



GORDON INSTITUTE
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**THE BENEFITS OF SARBANES-OXLEY AND CORPORATE
GOVERNANCE MEASURED AGAINST THE COSTS**

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ABSTRACT

The Sarbanes-Oxley Act of 2002 (SOX) is the only legislated corporate governance structure, and is aimed at increasing investor confidence in public companies by forcing them to be transparent in their financial affairs. In order for companies to comply with the legislation, significant costs need to be incurred without any guarantee that the benefits will accrue to the investors or the company. The legislation will be regarded as being successful if a) the benefits and costs can be identified and b) the benefits exceed the costs.

This study reviews the SOX legislation elements using documentary and secondary interview research, and reveals a convergence between the two. While the purpose of the regulation is to prevent fraud and restore investor confidence, there was no empirical evidence suggesting that investor confidence has increased after complying with the legislation. The benefits of complying with the legislation appear to be access to capital markets in the United States, and awareness of the controls environment by all employees. The costs incurred are listed as initial implementation costs and ongoing sustainable costs, and the overall costs are greater than benefits obtained. In the long term, benefits should exceed the costs, as the sustainable costs are low compared to implementation costs.

DECLARATION



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I declare that this research project is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Business Administration for the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university.

.....
Salim Motala

Date: 14 November 2007

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1. INTRODUCTION TO RESEARCH PROBLEM

1.1. *BACKGROUND*

The field of corporate governance has attracted a great deal of interest in the last decade, mainly as a result of financial scandals such as Enron and Worldcom in the United States (US), Parmalat in Italy and Leisurennet and Masterbond in South Africa.

These and similar financial failures resulted in the emergence of certain governance guidelines and regulations, which aim to promote transparency with regard to the affairs of the company to its investors and other stakeholders.

South Africa has a good corporate governance structure, mainly as a result of the King Report of 2002, which is widely accepted by listed companies in South Africa and which lays down the elements of good governance and represents a set of guiding principles. The Sarbanes-Oxley Act of 2002 (SOX) has brought about significant changes to corporate governance for certain companies, in that it changes the way in which management; audit committees and external auditors interact with one another and carry out their duties.

SOX was enacted in direct response to corporate scandals in the US, which damaged confidence in the financial markets and resulted in a loss of public trust in corporate accounting and reporting practices.



Public companies in certain parts of the world subscribe to various corporate governance structures. With many of these structures, compliance is not compulsory, with a 'comply or explain' approach being adopted; in other words, in the event of non-compliance, reasons must be provided.

In South Africa, the accepted corporate governance framework is the King Report on Corporate Governance for South Africa 2002 (the King Report). This report is an integrated approach to corporate governance in the interests of stakeholders. It is in line with best practice governance structures around the world and encourages transparency of an organisation towards its stakeholders, both internal and external, including media, employees, trade unions, consumers, suppliers, business and the financial press. The King Report relies on disclosure as a regulatory mechanism (IOD and PwC, 2003).

One possible effect of having these corporate governance structures in place could be that of constraining management in properly performing the functions necessary to achieve the objectives of the business. They result in management having to perform additional procedures aimed at good governance, and this has to be balanced with performance to ensure the financial success of the company. While there is general acceptance in financial markets of the need for good practice in governance, it is also recognised that too rigid an approach could restrain entrepreneurial spirit and overburden management.

On the contrary, a company without corporate governance structures is vulnerable to manipulation and fraud on the part of its management. This could lead to reduced confidence in the company by its stakeholders, and could result in the company not being sustainable in the medium to long term, due to loss of investment, withdrawal of support from suppliers, and the inability to attract and retain staff or engage the community.

The secret is to find the right balance between corporate governance and financial performance for success. Neither can be ignored if the company is to operate successfully. Too much emphasis on one may have an impact on the other. With regulatory bodies adding to the list of requirements, the question could be asked as to the additional benefits to be derived from complying with the requirements of the relevant pieces of legislation. Do the benefits of compliance exceed the costs incurred in becoming compliant?

SOX is applicable to companies that are listed on the New York Stock Exchange (NYSE). Various South African companies are listed on the NYSE and have been burdened with the responsibility of having to comply with SOX in addition to the list of the King Report governance requirements.

1.3. RESEARCH AIM

SOX has created a complex regulatory environment that requires substantial management effort and company resources to ensure compliance. The complexity and cost required to comply with these regulations raises questions as to their benefits.

The aim of this research is to determine the corporate governance structures that were in place before the advent of SOX and the changes that SOX has brought about. It also aims to determine the specific additional benefits obtained and the components of costs incurred by applying the provisions of SOX. These benefits are measured against the costs incurred in compliance, to determine whether the legislation provides any value to shareholders and other stakeholders.

As mentioned, SOX is a piece of legislation that has arisen solely as a result of the Enron financial failure and is applicable only to companies that are traded on the NYSE (Hussain, 2006). In fact, it has been suggested that Enron was “the straw that broke the camel’s back”. The US investors have been greeted with many corporate failures and not much was done about the scandals. Although the scandals were not significant individually, the aggregation became a burden for the investors. Enron being the final scandal that brought about the legislation. The research will aim to determine the overall success of SOX in achieving its objective.



With this in mind, this study focuses on companies listed in the US, as well as other South African companies applying the provisions of SOX. The companies that form the study sample are all in the mining and minerals industry in South Africa. This will enable the researcher to determine the impact of SOX in the mining industry.

1.4. RESEARCH MOTIVATION

The rationale behind this research is personal and also pertinent to the questions that are being asked on the feasibility of South African companies achieving SOX compliance. On a personal level, the aim was to obtain knowledge on SOX and the wider topic of corporate governance, as well as to gain insight into the mining industry. In addition to the personal aims, the researcher was unable to find conclusive proof of the value of South African companies applying the provisions of SOX – this will be sought through the research.

McKinsey & Company conducted a series of surveys to discover how shareholders perceive and value corporate governance in developed and emerging markets. The findings reveal that in certain countries, investors are willing to pay a premium for companies that are well governed (McKinsey, 2000). However, the researcher was unable to obtain inconclusive proof to suggest without a doubt that good governance leads to an improved performance. The research is aimed at determining the effect of corporate governance and SOX on South African companies and investors.



The mining industry is and complexity. It is by far the largest in the economy, with resources accounting for over forty percent of the JSE index (Business Day, 2007). It is also one of the largest employers of labour. Mining is a capital-intensive industry and requires vast sums of capital to finance its operations. In acquiring capital, these companies seek funds from investors, both locally and off-shore. Although local capital is available, access to offshore capital is greater, as the audience is larger.

Since the advent of SOX, there has been no empirical evidence to suggest that SOX adds value, or whether it simply adds costs. Although there have been similar studies in the US, no such study has been conducted in South Africa, and this research aims to remedy this position. The research would be useful to South African companies considering listing on the NYSE or companies considering delisting from the NYSE.

1.5. OUTLINE OF THE RESEARCH REPORT

This report is divided into seven chapters, beginning with a review of the current literature on corporate governance, SOX and the mining industry in Chapter Two. Chapter Three outlines the research questions that emerged from the review of the literature, followed by a description of the research methodology employed to answer these questions in Chapter Four. The results are presented in Chapter Five and discussed in Chapter Six. The report is concluded in Chapter Seven, which recommends further avenues of research.

2. LITERATURE REVIEW

2.1. CORPORATE GOVERNANCE

2.1.1. Corporate Governance

The ordinary meaning of *governance* is the manner of directing and controlling the actions and affairs of an entity. Incorporated entities are called companies and corporations. The governance of incorporated entities is generally described as corporate governance (King, 2006).

2.1.2. History of Corporate Governance

The history and timeline of corporate governance shows that from 1855, which marked the start of the modern company; to the last half of the twentieth century there was no corporate legislation as to how directors should govern. Entrepreneurs were able to implement their business ideas with the protection of limited liability. During this time the focus was on the single bottom-line and the shareholder model of wealthy families (King, 2006).

In the last half of the twentieth century, financial institutions took over from wealthy families as major shareholders which by then were listed on stock exchanges. The concept of shareholders (those whose policies, funds and stocks were being managed by financial companies) was introduced (King, 2006).



In the last two decades, the concept of governance came into being as questions were asked in America and the United Kingdom as to whether directors were governing companies correctly. The questions were asked in response of the outperformance of the American companies by the Far Eastern companies (King, 2006).

2.1.3. Corporate Governance Structures

Around the 1970's and 80's, questions related to governance practices were raised on the basis of companies' performance and corporate scandals, such as the BCCI and the Maxwell sagas, in the UK emerged. The rise in corporate scandals resulted in the publication of the Cadbury Report in 1992, which focused on the financial aspects of governance (King, 2006).

In the UK, more reports followed on the back of the Cadbury Report, such as the Greenbury Report 1995, the Hempel Report 1998, Turnbull 1999, and the Combined Code in 2000 (Jones and Pollitt, 2003). In South Africa, the King Report was published in 1994. Subsequently, the King II Report on Corporate Governance was published in 2002. Internationally, the OECD Principles on Corporate Governance were published in 1999, followed by the CACG Guidelines in 2003.

Finally, the advent of corporate scandals in the US brought along legislative and other requirements for US companies, such as the Federal Corrupt Practices Act, Federal Sentencing Guidelines for Organisations and the Sarbanes-Oxley Act.

2.1.4. Good



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An organisation is created for a purpose. This purpose is likely to be the creation, protection and development of shareholder value. For a commercial organisation this value is to maximise the return on investment to its shareholders, sustainable employment for its employees and win-win relationships with its suppliers (PwC, 2002).

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place (Cadbury, 1992). The company's management runs the organisation in a responsible manner and is governed by the board of directors. The directors are accountable to the shareholders for the affairs of the company.

Good corporate governance requires that the board must govern the corporation with integrity and enterprise in a manner which entrenches and enhances the licence it has to operate (CACG, 1999).

2.1.5. South Africa

South Africa was excluded and isolated from the global economy between 1961 and 1994 by the United Nations because of its oppressive political environment. (Vaughn and Ryan, 2006). The country was also excluded from participating in international organisations and had trade and economic sanctions imposed against



it. As a result of the s global world, its economic practices, law reforms and corporate regulations fell well below international standards. This resulted in corporations losing focus and being run by complacent and entrenched managers, which made South Africa uncompetitive globally (Malherbe and Segal, 2001).

With the fall of apartheid, South Africa was readmitted into the global economy and business and diplomatic relations with the rest of the world began to develop and expand. This presented tremendous challenges for South Africa in the global market, and South African companies had to engage in practices to improve on corporate governance to compete effectively. “Investors wanted assurances that corporations practised accountability, transparency and fairness to all shareholders” (Vaughn and Ryan, 2006).

South Africa then developed various corporate governance initiatives to address its lack of governance compared to the first world countries. These included the King Report on Corporate Governance, the Insider Trading Act, the Financial Intelligent Centre Act (FICA) and various other listing requirements. Currently, South Africa is in the process of preparing the King III Report.

The King Report was not stimulated by a corporate crisis in South Africa and was developed as an initiative of the Institute of Directors in Southern Africa. The King Report drew attention to the importance of a properly functioning board of directors as a key ingredient of good corporate governance. It advanced many of the



standards and principles national codes that were adopted, particularly in the Commonwealth countries, following the release of the Cadbury Report in the United Kingdom in 1992 (Armstrong, Segal and Davis, 2005).

In response to growing awareness of the importance of good corporate governance, the Organisation for Economic Co-operation and Development (OECD) was mandated to develop a set of standards and guidelines for presentation to ministers. These principles are referred to as “OECD Principles of Corporate Governance” and form part of a broader international effort to promote increased transparency, integrity and the rule of the law. There is no single model of corporate governance due to different legal systems, institutional frameworks and traditions which results in a variety of approaches being developed around the world. The OECD Principles of Corporate Governance will represent core elements of good corporate governance to be used as a benchmark by governments to evaluate their laws and regulations (OECD, 1999).

2.2. THE ABSENCE OF GOOD CORPORATE GOVERNANCE

2.2.1. Management

The responsibility of corporate governance lies with the board of directors. In certain public companies the board of directors are the management, and in these instances they are effectively managing themselves, creating a catch 22 situation. While committees and various other structures are put in place to manage the process and to keep a check on the affairs of management, it is sometimes difficult



to report to management to oversee the affairs of management. At times this leads to independence issues, as in effect they will be reporting on their own managers - certainly a case of the turkey voting for the idea of Christmas!

In light of the above, the company is at risk of manipulation and fraud by its management team in instances where the board of directors is not independent. An independent director is defined as a person who is not employed by the company, has no contractual links to the company and is not an advisor or a shareholder to the company (King, 2006). Although there is governance structures in place fraud may occur at organisations and pose a risk to shareholders. The major global scandals that have surfaced are Enron, Worldcom and Parmalat, with Leisurennet in South Africa.

2.2.2. Enron

Enron was created in 1985 by a merger between Houston Natural Gas and Internooth (Terry, 2007). Under the leadership of Kenneth Lay and Jeffery Skilling, Enron adopted an aggressive growth strategy and as a result created a complex accounting structure and a strategy that required significant capital. The finance was raised using loan capital as opposed to equity and these loans were placed in special purpose entities (SPEs). The company used the SPEs and inappropriate accounting practises to inflate earnings. The business had reflected ample cash through its SPEs, yet there was no cash as it was an accounting entry to bolster its profits. The negative cash trend eventually surfaced when Enron had no cash to



finance its operations ruptcy. Fingers, attributing blame, were pointed in various directions, including auditors Arthur Andersen and the Enron board. “The failure of Enron’s board to take responsibility for the risks inherent in the company’s business plan, in particular the use of special purpose entities (SPEs) and related forms of so-called ‘structured finance’”(Deakin and Konzelmann, 2004).

2.2.3. WorldCom

The Worldcom fraud story arose as a result of an internal auditor who reported irregular practices to the CFO. After nothing had been done she took the matter into her own hands and reported the matter to the audit committee, which resulted in the dismissal of the CFO. The effect of the scandal was \$11 billion and was the biggest corporate fraud in US history (Lehigh University, 2005).

“Ms Cooper and her team are a case of middle managers who took their commitment to financial reporting to extraordinary lengths. As she pursued the trail of fraud, Ms Cooper time and again was obstructed by fellow employees, some of who disapproved of WorldCom’s accounting methods but were not willing to contradict their bosses or thwart the company’s goals” (CAE Bulletin, 2007).

John Ebbers (CEO) was in personal debt and had his shares in WorldCom held as security for the debt and the share price began to fall as a result of the earnings expectations announcements. The CFO was commissioned by the CEO to inflate



earnings. This had (ure on telecommunication services and equipment and resulting in an increase in earnings (Crawford, 2005).

2.2.4. Leisurenet

Leisurenet was a South African company that had been growing at a very fast rate and was growing through acquisition. As a result of its expanded growth, it ran into financial trouble and had cash flow problems. The directors involved were entering into transactions on behalf of the organisation and were failing to disclose their interests in the transactions. “The directors charged personal expenses – including home renovations, house purchases and travel and foreign exchange expenses for their children – to LeisureNet” (IOL, 2001).

2.2.5. Detection of Fraud

With the introduction of SOX, the duties of the auditors were increased significantly. Prior to Enron, auditors accounted for 9.6% of frauds detected by external parties, whilst post-Enron the figure has risen up to 16.9%. Previously auditors were only focused on frauds requiring financial restatements whilst after Enron the auditors were additionally focused on fraud cases not involving restatements. Auditors increased their activities as their exposure to liability has broadened (Zingales, Dyck and Morse, 2007).



2.3.1. Introduction to SOX

The Sarbanes-Oxley Act of 2002 is a US federal law passed in direct response to the major corporate and accounting scandals – Enron and WorldCom in particular (Wikipedia, 2007). The legislation establishes new enhanced standards for all US public company boards, management and public accounting firms.

The act is focused on financial reporting on the need to maintain a strong control environment (Wikipedia, 2007). Strong internal control over financial reporting is fundamental to providing reliable financial statements. The main difference between SOX and other corporate governance initiatives around the world lies with compliance. Compliance with SOX is legislated and is thus compulsory, as opposed to the ‘comply or explain’ approach adopted for the Cadbury and King Reports. Post-SOX, the acronym “CIO” means “Compliance isn’t Optional” (Leskela, 2004).

With all of these additional requirements, SOX has become despised by many businesspeople in the US and beyond. The authors have conceded that its hasty passage into law meant it was badly drafted in parts. “Frankly, I would have written it differently, but it was not normal times,” Michael Oxley, one of the former congressman who drafted the act said. He added that the same was true of his co-author, Paul Sarbanes (Kambayashi, 2007).

2.3.2. The In



It is difficult to assess whether investors believe that SOX is, overall, good or bad for US firms. There were various events surrounding the adoption of SOX and one cannot rule out other causes for market price changes of companies' securities listed in US markets. The effect of SOX was easier to assess on companies that were cross-listed, as cross-listed companies fall in two categories, namely companies that need to comply with SOX and companies that do not need to comply. The results of a study by Litvak (2007) measuring reactions of investors of cross-listed firms due to SOX, indicate that countries that are well governed produced a negative reaction, as investors thought SOX to be bad. The results further indicate that SOX has been positive for investors in companies located in poorly governed, low disclosing countries (Litvak, 2007).

In a study by Barger, Lehn and Zutter (2007), data on initial public offerings (IPOs) in the US and UK equity markets after the adoption of SOX were examined. The results indicate that the number of IPOs in the US decreased substantially post-SOX. The number of IPOs in the UK has increased dramatically relative to the US; however, not remarkably different from historic levels. The likelihood of an IPO occurrence in the UK increased significantly compared to the likelihood of an IPO occurrence in the US (Barger, Lehn and Zutter 2007).

2.3.3. Going Private

To evaluate the effect of SOX, a study by Kamar, Karaca-Mandic and Talley (2006) was performed and compared the change in the propensity of American public targets to be bought by private acquirers rather than by public acquirers to the corresponding change for foreign public targets. The results indicate that SOX disproportionately burdens small firms and induced small public companies to be sold. There was increasing propensity of small public companies to be sold to private acquirers rather than public acquirers in the first year after enactment of SOX. The price that public acquirers would pay for target companies would be lower than what private acquirers would pay, as public companies would inherit the compliance costs associated with the target firm (Kamar, Karaca-Mandic and Talley, 2006).

When a company delists from the stock exchange it is regarded as going dark. The two reasons for going dark are firstly costs of compliance, and secondly economic incentives of the internal and external shareholders. With the advent of SOX, compliance costs have increased and are one of the major driving forces behind a firm's decision to go dark. Investors in such firms suffer abnormal negative cumulative returns upon announcement of deregistration and are left holding illiquid shares. Inside and outside shareholders have divergent interests regarding cost of corporate governance as outside shareholders value corporate governance and inside shareholders view it negatively (Marosi and Massoud 2007).

2.3.4. Effect



In the study by Barger, Lehn and Zutter (2007), several measures of corporate risk taking for publicly traded US companies were examined since SOX came into law. The results indicate that US firms' measures of risk have decreased compared to UK firms. Decreases in risk measures in the US are generally larger than decreases in risk measures for UK firms, which imply that SOX has chilled risk-taking by US corporations. Since the adoption of SOX, US companies have significantly reduced capital expenditure and expenditure in R&D, and significantly increased holdings of cash relative to UK firms. The total risk for US firms - comprising market risk and firm-specific risk - has decreased since the adoption of SOX relative to UK firms (Barger, Lehn and Zutter 2007).

SOX has forced CFOs to spend nearly a third of their time on IT systems, paperwork and tedious board enquiries rather than focus on the bigger picture. CFOs are no longer considered the stars on the boardroom bench waiting to become CEO. According to 10-K wizard, companies with a market cap of at least \$1 billion changed CFOs three times more often in 2005 than in 2002. This can be attributed to SOX, however there is no conclusive evidence to prove the attribution. According to Richard Jacovitz of Liberium Research, among public companies of all sizes, CFO exits increased from 1 867 in 2005 to 2 302 in 2006 (Demos, 2007).



2.4.1. Benefits

“Increased shareholder activism in the United States and elsewhere stems from the conviction that better corporate governance will deliver higher shareholder returns. Yet repeated attempts by academics to show an irrefutable link between the two have failed, such is the complexity of the relationship” (McKinsey, 2000). According to the McKinsey Investor Opinion survey (2000), 75 percent of investors say board practices are at least as important to them as financial performance when they are evaluating companies for investment. In Latin America almost half the respondents consider board practices to be more important than financial performance. In addition, over 80 percent of investors say they would pay more for the shares of a well-governed company than for those of a poorly governed company with a comparable financial performance. The actual premium that the investors say they would be willing to pay for a well-governed company differs by country (McKinsey, 2000).

According to Miklovic and Leskela (2002), complying with SOX is good business. It isn't just about compliance, but also about having an efficient, effective organisation. If you can see into your production, identify where the problems are likely to arise and have an action plan to rectify the situation, your organisation can be more productive and generate more revenue (Miklovic and Leskela, 2004).

2.4.2. Costs



GartnerG2 conducted a survey and conducted interviews with 75 respondents from publicly traded companies on the US stock exchanges. The respondents were senior compliance managers responsible for, or directly involved in, managing the company's overall compliance with SOX. The findings revealed that 85 percent of respondents reported that they do not have an official budget for SOX compliance. Estimates of costs varied from \$15,000 to \$4.5 million in total. The estimates include external consultants, internal and external auditing costs, personnel, insurance and software (Leskela, 2004). The costs of compliance are high and vary from company to company.

According to the Financial Executives International (FEI), in a SOX compliance costs survey of 200 companies with average revenue of \$6.8 billion, the cost of compliance has decreased 23% from 2005 to 2006. The results show decreases in internal and external costs of compliance. The decreases are directly as a result of increased efficiencies in complying with section 404. The first year costs were high and future year's costs of maintenance will be less than costs incurred in initially complying with SOX. Initial year costs are impacted by lack of documentation; deferred maintenance catch-up of internal controls, large number of control deficiencies identified and remediated inadequate project management and resources (Kambayashi, 2007).



The overall costs of SOX are high relative to its private benefits, as it is too costly to eliminate all corporate fraud. Investors consider SOX to be costly and the message sent by the legislation is bad for business. In addition, firms with perceived weak governance experience more negative abnormal returns around events that increase the likelihood of passing tough governance rules. Firms with weak governance experience negative returns when tough governance structures are imposed on companies. The firms do not benefit from enhanced governance as expected, and challenge the value of SOX (Zhang, 2005).

There is some evidence that suggests that SOX is costly to implement as well as evidence to suggest that costs of SOX is decreasing on an annually. Understanding the costs of SOX in relation to the benefits will enable the companies to determine to what extent the costs are overcome by the benefits.

2.5. MINING AND MINERALS INDUSTRY IN SOUTH AFRICA

There is a great deal of evidence worldwide that resource-rich countries lend themselves to corrupt practices in the form of minimal fees and granting of licences. According to Feeney (2002), there has been insufficient public debate around the exemptions that mining companies have negotiated with governments that release them from compliance with national and international standards for lengthy terms (Feeney, 2002). Several recent studies have found that states with large oil and minerals sectors tend to be abnormally corrupt – perhaps because these sectors periodically flood the government with revenues, creating opportunities for the misuse of funds (Ross, 2001).

Corporate responsibility initiatives in the mining industry are important and necessary. However, it is not sufficient to ensure that natural resource exploitation results in economic growth and broad-based socio-economic improvements. Multilateral organisations may still deliver disappointing outcomes if weak governance structures cannot be changed and improved. Good investments in an environment of weak governance may fail to spread their benefits to the country as a whole (ICMM, 2006).

South Africa is a world leader in the mining sector and is internationally renowned for an abundance of mineral resources, accounting for a significant proportion of both world production and reserves. Globally, it is the largest producer of gold, vermiculite, platinum and chromium; in addition it has major deposits of antimony, coal, iron ore, manganese, nickel, phosphates, tin, uranium, diamonds, copper and vanadium (Diliza, 2007).

South Africa's mining industry is continually expanding and adapting to changing local and international world conditions. It remains a cornerstone of the economy, making a significant contribution to economic activity, job creation and foreign exchange earnings. The impact of SOX on the mining industry may affect the time and effort currently spent by mining companies on current programmes and initiatives.



In South Africa the mining industry is a leading sector, contributing 15% to 20% of GDP (directly and indirectly), 50% of merchandise exports, 12% of fixed investment, 20% of formal sector employment, 50% of the country's rail and ports, 93% of electricity generation via coal powered plants and 16% of electricity demand (Chamber of Mines, 2004).

The South African mining industry is the second largest mining sector by value of any country in the world after the US (Chamber of Mines, 2004). Being such a large portion of the economy and the most global industry in South Africa, the mining industry was chosen as the industry of specialisation for this research.

Listed companies on the Johannesburg Stock Exchange (JSE) are accountable to the JSE on the extent of compliance. In addition, mining companies are subject to the requirements of the Minerals and Metals Act and the industry charter. Companies operate substantial human resources developments, corporate social investments and other initiatives in South Africa and other operations worldwide. By and large, South African companies seek to apply best practices in health and safety and accounting standards, and their good performance is not generally limited to financial aspects.

Relatively few South African companies are required to comply with SOX, and most of those that do, fall in the mining industry, as it is a capital intensive industry and companies require access to capital. The US is one of the largest capital markets in the world and a listing on the NYSE would give good access to capital

in those markets. So the mining industry operate globally and require capital for their operations, thus often seeking listing on US markets.

AngloGold Ashanti Limited, Sasol Limited and Harmony Gold are South African companies that operate globally and are listed on the New York Stock Exchange. They are required to comply with SOX in all of their operations around the world.

2.6. CONCLUSION

SOX has come about with the intention of increasing investor confidence by eliminating corporate fraud. South African (SA) companies follow good corporate governance structures. Certain companies have to apply SOX in addition to the SA corporate governance structures. Understanding the costs involved and benefits obtained from will determine the cost-benefit equation of SOX and will indicate whether it is feasible to comply with the regulation.

3. RESEARCH QUESTIONS

The study investigates various factors relating to implementing governance guidelines and regulations. The factors were being considered in light of the each organisation's management, shareholders and providers of capital, and auditors. Due to the exploratory nature of the study, research questions were used to define the research problem pertaining to the value provided by SOX.

The following questions were formulated from the research problem:

Research Question 1:

What corporate governance structures were in place before the introduction of Sarbanes-Oxley and what has changed since the introduction of Sarbanes-Oxley?

Research Question 2:

What are the different categories of costs involved in achieving compliance with Sarbanes-Oxley?

Research Question 3:

What are the different categories of benefits that have arisen in achieving compliance with Sarbanes-Oxley?

Research Question 4:

What is the impact of Sarbanes-Oxley on companies in the mining industry operating in South Africa?

Research Question 5:

What is the objective of Sarbanes-Oxley and is it achieving its objective?

4. RESEARCH METHODOLOGY

The study aimed to quantify the costs and benefits involved in complying with the legislation laid out by the regulatory body, as well as to prepare an exhaustive list of qualitative factors.

The study was exploratory and qualitative as well as quantitative in nature. Exploratory studies provide information to use in analysing a situation (Zikmund, 2003). The study aimed to quantify the responses from the respondents in light of the above research questions. The results were quantified as far as possible and thereafter qualitative factors were explored to obtain a list of data, which was then analysed.

The research was conducted in two phases. Phase one consisted of documentary research, while phase two consisted of interview-based research. This approach was taken to ensure the validity of the analysis. The design of the research was a descriptive design using a structured interview technique. The survey took the form of personal interviews.

4.1. PHASE ONE: DOCUMENTARY RESEARCH

4.1.1. RESEARCH DESIGN

Phase one of the research was focused on an analysis of the SOX legislation and a review of the commentary and perceptions of some experts in the field of corporate governance. The review of the legislation required a detailed



understanding of the business environment and documentation thereof. The expected benefits and components of the costs were determined from the documentation and the results of the interviews.

4.1.2. UNIT OF ANALYSIS

The unit of analysis used in this phase of the research was the opinions of the experts on SOX legislation. They were assumed to have a good understanding of the Act and its implications.

4.1.3. POPULATION OF RELEVANCE

The population of relevance in this phase was experts in the field of corporate governance and SOX.

4.1.4. SAMPLING METHOD AND SAMPLE SIZE

The sampling method was non-probability sampling. This is characterised by the use of judgement and a deliberate effort to obtain representative samples by including typical areas or groups in the sample. As a result of the specialised nature of the population, purposive sampling was most effective. The sample size was to obtain one expert each from two of the big four audit firms. (The 'big four' is a collective term given to PricewaterhouseCoopers, Deloitte, KPMG and Ernst & Young.)

4.1.5. RESEARCH INSTRUMENT

There was no research instrument for documentary research. An interview guide was drawn up for the conducting of structured interviews with the experts.

4.1.6. DATA



The data collected consisted of documentary research obtained from various secondary data sources and the opinions of experts in the field SOX. The secondary data was sourced through a review of electronic databases, discussions with two of the big four audit firms, newspapers and other documentation in the public domain.

4.1.7. DATA ANALYSIS

Documentation collected for the SOX legislation was reviewed and relevant content extracted. A definition of the purpose of the Act, how it supported the environment and a listing of the benefits and costs were conducted from the documentation reviewed. The results have been summarised for ease of reference.

4.2. PHASE TWO: STRUCTURED INTERVIEWS

4.2.1. RESEARCH DESIGN

Phase two of the research focused on an analysis of the stakeholders of the organisations that were involved in the implementation. There are relatively few South African companies that are required to comply with SOX. These organisations comprise of the following companies:

- BHP Billiton Plc;
- AngloGold Ashanti Limited;
- Harmony Gold Limited; and
- Sasol Limited.



The benefits and costs of SOX legislation were computed from the results of the interviews with the stakeholders.

Benefits were determined for the organisation and its shareholders. Benefits included all benefits that were not obtained through previous corporate governance initiatives. In addition, they included benefits that were obtained in the process of preparing the compliance report and the improved perception of the shareholder on the organisation.

The costs included the initial implementation costs, as well as the annual maintenance costs. Costs comprised direct and indirect costs attributable to SOX. Direct costs included consultants' costs, staff costs and other costs *directly* attributable to SOX. Indirect costs included cost of corporate performance and other costs *indirectly* attributable to SOX. Indirect costs are non quantifiable and are determined by evaluating the time spent on SOX compliance by senior management and the cost of their time which could have been used more effectively in the business.

The stakeholders were identified as follows:

- Shareholders outside of the management of the company which will be represented by investor analysts;
- Management of the abovementioned companies, including financial managers who have the details of costs; and
- Auditors.

4.2.2. UNIT



The unit of analysis used in this phase of the research was the interview results from the stakeholders affected by and involved in SOX legislation implementation. These were all individuals in a senior management role within a governance-related role, executives, employees and providers of capital.

4.2.3. POPULATION OF RELEVANCE

The population of relevance in this phase was the management and employees involved in implementation of SOX and shareholders or providers of capital.

4.2.4. SAMPLING METHOD AND SAMPLE SIZE

The sampling method that was used is non-probability sampling as per phase one. Eight individuals were selected for this phase of the research. This comprised the following:

- Two shareholder analysts;
- Four management officials; and
- Two auditors.

4.2.5. RESEARCH INSTRUMENT

The research instrument was the interviews that were conducted. An interview guide was drawn up for the conducting of structured interviews with the stakeholders. The interview guide was drawn up using the research questions as a base, as well as the responses obtained from the experts identified in phase one of this research. The interview focused on the quantification of each of the cost components, as well as the quantification of the benefits. When costs and benefits

could not be quantif



rs were explored until an

exhaustive list of costs and benefits was drawn up.

4.2.6. DATA COLLECTION

The data collected consisted of the factual information on all the cost components and related benefits in achieving compliance, as well as the opinions of the stakeholders identified. The opinions were collected during the interviews with each of the stakeholders identified in the sample. The interviews were structured using the interview guide. The results of the interviews were kept on record and analysed.

4.2.7. DATA ANALYSIS

To ensure that the responses of the various individuals could be compared to reach a conclusion, the interviews conducted were structured and consistent from individual to individual. The data was summarised as per phase one, which provided a suitable format for ease of comparison amongst the various respondents. This resulted in being able to analyse the data and draw findings.

4.3. COMPARATIVE ANALYSIS

The results from the two phases above were compared and combined to provide a holistic answer to the research questions. Phase two results were used to corroborate the results of phase one and present the holistic view.

4.4.

RESEARCH



Some limitations were recognised at this stage of the research and findings were considered in light of these. The limitations are set out as follows:

- The nature of the study was predominantly qualitative and resulted in small sample sizes;
- The use of judgemental sampling produced results that may not be a true representation of the total population; and
- The data obtained was predominantly from the interviews. The interviews could have been influenced by factors such as emotional distress of the respondents and time pressures and could influence quality of information provided by the stakeholder.

Whilst every effort was made to mitigate these limitations, the limitations were present and could not be ignored.

5. RESULTS

The results of phase 1 and phase 2 of the research are detailed below. Phase 1 refers to the results of the documentary research and phase 2 refers to the results of the structured interviews.

The documentary research results include a section for each of the following:

- A detailed understanding of SOX;
- The purpose of SOX;
- The expected benefits of SOX;
- The expected costs of SOX; and
- The opinions of the experts interviewed.

The structured interview results include a section for the response to each of the following:

- Additional corporate governance structures as a result of SOX;
- Different categories of costs involved in SOX;
- Different categories of benefits arising from implementing SOX;
- The impact of SOX in the mining industry;
- Success of SOX; and
- Whether benefits of SOX compliance exceed costs.

The frequencies of the responses from the structured interviews will be disclosed where necessary.



5.1.1 UNDERSTANDING OF SOX

In response to a number of high-profile scandals since late 2001, Congress passed the Sarbanes-Oxley Act of 2002 (SOX) to enhance corporate governance and restore public confidence. SOX brought about significant changes in accounting, auditing, and reporting environment of organisations that traded in American securities markets (Kamar, Karaca-Mandic and Talley, 2006).

The Act has introduced significant changes in both management's reporting responsibilities and the scope and nature of responsibilities of the auditors. When President Bush signed the act into law, he characterised it as "the most far reaching reform of American business practices since the time of Franklin Delano Roosevelt" (Zhang, 2005).

Section 404 – Management Assessment of Internal Controls

The most significant provision introduced by SOX is section 404 of the Act, which requires organisations to maintain internal controls over the accuracy of financial reporting and to include in the firm's annual report an audit by an external auditor on the effectiveness of these internal controls, describing any material weaknesses and significant deficiencies found. This provision is the most challenging aspect of the Act and will cost organisations the most in becoming compliant, as it requires a substantial investment of time, people and intellectual capital. (SOX, 2002)



The main challenges presented by section 404

are:

- The need to devote significant time and resources to ensure compliance;
- The need for management to evaluate and report on the effectiveness of internal control over financial reporting;
- The requirement for external auditors to opine on management's assessment of the effectiveness of its internal control over financial reporting;
- The need to assess the implications of reporting the new information to the marketplace; and
- The need for board of director and audit committee oversight of management's process, findings, and remediation efforts as management scopes and executes its section 404 plan.

(PwC, 2004)

Section 906 & 302 – Corporate Responsibility for Financial Reports

Provisions other than section 404 did not take as long to implement. Section 906 requires that chief executive officers (CEOs) and chief financial officers (CFOs) certify the accuracy of the organisation's periodic reports. In addition, the CEOs and CFOs are subject to criminal penalties and fines for false declarations and certifications. Similar to section 906, section 302 requires that CEOs and CFOs certify the organisation's periodic reports on the effectiveness of internal controls over financial reporting. This section lays the foundation for section 404 (SOX, 2002).



Another immediate effect of SOX was the extension of the statute of limitations for filing shareholder lawsuits. Before the enactment of SOX, shareholder plaintiffs had been required to file claims within the earlier of three years of the occurrence of the fraud or one year of its discovery. Section 804 increased these time limits to five years and two years respectively (Kamar, Karaca-Mandic and Talley, 2006).

Section 306, 402 & 403 – Directors, Officers and Shareholders

SOX made immediate changes to executive compensation on several fronts. Section 402 bans loans by firms to directors and officers. Many of the loans to directors and officers are provided on attractive terms and were viewed as hidden compensation. Section 306 precludes directors and officers from trading in firm securities during pension blackout periods unless the trade is part of a trading plan. Section 403 requires directors, officers and 10% shareholders to report their trade in an organisation's securities within two business days following the trade – up from ten business days after the month of trade, and in some cases forty days after the end of the fiscal year of trade, under previous law (Kamar, Karaca-Mandic and Talley, 2006).

Section 301 and 407 – Audit Committees and Financial Expert

Section 301 of SOX requires that all firms listed on the stock exchanges have an audit committee comprising independent directors only. "Independent director" has been defined as a person who may not, other than his position as a member of the audit committee, accept any other form of fees from the organisation nor be affiliated to any subsidiary thereof. In addition, the audit committee has been

provided with full authorisation and other advisors as it determines necessary to carry out its duties (SOX, 2002).

Section 407 requires that organisations disclose whether any members of the audit committee are financial experts. If there are no experts on the audit committee, a reason needs to be provided (Kamar, Karaca-Mandic and Talley, 2006).

Section 201 – Services outside the Scope of Practice of Auditors

Section 201 of SOX prohibits an organisation's external auditing firm from providing various non-audit services, including bookkeeping or other services related to the accounting records or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, actuarial services, internal audit services, management or human resource functions, investment banking services, legal services and any other service that the board determines impermissible (SOX, 2002).

The above provisions of the Sarbanes-Oxley Act were legislated in 2002 and applicable to all organisations listed on US stock exchanges. Some provisions were applicable to listed organisations immediately, while others were phased in and applicable over a period of time, giving organisations time to implement the necessary provisions to become compliant.

5.1.2 PURPO



The purpose of the Act is to prevent deceptive accounting and management behaviour. As mentioned before, not much was done by the American regulators about the series of corporate scandals such as Enron and Worldcom, which were caused by questionable accounting practices, bad management and poor internal controls. In fact, these scandals proved to be the last two straws that broke the camel's back, resulting in the introduction of the Sarbanes-Oxley Act of 2002.

“The market decline and corporate failures led to just such a general sense that politicians should do something”. The fact that the November 2002 elections were very close also gave urgency to the legislation action, and corporate responsibility became an important political issue for first time in 70 years. In July 2002 congress passed the Act with only three members voting “no” (Atkins, 2003).

Another result of these scandals was low investor confidence, and 2002 was the first year since 1988 that US investors took more money out of stock mutual funds than they put in. Many investors had also lost confidence in equity securities since the burst of the dot com bubble and the effect of the corporate scandals simply exacerbated the situation. Corporate governance had to be strengthened to restore investor confidence (Atkins, 2003).

The Act acknowledges the importance of the investor and shareholder value and strengthens the role of directors as representatives of shareholders and reinforces the role of management as stewards of the shareholders interest (Atkins, 2003).

5.1.3 EXPEC



- Registrants' attention to maintaining effective systems of internal control and identifying and remediating internal control deficiencies before material misstatements occur has intensified and will improve reliability of financial reporting;
- Business processes are enhanced through standardisation and simplification, enhanced appreciation and accountability for internal controls and a shift from manual to automated controls;
- Reduction of risk in the organisation through an enhanced internal control environment and availability of funding and resources to remediate internal control deficiencies and weaknesses;
- Audit committees and boards of directors are more attentive to their fiduciary responsibilities related to financial reporting and are more engaged in overseeing the financial reporting process;
- Investors and analysts are currently being provided greater transparency, allowing them to make more informed investment decisions based on reliable and transparent financial statements;
- The audit profession has been subjected to regulatory processes that provide external oversight and focus on the profession's business platforms, independence, and professional practices; and
- Audit firms have enhanced their relationships with audit committees, have trained their people on auditing internal controls, and enhanced their audit approach to focus on the evaluation of internal controls along with the performance of the financial statement audit. These changes and

(PwC, 2005)

5.1.4 EXPECTED COSTS OF SOX

Unlike the benefits, the costs are more easily quantifiable. Initial implementation costs and setup costs will be much higher compared to subsequent year costs due to the benefits of the learning curve of year one and reduced documentation.

Costs associated with compliance are as follows:

- Internal costs
 - Staff costs – additional staff recruitment
 - Training and development
 - Computer software
 - Internal audit costs
- External costs
 - Computer software consultants
 - Implementation consultants
 - External audit costs arising from increase in audit fees due to increase in scope
 - External training consultants



A survey was conducted to review data on costs of SOX compliance for a sample of Fortune 1000 clients of the big four audit firms with a market capitalisation over \$700 million. The same survey was conducted to review data on costs of SOX compliance for a separate group of smaller public companies with a market capitalisation between \$75 million and \$700 million (CRA, 2006).

The survey of costs for smaller companies are summarised as follows:

Table 1 - Smaller Company Costs Summary

	Year 2	Year 1	% change
404 Cost Summary:	in 000s (\$)	in 000s (\$)	
Internal Issuer 404 Costs	301	355	-15.2%
Third Party Costs for 404	223	463	-51.8%
Total 404 Issuer Costs	524	818	-36.0%
404 Audit Fees	336	423	-20.6%
Total 404 Costs	860	1,241	-30.7%
Proxy Audit Fee Component Summary:			
404 Audit Fees	336	423	-20.6%
Other (non-404) Audit Fees	477	423	12.8%
Total Proxy Audit Fees	813	846	-3.9%

Source: CRA International

The total cost of section 404 has decreased on average by 30.7% from the first year to the second year for smaller companies. This decrease is attributable to a decrease in 36% for total issuer costs and a decrease in 20.6% for section 404 audit costs (CRA, 2006).



Table 2 - Larger Company Costs Summary

	Year 2	Year 1	% change
404 Cost Summary:	in 000s (\$)	in 000s (\$)	
Internal Issuer 404 Costs	2,220	4,260	-47.9%
Third Party Costs for 404	980	2,230	-56.1%
Total 404 Issuer Costs	3,200	6,490	-50.7%
404 Audit Fees	1,570	2,020	-22.3%
Total 404 Costs	4,770	8,510	-43.9%
Proxy Audit Fee Component Summary:			
404 Audit Fees	1,570	2,020	-22.3%
Other (non-404) Audit Fees	3,540	3,080	14.9%
Total Proxy Audit Fees	5,110	5,100	0.2%

Source: CRA International

The total cost of section 404 has decreased on average by 43.9% from the first year to the second year for smaller companies. This decrease is attributable to a decrease in 50.7% for total issuer costs and a decrease in 22.3% for section 404 audit costs (CRA, 2006).

The decrease in the total issuer costs in the tables above is attributed to the cost of implementation incurred in year 1 while year 2 cost is the cost of maintaining and had reduced documentation and better internal controls. The decrease in the audit fees is attributed to the learning curve experienced from year 1 to year 2 by the auditors (CRA, 2006).

For SOX to be sustainable in the long term, the annual costs must not be abnormally high. The costs of SOX compliance has been high initially when compared to the second year of compliance costs incurred. With the costs decreasing from initial costs, SOX may prove to be sustainable in the long term.



Table 3 - Experts interviewed

Interview			
Category	Company	Name	Function
Audit Expert	PricewaterhouseCoopers	Megan Naidoo	Senior Manager, Energy and Mining
Audit Expert	PricewaterhouseCoopers	Pieter Marais	Senior Manager, Energy and Mining
Audit Expert	Deloitte	Mike White	Director, Enterprise Risk Services

The results of the interviews with the experts were divided into the five research questions as discussed in Chapter 3 and the overall conclusion of whether benefits exceed costs provided. Where a response was stated by more than one expert, the number of times the response was given is stated in brackets at the end of the sentence.

Table 4 - Response from Experts on Corporate Governance Structures

5.1.5.1 Corporate Governance Structures
<ul style="list-style-type: none"> • Companies were following the King Code on Corporate Governance. (2) • SOX didn't change anything for companies that were listed on the JSE except for companies with dual listings. • SOX forces companies to implement internal controls that relate to financial reporting. (2) • SOX requires management to test controls for adequacy and effectiveness and requires the auditors to test management's assessment on controls. (2)



- SOX formalise documentation of the controls, as well as determining the adequacy of the controls.

The experts have indicated that the companies in South Africa were following the King report before SOX came about. This has not changed since the advent of SOX as companies were still following the King report in addition to SOX. With SOX, the companies implemented financial controls and this changed the mindset of individuals in the organisation towards controls and risk. Management were more involved in the financial reporting process and were now accountable for their processes. The results from the two stakeholders were consistent with each other.

Table 5 - Response from Experts on Costs of SOX

5.1.5.2 Costs of SOX
<ul style="list-style-type: none">• Constraints by internal audit departments due to the additional work responsibilities tasked to them.• Hiring of additional staff due to the increased work requirements.• Consultants' costs as firms outsourced of the whole control identification and documenting process to certain audit firms in the readiness phase.• Additional audit costs due to application of Auditing Standards. (2).• SOX resulted in unintended consequences of certain companies shifting away from a US listing to an alternate exchange because of the costs involved with compliance. (2)



Table 6 - Response from

5.1.5.3 Benefits of SOX
<ul style="list-style-type: none">• There was an awareness of the controls process by all employees.• Audit committees were more involved and focused and ensured that management did not override controls by following up vigorously on any abnormal occurrences.• Companies' operations have improved by addressing the risks.• The quality of the external audit has been improved.• Companies with bad governance or no governance structures in place have benefited by being forced to have good governance structures.• Allows companies access to the US capital market, which is one of the most liquid markets to raise finance. (2)

Table 7 - Response from Experts on SOX Impact on Mining Industry

5.1.5.4 Impact on Mining Industry
<ul style="list-style-type: none">• The mining industry is one of the oldest industries in South Africa and has good controls. The existing controls in place before SOX were adequate and the additional controls that came about through SOX merely filled the gaps.• SOX provided no additional enhancement to fraud prevention as code of ethics with mining companies is high.



5.1.5.5 Does SOX achieve its Objective

- It is uncertain whether SOX is achieving its objective.
- Maybe it does achieve its objective, as there have been no scandals since the inception of SOX. (2)
- Has SOX restored investor confidence? It is debatable.
- Investors know which companies are well governed and the disclosure of significant deficiencies makes a company more transparent and hence the investor will have more faith in the company.

Table 9 - Response from Experts on SOX Benefit vs Costs

5.1.5.6 Does Benefit Exceed Costs?

- If SOX is implemented smartly it can result in benefits exceeding costs. Year 1 costs were high and benefits were not as high as costs involved in compliance, as too many controls. Year 2 costs have come down as companies found the right level of controls and benefited from the learning's achieved in year one. (2)
- You can't legislate for governance. It is an attitude and not a set of rules. SOX is a set of rules to enforce good morals and common sense. The SOX argument is an exercise in futility and the cost benefit equation is nil. If people are rotten apples they will override the rules. You can't force people to have good morals. It is interesting to have a correlation between poorly governed before SOX and share price and SOX compliant and share price.



5.2 PHASE TWO: STRUCTURED INTERVIEWS

Table 10 - Respondents Interviewed

Interview Details			
Category	Company	Name	Function
Management	AngloGold Ashanti	Hester Hickey	Executive Officer, Head of Risk
Management	Harmony Gold Mining Company Limited	Nolubabalo Sondlo	Sarbanes-Oxley Compliance Manager
Management	BHP Billiton	Kobus Boolsen	Regional Audit Manager
Management	BHP Billiton	Carl Klingenberg	Assistance Audit Manager
Management	Sasol Limited	Nina Stofberg	Group SOX 404 Compliance Manager
Investment Analyst	Macquarie First South Securities	Justin Froneman	Equity Research Analyst
Investment Analyst	JP Morgan	Allan Cooke	Equity Research Analyst
Auditor	PricewaterhouseCoopers	Hermann Waschefort	Senior Manager, Systems and Process Assurance
Auditor	Deloitte	Sidesh Maharaj	Director, Enterprise Risk Services



The results of the interviews were included into the five research questions as discussed in Chapter 3 and the overall conclusion of whether benefits exceed costs provided. Where a response was stated by more than one expert the number of times the response was given is stated in brackets at the end of the sentence.

Table 11 - Responses from Stakeholders on Governance Structures

5.2.1 CORPORATE GOVERNANCE STRUCTURES IN PLACE

- The organisations were complying with the King Code on Corporate Governance. (7)
- The company conducts annual stewardship reviews, which requires a site visit and inspection of the financial reporting processes across the various sites.
- The company complies with the Principles of Good Governance and Code of Best Practice contained in section 1 of the UK combined code.
- The organisation used to apply the COSO framework of internal controls. (3)
- After the introduction of SOX, the company still applies the previous corporate governance structures in addition to SOX initiatives. (8)
- With the application of SOX, the company has set up a project team to implement the Sarbanes-Oxley Act and has created a Compliance Office. The company set up a SOX steering committee, which discusses issues between external audit, internal audit, the SOX office and finance. (2)
- Main additional effect of SOX was the documentation and testing of controls, a disclosure committee that is responsible for signing off of financial statements (20F) before being given to the CEO and CFO, and the creation of a Code of Ethics for employees and senior financial officers. (6)



- CFOs and CEOs sign off on their respective divisions' financial reporting controls (20F) to sign off the SOX certification. (2)

Table 12 - Response from Stakeholders on Costs Involved in Compliance

5.2.2 COSTS INVOLVED IN COMPLIANCE

Internal Costs

- Additional staff costs – (4)
- Internal audit costs
- Systems to put in place (4)
- Systems specialist (4)
- Overseas visits and travel costs (3)
- Productivity losses and loss of business focus.
- Management's time spent on governance (3)
- Telephone costs
- Time to develop a central SOX team
- Time lost spent on internal audit (2)
- Training of staff
- Use of SOX as a budget enhancer

External Costs

- External audit fee increase (4)
- External consultants costs (6)
- Systems reviews (2)
- Additional office space



- Tools – SOX-cc
- Legal fees
- Offshore listing costs
- Additional compliance costs

Below is the actual costs provided by one of the stakeholder respondents. The costs represent a breakdown of costs from the application of SOX.

Table 13 - Costs of Compliance for a Company

Expenditure	2008	2007	2006	2005
Software for SOX	R300 000	R300 000	R300 000	Nil
External Consultants	R7 500 000	R9 000 000	R10 000 000	R9 000 000
Internal Staff Costs	R7 500 000	R9 000 000	R4 000 000	R1 000 000
Travel Costs	R1 000 000	R1 000 000	R1 000 000	Nil
Total Costs	R16 300 000	R19 300 000	R15 300 000	R10 000 000

Costs involved in compliance were minimal for all sections but section 404. The costs incurred in 2005 were low, as the company was not required to comply with the Act and was at the beginning of its implementation phase. The costs for 2006 contained the majority of the costs as it was in the finalisation of its implementation phase as well as the testing phase. Although 2007 costs were higher than 2006 costs, a fair bit of expenditure included in 2007 is related to 2006. The 2008 expenditure is an estimate and costs are expected to fall from the 2007 levels. The 2008 cost is expected to represent the average costs of compliance going forward.

The above costs exclude external audit fees that relate to the audit of SOX. The audit of SOX was conducted together with the annual audit and resulted in a significant jump in audit fees, from R24 million to R60 million – of this, the increase attributable to SOX was R24 million. The audit was passed with no material weaknesses.

After SOX there was a radical shift - fear and hype about the Public Company Accounting Oversight Board (PCAOB), Securities and Exchange Commission (SEC) and possible prosecution abounded. No guidance was given by the SEC on AS 2 and significant effort was put into implementing controls and using internal audit more effectively. The result - a huge increase in audit fees - noted in one circular to be ranging from 50% to 110%.

Table 14 - Response from Stakeholders on Benefits Obtained from Compliance

5.2.3 BENEFITS OBTAINED FROM COMPLIANCE
<ul style="list-style-type: none"> • Controls are in place and are formalised through adequate documentation of controls in place. (4) • Significant awareness by management of consequences of non-compliance • Perceived benefit by shareholders due to confidence in management and more detail in the 20F certification of the financial statements • Audit committees have additional comfort. (2) • People are more accountable for the work under their review. (2) • There is a better understanding of the business processes, control environment



and the risks in

- Processes have been mapped out and have become streamlined.
- Removed silos that prevented interaction between various business units and departments.
- Identified gaps and weaknesses in the control environment and financial reporting system that have been addressed or are in the process of being addressed.
- It puts the investor more at ease with the affairs of the company with regard to the disclosure of material weaknesses that do or do not materially misstate the financial results of the company. (3)
- Peace of mind by the management team if proper processes have been followed
- Companies now have a comprehensive corporate governance structure in place.
- There is an increased transparency of corporate affairs.
- Investors have greater confidence in the company.
- There was a great improvement in the processes.
- There is a benefit from the change in mindset.
- Leadership has been moved in the right direction with a control focused organisation.
- Committees were created, which added additional admin initially and have evolved into a controls steering committee.
- Credibility has been brought to the Internal Audit function.
- It has changed the level of communication and relationship at CFO level.



- The world has towards shareholders.
- Governance in the organisation has improved.
- Internal control rating has improved.
- Maintain a listing on the NYSE – access to one of the largest capital markets
- International exposure to global markets
- Implemented a culture of control awareness at an employee level
- Heightened fraud awareness
- Overseas investors were fickle about SA and SA companies and paint one brush over all companies in SA. Being SOX-compliant changed perception of US investors in SA markets.

Table 15 - Response from Stakeholders on the Impact on the Mining Industry

5.2.4 IMPACT ON MINING INDUSTRY

- A significant amount of costs have been incurred by the mining industry, as they are huge organisations with operations and offices around the world. (5)
- The additional work performed by the auditors will also be substantial and the organisation will incur huge audit costs compared to previous years. It is difficult to measure the benefit to the mining industry, as there is no real benefit to the industry that has arisen due to SOX. (2)
- There was no significant impact other than costs that affected the mining industry. SOX had no real impact on corporate governance. SOX made things more onerous with no real quantifiable benefit. (2)



- Mining industry SOX costs might be individually significant; however, immaterial in the mining industry. (2)
- Management's target is production in the mining industry and SOX had the impact of making managers look at all areas within their processes and resulted in managers looking at areas previously overlooked by them. SOX mitigated those risks.
- Big improvement in relation with the stores and procurement processes and had an effect of having a better managing environment.
- No extraordinary benefits isolated or attributable to mining but to all industries equally. (2)
- Added to senior executives' burden
- Added to the workforce in the industry

Table 16 - Response from Stakeholders on Whether SOX Achieves its Objectives

5.2.5 DID SOX MEET ITS OBJECTIVE?

- It gave people the awareness of responsibility and closed previous gaps that existed in the financial reporting environment.
- It will not stop fraud being committed at a senior level; however, with the harsh punishments laid down, it is a deterrent.
- It did help stop financial statement fraud at the senior management level and staff level and can be seen as successful.
- It results in bringing people to book by having additional disclosure requirements.



- Yes and no. It a financial risk; however, operational risk has not been reduced by SOX.
- SOX would not have stopped Enron and Worldcom and therefore did not meet objectives.
- Financial scandals will occur if executives are corrupt and collude.
- SOX has met its objective as companies have tightened up and are more responsible. Investors are happier and have a level of comfort.
- Achieve its objectives if it is integrated effectively with other governance and compliance initiatives.
- Objective of creating a control-focused mindset, reduce possibilities of corporate collapses and introduce strict control discipline into organisation
- Did achieve its objective in a roundabout way. From having very few controls before SOX to having the nth degree, to eventually scaling down to a more realistic and reasonable level of controls that makes it sustainable. (2)
- Enron would not have happened if SOX was implemented. Focus was on limit authorisation and key controls in an organisation and irregular practices would have been picked up by internal audit and external audit and executives will be reluctant to commit corporate crimes.
- If executives want to commit fraud they will; however, SOX made it difficult to commit fraud and it is more difficult at the lower level.
- Worldcom would have been prevented by SOX; however, Enron would not have been. The culture and tone at the top were not right. SOX will achieve its objective if the tone at the top is right. If buy-in from management is good then objective will be met. Senior executive setting time in diary for SOX work



shows commitr

the top.

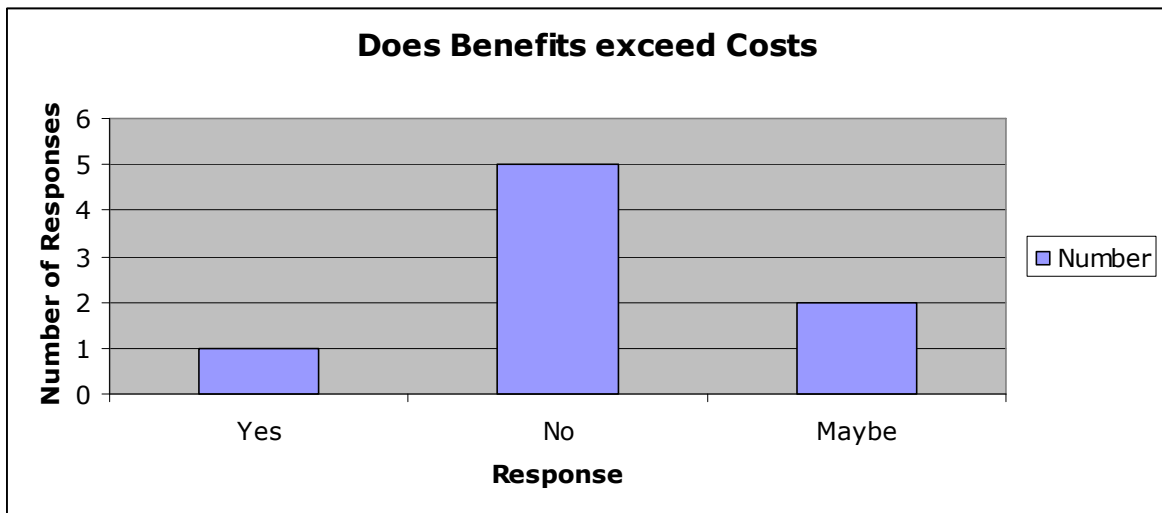
- If implemented controls properly then no need to be compliant
- If controls in place, SOX wouldn't have changed the process
- There are huge benefits and this should not have arisen through an Act.

Table 17 - Response from Stakeholder Interviews - Do SOX Benefits Exceed Costs?

5.2.6 OVERALL SOX: DO BENEFITS EXCEED COSTS?

- No (5)
- Maybe. Initial implementation costs are greater than benefits; however, annual compliance costs are not greater than benefits (2)
- Yes (1). A non-compliant company will be delisted and there won't be large access to capital, which will be extremely costly.

Figure 1 - Summary of Respondents



6. DISCUSSION OF RESULTS

The stakeholders interviewed are the four members of management of each of the companies selected; two investment analysts and two auditors. Two members of management sat in one of the interviews and the results were presented as a single finding. The findings of the interviews with stakeholders are discussed here and are compared to the information gathered during the documentary research and opinions of the experts. The results are further discussed in terms of the research questions posed in Chapter 3 and in terms of the literature review. The questions are as follows:

- What corporate governance structures were in place before the introduction of Sarbanes Oxley and what has changed since the introduction of Sarbanes-Oxley?
- What are the different categories of costs involved in achieving compliance with Sarbanes-Oxley?
- What are the different categories of benefits that have arisen in achieving compliance with Sarbanes-Oxley?
- What is the impact of Sarbanes Oxley on companies in the mining industry operating in South Africa?
- Is Sarbanes-Oxley achieving its objective?

For ease of reference these questions have been included as subheadings and analysed accordingly.

6.1. CORPORATE GOVERNANCE STRUCTURES IN PLACE

6.1.1. Corporate Governance Structures in place before SOX

The corporate governance structures in place before SOX were the King II Code of Corporate Governance and the Combined Code of Good Practice. Both focus on the importance of a properly functioning board of directors as a key ingredient of good corporate governance (Armstrong, Segal and Davis, 2005). South African companies followed the King II Code of Corporate Governance whilst UK companies followed the Combined Code.

This is corroborated by the opinions of the experts, as mentioned in Table 4. (They only mentioned the code relevant to South African companies and did not mention any of the corporate governance structures applied by other companies.) They were of the opinion that the introduction of SOX did not change anything for companies listed on the Johannesburg Stock Exchange (JSE), but did for companies with listings on United States (US) stock exchanges. These companies were further required to comply with SOX.

The results of the structured interviews with stakeholders as mentioned in Table 11 corroborate the results of responses from the experts as mentioned in Table 4. The results indicated that SA companies were complying with the King II Code of Corporate Governance, UK companies were complying with the Combined Code, and Australian companies were complying with Principles of Good Governance. In SA, all organisations were complying with the King II Code, except for one which

was applying the Code of Good Governance. This was by virtue of it being listed on the London and Australian Stock Exchanges.

The results from the stakeholder interviews revealed that previous governance structures were known only to top management. Middle management downwards knew about corporate governance as a concept and had no concept of what it entails.

The results further indicated that in the past organisations used to apply the COSO framework of internal controls as well as stewardship reviews as part of their governance process. The COSO framework is described in Appendix 9.1. Stewardship reviews entail a yearly visit to each business unit and the discussion, a walkthrough and inspection, if necessary, of the financial reporting processes.

6.1.2. Corporate Governance Structures in place after SOX

After the introduction of SOX, other governance structures did not fall away, but SOX was the only one that was compulsory. However, companies had to provide reasons for non-compliance with the other structures. SOX required the CEO and CFO to provide certification of the company's internal controls and the accuracy of the financial statements and periodic reports (SOX, 2002).

The results from the interviews with the experts in Table 4 agree with the literature as the experts' state that SOX didn't change anything for companies other than companies with dual listings or listings in US as they still complied with the King



Code. In addition the which was on governance and financial reporting controls.

The results of the structured interviews with the stakeholders as mentioned in Table 11 corroborated the literature and the results of the expert opinions. The respondents stated that all companies continued with the previous corporate governance structures, and added SOX as an additional compliance requirement. They further stated that the work required the documentation and testing of controls by management, as well as the auditing of management's testing of controls relating to financial reporting controls.

The findings from the interviews with the expert and the stakeholders indicated the level of detail that was initially followed was due to the lack of guidance provided by the SEC on the level of control implementation. When SOX came about, an Auditing Standard 2 (AS 2) specified what should be audited. AS 2 was interpreted as the bottom-up approach and meant that companies should document and test controls in each and every process, account balance and business unit.

Auditors were feeling the strain, as they were slapped with significant penalties if it was found that their work was insufficient - the levels of risk involved also resulted in more detailed procedures.

Guidance was later provided by the standard setting body, which indicated that a company could either follow a company-wide control approach or a risk-based approach. The latter (top-down approach) requires organisations to determine



account balances, but processes that are material and key to the organisation and document and test those controls that relate to those processes. Auditing Standard 5 (AS 5) replaced AS 2, and provides more guidance on how to audit an organisation, what level of controls needs to audited, and the level of testing that is required.

The paradox of SOX is that the reason for it coming into existence was to curb fraudulent executives and negligent auditors, while the result has been that the auditors have been the one of the real beneficiaries of the legislation, in that they are getting additional work and consequently, additional fees.

6.2. COSTS INVOLVED IN COMPLIANCE

Companies were reluctant to provide detailed breakdowns of costs or disclose the costs involved in compliance due to confidentiality. Hence, the study could not compare the various costs amongst the companies. Where information was provided the amounts have been disclosed as per Table 13 - Costs of Compliance for a Company.

The literature states that first-year costs will be high due to documentation of controls and the high level of implementation costs, and that this will reduce in the following years (CRA, 2006). This was corroborated by the discussions with the experts as mentioned in Table 5, who stated that the costs were high as the demand for internal auditors increased. The salaries paid to the internal auditors also increased as a result of the increased demand.



The experts further s as there was no guidance on the level of controls to be documented and tested. Audit firms applied judgement, adopted a conservative approach and tested controls on a company-wide level. Certain companies documented and tested each and every control in the organisation at a high cost. The experts further stated that the costs decreased from year 1 as the organisation benefited from a level of learning and finding the right balance of controls.

Further guidance gave companies the opportunity to use a risk-based, top-down approach. This had the effect of reducing the level of testing required and lowered the costs of compliance. Auditors felt that they were at risk with the new imposed penalties, and wanted a level of comfort before signing off on management's assessment of controls. This entitled the auditors to perform additional work at the expense of their clients.

The stakeholder interviews suggest that costs have come down from initial years to subsequent years, as mentioned in Table 12. However, Table 13 - Costs of Compliance for a Company reflects that 2006 is the first year of compliance and 2007 costs are higher than 2006. The costs table was qualified by the executive at the respective company, stating that 2007 costs included many 2006 costs, which came through after the financial year end that related to the 2006 year.

The results of the expert interviews on the lack of guidance provided by AS 2 are further corroborated by the results of the stakeholder interviews. The stakeholders



have indicated that had they initially, companies would have saved a lot of additional time, money and effort.

The categories of costs as mentioned in Table 12 are fairly consistent and the majority of these costs come from additional staffing, external consultants, increase in audit fees, travel expenditure and software. In addition, it was elaborated that certain costs, such as loss of business focus and loss of productivity, are difficult to quantify.

Litvak (2007) states that SOX and its associated costs are driving companies away from US listings, and cross-listing companies are seeking listing away from the US. This is corroborated by the opinion of the expert who states that companies like Naspers have delisted in the US and other companies are considering doing the same. This, however, has not been corroborated by the results of the stakeholder interviews. The stakeholders as mentioned in Table 14 stated that listing on the NYSE is a benefit, as it is one of the largest capital markets in the world and the listing provides access to this and others. This argument also ties in with Marosi and Massoud's (2007) reasons why firms go dark.

The stakeholder interviews as mentioned in Table 12 mention the cost of management's time in the process. This was not found in the literature and did not reflect in the experts' opinions. The cost of managers' time is difficult to quantify, as management spends a significant amount of time on the SOX process in addition to their normal process and do not keep records of time spent between the two. In addition, time was spent by the executive officers and their time comes at a



premium - having the and certification of financial statements when they should rather be involved in the strategic direction of the company, simply doesn't make good sense.

The companies that had good corporate governance structures would not have incurred significant costs to become compliant, as most structures are already in place. However, although certain companies had the structures in place, they were not documented, which could have cost additional time.

6.3. BENEFITS

The benefits of the implementation of SOX have all been qualitative. Investors are willing to pay a premium for companies that are well governed and for companies situated in countries that have sound governance structures in place (McKinsey, 2000). A SOX-compliant company is regarded as a well governed company and could potentially attract a premium from investors. Yet the benefit of compliance is not quantifiable.

The experts agree that good governance makes a company desired. The stakeholders are of the opinion that companies that have been displaying corporate governance and that comply with SOX provide no additional benefit to the shareholders other than costs. However, companies that initially do not have corporate governance structures in place, and then have to comply, do provide benefits to the investors. There was another view that the investor is more at ease with the affairs of the company with regard to the disclosure of material weaknesses that do or do not materially misstate its financial results.

The experts stated that complying with SOX allows a company access to one of the largest capital markets in the world, namely the US market, which is one of the most liquid in which to raise finance. These comments were corroborated by the results of the stakeholders, who were of the opinion that SOX provides exposure to this international capital market.


Leskela (2004) states that SOX compliance makes a company more productive due to streamlined processes with good controls; however, this is difficult to quantify and qualitative in nature.

This is corroborated by the experts in Table 6 who say that the organisation has been strengthened and the number of errors reduced. They state that gaps have been filled by the documenting and testing of control processes, and audit committees are more focused and challenge management more vigorously on abnormal occurrences.

The results of the stakeholder interviews in Table 14 corroborate the results of the expert opinions above and state that controls are in place and are formalised. People have a better understanding of business processes and the control environment.

There is a belief, as mentioned in Table 6 by the experts, that SOX came about to protect investors from fraudulent executives, as well as regulate the auditing profession. However, it appears that the auditing profession has benefited a great



deal. This benefit has  iditors are more at risk due to the penalties imposed by SOX. They have the added burden of being checked up on and scrutinised and their personal lives have been affected. This additional scrutiny and risk comes at a premium - it is the company that bears the costs, which effectively come from shareholder returns. This was not corroborated by any of the results of the interviews with stakeholders as stakeholders state that the auditors took the opportunity to increase their work procedures.

Management spending time on controls in an organisation adds value to the organisation, as they set the tone of the organisation. It demonstrates that senior level employees are aware of what goes on 'on the ground' and strengthens the control environment. This behaviour is driven down to the lower level employees, and if the tone at the top is right the company will be a well-governed company. This view was seen as a benefit as well as a cost, based on the conflicting opinions of the stakeholders interviewed.

One of the stakeholders have stated that overseas investors are fickle about South Africa and have a general view that all companies are poorly governed. One of the benefits of SOX compliance identified is the overall view of South African companies. Being SOX compliant has changed this perception - something that was not corroborated by the literature review or the expert opinions.

The stakeholders interviewed said that where companies have been following good corporate governance structures, SOX provided no additional benefit. However, companies that did not previously follow corporate governance guidelines and



were forced to follow Benefit would be obtained by these companies by having a good control environment and good governance. A company with good corporate governance practices in place wins investor confidence, and vice versa.

6.4. IMPACT ON MINING INDUSTRY

Mining is the largest industry by sector on the JSE (Business Day, 2007), and the expert opinions in Table 7 state that it is the oldest industry in South Africa. The more established the industry, the more likely it is to have good controls. The existing controls in place in the mining industry before SOX were adequate; however, the SOX exercise served to fill some gaps.

The results further state that fraud prevention in the mining industry was not enhanced by SOX. Ethics in the mining industry are high and SOX doesn't prevent fraud any more than what the industry's code of ethics does. Corporate governance had a significant impact on companies when the Cadbury and King reports came out in the nineties, but SOX had no such impact.

The above was partly corroborated by the results of the stakeholder interviews as mentioned in Table 15. While some respondents stated that gaps have been filled by the SOX process, SOX had no impact on the mining industry. In fact, the majority of the respondents stated that the biggest impact on the mining industry was the costs, with no additional benefits. (A significant amount of these costs relate to the additional work performed by auditors.)

Individual company's costs of compliance were significant, yet the amounts are immaterial to the mining industry as a whole. While the industry has been changing to a more governed environment, it is not because of SOX. One stakeholder has stated that the Brett Keble stories that have been hitting the headlines highlighted the lack of governance and accountability on the part of companies - SOX merely adds credibility to the process. This is inconsistent with the response from the expert who stated that the mining industry is an old one with good controls.

6.5. OBJECTIVE

The objective of SOX was to instil confidence in investors following the corporate scandals of Enron and Worldcom, by eliminating corporate fraud. There is no evidence in the US that suggests that SOX achieved its objective and eliminated corporate fraud. To date, no fraud has been reported since the implementation of SOX, yet can it be said that SOX halted fraudulent practices?

The expert opinions as mentioned in Table 8 corroborate the above by mentioning that there is uncertainty as to whether SOX has achieved its objectives. It is difficult to determine whether investor confidence has been improved and whether fraud has been reduced because of SOX. SOX has made the companies more transparent by prescribing companies to disclose the state of its affairs and its significant deficiencies to its shareholders. This transparency brings about faith in the company by its shareholders.



Would Enron have occurred if SOX was in place at the time of the Enron scandal? The answer is yes, because SOX will not prevent fraud if there is collusion amongst senior management and board members. At Enron the senior management were colluding and this collusion would not have been prevented by SOX. A strong audit committee could deter fraud; however, if top management is corrupt, it could still go undetected. The introduction of SOX would simply make it much more difficult to commit fraud. In addition, auditors are now more thorough and audit committee are more focused.

The results of the stakeholder interviews mentioned in Table 16 partly corroborate the opinions of the experts, which stated that fraud would not be prevented by SOX and would still occur if senior-level management is corrupt and colludes. There were certain conflicting opinions, with some suggesting that SOX would prevent fraud at all levels and is a deterrent.

Enron would not have been prevented by SOX; however, Worldcom would have been. This partly corroborates the expert opinions, in that Enron occurred because of collusion at the top and financial statement fraud, and Worldcom because of irregular accounting practices that would have been identified and detected during the management testing of controls.

For SOX to achieve its objective of creating a company with accountability and transparency, the culture of the organisation has to be correct. If the tone at the top is correct, it will filter down to the employees and if management buy-in is achieved from the outset, SOX will assist in overcoming fraud.

It is further stated by the stakeholders interviewed that SOX has achieved its objectives and reduced financial risk. However, it did not meet its objectives in that it does not address operational risks. It would be more beneficial and cost efficient if it is integrated effectively with other governance and compliance initiatives. This would be achieved by incorporating other legislation into the SOX process as opposed to having separate processes for each legislation that is applicable to the company.

6.6. BENEFIT vs COST

As per Figure 1 - Summary of Respondents, the overall opinions of the respondents mention that the benefits do not exceed the costs. The main reason is the high level of costs with no real tangible benefit. Although there are benefits available, they are non-quantifiable in the short term and will only become obvious in the long term.



7. CONCLUSION

7.1. FINDINGS

This study has analysed the Sarbanes-Oxley Act (SOX) in order to understand its purpose, contribution to the mining industry, benefit and cost composition and the extent of these costs and benefits. From the results of this analysis, a number of observations can be made.

Firstly, the Act arose as a result of dishonest practices and corporate scandals in the United States (US), which reduced investor confidence - something needed to be done to restore this confidence. A conflicting belief is that SOX was a political agenda by Congress to demonstrate its commitment to punish corporate crime offenders.

Secondly, when determining the costs benefits equation, a true drilldown of the benefits is advisable. Costs are easy to bring to book as they are incurred and readily quantifiable. Benefits are qualitative in nature and are often not easily noticeable and tangible. While fairly significant SOX-related costs were established during the implementation stage, these have been decreasing annually and the process of compliance is more sustainable, a fact that is impacting the sustainability of the legislation favourably. Business processes have been streamlined and employees are more accountable and have a greater awareness of the controls in the business process.



Thirdly, the regulator management and auditors has been highlighted by this study. While some provisions were made by the legislation in terms of prescribing the action required from companies, no guidance was provided on the level of detail. This had the effect of extreme amounts of work being performed to protect the management and auditors from stiff penalties, all along in the face of uncertainty as to the levels of assurance required for the satisfactory implementation of the Act.

The paradox that has arisen from the study is that one of the real beneficiaries of the legislation, which now appears to be the auditors. The auditors of Enron, namely Arthur Andersen, were partly guilty in the Enron scandal and were suspended from the profession. The legislation then came about to prevent such scandals, and it is now the auditors that perform additional audit work on the clients, and are justified in charging a higher fee based on this additional work.

Fourthly, the legislation has had little or no impact on the mining industry in South Africa. The organisations that had to comply with SOX only benefited if they did not follow any corporate governance structures previously, as SOX provides no additional benefit to corporate governance structures. If any, the only impact on the industry has been the costs incurred.

Finally, the legislation has had no effect on fraudulent senior level executive employees, other than imposing significant penalties and prosecutions. Jail terms and prosecution are seen as deterrents, but not barriers to fraud. The major success of the legislation is determined by the tone of the senior level executives,



who are of the opinion that, in the absence of the legislation, the legislation will demonstrate significant benefits. Overall, the consensus is that scandals like Enron would have occurred under SOX; however the likes of Worldcom could have been prevented by the SOX process.

7.2. RECOMMENDATIONS

This research was exploratory in nature and aimed to understand the intention and cost benefit of the SOX legislation. It was a high level study that did not seek to resolve any particular issues, but rather expose issues that relate to the Act. After conducting the documentary research and meeting with the respondents, certain recommendations to stakeholders based on observations were identified.

7.2.1. Management

From the interviews, it appears that management has accepted the legislation and implemented the Act fully. Certain companies have had challenging discussions with their auditors about the understanding and interpretation of the legislation, and others have accepted the interpretation of the auditors. The first recommendation to management, based on the results of this study, is to conduct discussion forums involving technical subject matter experts before implementing a course of action. The application of AS2 in implementing controls could have been discussed in a forum and could have resulted in applying the top-down risk based approach. The subject matter experts consulted with should be independent from the implementation and testing service providers and will provide unbiased advice. Decisions should be vigorously debated in order to reach an objective solution, and



the result will be that  relinquish overall control in its decision making process.

Finally, any new regulation should be incorporated into the company's overall strategy and should be integrated with similar compliance initiatives. This would result in a decrease in the overall effort of compliance and prevent duplication of procedures common to all legislations applicable to the company. The strategy should be communicated to all employees with the intention of obtaining buy in and to demonstrate management commitment.

7.2.2. Auditors

A high level study of this nature does not result in detailed recommendations as to how the auditors should approach the legislation. The auditors are the stakeholders who will either perform the testing of the controls and management's assessment of controls, or implement the Act as consultants. These auditors are knowledgeable in this field and aim to implement the ideal solution for their clients.

It is difficult for auditors, as the industry is fairly regulated and there is not much choice provided to the service provider. The auditor signs off on the state of affairs of the client and is accountable for the work performed. For the level of risk involved, the auditor is thorough in the approach and will perform additional work and obtain a level of comfort over the state of affairs of the company. This approach will be specific to each client and will vary depending on the nature of each client. A recommendation to the auditing profession is to apply judgement on the level of testing and not to over-audit.

7.2.3. Investors

The recommendation to the investors is to be more actively involved in the companies in which are being invested. Attendance of shareholder meetings should be done, and the decisions of company management questioned. Actively involved shareholders will be seen as company watchdogs.

7.2.4. Regulators

The Securities Exchange Commission (SEC), through the various congresses, is responsible for the promulgation of this legislation. Recommendations based on the results of this study are relevant to the introduction of the legislation.

Firstly, the legislation is applicable to *all* companies listed on stock exchanges in the US. The recommendation is that such pieces of legislation should only be applicable to companies that operate in the US. Companies located and operating outside the US should have the option of either complying with SOX or being exempted from certain provision of SOX if they follow other recognised corporate governance structures.

Secondly, companies should be afforded certain exemptions based on the size of the organisation. It is not feasible for a listed company with \$20 million in revenue to be following all the provisions of the Act. This is closely related to the first recommendation, as it refers to the applicability of the legislation to the various companies listed in the US.



Finally, any future legislation should be phased in slowly and not adopt the 'big bang' approach. The consultation process should include continuous engagement with investor groups and auditors. Thereafter, proper guidance notes should be submitted and published at the same time as the legislation. Workshops and discussion papers should be conducted well before the release of the legislation to the public. This would have prevented substantial costs incurred by the various companies in adopting a company-wide controls-based approach to SOX.

7.3. FUTURE RESEARCH IDEAS

The topic of corporate governance and its benefits is extremely broad. The scope of this research report was restricted to certain questions and respondents in order to ensure that it was limited and specific to Sarbanes-Oxley and the mining industry. However, this restriction has highlighted a number of areas in which future research can be performed. These include:

- The opinions in the study were restricted to Sarbanes-Oxley. The study could be extended to other corporate governance structures.
- The opinions in the study were restricted to the mining industry. The study could be extended to other industries in South Africa.



- The companies, which are required to comply with the legislation and have incurred all these costs of implementation. The study could be performed in another two to three years to determine the maintenance costs of SOX, and its sustainability.
- The study was performed in a South African context using South African companies. It could be performed on an international level using various companies that comply with SOX.

7.4. CONCLUSION

As a broad overview, this study has analysed the Sarbanes-Oxley Act to determine its purpose; whether it achieves its objective in the environments in which it is applied; the associated cost components; the benefits it brings; and whether the benefits exceed the cost or vice versa.

The analysis of the purpose of the regulation and the achievement of its objective showed that the purpose of the Act is to restore investor confidence and its objective was to prevent fraud. There was no evidence suggesting that investor confidence has been increased by implementation of the regulation. The objective of the regulation has been partly achieved, as there has been no evidence of fraud since the implementation of SOX. However, it cannot be proved that the elimination of fraud is directly as a result of the implementation of SOX.

The benefits of the legislation are access to capital markets in the US, awareness of the controls culture by all employees, as well as an accountable workforce. The



external costs incurred, consultants' costs for implementation and documentation of controls as well as computer consultants for systems and software. Internal costs relate to staff recruitment, training and travel costs. Other costs are difficult to quantify and relate to senior management-level employees' time on internal controls and financial statement certification.

The ultimate success of SOX will depend on whether the benefits created by the legislation will exceed the costs. The results of this study show that costs are greater than benefit. However in the long term, benefits should exceed the costs, as a sustainable level of costs will be incurred each year in the future years. The benefits are not quantifiable in the short term and will provide value in the long term and the high implementation costs initially incurred will not be incurred in the future.

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9. APPENDICES

9.1. The COSO Framework

Committee of Sponsoring Organisations of the Tradeway Commission (COSO) defines internal control as a process designed to provide reasonable assurance of an organisation's achieving its objectives in three areas:

1. Effective and efficient operations;
2. Reliable financial reporting; and
3. Compliance with applicable laws and regulations.

The COSO framework presents five interrelated components, each spanning the three objectives. Based on a company's size and structure, the components could be implemented differently; however, each component is relevant to all companies. Thus, when evaluating its internal control, management must consider each of the following five components:

1. Control environment;
2. Risk assessment;
3. Control activities;
4. Information and communication; and
5. Monitoring.



The COSO framework (

lows:-

Figure 2- The COSO Framework

