

Monday, September 18, 2006 Volume 3, Issue 32



PLI's Compliance Counselor

CLEARING THE HURDLES TO GOOD
CORPORATE CITIZENSHIP



Hurdle of the week: What's Worse Than Getting Nickel And Dimed To Death? The Hidden (Non-Monetary) Costs Of Sarbanes-Oxley Disclosure

Next Week's Hurdle: Accounting Fraud Prevention

What's Worse Than Getting Nickel And Dimed To Death? The Hidden (Non-Monetary) Costs Of Sarbanes-Oxley Disclosure

The CC has chronicled the outsized monetary cost of SOX before. Indeed, the very first issue of this newsletter, back in January 2004, was about the struggle that many smaller public companies were engaged in to try and remain public in the face of increased compliance costs. At the time, the CC reported that "some middle market companies 'expect[ed] costs directly associated with being public to increase by almost 100% as a result of corporate governance compliance and increased disclosure as a result of SOX, new SEC regulations and changes to exchange listing requirements.'" And now, a little more than four years after SOX went into effect, we witness the SEC's follow-up to the final report issued by the SEC-commissioned Advisory Committee on Smaller Public Companies, which recommended 33 specific alterations to SOX to make compliance more financially palatable, particularly for smaller companies. On August 9, the SEC offered **SOX Section 404 relief** to smaller companies, relief that extends the filing deadlines and that will be welcomed by many that have struggled with the burdens of SOX compliance.

What hasn't gotten as much attention as the financial costs SOX compliance are, for lack of better terminology, the existential costs of SOX--that is, how it impacts the ways in which companies function under its umbrella. Yet, and the CC had forgotten this, the first issue dealt with that a little bit, too. But in the end, that may be the longest-lasting impact of SOX. It's easy to tinker with the financial side, but what about the psychic costs SOX compliance has on companies, from board members on down to the rank-and-file employee? These psychic costs, which force businesses to spend increasing amounts of time looking over their corporate shoulders, have impact. As you all know, the law deals very well with monetary loss; but non-monetary challenges are always a more difficult nut. That leaves it to you to help your clients strike the right balance. How do you keep your clients from spending too much non-monetary capital on their SOX disclosure?

Public Companies: Sarbanes-Oxley's Subtle Disclosure Costs, by Marc H. Morgenstern (Sonnenschein Nath & Rosenthal LLP) addresses one aspect of the

non-monetary cost of SOX compliance--the "subtle cost" involved in "the rigor and sophistication required to comply with the increasingly 'rapid and current' disclosures required by SOX and the SEC, as reflected by the 2004 passage of the SEC's expanded 8-K disclosure requirements." The CC made light of this conundrum back in issue 3-9 in the following imagined scenario:

- **Employee: Hey, the toilet is overflowing in the men's room. Who should I call?**
- **Manager: First, call maintenance. Then call legal and have them file a Form 8-K notifying the public.**
- **Employee: An 8-K...why?**
- **Manager: Item 2.05 - Material costs associated with...disposal activities... Look, I know we don't have to, but I'd be a whole lot more comfortable if we just started filing a Form 8-K for everything that happens to us.**

Maybe funny divorced from reality, but according to the author, while the expanded 8-K (along with its sped-up reporting period) may be "good for the overall market," it "decreases the probability of successful compliance":

- **Human error under time pressure increases the chance of disclosure error by a company, thereby increasing the risk of individual liability of its directors for failing to adequately oversee corporate disclosure. [I] anticipate increased litigation against public companies and their Directors challenging corporate and Director compliance with, and oversight of, expanded statutory and self-regulatory organizations' rules.**

And all that has a measurable impact on the bottom line. Morgenstern's article is an effort to place this problem in perspective and to offer a framework for the potential way out of the conundrum. And in short, it calls for better corporate teamwork to achieve a combination of rapid and accurate disclosures. And the focal point of this is the Board meeting, which must be transformed from the rote recitations of the past to an "interactive, challenging dialogue among Board and management." As this is a "major goal of corporate governance," it is all to the good and will "create[] an ever-faster, real-time, disclosure environment."