



INDEPENDENT COMMUNITY
BANKERS of AMERICA

ICBA COMMUNITY BANK SURVEY:



The Costs of Complying with
Section 404 of the
Sarbanes-Oxley Act

March 4, 2005



INDEPENDENT COMMUNITY BANKERS *of* AMERICA

Survey on the Costs of Complying with Section 404 of the Sarbanes-Oxley Act

Background

The Sarbanes-Oxley Act of 2002 (“Sarbox”), signed into law on July 30, 2002, made significant changes to the way that companies manage and oversee their internal controls over financial reporting. One of the key provisions of Sarbox is Section 404, which requires management to assess and report on the company’s internal control over financial reporting. It also requires a company’s external auditors to attest to management’s assessment of the company’s internal controls. Section 404 of Sarbox applies to all companies that are subject to the reporting requirements of the Securities Exchange Act of 1934.

Summary of ICBA Survey

Independent Community Bankers of America surveyed ICBA-member, publicly held community banks throughout the United States from December 1, 2004 to February 25, 2005 to determine the costs of complying with the new internal control attestation requirements of Section 404 of Sarbox. Ninety-one banks responded to the survey, for a response rate of approximately 13%. The asset size of the respondents ranged from \$21 million to almost \$6 billion while the average size was approximately \$482 million.

Approximately three-fourths of those who participated in the study were “non-accelerated SEC filers”, (e.g., those banks with public floats of less than \$75 million) that must comply with Section 404 beginning in 2005. Most of the respondents (61%) are listed on one of the major exchanges but a large number of the respondents (39%) are “pink sheet” or “bulletin board” companies.

A summary of the survey results is as follows:

- **Internal Staff Hours:** Publicly held community banks are devoting (or plan to devote) a great deal of internal staff time to comply with Section 404. On

average, community banks reported that Section 404 required (or will require) approximately 2,079 internal staff hours to comply.

- **Outside Audit Costs:** Community banks estimated significant outside audit costs for complying with the internal control attestation requirements of Section 404. On average, approximately 428 hours of outside audit time was expected which represented approximately 52% of total annual financial statement audit fees. Community banks' expectation of additional audit fees from Section 404 ranged as high as \$4,000,000 with the average being approximately \$87,000.
- **Software and Consulting Costs:** Outside consulting costs for Section 404 compliance were estimated to be as high as \$800,000 and averaged about \$86,000. However, expected costs for purchasing compliance software averaged approximately \$9,000 due to the fact that many of the respondents indicated that they did not plan any software purchases. Other vendor costs averaged approximately \$20,000.
- **Total Outside Section 404 Costs:** Based on survey results, the average total costs for a community bank to comply with Section 404 of Sarbox is as follows:

Consulting costs:	\$85,802
Outside audit fee:	\$87,198
Software costs:	\$9,089
Other vendor costs:	<u>\$20,053</u>
Total Section 404 Costs:	\$202,142

- **Documenting Internal Control Processes:** Community banks anticipate having to document on average approximately 78% of their internal control process covering 80% of revenues to comply with Section 404. On average, about 54% of these documented processes will have to be tested by an outside auditor. Community banks expect that they will have to document internal control processes at 74% of their physical locations.
- **Sample Survey Comments from Community Bankers:** Community bankers were very critical of Section 404. Many commented that the Section 404 requirements added a significant compliance burden to the bank with little public benefit. One banker complained that the added compliance burden of Sarbox contributed to the decision to sell the bank. Several community bankers that responded were CEOs of recently formed banks and they were particularly critical of the costs of Sarbox, noting in some instances that the costs were going to push their profitability point a significant time into the future. One banker summed up the comments by saying that Sarbox "adds a major financial burden on smaller businesses, especially community banks who are already profusely regulated."



Survey on the Costs of Complying with Section 404 of the Sarbanes-Oxley Act

The following is a compilation of data gathered from the ICBA survey. Ninety-one, ICBA-member, publicly held community banks responded to the survey. Percentages are based on those responding to the question.

1. What is your bank's asset size?

- Less than \$100 million: 10/76 (**13%**)
- \$100 million to \$250 million: 27/76 (**36%**)
- \$251 million to \$500 million: 21/76 (**28%**)
- \$501 million to \$1 billion: 12/76 (**16%**)
- Greater than \$1 billion: 6/76 (**8%**)
- Didn't disclose or indicated N/A: 15

Average Size: \$482 million

Median: \$240 million

2. What Exchange is your bank listed on?

- Nasdaq: 28/56 (**50%**)
- Amex: 4/56 (**7%**)
- BB/ Pink Sheets: 22/56 (**39%**)
- NYSE: 2/56 (**4%**)
- Didn't disclose or indicated N/A: 35

3. How many internal staff hours in total have you needed (or do you anticipate needing) to comply with the internal control attestation requirements of Section 404 of Sarbox?

- Less than 500 hours: 20/86 (23%)
- 500 to 1000 hours: 24/86 (28%)
- 1,001 to 5,000 hours: 35/86 (41%)
- Greater than 5,000 hours: 7/86 (8%)
- Didn't disclose, unsure, or indicated N/A: 5

Average total hours: 2079 hours

Median: 1,000 hours

4. How many external staff hours do you expect to pay your outside auditor to comply with the internal control attestation requirements of Section 404 of Sarbox?

- Less than 200 hours: 25/73 (34%)
- 200 to 300 hours: 21/73 (29%)
- 301 to 500 hours: 7/73 (10%)
- 501 to 1,000 hours: 15/73 (21%)
- 1,001 to 5,000: 5/73 (7%)
- Didn't disclose, unsure, or indicated N/A: 18

Total Average Hours: 428 hours

Median: 250 hours

5. What is your estimated cost for outside consulting?

- Less than \$50,000: 35/87 (**40%**)
- \$50,000 to \$100,000: 37/87 (**43%**)
- \$101,000 to \$500,000: 14/87 (**16%**)
- More than \$500,000: 1/87 (**1%**)
- Didn't disclose, unsure, or indicated N/A: 4

Total Average: \$85,802

Median: \$50,000

6. What is your estimated cost for compliance software?

- Less than \$5,000: 29/69 (**42%**)
- \$5,000 to \$10,000: 16/69 (**23%**)
- \$10,001 to 20,000: 17/69 (**25%**)
- More than \$20,000 = 7/69 (**10%**)
- Didn't disclose, unsure or indicated N/A: 22

Total Average: \$9,089

Median: \$8,000

7. What is your estimate for other vendor costs needed to comply with Section 404 (excluding auditor's fees for attestation)?

- Less than \$5,000: 27/57 (47%)
- \$5,000 to \$10,000: 14/57 (25%)
- \$10,001 to \$20,000: 8/57 (14%)
- More than \$20,000: 8/57 (14%)
- Didn't know, unsure or indicated N/A: 34

Total Average \$20,053

Median \$5,000

8. What is the additional audit fee you expect to pay for the external auditor attestation report required by Section 404?

- Less than \$10,000: 13/81 (16%)
- \$10,000 to \$30,000: 35/81 (43%)
- \$30,001 to \$50,000: 15/81 (19%)
- More than \$50,000: 18/81 (22%)
- Didn't know, unsure or indicated N/A: 10

Total Average \$87,198

Median \$30,000

9. What percentage is this fee of your total annual audit fee?

- Less than 25%: 18/80 (**23%**)
- 25%-50%: 37/80 (**46%**)
- 51%-75%: 7/80 (**9%**)
- 76%-100%: 13/80 (**16%**)
- Over 100%: 5/80 (**6%**)
- Didn't know, unsure, or indicated N/A: 11

Total Average: 52%

Median: 50%

10. What percentage of your internal control process are you documenting to comply with Section 404?

- Less than 50%: 5/76 (**7%**)
- 51%-75%: 21/76 (**28%**)
- 76%-85%: 14/76 (**18%**)
- 86%-100%: 36/76 (**47%**)
- Didn't know, unsure or indicated N/A: 15

Total Average: 78%

Median: 85%

11. What percentage of your documented processes do you expect your outside auditor to actually test?

- Less than 25%: 18/70 (**26%**)
- 25% to 50%: 19/70 (**27%**)
- 51% to 75%: 12/70 (**17%**)
- 76% to 100%: 21/70 (**30%**)
- Didn't know, unsure, or indicated N/A: 21

Total Average 54%

Median 50%

12. At what percentage of your bank's physical locations (e.g. branches, operation centers, etc.) will you document internal control processes?

- Less than 25%: 13/79 (**16%**)
- 25% to 50%: 13/79 (**16%**)
- 51% to 80%: 5/79 (**6%**)
- 81% to 100%: 48/79 (**61%**)
- Didn't know, unsure or indicated N/A: 12

Total Average 74%

Median 100%

13. How many physical locations do you have?

- Less than 5: 32/90 (**36%**)
- 5 to10: 31/90 (**34%**)
- 11 to20: 16/90 (**18%**)
- More than 20= 11/90 (**12%**)
- Didn't know, unsure or indicated N/A: 1

Total Average: 9.84 branches

Median: 6 branches

14. What percentage of gross income is covered by your documentation?

- Less than 25%: 6/63 (**10%**)
- 25% to 75%: 7/63 (**11%**)
- 76% to 90%: 27/63 (**43%**)
- 91% to 100% = 23/63 (**37%**)
- Didn't know, unsure, or indicated N/A: 28

Total Average: 80%

Median: 90%

15. When does your bank expect to deploy a permanent software solution for Section 404 compliance?

- 2004: 7/41 (17%)
- 2005: 25/41 (61%)
- 2006: 4/41 (10%)
- Not sure: 5/41 (12%)
- Didn't know or indicated N/A: 50

16. Which year, 2004 or 2005, will your bank or bank holding company be subject to Section 404 compliance?

- 2004: 14/76 (18%)
- 2005: 62/76 (82%)
- Didn't know or indicated N/A: 15

17. Is your bank an accelerated filer?

- Yes: 20/77 (26%)
- No: 57/77 (74%)
- Didn't know or indicated N/A: 14