THE IMPACTS OF SARBANES-OXLEY ACT OF 2002:
A PERSPECTIVE FROM CFOS

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Abstract

In this paper, we conduct a comprehensive survey that describes the impact of The Sarbanes-Oxley Act of 2002 (the Act) from the perspective of CFOs who are members of the Financial Executives Institute (FEI). Congress passed the Act in response to a wave of corporate scandals. It is a major legislation of financial regulation reform in recent U.S. history. The Act has profound impacts on how a CFO performs the job duties and the structure of corporate governance of a public company. In addition, the Act has created the Public Company Accounting Oversight Board (the PCAOB), which will be funded by mandatory fees on public companies. Compliance with the Act appears to be an undertaking of tremendous amount of resources in Corporate of America. Per one recent study released by the FEI, the cost of compliance with the Act is estimated to be $2 million annually for some large companies. The Act increases the responsibility of CEOs and CFOs of public companies by requiring them to certify the quarterly and annual financial statements submitted to SEC, and criminal penalties for any CEO or CFO who knowingly falsely certifies these statements include significant monetary fines or imprisonment up to 20 years. On the one hand, the very purpose of the Act is to restore and maintain investor confidence after recent corporate scandals. On the other hand, the cost of compliance with the Act is ongoing and considerable to public companies. Does the benefit of the Act provided outweigh its cost? It is the CFOs who are on the firing line on a daily basis to strive for the compliance with the Act. The aim of this paper is to survey CFOs’ perceptions of the Act in terms of their companies’ compliance of the Act and its impacts on the businesses. No such survey has been conducted previously. We believe that our results will be of interest to individual investors, the investing public, the academic community, as well as the policymakers.

The survey will be delivered by internet-based technologies. The questionnaire will be available on a website at Texas Tech University, and the content of the survey may also be contained at the first author’s website at SUNY Oswego. We will first send the request to a prospective respondent by email. The hyperlink contained in the email opens the questionnaire, which can be answered by a CFO on the Internet. After the survey is completed, the respondent simply needs to click the “Submit” button at the bottom of the web page. A response will be electronically stored at an online Microsoft Access database. At the end of the survey collection period, we will download the data to the first author’s personal computer.
Questionnaire

Part I: Background Information

1. Which of the following industries best fits your company?
   - Consumer Discretionary
   - Consumer Staples
   - Energy
   - Financials
   - Health Care
   - Industrials
   - Information Technology
   - Materials
   - Telecommunication Services
   - Utilities
   - Other (specify: _________________________)

2. What is the best estimate of the market capitalization of your company as of the end of the firm’s second fiscal quarter in 2004? What is the ending date of your company’s fiscal year?
   - < $75 million
   - between $75 million and $700 million
   - between $700 million and $1 billion
   - between $1 billion and $3 billion
   - > $3 billion

   The ending date of your company’s fiscal year is: ________________________.
3. How many common stock shareholders as defined by SEC Rule 12g5-1 does your company have as of the end the firm’s second fiscal quarter in 2004?

- < 300
- between 300 and 500
- between 500 and 2000
- > 2000
- Any additional information, i.e., the number of round-lot holders:

The common stock is listed on:

- NYSE
- NASDAQ
- NASDAQ National Market
- NASDAQ Small Cap Market
- Other: _________________________

Part II: Corporate Governance Structure before the Enactment of the Sarbanes-Oxley

4. Number of members of the Board of Directors: _____________.
   How many directors were also executives/officers of the company? ____________.
   Please provide any explanation below if necessary.

5. Composition and Function of the Audit Committee.
   Number of members of the committee: _____________.
   Among the committee members, how many of them were independent of the management, i.e., they did not receive any consulting, advisory, or other compensation from the company except for that as a board and audit committee member? _____________.
   How many financial experts as defined by the SEC’s final rule pursuant to Sections 406 and 407 of the Act did the audit committee have?

- Zero
- One
- Two
- Other (specify: ______)
Was the committee ever in contact with the firm’s auditors? (Please select all the applicable answers.)

- Yes, the committee hired/fired the auditors.
- Yes, the management needed to have the committee’s approval of the auditor’s selection.
- Yes, the committee was involved in coordinating the audit or audit fee negotiation.
- Yes, the committee was involved in other capacities. (Please explain.)

- No

Any Explanation (if necessary)

6. Did the auditor also provide any non-audit services to the firm?

- Yes (If “yes”, please continue to #7 and #8.)
- No (If “no”, please skip to #9.)

7. What type of non-audit services did the auditor provide to the firm?

- Tax Services
  What type of tax services was provided? (Please explain below.)

- Other non-audit services (Please explain below.)

- No

8. Did the audit committee pre-approve any of these non-audit services?

- Yes
- No
9. Did the company have a written code of ethics that applied to senior management, including the CEO, CFO, and principal accounting officer or controller?
   - Yes
   - No
   _ Any Explanation (if necessary)

**Part III: Corporate Governance Structure after the Enactment of the Sarbanes-Oxley**

10. Number of members of the Board of Directors: _____________.
    How many directors are also executives/officers of the company? ___________.
    Please provide any explanation below if necessary.

11. Composition and Function of the Audit Committee.
    Number of members of the committee: _____________.
    How many financial experts as defined by the SEC’s final rule pursuant to Sections 406 and 407 of the Act does the audit committee have?
    _ One
    _ Two
    _ Other (specify: ______)
    _ Any Explanation (if necessary)

The SEC final rule requires that at least one of the audit committee members be a financial expert. In your opinion, how important is this rule to prevent an audit error or fraud from occurring? (Please check one of the five boxes on the 5-point scale below.)
Section 301 of the Act requires that each member of the audit committee be a member of the board of directors and be independent of the management. In your opinion, how important is this provision to prevent an audit fraud from occurring?

Not Important At All 1_ 2_ 3_ 4_ 5_ Very Important

Section 301 also requires that the audit committee be responsible for pre-approving all audit services provided by the auditor. In your opinion, how important is this provision to ensure auditor independence?

Not Important At All 1_ 2_ 3_ 4_ 5_ Very Important

Furthermore, Section 301 requires that any non-audit services that are not prohibited by the Act and the SEC rules be pre-approved by the company’s audit committee. In your opinion, how important is this provision to ensure auditor independence?

Not Important At All 1_ 2_ 3_ 4_ 5_ Very Important

12. Does the auditor also provide any non-audit services to the firm?
   _ Yes (If “yes”, please continue to #13.)
   _ No (If “no”, please skip to #14.)

13. What type of non-audit services does the auditor provide to the firm?
   _ Tax Services
      What type of tax services is provided? (Please explain below.)

   _ Other non-audit services (Please explain below if necessary)

   _ No

14. Does the company have a written code of ethics that applies to senior management, including the CEO, CFO, and principal accounting officer or controller?
   _ Yes
   _ No
   _ Any Explanation (if necessary)
The SEC requires that each publicly held company to disclose whether it has adopted a code of ethics for its senior management. In your opinion, how important is this SEC rule to prevent accounting irregularities or corporate scandals from occurring?

Not Important At All
1
2
3
4
5
Very Important

15. Cost Estimates of the Compliance

The Act has created the Public Company Accounting Oversight Board (the PCAOB), which will be funded by the mandatory fees, Accounting Support Fees, on public companies. What is the estimate of the fee paid by your company in 2004?

_ $100 - 500
_ $501 – 1,000
_ $1,001 – 5,000
_ $5,001 – 10,000
_ $10,001 – 50,000
_ $50,000

What would be your estimate of the ongoing, annual cost of compliance with the Act to your company?

_ < $500,000
_ between $500,000 and $1 million
_ between $1 million and $3 million
_ between $3 million and $5 million
_ > $5 million

Please rank each of the following factors in terms of its impact on the cost of compliance with Section 302 of the Act.

Least Costly

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<th>4</th>
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<tbody>
<tr>
<td>a) Labor</td>
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<td>b) Time</td>
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<tr>
<td>c) Software to automate business records including electronic documents and messages</td>
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<tr>
<td>d) Hardware to run the software and store the data and documents</td>
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<tr>
<td>e) Other _____________________________</td>
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Has your company formed a “disclosure control committee” as recommended in the SEC final rule pursuant to Section 302 of the Act?

_ Yes

_ No

_ Any Explanation (if necessary)

Please rank each of the following factors in terms of its impact on the cost of compliance with Section 404 of the Act.

<table>
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<th>Least Costly</th>
<th>Most Costly</th>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>a) Labor</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>b) Time</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>c) Software to automate business records including electronic documents and messages</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>d) Hardware to run the software and store the data and documents</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>e) Other _____________________________</td>
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How likely will the firm be able to file the first-ever report on the internal controls on time to the SEC in 2005 pursuant to Section 404?

<table>
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<tr>
<th>Least Likely</th>
<th>Most Likely</th>
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<td>1_ 2_ 3_ 4_ 5_</td>
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Please rank each of the following factors in terms of its impact on the cost of compliance with Section 906 of the Act.

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<th>Least Costly</th>
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<td>1_ 2_ 3_ 4_ 5_</td>
<td>a) Labor</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>b) Time</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>c) Software to automate business records including electronic documents and messages</td>
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<td>1_ 2_ 3_ 4_ 5_</td>
<td>d) Hardware to run the software and store the data and documents</td>
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<td>1_ 2_ 3_ 4_ 5_</td>
<td>e) Other _____________________________</td>
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Part IV: The Impact of the Act on Corporate America

16. Please rank the likelihood of each of the following as a reason for the firm to consider delisting its common stock, i.e., to terminate its stock registration with the SEC.

<table>
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<th>Least Likely</th>
<th>Most Likely</th>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>a) Unexpected early debt repayment request</td>
</tr>
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<td>1_ 2_ 3_ 4_ 5_</td>
<td>b) Self-dealings</td>
</tr>
<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>c) Inactive market/low stock price</td>
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<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>d) Control</td>
</tr>
<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>e) Investor relations</td>
</tr>
<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>f) Steeper costs of regulatory filings pursuant to compliance with the Act</td>
</tr>
<tr>
<td>1_ 2_ 3_ 4_ 5_</td>
<td>g) Other ____________________________</td>
</tr>
</tbody>
</table>

17. On the one hand, the very purpose of the Act is to restore and maintain investor confidence after recent corporate scandals. On the other hand, the cost of compliance with the Act is ongoing and it could be considerable. Does the benefit of the Act provided to the investing public outweigh its cost to corporate America?

_ Yes
_ No
_ Please justify your answer below.