston Scientific Corp., 433 F.3rd 1 (1st Cir 2006).} It is broad, covering subcontractors’ and other employees’ actions as well as those of direct employers. The complainant must file with OSHA within 90 days of the occurrence. After an investigation, written findings, and a hearing before an administrative law judge, OSHA may award damages making the employee “whole,” which can include litigation costs, expert witness fees, and reasonable attorneys’ fees.\footnote{See, e.g., Welch v. Cardinal Bancshares Corp., No. 2003-SOX-15 (Dept. Of Labor, Jan. 28, 2004)(full award and reinstatement awarded to former corporate CFO).}
3. Private Inspector General Position. Then SEC Enforcement Director Stephen Cutler has urged companies to appoint a permanent ombudsman or business practices officer to receive and investigate complaints."\(^{198}\)

4. Formal Intake Process. The corporation must insure that a process exists in which the employee has reasonable assurance of confidentiality. The employee should not have to notify anyone in a supervisory role over her\(^{199}\) and may, under certain schematics, blow the whistle to a


\(^{199}\) Mark R. Attwood, When the Whistle Blows: Renewed Enthusiasm Among Employee Watchdogs, in PLI, ADVANCED CORPORATE COMPLIANCE 2003 1157, 1174 (PLI Handbook No. 1378);
third party subcontractor interposed precisely for purposes of preserving anonymity.\textsuperscript{200}

5. Publicized Corporate Policy. The corporation should post notices, send letters, and otherwise inform employees of their whistleblowing apparatus, including the intake procedure and provisions for employee anonymity.\textsuperscript{201}


\textsuperscript{201} See, \textit{e.g.}, Steinberg & Kaufman, \textit{supra} note 119, at 460.
6. Educational Programs. Corporations must assure that training exists in contractor and subcontractor organizations because, even through these entities may not be publicly held, the SOX whistle blower protections apply if the entity renders services for the publicly held corporation.\textsuperscript{202} At the end of training, the company should retain SOX policy acknowledgment certificates stating that employees understand the policy and agree to abide by it.\textsuperscript{203}

7. Documentation. Employees must create a document gathering and retention system so that, if the need arises, the company possesses evidence tending to show, or actually showing, the supervisors took adverse employment for reasons other than possible knowledge of whistleblowing activities.\textsuperscript{204}

\textsuperscript{202} Further, criminal penalties apply both to public and private companies. \textit{See, e.g.}, id. at 448; SOX § 1107.

\textsuperscript{203} Victoria Donati, \textit{Whistleblowers and Other Retaliation Claims} in PLI, LITIGATION 2003, 987, 1021 (PLI Handbook No. 697).

\textsuperscript{204} \textit{Id.} at 1020; Steinberg & Kaufman, \textit{supra} note 119, at 462.
• More Is Not Necessarily Better. If four meetings a year had been adequate, and some corporations had six, eight meetings per year is the new standard and ten or twelve is better yet. If meetings lasted an hour or an hour and a half in the “bad old days,” meetings now should go on for three, four, or five hours. More is better.

• The Role of Board Committees, Particularly Audit Committees. Again, as originally conceived, committees were constituted by the board from among their own number. The original purpose was to aid the board in its work, and none other. For example, the audit committee was an additional check, additional to the outside auditor and to such internal controls as existed, on the integrity of financial statements and similar information which would ultimately reach the full board and upon which it would evaluate the corporation's senior executives.

SOX, preceded by the NYSE and others’ public statements, has changed all of

\[\text{supra}\]\n
\[\text{footnote115}\] See, e.g., SIMON RAMO, MEETINGS, MEETINGS, AND MORE MEETINGS; GETTING THINGS DONE WHEN PEOPLE ARE INVOLVED at 11-20 (2005).


\[\text{footnote207}\] See footnote115 & text accompanying supra.
Audit committees now have responsibilities deemed to be directly to shareholders and the investing public. Under SOX, an audit committee now has a stand alone existence. The committee, and not the board, hires the outside auditor and receives reports. The committee has the freedom to hire attorneys, accountants, and consultants on its own. This is a sea change in the makeup and use of board committee but it is a sea change that has been little noticed, or taken for granted.

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208 See, e.g., Comment to ALI CORP. GOV. PROJ. § 3.01, at 82 (“The formulation ... differs from the literal terms of the older statutory formulations (which commonly provided that the business of a corporation ‘shall be managed by [its] board’); Mo. Rev. Stat. § 351.310 (“The property and business shall be controlled and managed by a board of directors”)(1943)(2000).

209 For example, the ABA CORPORATE DIRECTORS GUIDEBOOK at 1603 (rev. ed 1978), reprinted in 33 Bus. Law. 1595, states:

It is generally recognized that the board of directors is not expected to manage the business. Even under statutes ... it is recognized that actual operation is a function of management. The responsibility of the board is limited to overseeing such operation ....

It is important to note that the role of the director is to monitor ....

by the board of directors.

211 In turn, the highest calling and primary mission of the board became to select, regularly evaluate, fix the compensation of, and, where appropriate, replace the senior executives.

212 In the 1990s many corporate boards adapted to this new, more focused role for boards of directors, monitoring the senior executives. Where were the directors? Why weren’t they managing? The answer was that, under the prevailing model, they weren’t supposed to be. Boards must manage now. The prevailing view seems to have put boards of directors back in the position of deciding whether the device has reached or gone past its inherent limitations. Reflecting doubts about boards ability to manage, SOX and

211 ALI CORP. GOV. PROJ. § 3.01.

212 Id. § 3.02(a)(1).

213 The author is an elected member of the American Law Institute and attended every one of its annual meetings from 1981 to 1994, save the San Francisco meeting in 1991.

214 ALI CORP. GOV. PROJ. § 3.02(b).

215 “It is plainly impossible for a board composed partly of ‘outsiders,’ that is partly of persons who are not full time employees, to conduct ... day-to-day [corporate] affairs.”
other modern reforms place much of their emphasis on strengthening gatekeepers other than independent directors. The ... another sea change has taken place, with little seeming awareness of where we have been, or of where we might be going.

Monitors and Inspectors. Under English Company law, regulators may appoint an inspector, who delves deeply into the affairs of public companies that have gone awry. She then publishes a book length work that divines what may have gone wrong. In commonwealth countries, company law may provide for a Royal Commission, a distinguished body, headed up by a judge on leave from the bench. After its investigation, the Royal Commission reports its findings, often in a multi-volume work. In Australia, for example, a Royal Commission has reported back on what went wrong at HIH Insurance, Australia’s largest corporate collapse.

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217. See, e.g., Royal Commissions Act of 1902 § 1A (Australia).


219. See notes 85-87 & accompanying text supra.

220. See Joann Lublin & Shawn Young, Even as MCI Makes Strides, Monitor Stays, Wall St. J., April 20, 2004, at B1 (former SEC Chair Richard Breeden, alone and via his Greenwich, CT, consulting firm billed $2.3 billion at $800 per hour, over 21
Perhaps the next bell (or whistle) may be a proposal statutorily to authorize this new breed of outside corporate cop. Certainly, many corporate monitors and legal academics do not ascribe to the proposition that more isn’t necessarily better. They tend not only to hold the opposite view but would be willing to write the law review articles, give the Congressional testimony, and do whatever else it takes, to advocate a scheme in which the presumption is that more is better.

Conclusion. The time has come for a retrenchment from Sarbanes-Oxley. This article attempts to demonstrate not only one of the costs of always thinking larger, but also the unexpected result that a $35 billion per year industry has been created around the 10-K form (even for companies that are in business less than 2 years). The legislation’s most outspoken sponsor, Representative Michael Oxley, has taken the position that it is unlikely that Congress will revisit it. By contrast, the SEC’s Advisory Committee on Small Companies has taken a refreshing and proactive stance, recommending elimination of SOX §404 for Micros, Small Caps, and even three tiered system not only of disclosure but of SOX as well. Such a system would constitute the rootstalk for a generation of renewed entrepreneurship and capital formation in the United States.

