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Twenty Years of Sarbanes-Oxley: A Look at the Act's History and Its Impact in Kansas

By William Quick and Toni Ruo

The Public Company Accounting Reform and Investor Protections Act of 2002,¹ commonly known as the Sarbanes-Oxley Act has been in effect for 20 years. As we commemorate the act's platinum anniversary, it is important to remember what led to its enactment and reflect upon how the act has and continues to impact Kansas law and companies.

The financial and corporate scandals surrounding Enron and Arthur Anderson in 2002 left investor confidence at an all-time low. These scandals, characterized by extreme related-party transactions, creative financial accounting, excessive compensation, and poor corporate culture, propelled Congress to enact the Sarbanes-Oxley Act of

2002 (SOX for short). SOX addressed three primary issues: Corporate governance, fraud, and accounting transparency. Additionally, SOX shifted views on corporate governance within companies, which, in turn, protects financial data integrity and privacy.

While SOX addressed these issues at a federal level, Kansas echoed these ideals just two years later in 2004 when it passed the Kansas Uniform Securities Act (KUSA). Although prior to SOX, Kansas had one of the most "pro-investor blue sky acts in the nation,"² many of the changes in the KUSA reflected a heightened awareness of fraud prevention and transparency, prevalent in SOX. Additionally, as ESG (environmental, social, and corporate governance) ideals gain

more traction across the United States, Kansas companies may seek to use SOX compliance standards and practices as a guide in addressing associated investor demands.

Corporate Governance and Accountability

SOX placed heightened controls and requirements on high-ranking corporate individuals to ameliorate corporate governance and accountability shortcomings. According to Andy Whittle, senior manager of Internal Audit and Financial Advisory at Protiviti, SOX represented a “paradigm shift” in corporate governance to “revitalize dangerously low public confidence,” and officer certifications were the “lynchpin” in the shift.³ Specifically, SOX requires the CEO and the CFO to certify to the accuracy, completeness, and fairness of the company’s annual reports and financial statements.⁴

Officer certifications, according to Whittle, inspired a focus on financial data integrity. Officer certifications “inspired a more pronounced need from CEOs and CFOs to bolster confidence in the reliability of the reporting they are being asked to certify. These programs principally focused on financial data process discipline, and other methods, to protect financial data integrity.”⁵ While corporate financial scandals plagued the early 2000s, data breaches have taken center stage in the late 2010s and early 2020s. SOX movement encourages business decision-makers “to visualize cross-department process and application data integrity risks associated with maintaining and capturing data on its way to the financials.”⁶ Because the officer certifications have a trickle-down effect on business decision-makers, “SOX compliance protects data integrity”⁷ and arms business decision-makers with accurate and meaningful information in a corporate environment plagued with the risk of data security breaches.

Because Kansas does not have a general privacy act⁸, officer accountability regarding data privacy is especially important. While Kansas does have privacy-related legislation in the form of the No-Call Act and the Kansas Consumer Protection Act,⁹ these statutes relate to the consumer’s rights rather than a company’s duties. Public and private companies must put their own controls in place to protect their own and their customers’ data. As Whittle described, SOX promotes data integrity. In Kansas, companies that implement SOX internal controls will create the “trickle-down” effect to in turn protect their company’s data integrity.

Fraud Prevention

SOX set standards to better detect and prevent fraud. Among these standards are whistleblower protections that prevent discrimination against employees who lawfully assist in investigations related to securities laws or fraud violations.¹⁰ Additionally, the act imposes harsher penalties for those who perpetrate the fraud.¹¹

Echoing SOX, the KUSA implemented more robust fraud prevention procedures. This Kansas act expanded state enforcement powers to include civil and criminal actions against perpetrators of fraud and increased investigatory and subpoena powers for securities administrators.¹² These actions provide Kansas administrative agencies the power to better detect and prevent fraud.

Accounting Practices and Financial Transparency

To increase financial transparency and improve accounting practices, SOX created the Public Company Accounting Oversight Board (PCAOB) to oversee the auditing of public companies and related matters.¹³ Primarily, accounting firms are required to be independent from the companies they are auditing. Additionally, the firm performing an audit may not perform non-audit services for that company.¹⁴ Finally, the fiduciary duty of care was extended to the hiring and retention of accountants, and a company is liable if it knew or should have known an accountant it is associated with was barred by the PCAOB or the SEC.¹⁵

While the KUSA approaches financial transparency differently, the Kansas act incorporates these SOX ideals with additional registration requirements. The KUSA requires three forms of securities registration: notice, coordination, and qualification.¹⁶ These three additional filing requirements improve marketplace transparency because they require a company to file with Kansas the documents previously filed with the SEC.

Future SOX Impact on Kansas Industries

Kansas industries are sure to be impacted as their stakeholders demand more attention be paid to ESG factors. The future of ESG factors is closely tied to SOX compliance. Corporate investors are increasingly interested in companies that prioritize ESG factors.¹⁷ This year the SEC proposed rules requiring registrants to disclose climate-related risks that are reasonably likely to have a material impact on their business and financial condition.¹⁸ In light of these proposed rules and the growing uncertainty surrounding other ESG regulations, professionals are looking to SOX compliance procedures for guidance.¹⁹ As more regulations around ESG reporting emerge, it is important to have internal controls to communicate that data accurately and completely.²⁰

The SEC’s new climate disclosures and ESG reporting will directly impact Kansas businesses, both public and private. Two of the largest industries in Kansas are agriculture and natural resources and energy.²¹ Additionally, Kansas is a top 10 oil-producing state, accounting for close to one percent of the total crude oil output in the United States.²²

While these companies may not be public, and thus not directly impacted by the SEC's new climate disclosures, SOX compliance has evolved as a standard of best practices for private companies. To this point, court cases support the idea that SOX standards may provide a benchmark for a director's fiduciary duties to the company in general.²³ As such, stakeholders of Kansas oil and agricultural companies may demand to know the impact the business has on the environment. These companies will be able to use SOX compliance standards as well as the SEC's climate disclosure regulations to keep pace with environmental disclosure demands.

Conclusion

Looking to the Sarbanes-Oxley Act, its lead-up and its aftershocks over the past 20 years provide useful guidance and instruction for the Kansas business and legal communities in their pursuit of solutions to present and future exigencies facing Kansas and the nation. Whether it be tempering data privacy risks, managing ESG considerations and expectations, or beyond, the Sarbanes-Oxley Act provides a familiar refrain promoting constructive procedure, process, and practice in promoting accountability and transparency in our business marketplace. ♦



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9. *Id.*
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11. *See id.* § 303; Improper Influence on Conduct of Audits, SEC Release No. 34-47890 (June 26, 2003).
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23. *See Pereira v. Cogan*, 294 B.R. 449, 520-24 (S.D.N.Y. 2003); Amy L. Goodman & Steven M. Haas, Corporate Governance: Law and Practice § 1.03 (2021). *See also* Fletcher's Cyclopedia of Corporations § 844.10 (perm. ed., rev. vol. 2002). The proposition has also been made that corporate fiduciary obligations are universal and not dependent on the size of the corporation. Fletcher's Cyclopedia of Corporations § 844.20 (perm. ed., rev. vol. 2002) ("The fiduciary obligations of a close corporation's directors or majority shareholders is not relaxed any more than in other corporations.").