Has Section 404 of the Sarbanes-Oxley Act Discouraged Corporate Investment? New Evidence from a Natural Experiment

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Ana Albuquerque
Boston University

Ana Albuquerque completed her PhD in accounting, her MS and MBA degrees at the University of Rochester, and a Bachelor at the Universidade Catolica Portuguesa, in Portugal.

Her research interests lie on the impact of regulation and financial reporting on executive compensation and incentives.

Ana Albuquerque has published in the Journal of Accounting and Economics, the Journal of Financial Economics and her work has been featured in the Wall Street Journal.

[Abstract]: Prior studies conclude that an unintended consequence of firms complying with Section 404 of the Sarbanes-Oxley Act (SOX404) is lower levels of risk-taking activities, including investment. We first demonstrate that the results in prior studies showing a reduction in investment and other risk-taking activities are not related to SOX implementation but are instead due to the failure to isolate the effects of SOX from other contemporaneous events. We then use the implementation requirements of SOX404 to construct a natural experiment that isolates the effects of SOX404 in a sample of small firms. We do not find a reduction in investment and other risk-taking activities for firms that had to comply with SOX404, relative to other firms. Because small firms are expected to be the most adversely affected by the regulation, our results cast doubt on the notion that SOX404 had a negative impact on larger firms.