404
INSTITUTE

ENHANCING INTEGRITY IN FINANCIAL REPORTING

SARBANES-OXLEY SECTION 404
2004 BENCHMARK SURVEY

As part of the 404 Institute's ongoing commitment to helping organizations remain current with issues and practices related to Sarbanes-Oxley section 404, the Institute recently conducted a survey to help assess where companies are in the compliance process. Conducted from August 24 through September 30, 2004, the Web-based and telephone survey brought responses from more than 550 representatives of companies from a wide array of industries.

Respondents have direct oversight or overall responsibility for, or are actively engaged in, Sarbanes-Oxley section 404 compliance efforts within their organizations, 71 percent of which are calendar-year close reporting companies.

OBJECTIVES

The 404 Institute had several objectives in conducting the survey:

- To assess companies' current levels of completion for documentation and testing relative to section 404 requirements

- To identify companies' progress against section 404 filing requirements

- To identify companies' top concerns and planning status for future and ongoing section 404 compliance

KEY FINDINGS

Documentation

When asked if their companies had completed documentation of internal control over financial reporting relative to the requirements of section 404, roughly 50 percent of respondents said their companies are "well on schedule" for complying with section 404, versus 20 percent who said they are not on schedule. Of those companies with annual revenue of more than $5 billion, two thirds said they are well on schedule. *(See Chart 1.)*

1. How close is your company to being on schedule to comply with the provisions of section 404 by the required filing date?

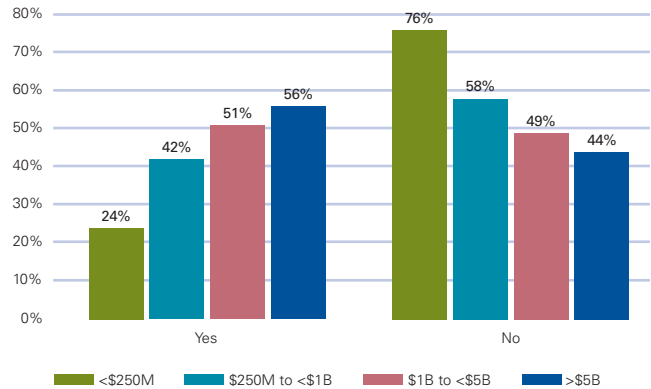|	Well on schedule	Nearly on schedule	Not on schedule
	49%	31%	20%
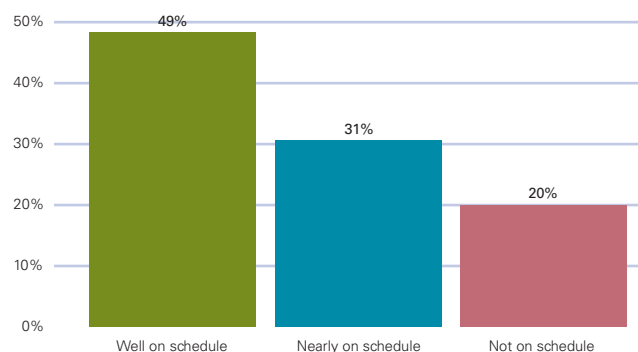
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Documentation continued

Larger companies (those with revenue totaling $5 billion or more) are much more likely to have completed this documentation than smaller companies (those with revenue of less than $250 million). That is, 56 percent of larger companies have completed documentation, versus 24 percent of smaller companies. *(See Chart 2.)*
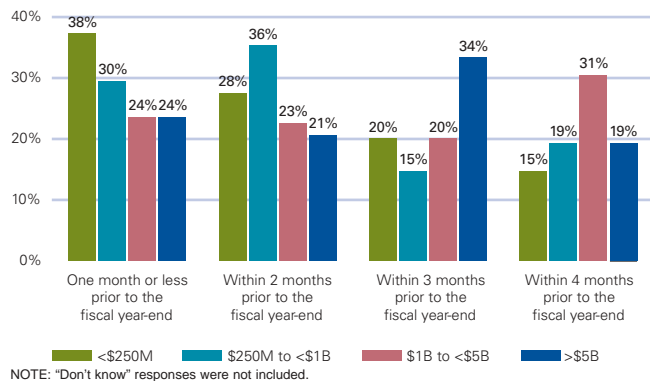
Among those companies that have not completed the required documentation, larger companies generally are farther ahead than smaller companies. In addition, larger companies (those with revenue totaling $5 billion or more) anticipate completing the evaluation and testing phases of the process farther ahead of their fiscal year-end than do smaller companies, with 53 percent of larger companies anticipating completion within three to four months prior to fiscal year end. *(See Chart 3.)*

Regardless of size, respondents' companies share a common challenge in the documentation process—IT general and application controls have been the most challenging areas to document. *(See Chart 4.)*
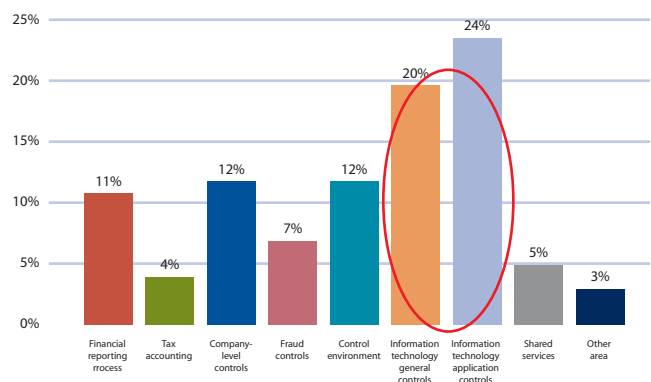
2. Has your company completed documentation of its internal control over financial reporting relative to the requirements of section 404 of Sarbanes-Oxley?

Yes: <$250M 24%, $250M to <$1B 42%, $1B to <$5B 51%, >$5B 56%

No: <$250M 76%, $250M to <$1B 58%, $1B to <$5B 49%, >$5B 44%

Legend: <$250M | $250M to <$1B | $1B to <$5B | >$5B

3. When do you anticipate completing the evaluation and testing phases in relation to your company's fiscal year-end?

One month or less prior to the fiscal year-end: 38%, 30%, 24%, 24%

Within 2 months prior to the fiscal year-end: 28%, 36%, 23%, 21%

Within 3 months prior to the fiscal year-end: 20%, 15%, 20%, 34%

Within 4 months prior to the fiscal year-end: 15%, 19%, 31%, 19%

Legend: <$250M | $250M to <$1B | $1B to <$5B | >$5B

NOTE: "Don't know" responses were not included.

4. What was the most challenging area to document?

Financial reporting process 11%, Tax accounting 4%, Company-level controls 12%, Fraud controls 7%, Control environment 12%, Information technology general controls 20%, Information technology application controls 24%, Shared services 5%, Other area 3%
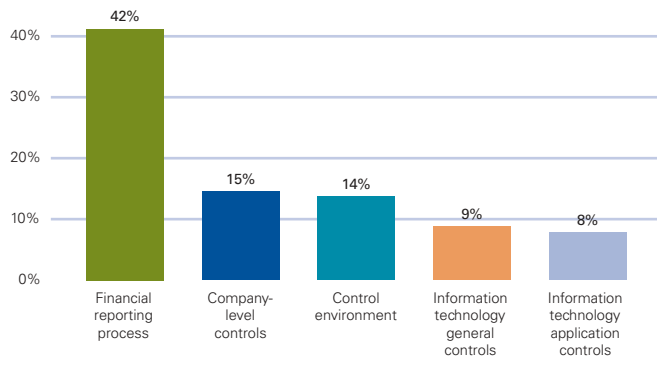
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Testing

When asked where their companies are in the testing of internal controls over financial reporting, 75 percent of respondents said testing is not complete. Again, among those that have not completed testing, larger companies are generally ahead of smaller companies; most respondents indicated that most testing time would be spent on the financial reporting process. (*See Chart 5.*)

As was true of documentation, large companies are ahead of their smaller counterparts in the testing of internal controls over financial reporting. Roughly 79 percent of companies with revenue totaling $5 billion or more have started testing internal controls for operating effectiveness over financial reporting, versus 42 percent of those companies with revenue totaling less than $250 million. Among those that have started, larger companies generally plan to test a larger proportion of internal controls than do smaller ones. (*See Chart 6.*)
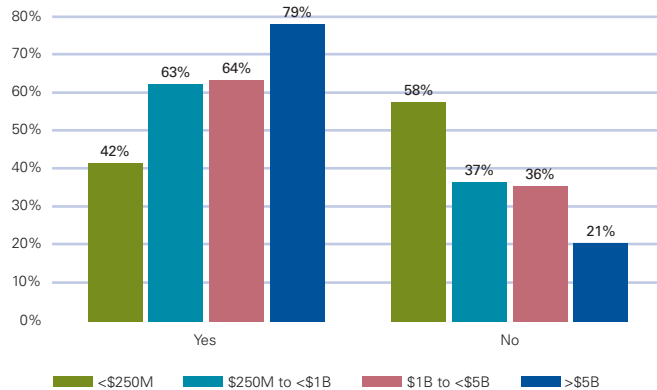
Resources

About 62 percent of respondents said that their companies had added additional resources to help them stay on schedule with the documentation and testing processes. Again, more larger companies—$5 billion or more in revenue—have added resources than smaller ones (77 percent versus 45 percent). (*See Chart 7.*)
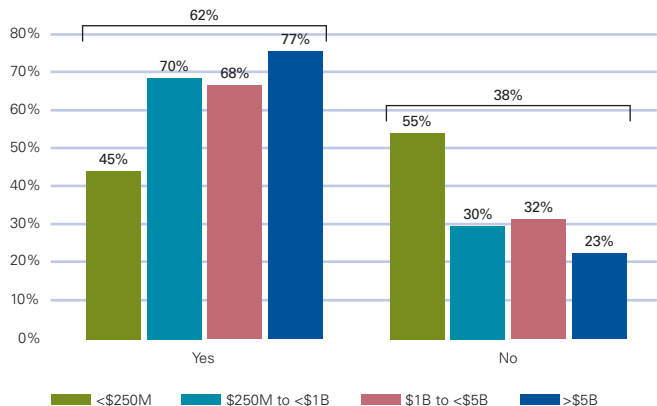
5. Where will your company spend most of the testing time?

6. Has your company commenced testing the operating effectiveness of internal controls over financial reporting?

7. Have additional resources been added to help with adhering to the schedule?

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Resources continued

Among companies that have added resources, 40 percent have added fewer than 1,000 resource hours, while 53 percent have added between 1,001 and 10,000 hours. Interestingly, 73 percent of companies with revenue totaling between $1 billion and $5 billion lead the way in adding resources to keep them on schedule, versus 50 percent of companies with revenue of more than $5 billion. *(See Chart 8.)*

Long-term Compliance

Resources, competing priorities, system changes, and continued management support and attention ranked as the top issues on respondents' minds relative to development of a continuing section 404 compliance process. While 49 percent of respondents' companies are currently developing a plan for long-term compliance with section 404 provisions, 35 percent have not yet started to plan. Of these, 45 percent are companies with revenue of less than $250 million. Only 16 percent currently have an internally approved plan in place. *(See Charts 9 and 9a.)*
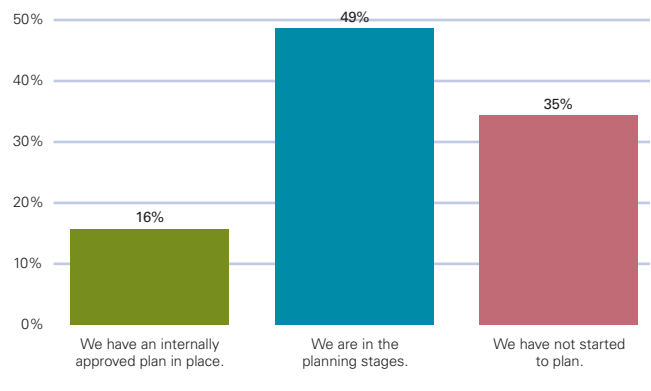
About Respondents

Respondents to the 404 Institute Sarbanes-Oxley Section 404 survey represent more than 500 companies from 18 industries. Thirty-two percent represented companies with revenue of less than $250 million; 22 percent have revenue between $250 million and less than $1 billion; 27 percent have revenue between $1 billion to less than $5 billion; and 19 percent have revenue of $5 billion or more.

Twenty-three percent of respondents have oversight or overall responsibility for section 404 compliance and represent boards of directors, CEOs, or CFOs. Fifty-six percent of respondents are actively engaged and responsible for compliance, while 21 percent are actively engaged in complying.

8. What resources have been added?

Legend: <$250M | $250M to <$1B | $1B to <$5B | >$5B
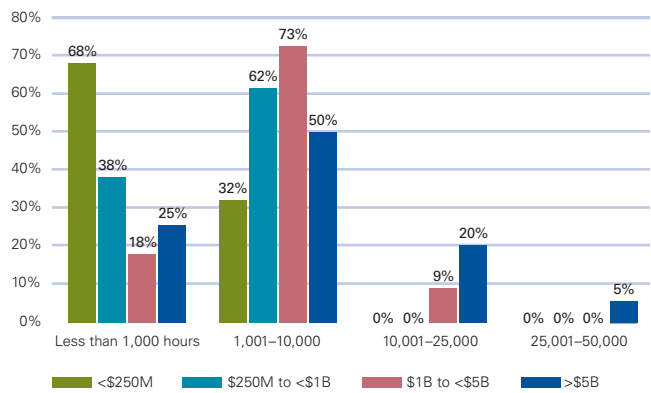
9. At what stage is your company currently in terms of a plan to maintain compliance with provisions of section 404 in future periods?

9a. By revenue

Legend: <$250M | $250M to <$1B | $1B to <$5B | >$5B