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Is SOX Compliance Undermining Your Edge?

By Fred White

Many entrepreneurs argue that IPOs are going overseas because Sarbanes-Oxley compliance costs are too high in the U.S., thus undermining the nation's economic competitiveness. Yet a first-of-its-kind report offers surprising results of the actual cost of compliance.

The Sarbanes-Oxley Act of 2002 was created in response to a number of significant public registrants issuing financial statements and reports that were grossly misleading.

Basically, SOX is meant to establish standards and requirements for advancing activities associated with corporate governance (ethics, integrity, HR policies/procedures, etc.), company-wide and activity-level internal controls, IT controls over financial reporting and risk assessment. The overall goal of SOX is to improve transparency in financial reporting and advance the accuracy and timeliness of public company disclosures.

For years, we knew it was costing us to spend professional time — i.e., money — to make financials transparent, but we didn't know how much.

In a new report from consulting firm [Lord & Benoit](#) (via [Reuters](#)), data for smaller companies reveal that "for non-accelerated filers, the total average first-year cost for management assessment and additional audit fees is \$78,474."

The Lord & Benoit study was based on a cross-section of 29 smaller public companies in the semiconductor, manufacturing, distribution, banking and finance, energy, services and biotech industries. The report also results from an Audit Analytics study of actual audit fees reported by nearly 5,500 public companies, Reuters explains.

Detractors, including many venture capitalists, say that initial public offerings (IPOs) are going overseas because complying with SOX costs is too high. Entrepreneurs claim it is so expensive to gain compliance, that it is not always worth it to go public.

Indeed, Securities and Exchange Commission (SEC) Chairman Christopher Cox last month announced that the SEC "will soon approve a one-year delay of Sarbanes-Oxley Section 404 (b) for the country's smallest public companies." The announcement came after repeated calls for a postponement from House Small Business Committee Chairwoman Nydia M. Velásquez. Small companies reported that SOX 404 (a) compliance costs would represent more than three percent of their net income.

The SEC will conduct its own research regarding the effects of SOX compliance on small firms. According to [an announcement](#) from the House Committee on Small Business, Chairwoman Velásquez says she will make certain that everything is done to ensure that SOX does not undermine the competitiveness of the United States economy.

The concern over the cost as a percentage of net income matters because it is deemed by many as unjust that smaller companies have to pay proportionately more than medium-sized and larger companies pay to comply. However, as anyone who has bought and sold knows, it is unfair not to look at investment benefits as well as costs.

Lord & Benoit contends:

Compliance costs are not without corresponding benefits. The improvement in procedures has removed volatility in reporting and this, in turn, has contributed to the recent dramatic decrease in security class action claims against companies. In addition, the market capitalization to revenue ratio of companies with good financial reporting procedures and filings results in higher stock values.

However, there has not been a lack of IPOs to point to for those who argue against SOX, a new report from [National Venture Capital Association](#) (NVCA) argues: "For the year [2007], a total of 86 companies went public for \$10.3 billion, compared with 57 companies for \$5.1 billion in 2006."

In the fourth quarter of 2007 alone, 31 venture-backed IPOs totaling \$3.0 billion in proceeds were issued — representing the highest quarterly number of IPO's since the third quarter of 2000 — according to NVCA and Thomson Financial's "Exit Poll" report.

As of the first week of January, 58 percent of venture-back companies that went public in 2007 were trading at or above their offering price, according to the report.

The questions that emerge from this situation become:

- If SOX is so great, why don't non-U.S. companies spend big bucks to comply and become financially transparent?
- What is the quantifiable benefit of preventing class action lawsuits?
- And how much investment in U.S.-based entrepreneurial companies has come from non-U.S.-based companies, and is this good for Americans?

After all, the more data a company provides about its costs, profits, operations and plans, the more attractive it can appear to investors.

Without all the evidence, the jury, too, is still out. And while the figures and statistics given here flow mainly from industries not exclusive to manufacturing, our industry has its own special characteristics and benefits to society. Even more reason to withhold judgment before seeing the facts.

Resources

[First-of-Its-Kind Report Quantifies Actual Cost of Sarbanes-Oxley Section 404 Compliance](#)

Lord & Benoit, Jan. 9, 2008

[SEC Chairman Announces Delay of SOX 404 Implementation](#)

U.S. House Committee on Small Business, Dec. 12, 2007

[Venture-Backed Acquisition Quarterly Volume Hits 10-Year Low While Average Disclosed Value Hits 7-Year High](#)

NVCA, Jan. 2, 2007

[Sarbox Survival Guide](#)

by Lora Bentley

IT Business Edge, Jan. 9, 2008

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