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Lord & Benoit Report: First Year SOX Results for Small Busin ...

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Lord & Benoit Report: First Year SOX Results for Small Business

Benefits of the Delays

Executive Summary

The Sarbanes-Oxley Act of 2002 (also called SOX) was passed by Congress and signed by the President to provide among other things, investors with transparency in financial reporting, including financial statements, disclosures and Internal Controls over Financial Reporting (ICFR).

The Act was created in response to a number of corporate frauds that occurred in several larger public companies (Enron, WorldCom, Tyco, etc.). Sections 404 (a) and (b) of the Act requires public companies to self assess their internal controls over financial reporting and have another assessment of controls performed and reported by external auditors.

Section 404 (a) management self assessments are essentially documentation and testing of the quality assurance function of the financial reporting process.

However, for smaller public companies with a public float under \$75 million, the Securities and Exchange Commission (SEC) delayed Section 404 (a) and (b) requirements . The delays for complying with Section 404 (a) moved from year ends after July 2005, to July 2006, July 2007 and finally Dec 15, 2007.

Section 404 (b) however (auditor attestation) continues to be delayed. The current requirement of the auditor attestation to be submitted with a smaller public company's Form 10-K has been extended to years ending December 15, 2009 or later.

The stated rationale for the delays was to give smaller companies time to identify their internal control weaknesses and make the necessary corrections over four years rather than trying to clean up controls all at once in one year like their larger counterparts. Additionally, the costs of compliance could be smoothed over a four year period rather than all at once.

For the year ended December 15, 2007, non-accelerated filers (smaller public companies) were required for the first time to file a Section 404 (a) assertion about the effectiveness of their Internal Controls over Financial Reporting (ICFR). This report analyses those results.

The timely questions are:

- "Now that more than 3,200 small public companies have filed their Section 404 (a) assertions, what can be ascertained about the four year delay?"

- "And further, what can be asserted about the wisdom of additional Section 404 (b) – auditor attestation extensions?"

Summary Results

Lord & Benoit, using data provided by the online research tool called Audit Analytics conducted a study of ALL first time smaller public company (non-accelerated) filers with year ends between Dec 15, 2007 and Jan 31, 2008 to ascertain what could be gleaned from the four years of SOX 404 delays.

For a slight majority of non-accelerated filers (68%), the delay appears to have helped companies prepare, test and remediate compliance issues, to satisfy Section 404 requirements. Although as expressed earlier, none of these Section 404 (a) assessments of controls were subject to independent review by outside auditors as required under Section 404 (b).

The following were the factual results:

1. Last Minute Reporting - For a significant minority of non-accelerated filer companies (32%), there is ample evidence that little or no consideration was given to the requirements of Section 404. For example, one study found that only one out of every eight small public companies disclosed an ineffective 302 (disclosure controls) assessment, in the quarter prior to asserting their controls being ineffective under Section 404.

Given the close relationship between these two criteria requirements

