

## **Internal Control over Financial Reporting and the Value of Cash**

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### ***Abstract***

*This study examines the trade-off between the precautionary benefits of liquidity management and its agency costs by exploring whether the value of cash is contingent upon the quality of internal control over financial reporting. We find that the disclosure of material weaknesses in the Sarbanes-Oxley (SOX) 404 internal control assessments is an important determinant of the value of cash holdings. We estimate that the value spread for firms with weak controls vs. strong controls is about \$0.25 for an extra dollar of cash. Our inference is not driven by account-level weaknesses but by more severe, company-level weaknesses. Furthermore, cash valuation significantly decreases with the remediation of previously reported material weaknesses. Collectively, the agency costs from financial flexibility appear to be more than offset by its precautionary benefits.*

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**JEL classification:** *G3, M4*