Will Sarbanes-Oxley Be Effective? (HONRS 499)

by

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Abstract

In response to all of the recent accounting failures, Congress passed the Sarbanes-Oxley Act. Its objective is to prevent the same types of accounting failures and fraudulent activity from occurring in the future. However, the effectiveness of Sarbanes-Oxley is largely uncertain. In my opinion, it will not be very effective. Penalties to deter corporate fraud existed prior to the legislation, and they have not worked very well. Studies conducted by the United States Bureau of Justice confirm this. One of Sarbanes-Oxley's main approaches to correcting the problem of corporate fraud is to increase the existing penalties. HealthSouth, the first firm to be charged under Sarbanes-Oxley, proves that the increase in penalties will not serve as an effective deterrent for corporate crime. In order to support this conclusion, I give a brief analysis of the major provisions of Sarbanes-Oxley and then discuss a couple of the major accounting failures that have recently occurred. In addition, statistics on fraud crime and the success rates of parole are also included.

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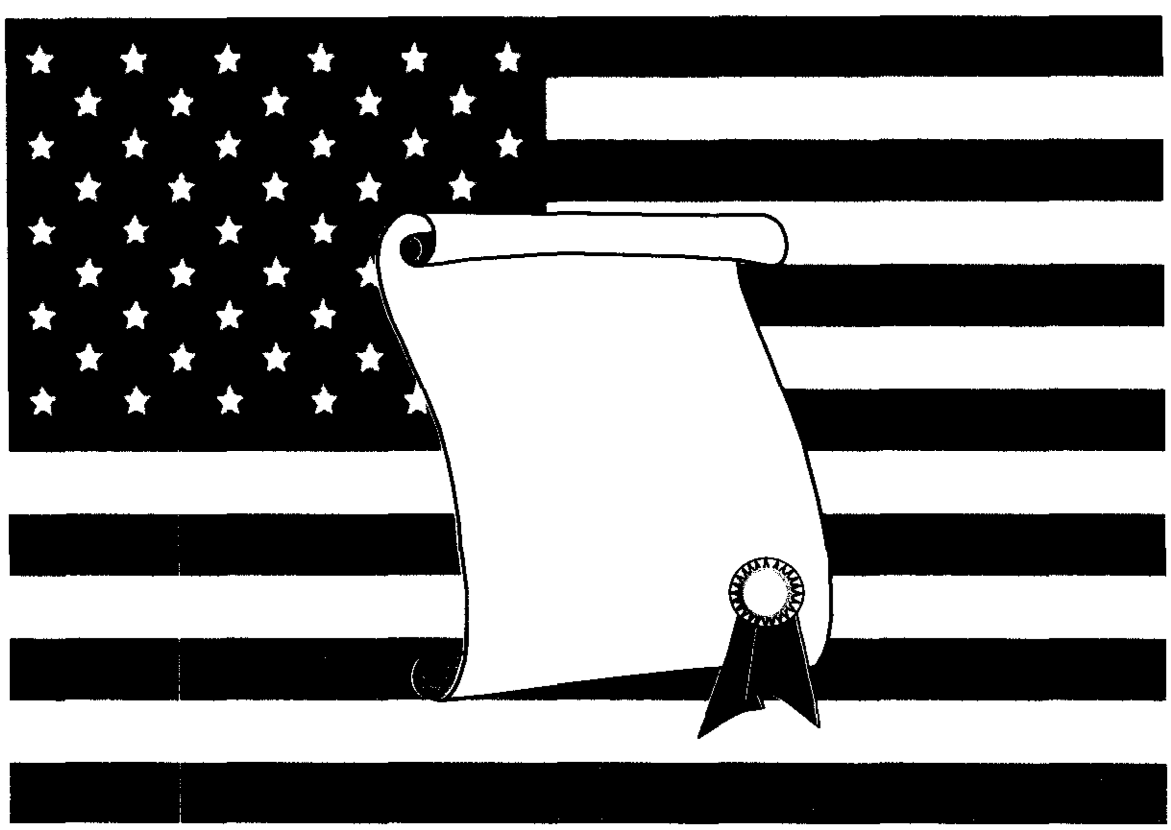
Will Sarbanes-Oxley Be Effective?



The Sarbanes-Oxley Act was passed by Congress in July of 2002. This act is the legislative government's response to all the recent failures that have occurred in public accounting. The objective of Sarbanes-Oxley is to prevent fraudulent acts from occurring in order to protect current and prospective creditors and investors and to restore their confidence in the business economy. The significant issue is whether or not this will be effective. There are two big questions weighing on people's minds. Is it is possible for legislation to curb negative actions? Will this Act prevent situations that have occurred in some of the recent accounting failures? Through a discussion of the elements that comprise Sarbanes-Oxley, the scandals that occurred in some of the recent accounting failures, and whether or not Sarbanes-Oxley will be effective against accounting misconduct in the future, these questions will be answered.

It is important to have a strong understanding of what components make up this Act in order to assess its effectiveness. Sarbanes-Oxley applies to all companies which are registered under the Securities and Exchange Commission Acts. Most companies register so that they can issue stock. Sarbanes-Oxley also applies to all accounting firms which are registered with the newly created Public Company Accounting Oversight Board. Any accounting firm which wishes to prepare or issue any type of audit report for a company issuing stock is required to register with the Public Company Accounting Oversight Board by the laws set forth in Sarbanes-Oxley.

One of the first things that the Sarbanes-Oxley does is to establish the Public Company Accounting Oversight Board (101a). The responsibilities of this Board are to register public accounting firms and to establish or adopt auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports. The Public Accounting Oversight Board is also required to enforce compliance with Sarbanes-Oxley by inspecting registered public accounting firms, conducting investigations of those firms when necessary, and punishing fairly all firms or persons not in compliance with the act (101c).

Members of the Public Company Accounting Oversight Board are appointed by the Securities and Exchange Commission. The Board must consist of five individuals who have shown their dedication to the protection of investors, creditors, and the public interest. These individuals must also possess an understanding of the importance and purpose of financial disclosures and audit reports. In addition, exactly two members of the Board shall be or have been certified public accountants. All members of this Board will serve on a full-time basis and will not be permitted to be employed by any other person or firm while serving as a member of this Board. Also, members of the Board will not be allowed to share profits with or receive payments from any public accounting firm, with the exception of fixed continuing payments such as a retirement pension. Each term of service to the Board will last for five years, and no individual may serve more than two terms. The terms may be served consecutively. In order to create stability on the Board, only one member's term shall expire and be filled by a new member each year (101e).

The Public Company Accounting Oversight Board serves a government function, but it is not a government agency. It has the power to conduct operations and maintain offices, to appoint employees, accountants, attorneys, etc. as needed, and to lease, purchase, or otherwise acquire or sell property. It also has the power to enter into contracts, to sue and be sued, and to collect and disburse accounting support fees (101f).

As mentioned previously, the Board has the authority and responsibility to conduct investigations of firms which are not in compliance with law. Specifically, the Board may investigate any action, practice, or failure to act that violates Sarbanes-Oxley, the rules set forth by the Board, securities laws, or professional standards that are committed by a registered public accounting firm or any person related to a registered public accounting firm, regardless of how the Board becomes aware of the violation (105b).

While conducting the investigation, the Board has the power to require the testimony of the firm or any related person, including any client of the firm, if such a testimony is considered to be relevant and material to the investigation. The Board may also require the production of audit workpapers and any other relevant documents or information by the firm or any other person, including any clients of the firm. If the registered public accounting firm or any person related to it does not willingly produce any of the previously mentioned items, the Board may seek a subpoena from the Securities and Exchange Commission to require the production of any or all of them. All documents that are given to the Board during an investigation will be kept confidential (105b).

If a registered public accounting firm or any person related to such a firm is found to be in violation, the Board will first bring specific charges against the firm or person. The firm or person charged with a violation will be notified of the charge and given an opportunity to defend its position. The Board may also impose any of the following disciplinary or corrective sanctions:

(A) a civil money penalty for each such violation, in an amount equal to – not more than $100,000 for any natural person or $2,000,000 for any other person

(B) censure

(C) required additional professional education or training

(D) any other appropriate sanction provided for in the rules of the Board

If the violation is found to be caused by intentional or knowing conduct, reckless conduct, or by repeatedly negligent conduct, then the Board may impose one of the following disciplinary or corrective sanctions:

(A) temporary suspension or permanent revocation of registration under this title

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training)

(D) a civil money penalty for each such violation, in an amount equal to – not more than $750,000 for any natural person or $15,000,000 for any other person (105c).

The Board also reserves the right to enforce sanctions on any registered public accounting firm if it refuses to cooperate during an investigation. The Board may impose the following sanctions for lack of cooperation:

(A) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association

(B) suspend or revoke the registration of the public accounting firm

(C) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board (105b)

The creation of the Public Company Accounting Oversight Board is very significant. It is the first legislation ever enacted with the purpose of regulating the accounting profession. Prior to this legislation, the American Institute of Certified Public Accountants, a voluntary national organization, established rules and standards to direct accountants through challenges and uncertain situations that may arise (Whittington and Pany 13). The American Institute of Certified Public Accountants no longer performs this activity because Congress gave the Public Company Accounting Oversight Board legal authority to establish rules and regulations for the accounting profession. This is a very huge blow to the profession because accountants had always been viewed as being so honest and trustworthy that Congress allowed them to be self-regulating. It is not that people believed that there were not any accountants who lied and cheated. However, the public did believe that the vast majority of them would do what was right in any situation and that this majority was strong enough to regulate or filter out the corrupt accountants. For the most part, people believed that accountants would not "cook the books" or assist someone in doing so. They protected investors and the public from the treachery of evil executives. Unfortunately, with this new legislation, a new, less respectable light has shone on accountants. Now that Congress has taken away their power of self-regulation because of all the recent scandals, the positive view the accounting profession used to enjoy is quickly slipping away.

Regrettably, the Public Company Accounting Oversight Board got off to a very rocky start. When Congress created this Board, it did so with the idea that the Board would stand for the highest accountability and ethical standards possible. Unfortunately, among the selections to the Board was William Webster. In fact, he was chosen to serve as the chairman of the Board. Until July of 2002, Webster had been a member of the board for a small company called U.S. Technologies. While he was serving as a member of this board, there was an incident of possible fraud. Webster was accused of not investigating issues that the company's independent auditor brought to his attention. It appeared that he did not want to find out the truth. This tarnished the view of the Public Company Accounting Oversight Board before it even began functioning as its own unit because Webster's situation was the exact kind of situation the Board was created to prevent ("PCAOB Challenged").

According to Sarbanes-Oxley, the Securities and Exchange Commission (SEC) functions as the regulatory body of the Public Company Accounting Oversight Board. It possesses supervisory and enforcement power over the Board (107a). One of the duties of the SEC is to approve rules and punishments for breaking the rules that are created by the Board. A new rule or a modification of an existing rule will not become effective until the SEC has approved it (107b). In addition to the SEC review of punishments for the violation of rules, the United States Sentencing Commission will review them (1104a).

The SEC also has the responsibility to review disciplinary actions of the Board. The Board is required to file any final sanction issued against a registered public accounting firm with the SEC. The SEC has the power to increase, modify, reduce, or terminate any sanction of the Board if it finds the sanction to be unnecessary or inappropriate according to Sarbanes-Oxley or the securities laws or if the sanction is extreme, oppressive, or insufficient (107c).

Along with reviewing the Board's actions, the SEC must also review its financial stability. The budget created each year by the Board is subject to the approval of the SEC (109b). The Board is also required to submit an annual report to the SEC. This report must include audited financial statements (101h).

Auditors, as individuals and as firms, are required by law to maintain independence from the client that they are auditing so that every person will know, without a doubt, that they were not biased during the audit or in their opinion of the financial statements of the client. Sarbanes-Oxley has both expanded and clearly defined the level of independence that the auditor is required to maintain. It is now illegal for a person or firm providing any type of audit service required by Sarbanes-Oxley or by the Securities and Exchange Commission to simultaneously provide any non-audit services prohibited by the Securities and Exchange Act of 1934 and any of the following non-audit services:

(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

(2) financial information systems design and implementation;

(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(4) actuarial services;

(5) internal audit outsourcing services;

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services unrelated to the audit; and

(9) any other service that the Board determines, by regulation, is impermissible.

However, the person or firm providing audit services will be permitted to provide any non-audit services, such as tax services, not specifically prohibited above or by the Securities and Exchange Act of 1934 on one condition. The audit committee of the client must approve the non-audit service before it can be performed (201a&b). Of course, there are exceptions to the rule of prior approval. If the non-audit services comprise 5% or less of the total revenues received by the auditor or the auditor's firm from the client or if the services were not recognized as non-audit services by the client at the time of their performance, the services do not need to be approved by the audit committee of the client. Also, if non-audit services begun prior to approval are brought to the attention of the audit committee in a timely manner and are approved before completion, the prior approval requirement can be waived (202i).

The two remaining issues of importance related to the independence of auditors deal with the required rotation of auditors and conflicts of interest. According to

Sarbanes-Oxley, the audit partner planning and controlling the audit and the audit partner reviewing the audit must be rotated at a minimum of five years intervals. The audit partners may be changed sooner, but they cannot remain on a job for the same client for longer than five years (203). Also, the client of the registered public accounting firm cannot fill certain offices with a person that previously was employed at the firm and participated in the audit of the client during the one-year period prior to the date the current audit was started. These offices include, but are not limited to, chief executive officer, controller, chief financial officer, and chief accounting officer (206).

Sarbanes-Oxley sets out specific responsibilities and requirements of corporations for increasing the accountability and the effectiveness of financial reporting. One of the most important responsibilities that a corporation bears is preparing the financial statements. The officer who signs each report, whether quarterly or annually, is required to have actually reviewed the report. After reviewing the report, the signing officer must believe that report fairly reflects the financial position of the firm, which means to his or her knowledge the report contains no material misstatement or fraud. Material misstatement means either the exaggeration of or the omission of an amount that would affect an investor's decision that was made based on financial statements or reports (302a).

Officers who sign financial reports also have responsibilities related to internal controls. They are required to establish and maintain internal controls that relay material information to the officers who sign financial reports. They are also required to assess the effectiveness of the controls within 90 days before the report is issued and document their findings. It is the responsibility of those officers whose signatures are on financial reports to keep both the auditors and firm's audit committee informed. They are required to relay information concerning any significant weaknesses or changes in internal controls and any degree of fraud that is found (302a).

Members of the audit committee are also members of the board of directors and must maintain their independence. They are not allowed to receive any compensation from the firm whose board they serve on other than compensation directly related to their membership on the board or on the audit committee. In regard to audit services, members of the audit committee have the responsibility of choosing and compensating the services of any registered public accounting firm employed by the firm. This committee is also responsible for overseeing the work that public accounting firms do and settling any disputes that may arise between the auditors and management. Another important task of the audit committee is to deal with complaints from the firm and anonymous complaints from the firm's employees concerning the accounting and auditing procedures being used and the internal control procedures that are implemented (301).

Restrictions focusing more on individuals in a firm than the firm itself deal with improper influence, loans to executives, and ethics. Sarbanes-Oxley makes it illegal for any officer, director, or person acting on behalf of an officer or director to attempt to influence the independent auditor to act in a fraudulent or manipulative way that would cause the financial statements of the firm to be materially misstated (303a). A firm is restricted from issuing personal loans to its executives unless the loan is provided in its ordinary course of business, is of a type that is typically available to the public, and is issued on market terms where the terms are no more favorable than those offered by the firm to the general public (402a).

According to the Securities and Exchange Act of 1934 and Sarbanes-Oxley, all public firms are required to report whether or not they have adopted a code of ethics and why (406a). They are also required to report any changes made to the code (406b). A code of ethics refers to standards that advocate honest and ethical conduct, especially in the treatment of conflicts between personal and professional goals and relationships. The code of ethics also provides for standards relating to complete, accurate, and timely disclosure of financial information in an understandable format that is in agreement with relevant rules and regulations (406c).

One of the main purposes of Sarbanes-Oxley is to curb corporate fraud by increasing the penalties that will be received for committing it. There are two goals that Congress has in mind for the penalties. The first goal is to create penalties that are strict enough to deter people from committing fraudulent acts, and the second goal is to make sure that the penalties match the severity and seriousness of the violation that is committed (805a & 905b). Specifically, punishments will be adequate for severe situations where the violation includes a misuse of special skill or a position of trust or where "the destruction, alteration, or fabrication of evidence involves—

(A) a large amount of evidence, a large number of participants, or is otherwise extensive;

(B) the selection of evidence that is particularly probative or essential to the investigation; or

(C) more than minimal planning (805a)."

As a result of this act, some existing penalties have been increased. For example, corporate officers are required to sign any financial report or statement that will be issued to the public to verify that the information represents the company's financial position in all material respects. If any of the signing officers are aware that the statement or report does not fairly reflect the company's situation, that officer may be fined up to $1,000,000 or imprisoned up to 10 years or both. If any officer is aware that the statement or report does not fairly reflect the company's situation and willfully certifies it with his or her signature, then that person may be fined up to $5,000,000 or imprisoned up to 20 years or both (906c).

Other penalties for corporate fraud have also been created or increased. Any person who changes, hides, destroys, or makes a false entry on a document or record with the purpose of obstructing an investigation will be fined or imprisoned up to 20 years or both (802a). All audit workpapers must be kept for a period of 5 years after the audit is completed. If any person or accountant destroys these records before the 5-year term is up, then he or she may be fined or imprisoned up to 10 years or both (802b). Any person who defrauds or attempts to defraud shareholders will be fined or imprisoned up to 25 years or both (807a). Penalties for mail and wire fraud have both been increased. A person committing mail or wire fraud may now be imprisoned up to 20 years. The punishment for each of these crimes had previously been imprisonment up to 5 years maximum (903a & b).

In addition to increasing the severity of penalties for corporate fraud, Sarbanes-Oxley established a Statute of Limitations for Securities Fraud. Action must be brought against a violator by the earlier of the following periods: 2 years after the discovery of facts of the fraudulent act or 5 years after the fraudulent act was committed (804b).

Protection for employees who provide evidence of any violation to this Act or the securities laws, also known as whistleblowers, is provided by this legislation. Any employee who acts in a lawful manner to provide a federal regulatory agency, a federal law enforcement agency, a member of Congress, a committee of Congress, or any person with supervisory authority over the employee with information about violation shall be protected. Any employee who files or assists in filing a complaint or testifies in a complaint filing will also be protected under this Act. People who are protected by this legislation shall not be released from their employment, suspended from their employment, removed from their positions, threatened, harassed, or treated unfairly in any other way by their employer (806a).

A person who believes that he or she has been discriminated against in one of the ways previously mentioned or in any other way may seek justice by filing a complaint with the Secretary of Labor. There is one stipulation that must be followed when a violation occurs. Action must be taken within 90 days of the violation, which means that the complaint must be filed within 90 days of the day on which the violation occurred (806b).

Those whom the Secretary of Labor has found to be discriminated against will receive remedies for the mistreatment they have received. Those people will be compensated by reinstatement of their position with the same seniority they had prior to discharge, receipt of the amount of back pay owed with interest, and receipt of any amount owed due to special damages caused by the mistreatment and litigation fees (806c).

Finally, Sarbanes-Oxley increased the power and the responsibility of the Securities and Exchange Commission (SEC). This federal agency now has the power to censure any person who willfully violated or aided in the violation of any stipulation of Sarbanes-Oxley or the securities laws, who does not hold the essential qualifications to represent others, or who is deficient in integrity. The SEC may also censure anyone who is found to take part in unethical or improper professional conduct (602a). Improper professional conduct is defined as intentional and knowing conduct or negligent conduct, whether the negligence is one extremely unreasonable act that violates professional standards or several repeated acts (602b).

The SEC now has the power to issue a temporary freeze on extraordinary payments to be made by a company during an investigation for a violation of the Federal securities laws or Sarbanes-Oxley. The company will be required to deposit all funds to be paid in an interest-bearing account for 45 days (1103a). The SEC may also prohibit any person from serving as an officer or director of a company if the behavior of that person makes it evident that he or she is unfit for such a position (1105a). In addition, the SEC has been given the authority to appropriate $98,000,000 to hire a minimum of 200 qualified professionals to improve the supervision of audit services and to increase the SEC's investigative and disciplinary efforts over auditors and the services that they provide (601).

The recent accounting failures that have occurred have had a tremendous impact that has been felt all over the United States. Those failures are the reason that Sarbanes-

Oxley was created. Some of the major downfalls that have made a huge impression in the last year include Enron, Arthur Andersen, WorldCom, and Xerox. Enron and Arthur Andersen are basically credited with starting the beginning of the end for accounting self-regulation and the confidence with which the accounting profession was previously viewed.

Enron was an energy firm. Its big scandal was off-the-book financial transactions that hid millions of dollars worth of debt and deals designed to inflate profits (Teather). The company began by creating partnerships and using these partnerships to borrow money, purchase assets, and enter into contracts. As long as Enron kept their ownership in those partnerships below 50%, they were only required to report information about the partnerships in the footnotes of their financial statements. This means that the information from these partnerships were not included in the numbers for Enron's financial statements. So, Enron was able to borrow money without recording any debt ("Wheels within wheels"). This definitely made Enron appear to be in a much better position to investors and creditors than it actually was. In the end, the company was forced to declare bankruptcy, causing millions to lose jobs and retirement funds.

There were many people to blame for transactions that had been allowed to occur. Some people felt that investors and agencies issuing credit ratings were to blame for not examining Enron's public filings carefully enough. Others turned to point a finger at those legislators who had passed the rules that Enron used to get by with their scheme ("Not just a few bad guys"). However, most of the blame was shifted towards the company's auditor, Arthur Andersen. The world was left to wonder how an accounting firm with such a long-standing reputation for excellence had missed or been negligent regarding such behavior. It is, of course, the auditor's job to review, test, analyze, and do whatever else is necessary to determine whether or not the information on a company's financial statements fairly represents the company's financial position. Once that has been done, the auditor will issue an opinion on the fairness of the statements.

Arthur Andersen did issue an opinion that stated that the financial statements did, in fact, reflect the current financial position of Enron, even though they did not. There is always that chance that the auditor's test will produce incorrect results or that the auditor will make a mistake. However, this is highly unlikely in Andersen's case because the fraud had been on going for years.

The root of Andersen's unethical behavior was its consulting business. While auditing fees began to plummet, consulting fees began to rise. So, Andersen's focus shifted accordingly. Andersen's consulting business was a gold mine. It made millions for the company and for its partners. In the partners' attempt to preserve their income levels through increased consulting fees, they lost sight of importance of auditing. They began to allow clients who provided them with large amounts of consulting fees to carry out accounting practices and transactions that were not in accordance with Generally Accepted Accounting Principles. Andersen crossed a huge line in doing this because the Generally Accepted Accounting Principles, better known as simply GAAP, are what governed the accounting profession prior to Sarbanes-Oxley's creation of the Public Company Accounting Oversight Board. The company was even accused of committing fraud because it had bent the rules so far in its audit of Waste Management, Inc. (Brown and Weil).

WorldCom, another client of Arthur Andersen, was the site of another major accounting scandal that recently occurred. WorldCom's first fraudulent act involved the capitalization of expenditures. This has a major impact on the amount of profit that is reported for the company (WorldCom). Profit is an item that investors and creditors use in their decision-making processes, and the higher it is the better. When an amount is capitalized, only a portion of the whole amount is written off or subtracted each year for the length of the capitalization. Expenses should immediately be subtracted in full from revenue. If they are only partially subtracted from revenue, then there appears to be more of a profit than there actually is. If profit is not presented correctly, many people are affected because so many people rely on it for decision-making.

The second fraudulent act committed by WorldCom involves revenue recognition, which has been a constant source of problems because of all the different rules and exceptions involved with it. The company had recorded 3.3 billion dollars worth of profit that had not been earned, which further boosted its profit level (WorldCom). The scandal at Xerox, as well as many other accounting firms, also dealt with revenue recognition. Xerox has been fined 10 million by the Securities and Exchange Commission for recording 6.4 billion of revenues over a five-year period that it did not earn (Pham).

The scandals previously listed are only the tip of the iceberg. There are many others, and more will probably be revealed in the near future. A more important issue is whether or not Sarbanes-Oxley will be effective in preventing the fraudulent acts previously mentioned. In my opinion, it probably will not be effective. I believe that there are a couple of provisions that may stop a few people from acting fraudulently, but the vast majority of people who are willing to cheat others to get what they want will continue their scandalous behaviors. Sarabanes-Oxley may be a bump in their road, but I think that they will find a way around it just like they have every other law, person, or rule that was a previous bump in their road. This also leads me to believe that if Sarbanes-Oxley does work, it will be short-lived. Once the loopholes are found, which never seems to take very long with any type of legislation designed to curb negative activity, its effectiveness will be lost.

However, the fact that many audit and non-audit services may not be performed simultaneously by the same company will definitely help decrease the motive for fraud and collusion with clients in accounting firms. This would have been specifically applicable in Arthur Andersen's case. The reason that Andersen would not put its foot down and force its clients to make adjusting entries to fix their fraudulent activities is that it was afraid of losing clients that provided high consulting revenue. The clients committing fraudulent acts probably just told Andersen that if it did not allow them to do what they wanted then they would find an auditor who would. Unfortunately, the partners at Andersen were not willing to risk a decrease in salary for properly reported financial statements. Now, without the risk of losing consulting revenues hanging over auditors' heads, it may help auditors be firmer when they think their clients should make certain adjustments to their financial statements. The business world will probably see a rise in auditing fees as a result of this legislation. It would be optimistic to think that in the future auditors will walk away from clients who refuse to make necessary adjustments. Unfortunately, I doubt that this will ever happen. For a certain price, somebody will take the chance.

The other regulation that will probably reduce some client and auditor collusion in fraud is the regulation that requires audit partners to be rotated every 5 years. More people will have to be involved and aware of the fraud for it to continue beyond a 5-year period. The more people that know, the more likely it is that someone will report or attempt to stop the fraudulent activity. Although many people were probably aware of the activities going on at Arthur Andersen, and no one told about those. However, the fear of losing a job, possibly a career, stops most people from reporting fraudulent acts that occur at their place of employment. They believe that if they do report it they will lose their job and risk the chance of not finding another one. I think that people are right in fearing that another corporation will not hire them because they reported fraudulent activity at their previous job. Some companies may see these people as being annoying or bothersome, rather than helpful, and they may fear that something they have to hide will be uncovered. So the effectiveness of this regulation is uncertain.

The last major provision of Sarbanes-Oxley intended to curb fraudulent behavior was the increase in penalties such as fines and jail time. The big question is will increasing the severity of punishments really make people stop committing fraud, or will those who are inclined to partake in fraudulent activity do so anyway? Unfortunately, the statistics are not too favorable. Statistics compiled from 1990 through 1997 by the U.S. Department of Justice's Bureau of Justice show that the number of people held in State prisons has increased ("Correctional Populations").

	Number of Inmates in State Prison							
Serious Offense	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Total Property	173,700	180,700	181,600	189,600	207,000	226,600	231,700	236,400
Burglary	87,200	90,300	90,500	94,300	101,800	108,900	111,700	114,900
Larceny	34,800	35,700	33,500	35,300	39,600	44,500	45,000	45,100
Vehicle Theft	14,400	16,000	18,100	18,900	19,700	21,300	20,200	19,800
Fraud	20,200	20,400	20,200	21,300	23,600	26,300	27,600	28,900
Other Property	17,100	18,200	19,400	19,800	22,300	25,600	27,200	27,700

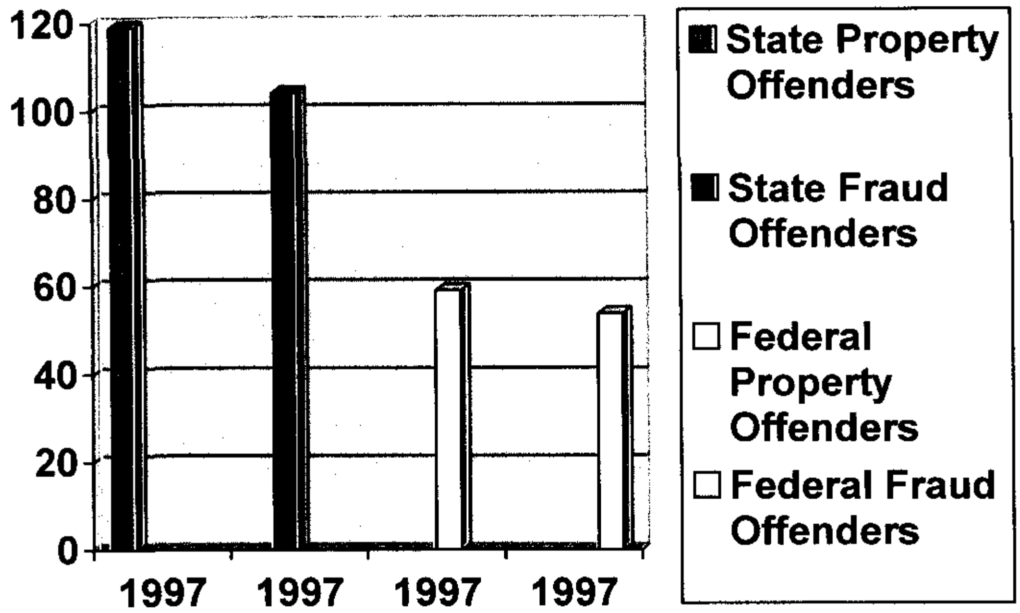
As displayed in the table above, many cases of fraud are classified as a serious property offense. (I included the other major categories of property offenses to show that these cases rank right up with burglary, larceny, and motor vehicle theft.) This table lists the total number of people who are in held in a State prison for serious fraud crimes only. This number does not include those sentenced or fined for petty fraud crimes, which means that these numbers would probably be significantly larger if they included all fraud related fines and sentences. This fact makes it even more significant that from 1990 to 1997 there was an enormous increase of 8,700 people being held in State Prisons alone for committing serious fraud crimes (Correctional Populations").

The table previously shown also does not include Federal statistics. However, those statistics show an increase in the number of persons being sentenced to a Federal prison for fraud in almost every year since 1990.

Most Serious Offense	Number of Offenders Sentenced to Federal Prison							
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Fraud	4,464	4,542	5,039	5,378	4,967	5,258	5,751	6,282

These figures do not include the number of prisoners being held in Federal prisons for committing serious fraud crimes. It only shows that number of individuals who are sentenced to a Federal prison for fraud each year from 1990 through 1997 ("Correctional Populations").

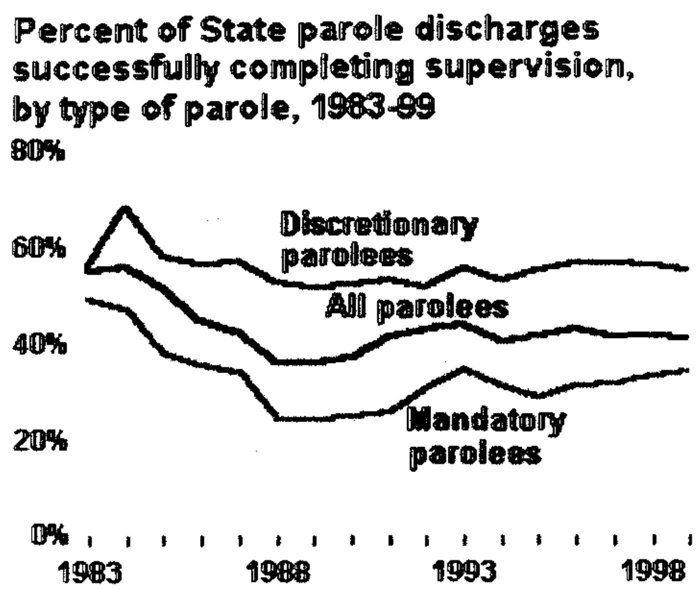
Surprisingly, these offenders spend almost as much time in prison as any other serious property offender. The average time spent in a State prison for a property offender in 1997 was 119 months. The average time spent in a State prison by serious fraud offenders was 104.1 months. That is approximately 8.5 years. While the time spent by property offenders in a Federal prison is less lengthy than in a State prison, the time spent in a Federal prison for the two crimes is still comparable. Property offenders, on average, spent 59 months in prison in 1997. Fraud offenders spent an average of 53.7 months, or 4.5 years, in a Federal prison in 1997 ("Correctional Populations").



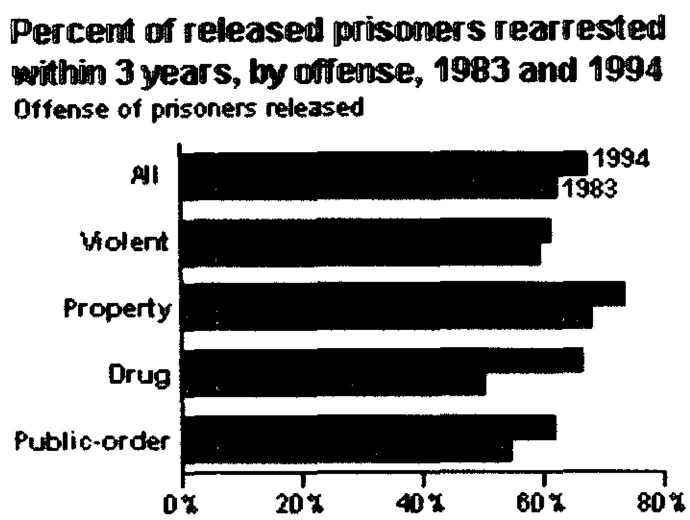
I do not know why there is such a difference between the State and Federal prison times served by fraud offenders. However, it is important to note that fraud offenders are punished almost as harshly as any other property offender, such as burglars and car thieves.

The statistics cited thus far indicate how many people are punished for serious fraud crimes, but they do not indicate whether or not these punishments are effective. An effective punishment would stop the person who was punished for committing the act from doing it again. It would also stop other people from committing the act because they would not want to receive similar punishments. Because of the consistent rise in the number of serious fraud offenders punished each year, we already know that whatever punishments previous fraud offenders received were not successful in stopping other people from committing fraud. According to data collected by the Bureau of Justice from

1983 to 1999, most criminal offenders who are punished with jail time are not successfully rehabilitated, either. The study showed that 42% of those released on parole, regardless of their offense, successfully completed it ("Reentry Trends"). Information is not available on the effect of monetary penalties on criminal offenders.



Parole occurs immediately after the criminal is released from prison. During the period of parole, the criminal is still under supervision. If the parole is violated, the criminal may be returned to prison to serve any remaining time of his or her sentence. If only 42% successfully completed their parole, that means 64% did not successfully complete it. Of those 64%, 43% went back to jail, and the other 10% went on the run. According to a study conducted from 1983 to 1994, the majority of those who returned to jail, almost 80%, were arrested within 3 years of their release ("Reentry Trends"). These statistics include all criminals. Unfortunately, there are no statistics available that report this type of information specifically for fraud offenders or property offenders.



From 1983 to 1994, a study was conducted to find out what percent of prisoners who were released from prison were rearrested within 3 years of their release and what crimes they were rearrested for. More repeat offenders who were rearrested within 3 years of their release were property offenders than any other type of offender. I think that these statistics provide sufficient evidence to determine that individuals who are punished by serving time in our State and Federal prisons are not being rehabilitated. Most of them are getting out only to continue a life of crime. Because the number of people sentenced to prison for serious fraud crimes has increased almost every year, it doesn't appear that criminal penalties deter corporate crime.

In fact, HealthSouth, a health care provider, proves that the increase in criminal penalties for corporate crime brought by Sarbanes-Oxley in July of 2002 will not be a deterrent. On March 19, 2003, HealthSouth and it's CEO, Richard Scruffy, were charged with massive accounting fraud for overstating income in order to meet Wall Street's expectations ("SEC charges Richard Scruffy"). It has been found that HealthSouth overstated income by 2.5 billion since 1999. The company also overstated the value of its assets by 800 billion. Eight former employees of HealthSouth have pleaded guilty to fraud and conspiracy charges (SEC charges HealthSouth's"). Weston Smith, the former CFO of HealthSouth, was also charged with conspiracy to commit securities and wire fraud and for filing false certifications with the SEC. Smith pleaded guilty to all of these charges ("SEC charges Richard Scruffy").

In early April, Richard Scrushy, who was no longer the CEO of HealthSouth, was charged again by the SEC. This time the charges were for insider trading ("SEC charges HealthSouth's"). Insider trading means that a person is using non-public information in his or her decision to buy or sell stock. This is largely unfair to the public because the public has no way of finding out this information. That is why this practice is illegal. The SEC is attempting to collect up to 743 billion dollars from Scruffy. Two former CFO's, Weston Smith and William Owens, were also charged with insider trading ("SEC charges HealthSouth's").

The only chance for success that the increase in penalties has is if the judicial system utilizes them. If they are just going to be an intimidation factor, their strength will be very short-lived. Unfortunately, the world is not placing full faith in the judicial system. For example, Lawrence Cunningham, a professor of law at Boston College, believes that Sarbanes-Oxley was little more than political smoke. He believes that Congress wasted its chance for legitimate reform of a malfunctioning system (McDonald). I agree with him. I will be very surprised if the judicial system ever utilizes the full extent of Sarbanes-Oxley's power by punishing deserving crimes with the maximum penalties.

Will Sarbanes-Oxley be effective? Possibly, but for the most part, I think not. I believe that separating an auditor's ability to provide many audit and non-audit services simultaneously will decrease collusion between auditors and their clients. It may also decrease some of the fraud that is committed by all public firms because auditors will be less likely to allow fraud to occur. The requirement of rotating audit partners every 5 years will also make it more difficult to commit fraud. However, I don't think that the increase in penalties for fraudulent acts provided by Sarbanes-Oxley will be as effective a deterrent as legislators hoped. HealthSouth's situation is evidence of this. In addition, the numbers for fraud crime have been on the rise at least since 1990. The number of repeat offenders has also increased. The fact that the number of repeat offenders is increasing almost makes it seem that by sentencing criminals to prison, they are being sentenced to a life of crime, which is the exact opposite of the legal system's objective. While I don't believe that Sarbanes-Oxley is that answer to corporate America's problems, I do believe that it will make some improvement in the current situation.

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