

# RISKY BUSINESS

TEMPLE UNIVERSITY, FOX SCHOOL OF BUSINESS, DEPARTMENT OF RISK MANAGEMENT AND INSURANCE

## The Law of Unintended Consequences?

The Sarbanes-Oxley Act, enacted in mid-2002 in the wake of the Enron and WorldCom accounting scandals, aimed to improve the accuracy and reliability of corporate financial disclosures.

This objective may have been at least partly achieved, but a new study has found that the legislation may have had a serious side effect: It appears to have made Wall Street analysts less able to forecast corporate earnings.

Sarbanes-Oxley is complex legislation, containing an assortment of features. One is stiff fines and penalties for reporting misleading financial data; the law requires that a company's chief executive and chief financial officer personally certify the accuracy of its financial statements. Sarbanes-Oxley also made a number of changes to corporations' governance structure, like requiring that the board's audit committee be independent and that the outside auditor have no conflicts of interest.

The study, titled "The Impact of the Sarbanes-Oxley Act on Information Quality in Capital Markets," set out to document some of the law's effects. Its authors are Joy Begley, an associate professor of accounting at the University of British Columbia in Vancouver; Qiang Cheng, an assistant professor of accounting there; and Yanmin Gao, an assistant professor of accounting at the University of Alberta in Edmonton. A version of their paper, which has been circulating since earlier this year as an academic working paper, is at [ssrn.com/abstract=1008986](http://ssrn.com/abstract=1008986).

To measure the quantity and quality of the information available to investors when they're deciding whether to buy or sell a company's shares, the professors focused on the accuracy of Wall Street analysts' earnings forecasts. In an interview, Professor Begley said she and her co-authors reasoned that, if Sarbanes-Oxley had led to more and better information being available, the average analyst's earnings forecast should have become more accurate after the law took effect. In addition, she said, there should also be less variation among individual analysts' forecasts.

The professors began their investigation by gathering data on all publicly traded companies in the United States that are followed by at least two Wall Street analysts. They focused on analysts' earnings forecasts for these companies over a four-year period starting in August 2001, one year before the legislation's enactment. All told, the professors studied 1,807 companies over those four years.

The professors found a slight increase in analysts' forecast accuracy in the first 12 months after Sarbanes-Oxley was signed into law on July 30, 2002, but the improvement was short-lived. Over the next 12 months — from August 2003 through July 2004 — the average earnings forecast was less accurate than it was before the law. And it continued to be less accurate in the 12 months ended in July 2005.

But is it possible that this decline had nothing to do with Sarbanes-Oxley? It's worth asking, because many other changes have been made during this decade that also affect how analysts go about their jobs. For example, Regulation FD (for fair



materially important information to individual analysts in private conversations, requiring them instead to disclose it publicly. In addition, soon after Sarbanes-Oxley was passed, a number of state attorneys general began to scrutinize potential conflicts of interest under which analysts may operate.

Professor Begley acknowledged that while it was "highly likely" that Sarbanes-Oxley contributed to the declining accuracy, it was impossible to know with certainty the relative roles of the law and these other factors.

Still, she said, that doesn't necessarily mean that Sarbanes-Oxley has failed in meeting its objective of increasing the accuracy and reliability of corporate financial disclosures. She and the other researchers felt that they could measure such qualities only indirectly, however, by examining how changes in financial reporting may affect analysts' ability to forecast earnings.

For example, Professor Begley continued, it may well be that while corporate disclosures have become more accurate, the amount of information conveyed in those disclosures has declined sharply. The net effect of such a combination, she said, would be that analysts' forecasts, on balance, become less reliable.

It stands to reason, she said, that Sarbanes-Oxley would have led to a reduction in the total amount of information available to analysts: given the new penalties that the law imposes on misleading disclosures, corporations have an incentive to disclose less information, to avoid the risk associated with disclosing something that might get them into legal trouble.

## H. WAYNE SNIDER DISTINGUISHED GUEST LECTURER



### Pil Chung

Principal (Actuarial & Insurance Solutions)

Deloitte Consulting LLP

Wednesday, November 14, 2007

11:40am-12:30pm

Walk Auditorium, Ritter Annex

Pil Chung has over 16 years of Strategic, IT and Process / Controls consulting experience managing and implementing solutions enabling competitive advantage for fortune 1000 companies. Mr. Chung is a Principal in Deloitte Consulting's Actuarial & Insurance Solutions practice specializing in assisting Insurance and Financial Services Industry organizations to integrate IT and process / control improvements from strategy through operations leveraging both existing infrastructure and leading edge business transformation tools and tech-

nologies. His experience ranges from developing IT transformation, process and controls reengineering, enterprise support systems implementation (Policy/Claims Admin Systems, ERP, CRM, OSS, Supply Chain), and integrating eBusiness tools.

Mr. Chung has several other accomplishments including a New York University Teaching Fellow in Business Strategy and Policy, a New York University Stern School of Business Scholar. Additionally, he was co-inventor of the world's first continuous "Trim&Form" processing systems for the Semiconductor industry

Mr. Chung holds a Masters of Business Administration degree graduating as a Stern Scholar with distinction in Information Systems and Finance from New York University (Stern School of Management) and a Bachelors of Science degree in Management Information Systems from Rensselaer Polytechnic Institute

## Phi Beta Lambda Canned Food Drive

Ends Friday, November 16, 2007

Phi Beta Lambda (PBL) is spearheading their annual canned food drive from November 1, 2007 through November 16, 2007.

This food drive supports Project H.O.M.E.'s annual "Turkey Basket" efforts. Thanksgiving-themed food like canned vegetables, canned gravy, instant potatoes, etc. as well as donated turkeys from other organizations are combined to make baskets for a families that would not otherwise be able to afford a Thanksgiving meal.

Let's support PBL and Project H.O.M.E. (and families in need) by donating canned foods and other non-perishable dry goods for this worthy cause.

Last year we participated in a similar drive and were able to donate **200 lbs** worth of goods. This year let's all show our support and double that number!

Cans and other goods can be dropped off in the Gamma Office (Ritter Annex 400), outside Walk Auditorium during the Wednesday Meeting and at your respective committee meetings.

## Edifying and culturally relevant!



## Gamma Iota Sigma Bake Sale

Friday, November 16, 2007

9:00am-4:00pm

Speakman Hall (ground level)

The Sigma Chapter will be holding its final bake sale of the semester on **Friday, November 16, 2007 in Speakman Hall**. We will have brownies, cookies, cupcakes as well as other various pastries on sale for **50 cents apiece**. Be sure to come out and support us! **All proceeds go to charity.**

If you have any questions regarding this event, please contact Crystal Carmicheal: [ccarmicheal@temple.edu](mailto:ccarmicheal@temple.edu)



## COMPANIES ATTENDING THE 2007 ACTUARIAL SCIENCE INTERN RECEPTION

ACE INA

Aetna

AIG

Apex Management Group

Buck Consultants

CIGNA

Ernst & Young

GMAC Re

Independence Blue Cross

ING

Mercer

Milliman

Munich Reinsurance America

Penn Mutual Life Insurance Company

Prudential Financial, Inc.

SMART Group

Sun Life Financial

Towers Perrin

Watson Wyatt Worldwide

XL Group

### Philadelphia CPCU Breakfast

Thursday, November 15, 2007

8:00-10:00am

Union League (104 South Broad Street)

This is a great opportunity to attend a professional society meeting. As students will be involved with these types of organizations throughout their professional careers, this networking experience should prove invaluable. Several insurance executives will be present speaking to everyone, and there will be plenty of knowledge to gain. It should be an exciting and intriguing event for everyone attending.

If you would like to attend this event or if you have any questions regarding this event, please e-mail Kevin Johnson:

[kjohnson05@temple.edu](mailto:kjohnson05@temple.edu)

Don't forget to visit the Sigma Chapter website at <http://www.sigmachapter.org> for a full calendar of events, as well as other features!

### Actuarial Science Intern Presentations

Friday, November 16, 2007

11:40am-12:30pm

SAC 217D

Are you planning on having an internship next summer but aren't sure where you want to work or what you want to take away from your experience? If you answered yes to any of these questions then you should consider attending one or more of our Internship Presentation Sessions. This week will feature **Niraj Rana (CIGNA)**, **Josh Davis (SMART Business Consulting)** and **Tom Callahan (PricewaterhouseCoopers)**, each of whom interned over the Summer of 2007. Each intern will during give you their perspective on everything about their respective companies, from projects they worked on to the corporate culture. As usual, free pizza and food will be available.

If you have any questions regarding this event, please contact Nate Loughin:

[nmloug@temple.edu](mailto:nmloug@temple.edu)

### Risk Management Intern Presentations

Friday, November 16, 2007

11:40am-12:30pm

Speakman 113

Are you planning on having an internship next summer but aren't sure where you want to work or what you want to take away from your experience? If you answered yes to any of these questions then you should consider attending one or more of our Internship Presentation Sessions. **This week will feature Dave Kramar (NAPSLO)**, **Lucas Bouziat (ACE INA)** and **Samantha Solove (Willis of PA)**, each of whom interned over the Summer of 2007. Each intern will during give you their perspective on everything about their respective companies, from projects they worked on to the corporate culture. As usual, free pizza and food will be available.

If you would like to attend this event or if you have any questions regarding this event, please contact Karen Gaudet:

[k.gaudet@temple.edu](mailto:k.gaudet@temple.edu)