

TOP STORIES

INVESTING IN SARBANES OXLEY AS A BUSINESS STRATEGY

Private firms need to recognize today's business climate demands they are bound by SOX, by Thomas A. Basilo, WithumSmith+Brown Global Assurance, LLC.

12-08-2005 - The SEC's decision to delay the compliance deadline for Section 404 of the Sarbanes-Oxley Act (SOX) surely had many 'non-accelerated' filers breathing easier as a new deadline of June 2007 was announced. But, companies falling under this category need to avoid complacency and take advantage of the extension now to improve internal controls that usually are not managed by large staffs and segregation of duties. The time saved may be critical once testing by internal and external auditors begin.

Non-accelerated filers must also approach SOX differently as something more than the regulatory mandate it is. And, private firms need to recognize that although they are not currently bound by SOX, today's business climate practically demands that they do it too. For private businesses striving to grow (or possibly seeking an IPO or acquisition), SOX compliance should be seen as an investment strategy.

Studies have shown that a strong control environment coupled with well-defined risk management systems and processes will enhance shareholder value. In addition, companies that have a well-documented control environment tend to receive higher multiples when sold and traditionally outperform the competition.

The best way to gain investor confidence is to demonstrate that a company is well controlled and that there are checks and balances in place to protect invested funds. SOX offers a formal, recognized method that provides tangible evidence that a company has an effective system of internal control in place. My experience has been that once companies have documented their system of internal control, they have discovered inefficiencies, redundant controls and excessive processes—all of which can hinder or stop growth because of the costs that come along with supporting them.

As readers of American Venture know, selling a product can be easier than selling a business partnership or attracting capital if there is concern that a firm's internal processes are inhibiting success.

Today, banks, insurance companies, vendors and customers are inquiring about the internal control environment of companies and many are making SOX compliance obligatory to do business. This is occurring with financial institutions in making lending or insurability decisions, especially in higher risk portfolios (such as start-up companies).

States are also starting to require SOX-like standards to do business. In addition to the previous benefits I mentioned, SOX compliance also provides savings through streamlining processes and by reducing the risk of fraud via better records which enables the cost of insurance to be reduced as well.

In order to facilitate growth and investment, private business must embrace SOX as a vital component of their business plans. Companies that are SOX compliant have obtained higher valuations in mergers, acquisitions and initial public offerings than those that are not compliant. In addition, private equity and venture capital firms are also increasingly requiring at least partial SOX compliance in order to do business.

One barrier often cited as preventing private companies from complying with SOX is the cost. But, I believe the cost of non-compliance will prove to be even greater. In this age of business scandals and very public court cases, investors demand transparency. SOX provides investors with the confidence needed in today's volatile and short-term market and establishes a solid foundation on which to build a business and succeed.