The 2006 Oversight Systems Financial Executive Report on Sarbanes-Oxley

Despite its cost, The Sarbanes-Oxley Act continues to achieve its objective: bolster corporate integrity and investor confidence in U.S. public markets. The *2006 Oversight Systems Financial Executive Report on Sarbanes-Oxley surveyed* 261 financial executives and identified growing benefits of SOX compliance.

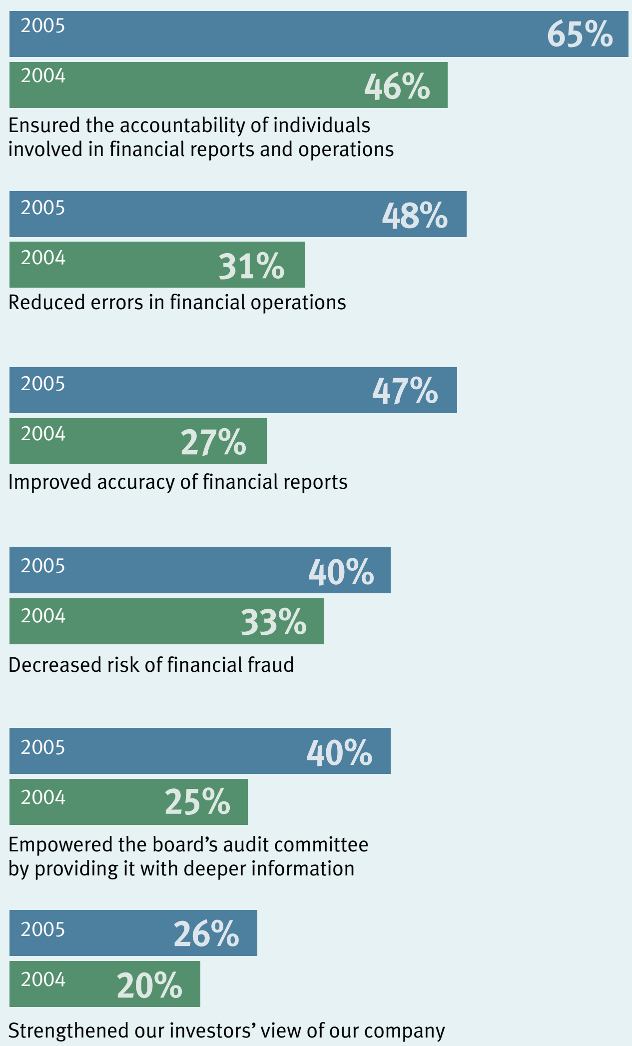
The findings show an across-the-board increase in the benefits that respondents experienced in 2005 from SOX compliance as compared to those reported in 2004. The greatest increases were found in SOX's ability to improve the accuracy of financial reports, up to 47 percent from 27 percent in 2004, and the ensured individual accountability in financial reports resulting from SOX, up to 65 percent from 46 percent in 2004 (see: Burgeoning Benefits).

"Corporate fraud and inaccurate financial reporting drove the creation of Sarbanes-Oxley, and it's clear that the medicine is addressing the disease it was intended to fight," said Dana Hermanson, Dinos Eminent Scholar Chair of Private Enterprise at Kennesaw State University. Hermanson is also an advisor to Oversight Systems and co-author of the COSO-sponsored research report *Fraudulent Financial Reporting: 1987-1997, An analysis of U.S. Public Companies*. "This legislation has a lot of meat to it, which brings about significant cost and much needed benefits."

The survey also reported double-digit increases for SOX compliance benefits to reduce errors in financial operations, up to 48 percent from 31 percent in 2004, and the empowerment of the board's audit committee through increased information, up to 40 percent from 25 percent in 2004. Additionally, decreased risk of financial fraud rose to 40 percent from 33 percent in 2004. More than a quarter of financial executives, 26 percent, reported benefits from strengthening investors' view of the company, a rise from 20 percent in 2004.

Burgeoning Benefits

When asked what benefits companies realized from SOX compliance, financial executives reported improvement across the board from one year ago.



"While the law strengthens a company's controls over financial reporting, SOX compliance also creates an opportunity for financial executives to evaluate their financial processes," said Patrick Taylor, CEO of Oversight Systems. "These results show that leading companies have benefited from their investment in SOX compliance to improve their overall financial operations with a stronger control environment."

When asked about the impact of SOX compliance on shareholder value, more than a quarter (27 percent) report SOX increased shareholder value because investors know they operate as an ethical business as compared to 37 percent from the 2004 findings. Meanwhile, many more respondents, 43 percent, report that SOX boosts shareholder value by building overall confidence in the market, up from 25 percent in 2004.

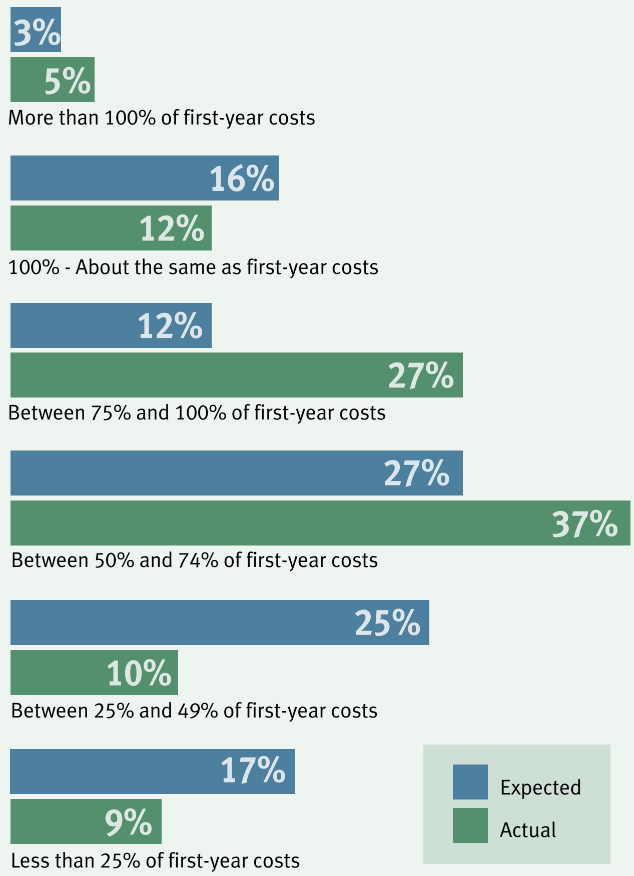
No Break on Year-Two Compliance Cost

The increased benefits companies are experiencing do not come without their cost, however. In fact, 37 percent of financial executives say SOX compliance created a cost burden that suppresses stock prices (up from 33 percent in 2004), and 13 percent feel that SOX decreased their ability to pay out dividends because compliance expenses are a significant drain on earnings (down from 14 percent in 2004).

In fact, the majority of financial executives report that their companies paid more for year-two compliance than expected. In 2004, 42 percent of financial executives reported that they expected to spend less than half of what they did as compared to year-one compliance costs. In reality, only 19 percent reported spending less than half of what they did for year-one costs in year-two (see: Costlier Compliance).

Costlier Compliance

When compared to predictions from one year ago, year-two SOX compliance costs have been higher than most financial executives expected. Although 42% of respondents expected to spend less than half of what they did for first-year compliance costs on year-two costs, in reality only 19% spent this amount. Here's the complete breakdown of what respondents expected to spend and what they actually spent on year-two compliance.



"SOX compliance costs are still driven by Section 404 of the law – the demand for stronger controls that are signed off on by management and tested by external auditors," said Todd DeZoort, Accounting Advisory Board Fellow at The University of Alabama and an advisor to Oversight Systems. "Many companies are still figuring out what's actually needed for compliance with Section 404 and external auditors are still settling their 404 audit methodologies."

While costs to sustain SOX compliance have not dropped significantly, 64 percent of financial executives report that SOX compliance costs have had "little" or "no effect" on capital spending plans. Twenty-one percent say capital spending is more scrutinized and 12 percent say capital spending has been reduced because of SOX compliance costs.

SOX for Small Caps, Non-Profits & Private Companies

The survey also identified a possible trend among organizations not required to abide by SOX compliance guidelines. Nearly half of financial executives, 45 percent, believe some elements of SOX will be rapidly adopted by private companies and non-profit organizations.

"The governance of U.S. non-profits is a personal concern for me," DeZoort said. "While non-profits have not seen an Enron-size scandal, we should not ignore the serious risks facing entities in this sector. Donors and other non-profit organization stakeholders should demand the accountability and stronger controls that are at the heart of Sarbanes-Oxley for public companies."

As for small cap public companies, a clear majority of financial executives, 72 percent, say that the requirements of Section 404 of SOX regarding internal controls should apply to all public companies regardless of size. These results contradict much of the public outcry against SOX, which has led to the delayed

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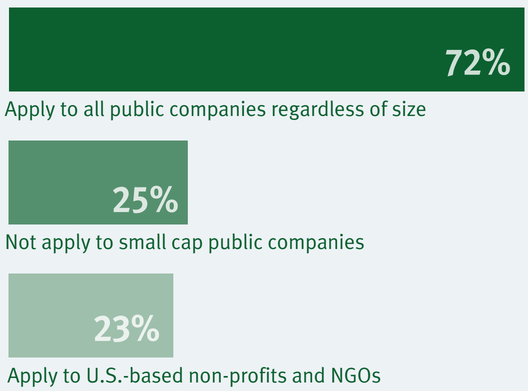
SOX for All Companies

While 45% say private companies and non-profits will rapidly adopt some elements of SOX, a clear majority say smaller public companies should not get a break on Section 404 of SOX. According to the survey, Section 404 of SOX should:



enforcement of Section 404 for non-accelerated public filers (see: SOX for All Companies).

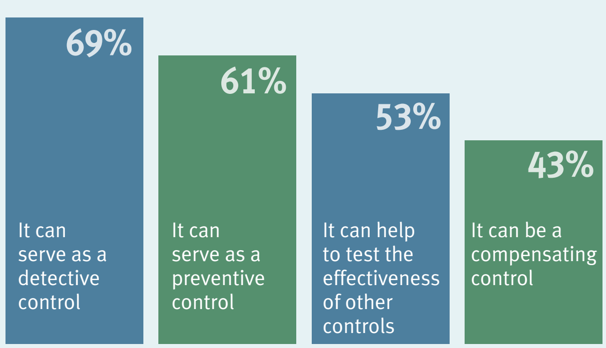
"Section 404 should be enforced for all public companies with varying standards for smaller companies," Hermanson said. "Small companies can have less formal controls and less rigorous documentation, but I'll be concerned if smaller companies are not required to have their controls independently audited. I don't see much value in a company's management telling you how great their controls are."

Emerging Role of Continuous Monitoring

The survey also identified another trend for compliance and financial operations. Continuous monitoring of financial processes and real-time transaction inspection can serve to automate manual controls for SOX compliance and, more importantly, strengthen their overall control environment.

Controls and Transaction Inspection

Continuous monitoring allows companies to examine financial transactions in real time. Executives feel real-time transaction inspection will play key roles in SOX compliance.

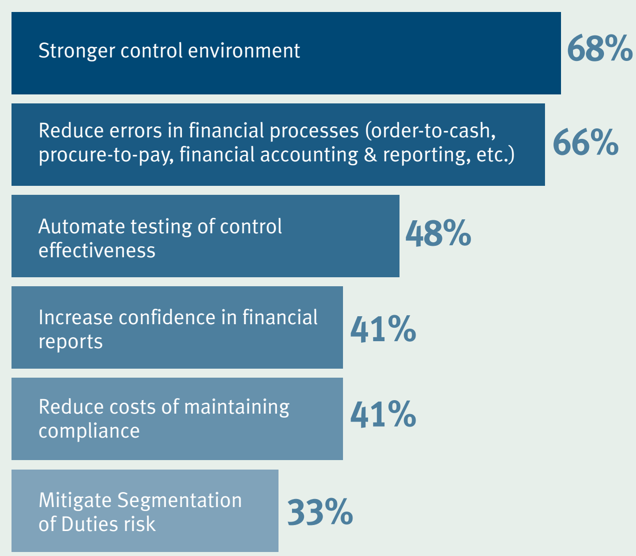


When financial executives were asked to identify the different roles continuous monitoring of financial transactions can play in their organization, the group seemed open to the application of continuous monitoring throughout their financial processes. In fact, 69 percent feel it can serve as a detective control, 61 percent view it as a preventative control, 53 percent think it can help test the effectiveness of other controls and 43 percent believe it to be a compensating control (see: Controls and Transaction Inspection).

"While the first two years of SOX compliance were achieved with manual labor for enforcing and testing controls, companies are now looking for ways to mechanize the process," said Joseph V. Carcello, co-founder & director of research for the University of Tennessee's Corporate Governance Center. "Continuous monitoring is the next big frontier for auditors and compliance with Section 404 of Sarbanes-Oxley." Carcello is also an advisor to Oversight Systems.

Monitoring Motivation

What do financial executives think are the greatest benefits of real-time monitoring of their financial systems?



Real-time transaction monitoring provides financial executives with great benefits. The most frequently cited benefits are a stronger control environment, selected by 68 percent of respondents, followed closely by reduced errors in financial processes with 66 percent. Nearly half of the respondents, 48 percent, said continuous monitoring of financial transactions automates the testing of control effectiveness. As for other benefits of continuous monitoring, increased confidence in financial reports and reduced costs of maintaining compliance were each selected by 41 percent of financial executives. Additionally, one-third of respondents see the benefit in real-time monitoring to mitigate segregation of duties risks (see: Monitoring Motivation).

"Managers and auditors often relegate continuous monitoring solutions into process-specific controls, but that can undermine appreciation of the greatest benefits of continuous monitoring – a stronger overall control environment," DeZoort said. "At the end of the day, internal controls should demonstrate management's commitment to a strong control environment, and continuous monitoring is one way to do accomplish that."

Managing and enforcing the segregation of duties (SOD) within a business process is frequently cited as a costly barrier to sustaining compliance with Section 404. While configuration and rights management within enterprise resource planning (ERP) systems are initial steps toward enforcing SOD controls, the fact is 90 percent of financial executives feel the configuration of ERP systems alone cannot prevent SOD violations.

When asked to name the major challenges faced in maintaining SODs following the tightening of controls mandated by SOX, 70 percent said keeping up-to-date with roles and access rights, such as promotions, transfers and terminations, among system users. Forty nine percent say ensuring proper SOD is followed in remote offices and in organizations with small financial staffs, and 47 percent say monitoring activities of "super users."

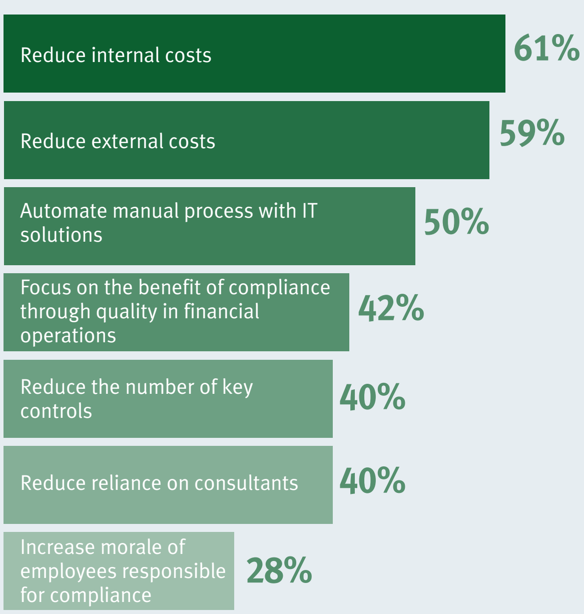
2006 Compliance Goals

Looking forward to 2006, the survey asked financial executives to identify their goals for the year as they relate to SOX compliance. The two most popular goals involve reducing costs internally, supported by 61 percent, and externally, supported by 59 percent. Half of respondents, 50 percent, would like to automate manual processes with IT solutions while 42 percent want to focus on the benefit of compliance through the quality of financial operations. Forty percent of respondents would like to reduce both the number of key controls and the reliance on consultants, and 28 percent desire an increase in morale among those employees responsible for compliance (see: Outlook for '06).

"While costs remain a top concern, financial executives should not aim to achieve SOX compliance as cheap as they can," Carcello said. "The goal should be to provide management with a solid base to evaluate controls and financial integrity in a way that uses minimal resources to meet that objective."

Outlook for '06

What SOX goals are financial executives aiming for in 2006?



About the 2006 Oversight Systems Financial Executive Report On Sarbanes-Oxley

Through a combination of an invitation-only online survey and survey intercepts, 261 financial leaders from across the U.S. participated in this study. Titles of those surveyed included chief financial officer, chief audit executive, controller, treasurer, vice president, director and internal auditor.

As part of a series of quarterly reports, this is the most recent study completed by Oversight Systems analyzing the role of Sarbanes-Oxley compliance in companies. All these research studies can be downloaded for free by visiting www.oversightsystems.com/survey.

About Oversight Systems

Errors in day-to-day financial transactions consistently result in adjustments, reversals and rework. Oversight Systems drives defect-free financial processes to eliminate these extra costly efforts. Increasing the quality of financial operations leads to accelerated, more accurate closes and validates policy compliance. Our software inspects each step of every financial transaction in real time for errors and control violations, so companies can address these issues when they are less complex and less costly to correct. For more information, visit www.oversightsystems.com.

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