



TRENDS

I N F I N A N C I A L M A N A G E M E N T

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Section 404 Costs Soar

► **COMPLYING WITH SECTION 404** of the Sarbanes-Oxley Act is costing public companies much more money and time than previously anticipated.

Section 404, which goes into effect for fiscal years ending after November 15, will cost public companies 62% more on average than they had previously thought, according to a new survey by Financial Executives International (FEI).

Compared to results from a similar FEI survey in January 2004, financial managers at 224 public companies of almost all sizes said in July 2004 that they expected internal costs of compliance to be 109% higher on average than previously thought, external costs 42% higher, and external auditors' fees to be 40% higher than expected.

Section 404 requires each company's annual report to contain: (1) a statement of management's responsibility for establishing and

maintaining an adequate internal control structure and procedures for financial reporting, and (2) management's assessment, as of the end of the company's most recent fiscal year,

of the effectiveness of the company's internal control structure and procedures for financial reporting. Section 404 also requires the company's auditor to attest to and report on management's assessment of the effectiveness of

the company's internal controls and procedures for financial reporting in accordance with standards established by the Public

Company Accounting Oversight Board (PCAOB).

In January, respondents thought compliance with 404 would require an average of

12,265 internal staff hours to develop the management report on internal controls. But by July, when companies were well into their documentation process, internal staff hours more than dou-

bled to an average

of 25,668 hours. Time spent by the internal audit staff accounted for 27% of the hours.

Companies have also been hir-



ing external consultants and people from auditing firms to document their internal controls. But the actual number of staff hours companies expected to pay for the fiscal year was 60% more, or 5,067 staff hours on average in July (except hours paid for auditor attestation), than the 3,059 they anticipated in January.

In January, the companies surveyed had expected their auditors would charge \$590,100 for the attestation of internal controls—before the PCAOB finalized its auditing standards. But afterward, in July, when companies had most likely begun receiving actual quotes from their auditors, the average expected fees increased by almost 40% to \$823,200. The auditors' attestation fee originally had been expected to represent an average increase of 38% over a company's expected audit fee. In July, the respondents said they expected the incremental fee for attestation to represent an increase of more than 53%.

For external consulting, software, and other vendor charges, responding companies in January expected to pay an average of \$732,100. But in July, after they had begun to hire consultants and purchase software, the total reported cost had increased by 41% to \$1.04 million. Although companies surveyed ranged from those with less than \$100 million in revenues to more than \$5 billion, the unexpected increase in consultant and software costs was incurred primarily by the largest companies surveyed.

Spotlighting the Internal Auditor

The Institute of Internal Auditors

Costs for external auditors' attestation of internal controls jumped from \$590,100 anticipated to \$823,100 actual.

(IIA) says Sarbanes-Oxley is clear about the roles of management, audit committees, and external auditors for complying with Sections 404 and 302 but doesn't address the parts internal auditors must play. Section 302 requires chief executives and CFOs to personally certify the accuracy of their companies' annual and quarterly reports.

So the IIA has outlined what the internal auditor's involvement should be to comply with those two sections of the Act. The internal auditor should:

Project Oversight

- Participate on the project steering committee, providing advice and recommendations to the project team and monitoring progress and direction of the project.
- Be a facilitator between the external auditors and management.

Consulting and Project Support

- Provide existing internal audit documentation for processes being reported on.
- Advise management on best

practices in documentation standards, tools, and test strategies.

- Provide training to management and process owners on risk and control.
- Perform quality assurance reviews of process documentation and key controls before financial information is handed off to the external auditor.

Ongoing Monitoring and Testing

- Advise management on the design, scope, and frequency of tests to be performed.
- Be an independent assessor of management testing and assessment processes.
- Test management's basis for its assertions, then help identify control gaps and review management plans for correcting those gaps.
- Perform follow-up reviews to ascertain whether control gaps have been adequately addressed.
- Put together discussions between management and external auditors on the scope and plans for testing auditing projects.
- Participate on the company's disclosure committee so all audit and examination activities are considered for disclosure.

The IIA says that because of the internal auditor's work in complying with Sections 404 and 302, he or she is in a better position to help increase management's awareness of risk and controls, help create stronger controls, reduce external audit fees, and fulfill a traditional assurance role for senior management, the audit committee, and the board of directors. ■