AN APPROACH TO ORGANIZING THE SARBANES-OXLEY ACT FOR TEACHING PURPOSES

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ABSTRACT

This paper provides an approach to organizing the Sarbanes-Oxley Act. Using a table format, the sections of the Act are categorized according to four categories of accounting regulation: measurement, disclosure, auditing, and governance. SOX resulted in major changes in disclosure, auditing, and governance, but deals with measurement issues to a minor extent only. Suggestions are given to help students understand the nature of accounting regulation and the specific provisions of regulation included in the Sarbanes-Oxley Act.

INTRODUCTION

The enactment of the Sarbanes-Oxley Act of 2002 (SOX) [2] resulted in the creation of a totally new organization to regulate public accounting firms. The Act also added many new kinds of accounting regulation. Accounting students need to familiarize themselves with the regulation that plays such a major role in their chosen field of study. Although students get exposed to accounting regulation at a variety of times during their educations, it can be difficult for them to connect the different types of regulation. The purpose of this paper is to provide an approach to organizing the provisions of SOX so that students will not only understand SOX better but also understand the nature of accounting regulation generally.

THE FOUR PRONGS OF ACCOUNTING REGULATION

In the U.S., accounting measurement and disclosure regulation are set by the Financial Accounting Standards Board under the direction of the Securities and Exchange Commission (SEC). The SEC also mandates additional disclosures for companies under its jurisdiction. Students normally learn about measurement and disclosure standards in financial accounting courses. Auditing standards have historically been set by the American Institute of Certified Public Accountants. These standards are usually covered in auditing courses. Traditionally, the U.S. federal government has played only a very small role in accounting-related governance regulation. Thus, historically, accounting programs have spent little time on governance issues [1].

Students can be so busy learning the details of accounting standards that they may not realize how measurement, disclosure, and auditing standards relate to each other. For example, the importance the investing community places on measurement information can be seen in the quick attention the markets give to earnings announcements. Because there is often flexibility in how the published numbers are measured, additional information is desired. Thus, disclosures are intended to provide that additional information. Disclosures are important for achieving the financial reporting transparency that is considered such an important factor in maintaining high-quality markets. Auditing standards are helpful for judging if the measurements and disclosures that are reported can be trusted.

With the enactment of SOX, the level of accounting-related regulation has been greatly expanded. The Act establishes measurement, disclosure, auditing, and governance regulations. In the full version of this paper, a multi-page table is used to categorize each section of SOX according to these four types of accounting regulation. The changes in regulation that result from SOX can be summarized as follows:

1 **Measurement**. SOX accepts the current manner of setting measurement standards. However, the Act does set guidelines required of any standard setter such as FASB and stipulates that a study must be completed to consider the value of principle-based approach versus the rules-based approach to standards.
2 **Disclosure**. SOX institutes numerous new disclosure requirements. These disclosures relate to off-balance sheet reporting, codes of ethics, the signing of financial statements and tax returns, whether the audit committee has a financial expert, and other issues. As a result of SOX, the SEC will continue to govern future disclosure rules.
3 **Auditing**. SOX creates an entire new organization, the Public Company Accounting Oversight Board (PCAOB) to regulate the auditing of public companies. This action constitutes a major increased role of government and a decreased role of the accounting profession in auditing regulation. SOX creates specific rules that public accounting firms must follow and charges the PCAOB to regulate the auditing profession in a way which strengthens public trust of corporations and their auditors.
4 **Governance.** With SOX, the federal government has entered in a major way the regulation of corporate governance. Several of the governance provisions in the Act refer specifically to accounting-related governance. These include new rules on independence and responsibilities of audit committees and management responsibility for internal control.
5 **Other.** Some provisions of SOX relate to enforcement, international issues, and regulation of non-accounting professions.

TEACHING SOX

Students have considerable difficulty learning the vast extent of financial accounting and auditing standards. They may have trouble differentiating the different types of regulation and standard-setting bodies. However, as accounting is a highly regulated profession, they need to have a basic understanding of the role regulation. With the enactment of SOX, regulation takes on even greater importance. The following suggestions are given to assist students in their understanding of accounting regulation:

- Teach accounting regulation from a broad perspective. Even though some regulatory issues may seem to fit in one course and other issues in another course, students benefit from a framework. They need to be familiar with the objectives of regulation, which include investor protection and improved performance of markets. The purpose of
- regulation in the accounting profession varies from some other professions because of the public trust responsibility held assigned to CPAs.
- Regulation is ultimately under the control of government. Governments can use varying approaches to establishing accounting regulation. For accounting standards, there is debate as to whether those standards should be more rules-based or principles-based. In establishing accounting regulation, governments decide whether to establish the regulation themselves or to delegate that responsibility to accounting professionals. SOX addresses the rules-based versus principles-based controversy.
- With this framework established, now organize the different types of accounting-related regulation including: measurement, disclosure, auditing, and governance. With these four types understood, the student should be prepared to understand the provisions of SOX in an organized

way. The table included in the full version of the paper consists of a section-by-section listing of the provisions of SOX organized by these four types of accounting regulation. The table can also be helpful in recognizing trends in regulation.

- Other issues in SOX that can be covered as desired include: criminal enforcement of the regulations, international implications of accounting regulation, and provisions of the Act dealing with non-accounting matters.

CONCLUSION

This paper discusses an approach to organizing the provisions of the SOX for teaching purposes. A table is provided which lists sections of the Act according to its coverage of measurement, disclosure, auditing, and governance issues. Suggestions are given to help students organize and learn the provisions of SOX.

REFERENCES

[1] Ribstein, L. International Implications of Sarbanes-Oxley: Raising the Rent on U.S. Law, Journal of Corporate Law Studies, Vol. 3, No. 2, 2003, Located at http://papers.ssrn.com/paper.tar?abstract_id=401660.

[2] Sarbanes-Oxley Act of 2002. This public law can be accessed at http://www.sec.gov/about/laws/soa2002.pdf and many other locations on the Internet.