Sarbanes-Oxley Stifling? Say It with a Straight Face

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LUCK is a many splendored thing, especially in the boardrooms of corporate America.

Just nine months after the practice of backdating options for executives became the latest business scandal, a study released Monday found backdating extends to company directors as well.

During the past decade, as many as 1,400 outside directors at 460 companies may have received options that had their grant dates manipulated to coincide with market dips, the study estimates.

Giving executives or directors options at a known low point in the market increases the value of those options when the stock rises. Hindsight, in this case, creates an added bonus.

The study, which was sponsored by the Harvard Law School Program on Corporate Governance, explains in part why executive backdating was so prevalent. Directors, the guardians of shareholder interest and the people who are supposed to monitor executive pay, were taking their own turn at the trough.

"Directors' luck and executives' luck have been linked," the study says.

The findings, by the way, came from the same research team that earlier this year uncovered the unusual instances — odds in some cases of as much as 1 in 300 billion — of executive option grants consistently timed to market lows. Those findings have touched off a litany of investigations and led to dozens of executive departures.

Backdating, whether it's in the executive suite or the boardroom, isn't the sort of scandal that brings financial ruin to most companies. Aside from restating financial results, the effects are minimal.

But it's one more deception put forth by those from whom the market expects honesty. It's a betrayal of investors by corporate leaders, an abdication of their responsibility in the name of self-enrichment.

Disturbing timing

The study found that while the reforms in the Sarbanes-Oxley law reduced backdating, it didn't eliminate it.

Which is why it's both ironic and disturbing that the latest backdating study should emerge less than a week after the Securities and Exchange Commission, bowing to years of intense corporate lobbying, took the first steps toward dismantling the Sarbanes-Oxley reforms.

Commissioners voted last week to allow companies with smaller market values more flexibility in assessing the strengths of their internal controls. The internal controls provision is a key part of the law's safeguards for ensuring accurate financial statements.

Companies, however, complained that the requirement was too expensive and burdensome.

No pass for small business

The SEC's vote was a big victory for the business lobby, which will no doubt continue to press for its long-sought goal of an outright Sarbanes-Oxley repeal.

From the standpoint of the law's intent, it's easy to give small businesses a pass. After all, the law was designed to address wrongdoing at large corporations in a response to scandals such as Enron and WorldCom.

But waiving the reforms for small business ignores a history that predates Enron. Small-cap markets, after all, have been a hotbed for self-dealing, stock manipulation and fraud for decades.

The business lobby argues that Sarbanes-Oxley is an arduous regulation that impedes growth and scares companies of all sizes from our public markets.

This argument is made, apparently straight-faced, at a time when corporate profits make up a bigger part of our economy than they have since the 1960s.

Merger and acquisition fees

Wall Street firms have racked up record earnings this year, fueled by banking fees for mergers and acquisitions and the most active market for initial public offerings in six years.

Goldman Sachs, which reported the biggest profit ever for a securities firm, set aside more than $16 billion this year for salaries, bonuses and benefits this year, according to the company's proxy statement. That's an average of $622,000 per employee.

Sarbanes-Oxley, in other words, is hardly having the stifling effect its opponents contend. Among other things, the law set clear limits on the conduct of directors as well as executives. It's a reminder to boards that their allegiance lies with investors, not their golfing buddies in the corner office.

Companies complain that because of the law, they can't find qualified directors.

The Harvard study raises the question of whether they ever really did. Perhaps they just found directors who were incredibly lucky.