

# Study validates effectiveness of Sarbanes Oxley 406 Financial Code of Ethics

October 24 2016, by Leslie Venezuela

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The Sarbanes Oxley (SOX) Act of 2002 was passed following the WorldCom and Enron accounting scandals with the intent of lowering the prevalence of financial misconduct. Section 406 of the Act requires public companies to disclose whether they had adopted a specific code of ethics for principal, financial and accounting officers.

A new study shows that when senior financial officers adopt a code of ethics the number of earnings restatements often associated with [financial mismanagement](#) are reduced.

The study, which includes O.C. Ferrell and Linda Ferrell of Belmont University in Nashville, and co-authored by Saurabh Ahluwalia from The University of New Mexico Anderson School of Management and Terri Rittenberg of the University of Wyoming, sought to determine the effectiveness of this requirement.

They studied companies' financial statements beginning in 2005. At the time, only 67 of the 176 Fortune 500 public companies examined in the study has a specific code of ethics for chief financial officers. A decade later, the number only increased to 77 of the 176 companies in their sample, despite the requirement of SOX.

However, the researchers found the companies that had a specific code of ethics caught misreporting earlier and saw significant declines in the number of financial restatements that were being made.

"Our tracking over the course of a decade found that companies that had implemented a specific financial code of ethics engaged in much improved scrutiny of their own practices," said O.C. Ferrell. "Catching problems more quickly and lowering the need for financial restatements."

"This study should encourage all public companies to develop and implement a financial code of [ethics](#)," said Linda Ferrell. "And public policy decision makers should continue to monitor and support SOX implementation."

The study was recently published in the prestigious *Journal of Business Ethics*, a Financial Times top 50 journal.

**More information:** Saurabh Ahluwalia et al. Sarbanes–Oxley Section 406 Code of Ethics for Senior Financial Officers and Firm Behavior, *Journal of Business Ethics* (2016). [DOI: 10.1007/s10551-016-3267-7](https://doi.org/10.1007/s10551-016-3267-7)

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