

# The 2008 Oversight Systems Financial Executive Report on Sarbanes-Oxley

**The 5<sup>th</sup> annual Oversight Systems Financial Executive Report on Sarbanes-Oxley reflects an overall drop in the incidence of 404 exceptions and a continuing decline in SOX costs, but shows that financial executives' number one SOX compliance goal for 2008 is to reduce compliance costs even further.**

## The Impact of Auditing Standard 5

The Public Company Accounting Oversight Board's (PCAOB) Auditing Standard 5, released last year, was intended to focus compliance efforts where they would do the most good in terms of meeting the initial goals of SOX, and to help control costs related to compliance and external audit. New data collected in this year's survey indicates that the guidance has created new challenges of its own. While it directs companies to practice a risk-based approach to compliance, more than half of financial executives (56 percent) say that one of their greatest challenges in following AS5 will be accurately identifying their areas of

greatest risk, and 39 percent say they struggle with finding a way to efficiently monitor all transactions within identified categories of fraud risk.

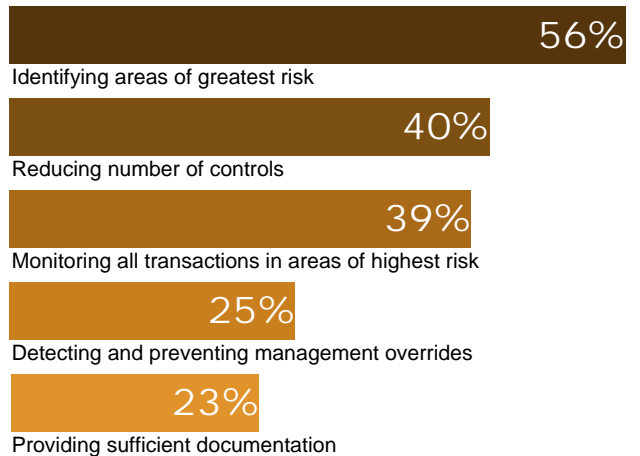
"AS5 calls on companies to put more forensic into the audit, in order to decrease the risk of fraudulent financial reporting" said Patrick Taylor, CEO of Oversight Systems. "Management override of controls, specifically, is cited as an area of risk that should be more proactively addressed by audit firms."

"Given the complexities of today's global enterprises, the process of identifying, assessing, and monitoring all kinds of risks requires more structure and robustness. The new Securities and Exchange Commission (SEC) / PCAOB focus on top-down risks is pushing organizations to improve their enterprise view of risks to ensure management and the board have an appropriate understanding of the key risk exposures (not just the risks they already think they understand)."

Mark S. Beasley  
 Deloitte Professor of Enterprise Risk  
 Management and ERM Initiative Director  
 Professor of Accounting  
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 North Carolina State University  
 Advisor to Oversight Systems

## Challenges in Complying with AS5

When asked what major challenges they face in complying with new SEC & PCAOB guidelines such as AS5, financial executives cited identifying fraud risk as number one.



Almost half of executives characterized their external auditors as trusted advisors (43 percent), and around a third of respondents (32 percent) said their audit firm provides unbiased validation of their internal controls for SOX compliance. Nonetheless, external audit and testing fees were cited as a significant cost of SOX compliance, and 18 percent of executives said that in 2007 their external auditor had increased fees without creating a measurable benefit to the company. In 2008, many executives are looking to AS5 for help in lowering these costs. The new guidance allows external auditors to rely on well-documented internal company results to know where to focus their time and attention, thus reducing costs and eliminating redundant work. For example, companies that have a continuous monitoring system in place can present the data already collected and addressed by the solution, doing away with the need for third-party testing (see *Continuous Transaction Monitoring*, below, for more information).

“The focus of AS5 is on entity-wide controls, including monitoring,” said Joseph V. Carcello, Ernst & Young Professor and Director of Research – Corporate Governance Center, University of Tennessee, and a member of Oversight Systems’ board of academic advisors. “Monitoring in a small business is effectuated by the day-to-day involvement of senior management. This level of detailed involvement is not possible for managers of larger businesses. But, a properly-designed and implemented continuous monitoring system can act as the ‘virtual’ eyes and ears of senior management, enabling these firms to achieve compliance with the monitoring component of COSO’s internal control framework in a cost effective fashion.”

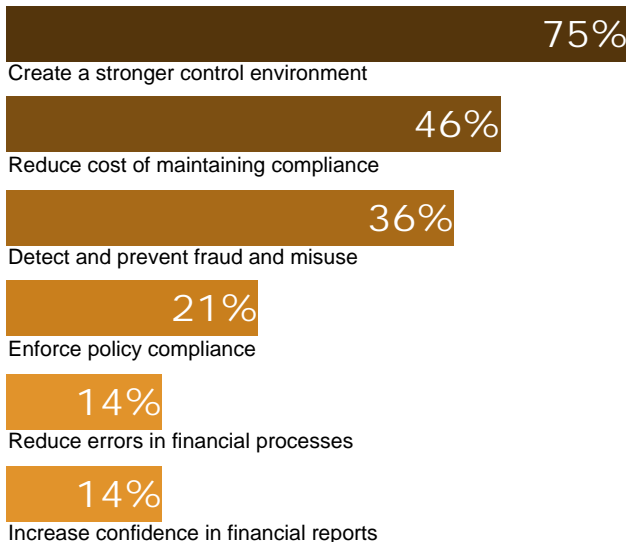
### The Fraud Factor

In 2007, corporate fraud continued to make headlines, and the *2007 Oversight Systems Financial Executive Report on Corporate Fraud* reported that three-quarters of respondents felt institutional fraud was more prevalent five years after SOX took effect than it was in 2002.

More than half of executives responding to this survey (54 percent) reported that fraud in the headlines had initiated internal discussions about their own current fraud risks, with a third of those indicating that they were exploring a fraud monitoring solution as a result. And, despite the specter of unmitigated corporate fraud risk, only 18 percent of executives feel that the answer lies in increasing controls. (That perspective clearly reflects the respondents’ number two SOX goal for 2008: to reduce the number of key controls.)

### Transaction Monitoring Hits Key Risks

**Of the following benefits of continuous transaction monitoring, which would be most valuable within your organization?**



As a result, executives are looking for new and more effective solutions to fight fraud that will also help them meet their SOX compliance goals. For many, the answer may be found in continuous transaction monitoring (CTM).

### Continuous Transaction Monitoring

Continuous monitoring of transactions is a real-time, automated testing of recorded transactions using rules and artificial intelligence. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), transaction monitoring hits the key risks inherent in the control and compliance environment, identifying control failures and management override of controls. And CTM is also seen as providing the only effective control for preventing “cooking the books” – senior management fraudulently manipulating financial reporting.

“Financial executives realize that there is a point of diminishing returns with preventive internal controls. Controls are costly and imperfect such that you cannot prevent all bad behavior. CTM offers an appealing supplement to traditional internal controls by providing a mechanism to instantly detect suspicious transactions.”

Dana Hermanson  
*Dinos Eminent Scholar Chair of Private Enterprise  
Kennesaw State University  
Advisor to Oversight Systems*

According to Dana Hermanson, Dinos Eminent Scholar Chair of Private Enterprise at Kennesaw State University and an advisor to Oversight Systems, “A huge benefit of CTM is its impact on the control environment. When people know that top management and the board are committed to real-time transaction monitoring, it sets a tone that the company takes quality and ethics seriously.”

The perceived benefits of CTM substantially align with the SOX goals executives are focused on in 2008.

Among the top three goals, the objective of automating manual processes speaks directly to the perceived benefits of CTM. Over a third of executives (36 percent) said CTM had specific value for their companies in terms of detecting and preventing fraud and misuse, and 21 percent cited its role in effective enforcement of policy compliance. Nearly half of executives (46 percent) listed CTM’s ability to reduce the cost of maintaining compliance as a top benefit to their respective companies, tying in with their number one SOX goal for 2008 – to reduce compliance costs. In addition, fully three-quarters of respondents indicated that the greatest benefit of CTM is its ability to create a stronger control environment – a crucial element in a 2008 compliance strategy that seeks to reduce the number of key controls (see *SOX Goals in an Uncertain Economy*, below).

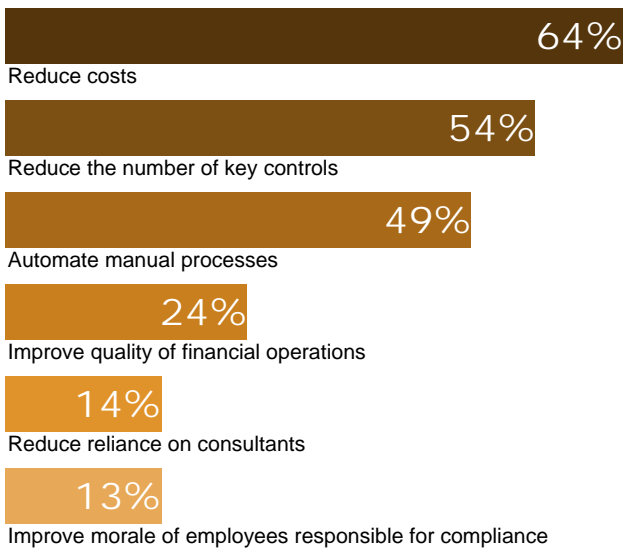
“Knowing that key risks are actually being monitored can be a huge deterrent to fraud, helping to prevent instances, which in turn reduces the need for detection. The mere presence of effective monitoring techniques send a strong cultural signal to the entire organization that ‘fraud is not tolerated’,” said Mark S. Beasley, Deloitte Professor of Enterprise Risk Management and ERM Initiative Director, Professor of Accounting, College of Management, North Carolina State University, and an advisor to Oversight Systems.

### Reducing the Cost of Compliance

In 2007, the most significant SOX-related cost was preparing documentation of compliance and problem resolution efforts (42 percent). Nearly as many executives (39 percent) cited the cost of investigating and remediating exceptions as a key expense. CTM solutions with integrated remediation workflow, and automated investigative and audit logging deliver direct cost reductions in these specific compliance cost areas. About a third of the respondents also listed the cost of identifying control violations (36 percent), as well as the cost of finding errors that may have material impact on financial results (32 percent); again, automated transaction monitoring directly reduces the costs involved with both of these compliance efforts.

### SOX Goals in an Uncertain Economy

#### What SOX goals do financial executives have for 2008?



### 2008 Goals Reflect Economic Times

The *2007 Oversight Systems Financial Executive Report on Sarbanes-Oxley* identified cost reduction as the leading SOX goal for 2007 (59 percent). In the uncertain financial environment of 2008, cost cutting is still number one, by an even greater margin (64 percent)—even though the majority of executives (80 percent) report their costs for compliance have stayed the same, or are down from previous years. Another cost-related goal, automation of manual processes, has also gained in importance with executives, up from 43 percent last year to 49 percent this year.

On the other hand, non cost-related goals have dropped in importance: improving the quality of financial operations is down to 24 percent from last year’s 31 percent; and improving the morale of employees responsible for compliance has dropped from 24 percent to only 13 percent. This may be related to the improvements companies have seen in these areas over the past year, or it may reflect a narrower focus on the bottom-line.

### All About Accountability and Accuracy

While the value of SOX compliance is still primarily perceived as its insurance of accountability (69 percent), nearly half of executives (45 percent) also give it credit for improving the accuracy of their financial reports, up slightly from last year. But in all other categories, the perceived benefits of SOX have hit new lows, making even the unenthusiastic outlook of 2004 seem ebullient. Most telling may be the fact that fewer than one-third of executives (29 percent) give SOX compliance any credit for decreasing their risk of financial fraud.

“SOX benefits have hit a plateau and boards and audit committees aren’t seeing continuing incremental benefits from SOX as we go forward. So they are now looking for other value adds.”

Mark S. Beasley

“Clearly the SOX honeymoon is over, and the pendulum is swinging back toward efficiency in financial operations. Financial executives now report reduced benefits of SOX and accordingly are seeking lower SOX-related costs,” said Hermanson, adding, “I hope that these executives will not lose sight of the critical importance of continuing to improve their financial operations.”

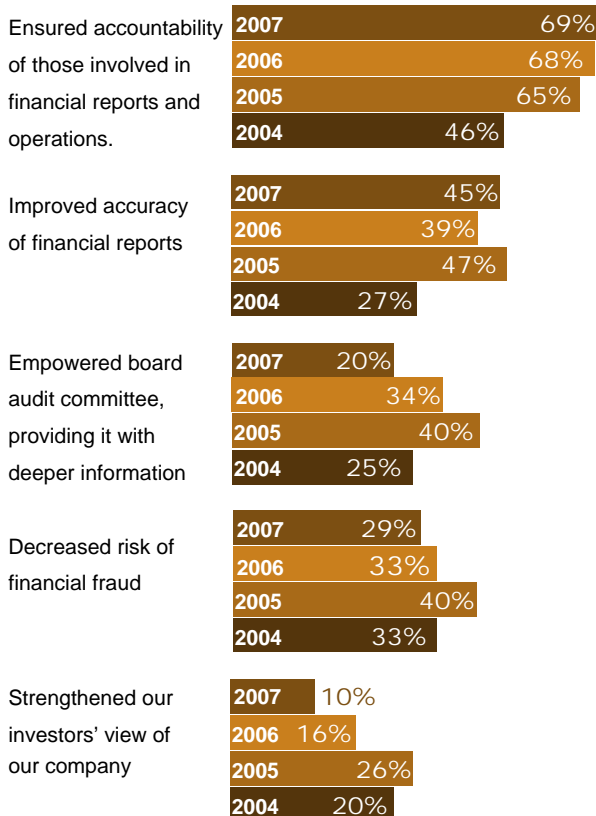
Most executives (86 percent) were favorable in their opinions of the shareholder value imparted by SOX.

Nearly half (45 percent) felt that SOX had boosted shareholder value by establishing that the company operates as an ethical business, and 23 percent said SOX compliance had boosted value by building overall confidence in the market. 18 percent felt that SOX had no measurable impact on shareholder value. Only 14 percent of executives felt that SOX compliance had a negative impact, creating a cost burden that suppressed the company's stock price.

"Despite the frequent grumbling about SOX over the past six years, for most companies, SOX appears to have been value-increasing or neutral. This is good news for investors," said Hermanson.

### What has SOX done for you lately?

**When asked about the benefits of SOX compliance, confidence in its ability to decrease risk of financial fraud hit a 4-year low in 2007.**



### About the 2008 Oversight Systems Financial Executive Report on Sarbanes-Oxley

Through a combination of an invitation-only online survey and survey intercepts, financial leaders from across the U.S. participated in this study. Titles of those surveyed included chief financial officer, chief audit executive, controller, vice president, director and internal auditor. This marks the fifth time Oversight Systems has conducted executive research into the impact of SOX. The previous annual SOX reports can be found at [www.oversightsystems.com](http://www.oversightsystems.com).

This study follows the release of the 2007 Oversight Systems Financial Executive Report on Corporate Fraud, a survey of financial executives that found that five years after the Sarbanes-Oxley (SOX) Act took effect, three-quarters of respondents felt that institutional fraud had become more prevalent than it was in 2002.

Other research studies completed by the company include *The 2006 Oversight Systems Executive Report on Shared Service Centers* and *The 2006 Financial Executive Report on Risk Management*. All Oversight Systems research studies can be downloaded for free by visiting the Resource section of the Oversight Systems website, at [www.oversightsystems.com](http://www.oversightsystems.com).

### About Oversight Systems

Oversight Systems uniquely delivers on the promise of continuous monitoring, with real-time transaction integrity inspection for identifying fraud, misuse and errors. Oversight's software provides a platform for continuous monitoring with powerful analytics that excel at finding problems, then raises the bar with an investigator's workbench for cost-effectively fixing the problem, and workflow-enabled audit trail and journaling for proving problem resolution and compliance. By inspecting each step of individual transactions across all financial systems, Oversight identifies all errors and fraud, drives defects out of the process, and sustains Sarbanes-Oxley compliance. For more information, visit [www.oversightsystems.com](http://www.oversightsystems.com).

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