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Industry-Wide Effects of the Sarbanes-Oxley Act of 2002

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The Sarbanes-Oxley Act of 2002 (the Act) is perhaps the most notable example of federal legislation aimed at reestablishing corporate accountability and restoring investor confidence. The Act was passed in response to numerous corporate and accounting scandals, which led to a substantial decline in investor confidence in public financial information. Rezaee and Jain (2002) document that the capital markets reacted positively to several Congressional actions surrounding the Act. This study examines whether the capital market reactions to the passage of the Act vary among industries. We find that some industries are positively affected, while several others are negatively impacted by the passage of the Act. Results suggest that financial scandals were not limited to a handful of companies because investors perceived them to be an industry wide problem.

INTRODUCTION

Two thousand two was a challenging and rather difficult year for corporate America as evidenced by the stock market's swift decline, a significant number of earnings restatements, substantial corporate and accounting scandals and resulting loss of investor confidence in corporate governance, financial reports and audit functions. To restore investor confidence, lawmakers enacted bipartisan legislation by passing the Sarbanes-Oxley Act of 2002 (hereafter, the Act) in July 2002. A major reason for enactment of the Act and establishment of the Securities and Exchange Commission's (SEC) related implementation rules was the belief that new regulations were necessary to make corporations more accountable to shareholders and to restore investor confidence in the capital market.[1] In signing the Act, President George W. Bush described the Act as "the most far-reaching reforms of American business practice since the time of Franklin Delano Roosevelt" (Bumiller 2002). The SEC Commissioner, Harvey Goldschmid, called the Act "the most sweeping reform since the Depression-era Securities Laws" (Murray 2002). Critics consider the Act as a patchwork

[1] Results of a real-time poll of 450 CFOs and senior financial executives during a live webcast with former SEC chairman Arthur Levitt revealed that 90 percent of participants believe new regulations intended to make corporations more accountable to shareholders are necessary (Levitt 2002).