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Sarbanes-Oxley forces big changes

The economic recovery for most companies has been excellent. If earnings are up 20 percent or more for the 12 months ending Sept. 30, the quarter will mark the fifth consecutive rolling 12-month period with S&P 500 corporate earnings up that much. This would be the best corporate earnings streak in 50 years.

PERSONAL FINANCE

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Consequently, the amount of cash companies have on hand is staggering. According to Morgan Stanley, corporate cash equals 16.3 percent of GDP, the highest percentage since 1959.

Despite solid financials, employment growth has been disappointing (October employment gains were surprisingly strong, but 2004 gains are far below expectations), and capital spending is a fraction of what it was in the late1990s.

Some believe companies see lousy times ahead. Rising oil prices, a Fed focused on pushing rates higher, consumers loaded with debt and a stagnant stock market are huge negatives that business must overcome. Many believe, as a result, companies are hoarding cash to help get them through these troubled times.

However, there is another school of thought that believes the buildup of cash is a byproduct of cultural changes in corporate America. These changes were caused not only by the 2000-02 recession and a more conservative approach to business but also by the most sweeping regulatory act involving business since 1933.

Sarbanes-Oxley has created huge reforms of public companies in financial reporting, disclosures, audit procedures and board composition. The Act has kept upper management focused on compliance with the new regulations, muting its ability to focus on expansion.

Many of Sarbanes-Oxley's portions were needed, but the market forced its own conformity as investors have rewarded squeaky-clean companies and punished those with aggressive or questionable practices.

Sarbanes has been a big burden for excellent companies, particularly smaller public one's.

According to CFO magazine, the average company expects to spend $1 million on external consulting, software and vendors to comply with aspects of Sarbanes. Internal costs are estimated to be significant as well.

Also, according to CFO magazine in a recent poll of 227 finance executives, 62 percent said they were under "great" or "very great" pressure today, and 68 percent say pressure has increased in the last two years.

This corporate cultural change may be good for business in the long run and I suspect that job growth and capital spending in 2005 will gain traction.

There are some negatives in the economy that need to be overcome – oil prices, rising rates, re-regulation. But corporate balance sheets are in solid condition and stock market valuations are at the after-the-crash 2002 levels.

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