Chapter 7.3
Diffusing Management Information for Legal Compliance:
The Role of the IS Organization within the Sarbanes-Oxley Act

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ABSTRACT

Information systems are vital to successful compliance with Section 404 of the Sarbanes Oxley Act. However, there is little published academic literature which reports systematic studies that explain how IS organizations implement 404. Institutional theory was adopted as the lens through which to examine the experiences of 404 implementation in three global organizations. The methodology for the research involved in-depth case study analysis. We conclude that key implementation drivers for 404 are directives from senior authorities, financial and resource subsidies, standards being set and adhered to, and knowledge being deployed. The findings are believed to present significant insights into the complexities and role of IS in providing valid and appropriate approaches to 404 compliance.

INTRODUCTION

The Sarbanes Oxley Act (SOX) creates the deepest changes to the Securities Exchange Commission (SEC) rules since 1934 (107th Congress, 2002; Banham, 2003; Aberdeen Group, 2005). The act was passed in response to financial misstatements and high-profile corporate frauds such as Enron, WorldCom, Tyco, and Global Crossing. The act aims to reduce the level and scale of financial fraud due to an organization's management being able to misrepresent its financial condition (Ferrell, 2004; Rone & Berman, 2004). Organization-wide strong governance—that is the formal and informal rules that guide organizational action and behavior—and robust controls are therefore seen as essential to avoiding future accountancy deficiencies.

Section 404 of the act requires organizations to provide external auditors with documentary evidence of the existence and effective functioning of processes, systems, and controls used to generate all financial and management information made available to the public. Since in most organizations, processes, systems, and controls are embedded in a wide range of information systems, the IS organization assumes a significant role in 404 compliance (Chan, 2004; Hackney, Burn, & Salazar, 2004;Coe, 2005).

This article analyzes the implementation of Section 404 within organizations through the lens of institutional theory. Unlike previous regulatory frameworks which are based on self-regulation, the act makes the management of effective internal controls mandatory. Furthermore, the act backs up the requirements for controls with severe penalties including fines and prison sentences for those in breach of its provisions. SOX is binding on all companies listed on any American Stock Exchange, and hence non-U.S. companies are subject to its provisions (Dalton & Dalton, 2005; Coffee, 2005). Therefore, companies incorporated in other legal jurisdictions, such as the UK, for example, can be prosecuted, for the first time, in U.S. courts for being in breach of SOX (Dewing & Russell, 2003). In the past, company officials, such as the chief executive officer (CEO) and chief financial officer (CFO), could only be prosecuted in the country of the company's incorporation.

TAXONOMY OF 404 INTERVENTION DRIVERS

There is a significant amount of practitioner literature available that provides managers with methods and procedures they need to consider when implementing Section 404 (Duffy, 2004; Ivancevich, Duening, Gilbert, & Konopaske, 2003; Mayer, 2003; Quall, 2004). However, as normal, the practitioner literature lacks a theoretical basis for the approaches being recommended and is akin to the plethora of prescriptions for successful implementation of information systems. As in the wider IS academic field, our aim is to examine the role of the IS organization when implementing Section 404 through a sound theoretical lens, based on valid methods, in order to provide conceptual insights for 404 implementation.

Section 404 adds to the body of corporate governance literature. The most common approach used to study corporate governance is agency theory (Dalton, Daily, Ellstrand, & Johnson, 1998; Dalton & Dalton, 2005), which stems from the seminal work of Berle and Means (1932). They argued that the separation of ownership (shareholders) and control (management) gave managers—agents—an opportunity to act in their own self-interest by making decisions or acting in ways to increase their financial prosperity rather than that of the shareholders (Fama, 1980; Jensen, 1993). A variety of methods are deployed to minimize the opportunities for promoting management's self-interest over that of shareholders. These are exemplified by managing the board's composition, strengthening the role of non-executive directors (Barnhart, Marr, & Rosenstein, 1994), and linking the board's com-

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