Management

Checks on Internal Controls Pay Off	
Topic	Control
Key Words	Controls, SEC, Public Company Accounting Board, Sarbanes-Oxley
News Story	A study by research firm Lord & Benoit LLC has determined that shareholders benefit when companies perform checks on their internal controls. Companies who are in compliance find that they will receive market-beating gains after the check-up, and those that find problems but act on them will eventually see a higher than average return. The study surveyed share performance at 2,481 companies that had to follow internal-control rules contained in the Sarbanes-Oxley corporate governance law of 2002 The SEC and the Public Company Accounting Board are considering changing the rules for companies whose market value is less than $128 million. The small-business advisory group that made this recommendation has also recommended that auditors should not have to sign off on internal controls, and that the attestment of management should be enough. Small companies have argued that the costs of following the rules are too burdensome, while investors are concerned that these small companies can be especially susceptible to accounting problems. There is growing acceptance that some changes to the rules might be needed, even if it will not mean exempting companies from them. Among the companies studied in the Lord & Benoit report, those reporting no problems in 2004 or 2005 showed an average share-price gain of 27.7% between March 31, 2004 and March 31, 2006. The average increase for that same period was 17.7%. Companies that reported internal-control deficiencies in both 2004 and 2005 saw an average price share decline of 5.7%. The markets, however, reflected increases for those that had problems in 2004 but fixed them in 2005. The companies who fit this profile saw an average price-share-gain of about 25%, slightly below those that didn't have any problems, and well above the average market value increase. Mr. Benoit concludes that the value of increasing controls will far outweigh the costs required to comply with the rules.
Questions	1. What are internal controls? 2. What could account for the increase in share price for companies who uncover problems with controls and then fix them? 3. What is the Sarbanes-Oxley corporate-governance law of 2002? What debate currently surrounds this law and small businesses?
Source	"Checks on Internal Controls Pay Off ," *Wall Street Journal*, May 8, 2006, page C3