

It's All About the Money

by Tim Fogarty

“U.S. college freshmen saying ‘being very well off financially’ is very important or essential has increased from 33% in 1970 to 70% today.”—UCLA Study

Am I the only person (other than Yogi Berra) who's getting that déjà vu feeling all over again? Hearing about companies spending money hand-over-fist to comply with the internal control aspects of the Sarbanes-Oxley Act (SOX) brings to mind an earlier era when companies stampeded for the opportunity to pay a lot for what now appears to be very little. Although a great deal of money has gone over the transom since then, the corporate theme of the late 1990s was the Y2K problem. Though it's unclear how many really believed the world was about to end if our computers weren't fixed to accept the fact of a new millennium, corporate America spent as if there were literally no tomorrow.

The same thing seems to be happening with SOX Section 404 compliance. The numbers are staggering. A January 2004 PricewaterhouseCoopers study showed that three-quarters of large companies expect their internal control evaluation and external auditor attestation compliance costs to substantially increase over their earlier expectations, a third of them by 75 % or more. One reason may be that SOX compliance isn't integrated with other compliance processes.

A survey of large public corporations by Financial Executives International (“Size Matters: Larger Companies Will Spend More for Sarbanes-Oxley Compliance Requirements,” February 10, 2004, press release) showed similar results. Total costs of first-year compliance could exceed \$4.6 million for each of the largest companies. External audit fees are estimated to rise by a staggering 38% across all sizes of companies. In addition to the jump in audit fees, large corporations are projected to spend an average of 35,000 hours of internal staff power and \$1.3 million for consulting and software. And while the largest companies may have the internal resources to reassign to SOX projects, mid-sized companies typically outsource many similar functions and so will have to pay even more proportionally than their larger cousins.

For many companies, the bills are large enough to show up as consequential impacts to the bottom line. Companies are starting to run up this flag as a cause of missing their analyst-induced earnings bogey. Let's give companies the benefit of the doubt and believe that this really is the case, but I wonder what “value added” we will get for all this trouble.

A Good Cover Story

Although few retrospective accounts of the Y2K saga have been attempted, that cash drain has to be chalked up as one of the largest boondoggles of recent corporate times. There may be a few true believers that cling to the notion

that this extraordinary effort to remediate computer code saved Western civilization. They benefit from their rigorous unwillingness to look at the evidence. European companies did little about the same challenge, and their world retained the same luster that ours did when we reached that anticlimactic day.

And so it will go with the documentation, assessment, and external auditor attestation of internal controls over financial reporting. That which companies have resisted forever has now become the only rational thing to do. If anything, the need to belabor processes in a rigorous manner is a stronger temptation than Y2K because compliance with the law provides a cover story.

CEOs shouldn't be allowed to pass the buck for financial controls down

the ladder. The prospect that CEO accountability translates into a concern that hasn't existed before is astounding.

The main point, however, is that SOX spending for certifications of internal control over financial reporting won't in itself produce higher levels of accountability. A paper trail a mile deep doesn't change the incentives to undermine integrity through earnings management and to co-opt the auditors. Believing that this is legally necessary as an expedient or as a magic bullet seems to be quite naïve and paranoid. Courts or regulatory agencies do *not* hand out brownie points for effort. The urge to make things more rational and more amenable to documentation is laudable to a point that we have long since passed.

An Indirect "Victory"

Please don't misconstrue this skeptical attitude as the rantings of an apologist for the practices that ushered in the new regulatory legislation. It would be extraordinary if we could achieve meaningful reform that would be worth its cost in terms of renewed confidence in the markets and a revival of actual corporate integrity. What isn't appropriate is symbolic gestures. The significant expense of a ceremonial posturing doesn't make it more substantive. The real question is: Which of these is the certification requirement of Sarbanes-Oxley?

Y2K wasn't without its silver lining. Many companies exploited this event to invest in material information technology infrastructure upgrades or revisions. Information technology that had been held together with bailing wire was finally modernized. Companies reimag-

ined their processing needs and information abilities "while the hood was up."

And the result for the SOX internal control certification exercise when (and if) its dust clears may be the same. The major advantage will be an incidental one, attributable to the sustained focus that it purchased. Thus, the review of internal controls, done nominally to facilitate official certification, will undoubtedly identify weaknesses and inefficiencies that should be eliminated. Perhaps this is the best that we can hope for—an indirect "victory" declared in the face of an obvious loss.

There is a uniquely American feeling about the parallelism that didn't start with Y2K. Anyone remember the Foreign Corrupt Practices Act fire drill? Nor will it end with SOX. Like fine wine, it isn't a question of getting what you pay for in corporate America. More likely, we respect nothing that doesn't cost significant money. Problems are important because we pay through the nose for them. This magnifies the inherent nature of the dilemma in a way that feeds off itself.

In America, it seems to be about the money. ■

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