



404 INSTITUTE

Sarbanes-Oxley Section 404 Benchmark Study

Winter/Spring 2005

Executive Summary

As part of its ongoing commitment to helping organizations remain current with issues and practices related to section 404 of the Sarbanes-Oxley Act (S-O 404), the 404 Institute recently conducted a survey to gain insight into December 31 filing results in terms of controls, deficiencies, and testing efforts by process; the role of the internal audit department (internal audit) in S-O 404 for 2004; and projected costs and expectations for 2005.

The Institute had two primary objectives in conducting the survey: to check the pulse of companies engaged in the S-O 404 compliance journey and to delve into the results of the compliance assessments of those companies.

Specific Topics Explored by the Survey

- The percentage of key controls by process
- The breakout of percentages for *deficiencies*, *significant deficiencies*, and *material weaknesses*, both overall and by process
- The degree to which controls are manual versus automated, and detective versus preventive
- Responsibility for oversight and day-to-day management of compliance efforts
- The involvement of internal audit in documentation and testing
- The amount of internal company resources (in terms of hours) dedicated to compliance efforts
- Whether costs of compliance efforts are expected to increase or decrease in 2005, and what may be driving any changes
- The benefits organizations expect to realize from their compliance efforts

Highlights of the Survey Results

It is important to note that the results presented here are based on self-reporting by the companies that participated in the survey. Conclusions may be affected by the differing methods companies use to report on various elements of Sarbanes-Oxley compliance, such as quality of controls, assignment of responsibility, and costs.

- Information technology (IT) controls dominate the deficiencies, significant deficiencies, and material weaknesses identified through the S-O 404 assessment; they account for approximately one third of the deficiencies and one quarter of the significant deficiencies and material weaknesses.
- Most controls are still manual and are weighted toward detective versus preventive.
- The CFOs and controllers remain the ones most likely to have oversight responsibility for S-O 404 compliance efforts; however, it appears that responsibility will shift slightly from the CFO to the controller in 2005.
- Dedicated project managers and chief internal auditors will maintain day-to-day project management responsibility for 2005 S-O 404 compliance.
- In the great majority of cases, internal audit was involved in the documentation or testing; however, the time internal audit will need to devote to S-O 404 compliance is expected to decline in 2005.
- Seven in ten organizations used more internal than external resources to comply with S-O 404 in 2004.
- Approximately two in three companies expect their costs related to S-O 404 compliance to decrease in 2005, and documentation is the most likely factor to drive that cost decrease.
- Respondents overwhelmingly mentioned improved controls as a primary benefit their company will realize as a result of their S-O 404 compliance efforts.

About the Respondents

Conducted in February 2005, this Web-based survey brought responses from 154 representatives of companies with revenue of \$250 million or more from a variety of industries. Respondents have direct oversight or overall responsibility for, or are actively engaged in, Sarbanes-Oxley section 404 compliance efforts within their organizations.

Note: Not all charts foot to 100 percent due to rounding.

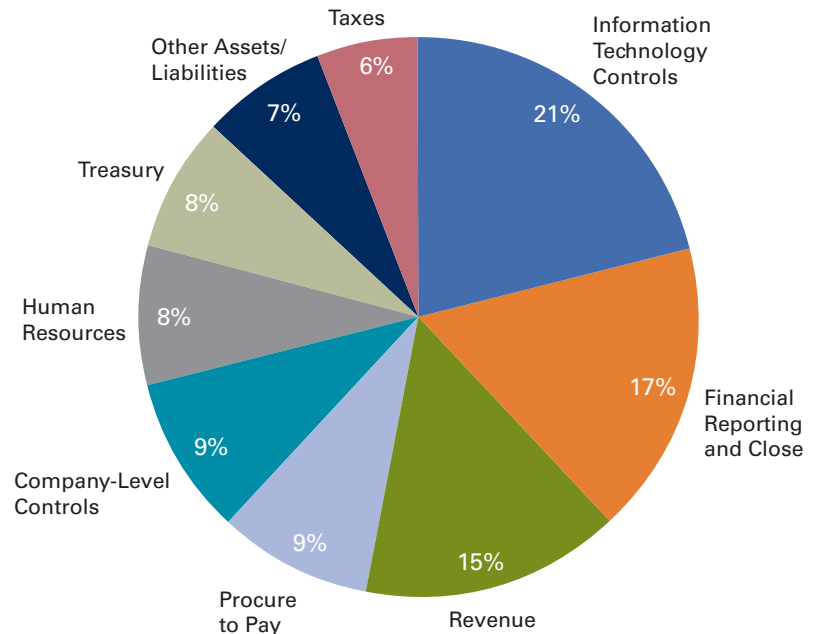
Key Findings

Key Controls

Key controls are most prevalent in the areas/processes of information technology (21 percent), financial reporting and close (17 percent), and revenue (15 percent). *IT controls dominate the deficiencies, significant deficiencies, and material weaknesses identified through the S-O 404 assessment.*

- The estimated percentage of deficiencies identified show IT controls accounting for the most (34 percent), followed distantly by revenue (13 percent), procure to pay (10 percent), and fixed assets (10 percent).
- The estimated percentage of significant deficiencies identified again shows IT controls leading the way (23 percent), followed by financial reporting and close (14 percent), procure to pay (13 percent), and revenue (12 percent).
- The estimated percentages of material weaknesses identified include IT controls (27 percent), revenue (18 percent), taxes (11 percent), and financial reporting and close (10 percent).

Estimated Percentage of Key Controls by Process



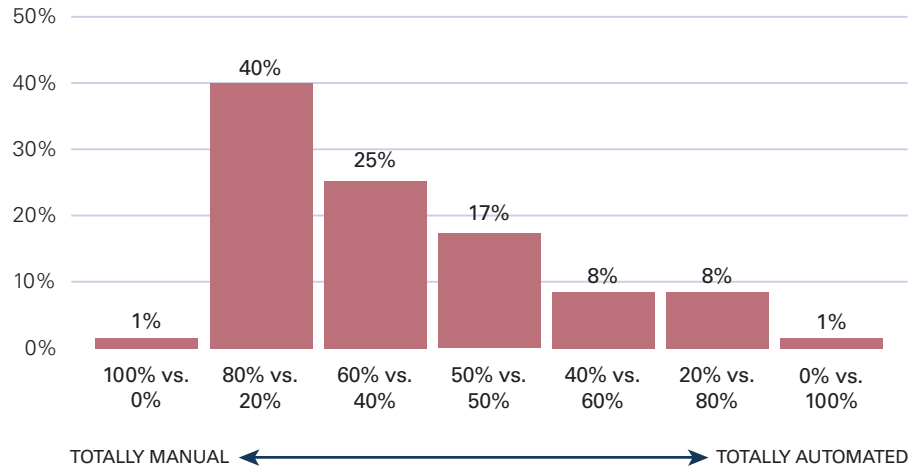
Key Controls

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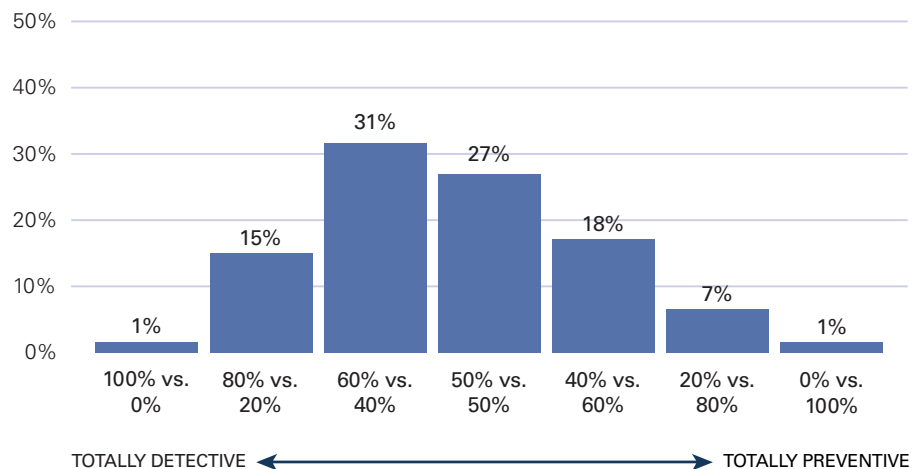
Most controls are still manual and are weighted more toward detective versus preventive.

- Sixty-six percent estimated their controls to be weighted more toward manual than automated, 17 percent estimated the percentages to be 50 percent/50 percent, and 17 percent estimated their controls to be weighted more toward automated.
- Forty-seven percent estimated their controls to be weighted more toward detective than preventive, 27 percent estimated the percentage to be 50 percent/50 percent, and 26 percent estimated their controls to be weighted more toward preventive.

What is the estimated percentage of your company's manual controls versus automated controls?



What is the estimated percentage of detective controls versus preventive controls (excluding information technology controls)?

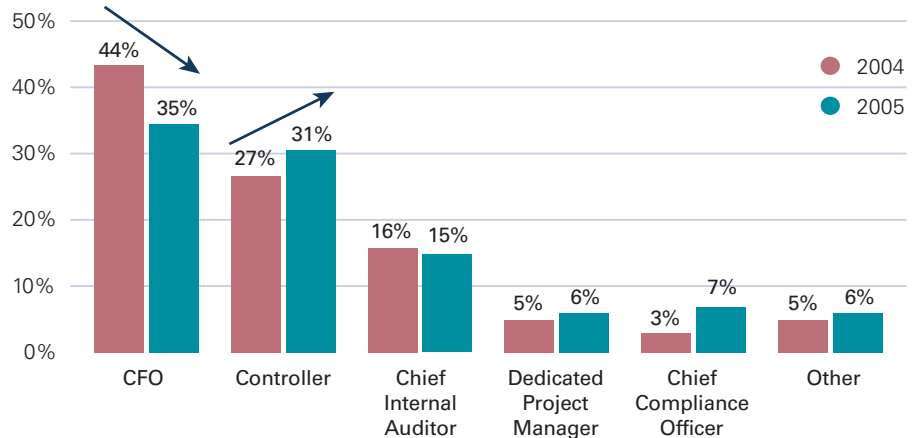


Responsibility for S-O 404 Compliance Efforts

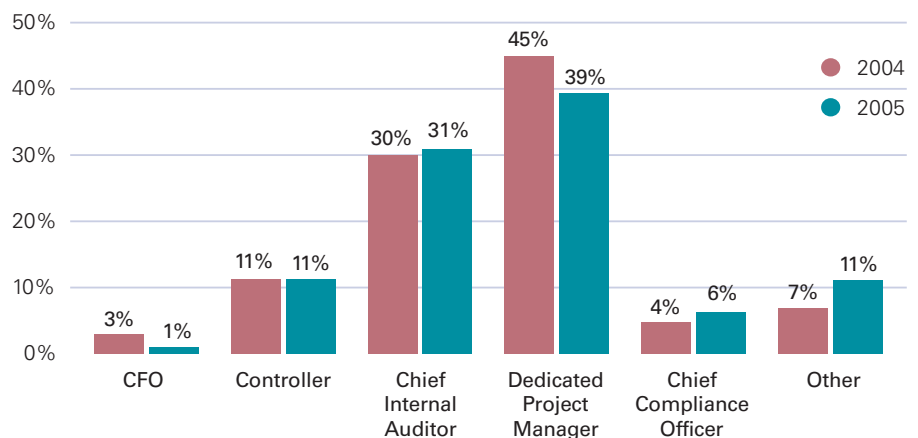
The CFOs and controllers remain the ones most likely to have *oversight responsibility* for S-O 404 compliance efforts. It appears that more responsibility is shifting slightly from the CFO to the controller in 2005, as those stating CFOs have oversight responsibility dropped from 44 percent in 2004 to 35 percent in 2005, while those stating controllers have oversight responsibility rose from 27 percent to 31 percent.

Dedicated project managers and chief internal auditors will maintain *day-to-day project management responsibility* for 2005 S-O 404 compliance, although somewhat fewer dedicated project managers were identified as having responsibility, as this responsibility in some cases is shifting to others.

Who had oversight responsibility for your Sarbanes-Oxley 404 compliance effort in 2004? In 2005?



Who had day-to-day project management responsibility for your Sarbanes-Oxley 404 compliance effort in 2004? In 2005?

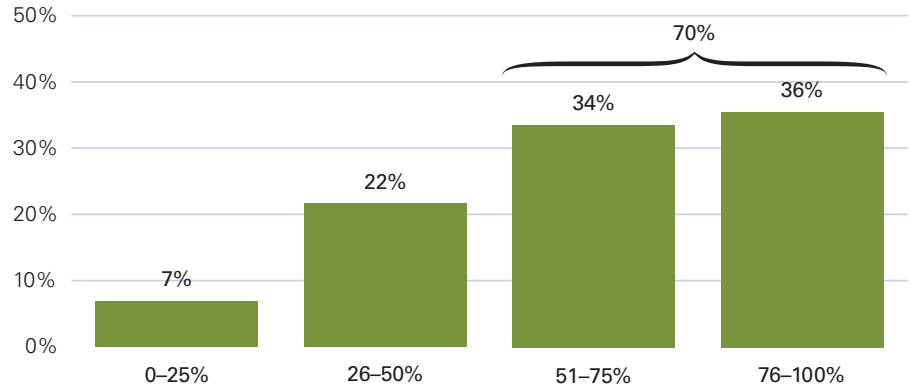


Involvement of Internal Audit and Internal Resources in Compliance Efforts

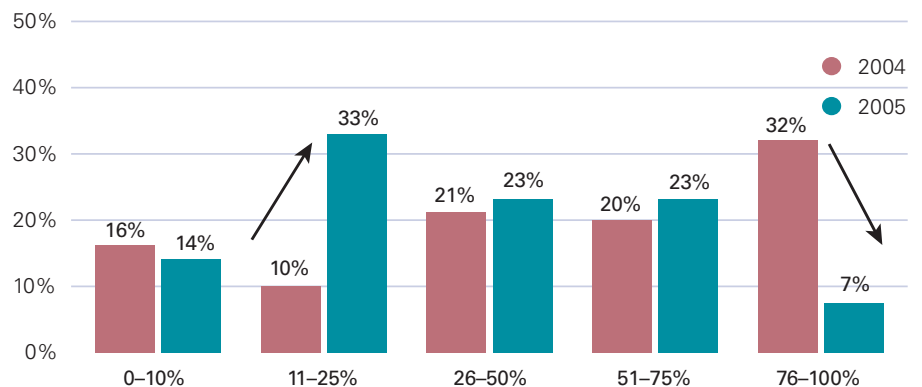
The vast majority, fully 85 percent, stated that internal audit is involved in the documentation or testing. Half said that internal audit has primary responsibility for testing. Seven in ten said they used more internal resources than external resources to comply with S-O 404 in 2004.

Respondents expect that the time internal audit will need to devote to S-O 404 compliance *will decline in 2005*. In 2004, 26 percent estimated the percentage of internal audit budgeted hours allocated to S-O 404 compliance to be 25 percent or less. For 2005, a notable 47 percent estimated the percentage of internal audit budgeted hours allocated to be 25 percent or less.

What percentage of these total hours was incurred by internal company resources (including internal audit)?



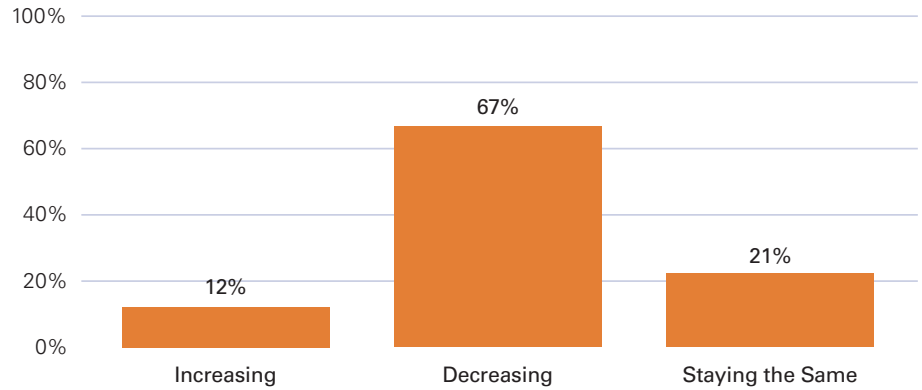
What was the estimated percentage of internal audit budgeted hours allocated to Sarbanes-Oxley 404 compliance during 2004? During 2005?



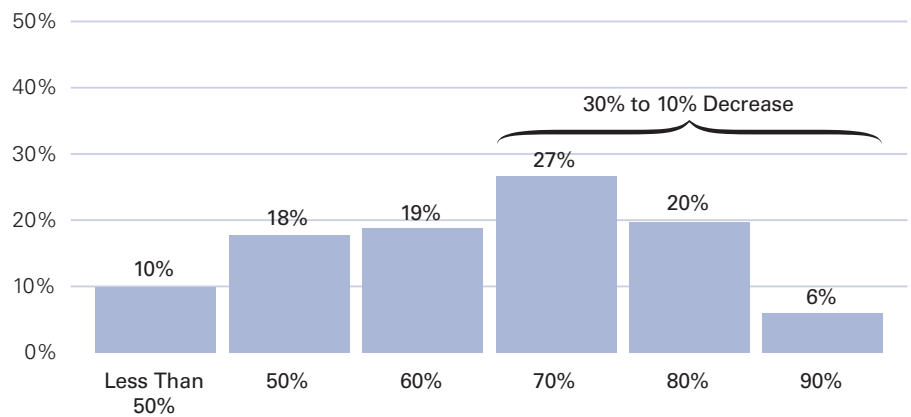
The Costs of Compliance

Approximately two in three companies (67 percent) expect their costs related to S-O 404 compliance *to decrease in 2005*. In fact, the majority expects a decrease of 10 percent to 30 percent.

Do you see the cost of Sarbanes-Oxley 404 compliance increasing or decreasing in 2005?



If decreasing, what do you estimate will be the cost of Sarbanes-Oxley 404 compliance in 2005 as a percentage of the 2004 cost?



The Costs of Compliance

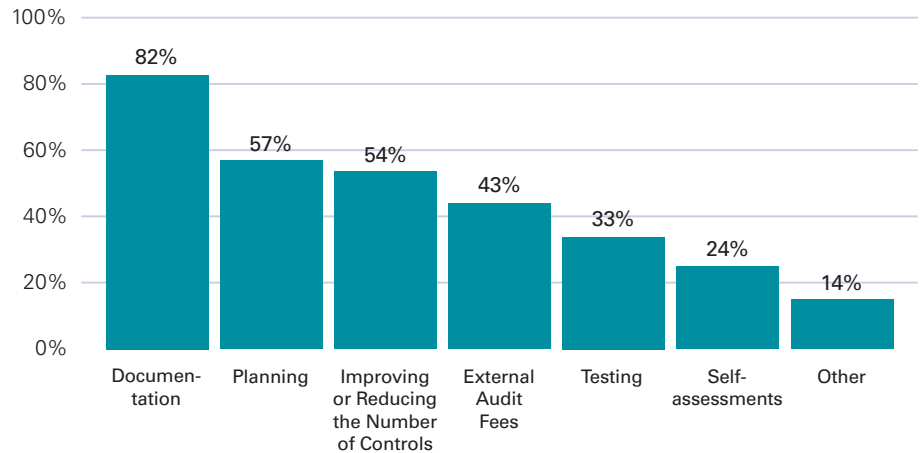
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Among those expecting a decrease in compliance costs, fully eight in ten said *documentation* would drive that cost decrease. Secondary areas expected to contribute to the decrease include *planning* and *improving or reducing the number of controls*, each mentioned by more than half of respondents.

The Benefits of Compliance

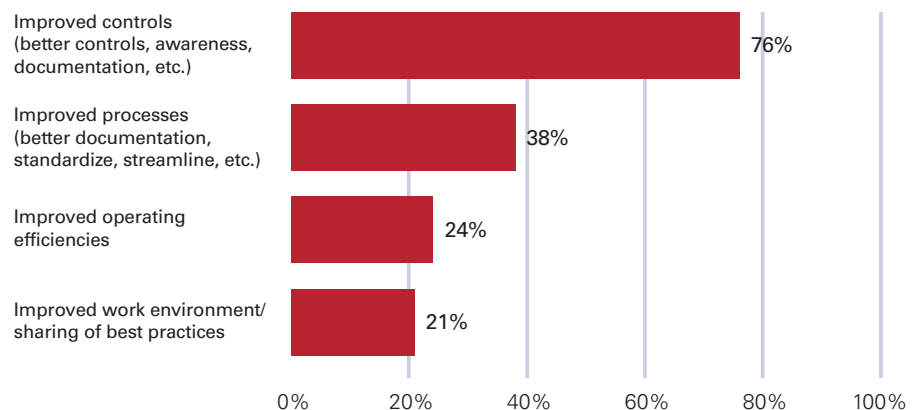
Respondents overwhelmingly (76 percent) mentioned *improved controls as a primary benefit* their companies will realize as a result of their S-O 404 compliance efforts. Other benefits include improved processes (38 percent), improved operating efficiencies (24 percent), and improved work environment/sharing of best practices (21 percent).

Which of the following areas will drive the decrease?



Multiple Responses Allowed

In light of all the work done to comply with S-O 404, what are the top three benefits you expect your company to realize as a result?



Multiple Responses Allowed