



# **Sarbanes-Oxley Section 404:** **Project to Process** **Practical Actions to Getting Started**

**Florida West Coast IIA Chapter**

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1. SOX COSTS A LOT.
2. Focus on scopes (use a top-down, risk-based approach).
3. More IT resources are needed.
4. Deficiency reporting is complex.
5. You need someone to manage SOX (preferably not internal audit).
6. Ensure controls are fixed.
7. Involve the external auditors.
8. This is a technical project.
9. It is hard to get people to do this work.
10. Start earlier.

*SOA “Project to Process” is about the transition from an ad hoc project, which most first adopters experienced in Year One, to a sustainable, cost-effective and value-added process over time.*

- The Year 2 window closed quickly
- The Lesson: The ideal time for planning is during the budget cycle so that expectations and action steps can be built into the business plan
- That didn't happen for Year 2:
  - Companies deferred planning for Year Two until after Year One was completed
  - For many first year adopters, Year One compliance consumed most of the first quarter of Year Two
  - Assigning ownership and budget has been difficult
  - Everyone waited for Washington to act
  - Accounting firms are waiting for the PCAOB inspections to finish
- The Result: There wasn't enough time and the status quo continues
  - Year Two continues reactive and understaffed
  - There continues to be excessive emphasis on testing manual controls

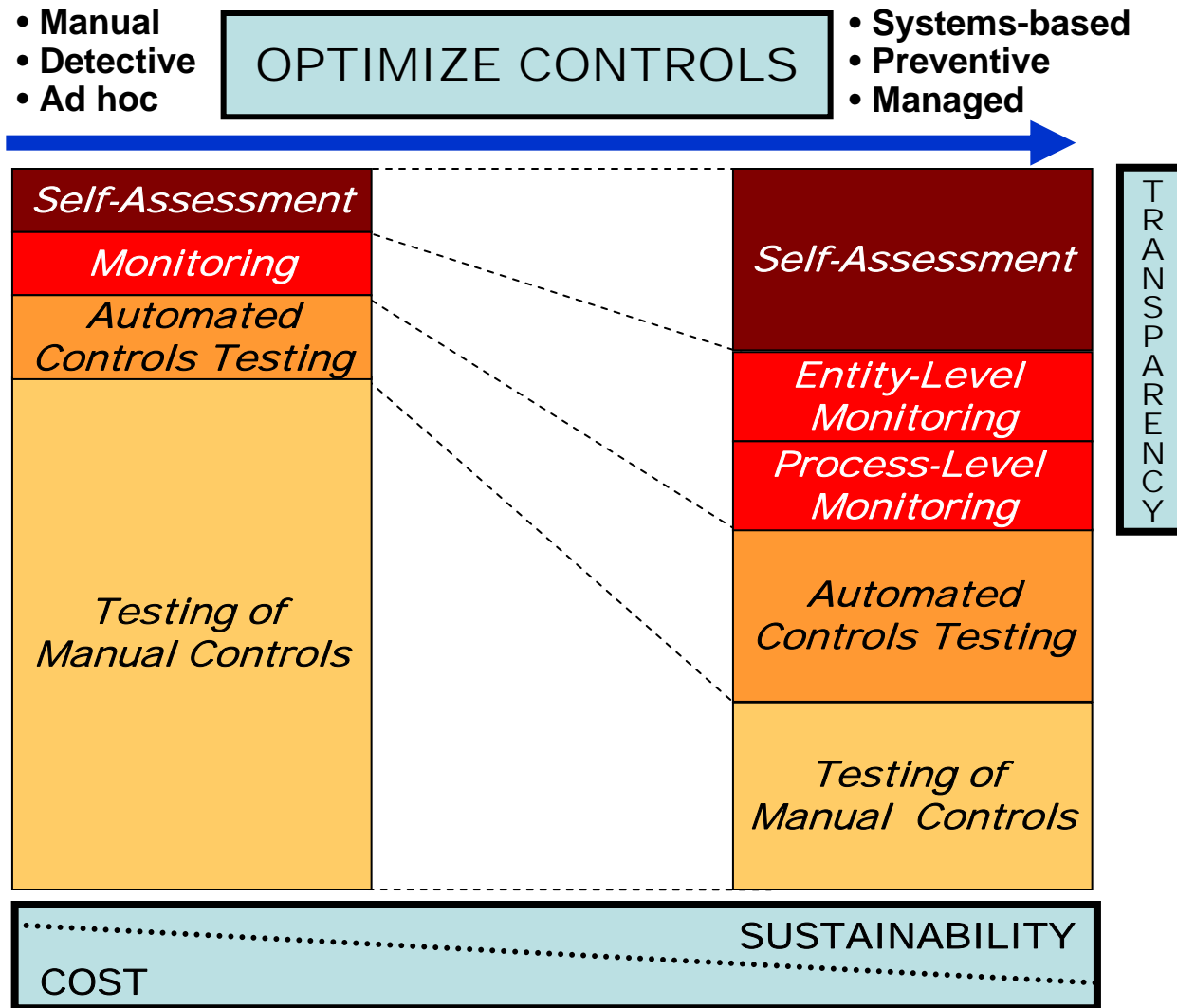
What We Know:

- Costs exceed benefits
- Personnel are tired
- “Catch up” on important things was a priority
- Resource shortages continue to be acute
- Angst in the auditor relationship – auditors are tightening their approach
- It still takes longer than anticipated
- # of key controls is still THE cost driver
- Sole reliance on independent tests of controls remains THE “high cost” approach

***Sustainability and cost-effectiveness are recognized as important; however, companies don't know where to start.***

*Management should break down the costs of compliance into meaningful components:*

- Eliminate testing through control filtering
- Reduce extent of testing with self-assessment and increased focus on monitoring at process and entity level
- Streamline processes by eliminating nonessentials and simplify
- Create value while improving sustainability



*Client Example - Results by Business Unit*

	Prior Year Control Population	Prior Year Controls Tested	Proposed Current Year Controls To Test	Increasing Reliance	Decreasing Reliance	Improvement Required
BU 1	399	157	123	31	58	23
BU 2	242	115	61	39	75	22
BU 3	59	39	22	14	25	9
BU 4	257	112	43	12	21	8
<b>Total</b>	<b>957</b>	<b>423</b>	<b>249</b>	<b>96</b>	<b>179</b>	<b>62</b>
% of p/y Control Population		44%	26%			

- **Decreasing Reliance** — Related to transaction controls
- **Increasing Reliance** — Related to process and GCIT monitoring
- **Improvement Required** — Using 6 elements of infrastructure as a framework

***“Self-assessment  
...drives the ‘tone at  
the top’ down to  
process owners...”***

***Issue 1, Volume II, The  
Bulletin, “The Self-  
Assessment Process:  
Management’s Tool for  
Reinforcing Process  
Owner Accountability”***

- Self-assessment reinforces process owner accountability for critical controls
- Self-assessment can be an integral component of management’s compliance with Sections 302 and 404
- Self-assessment is a cost-effective tool for collecting insights and evidence during management’s assessment process
  - It is low cost in application
  - It facilitates roll-forward of preliminary testing
  - It reduces scope of detailed controls testing which would otherwise be required

***“Some companies are planning to reduce independent control testing by up to 50 percent or even more next year, with self-assessment as an important component of the revised test plan.” Issue 5, Volume II, The Bulletin***

***There is a strong link between:***

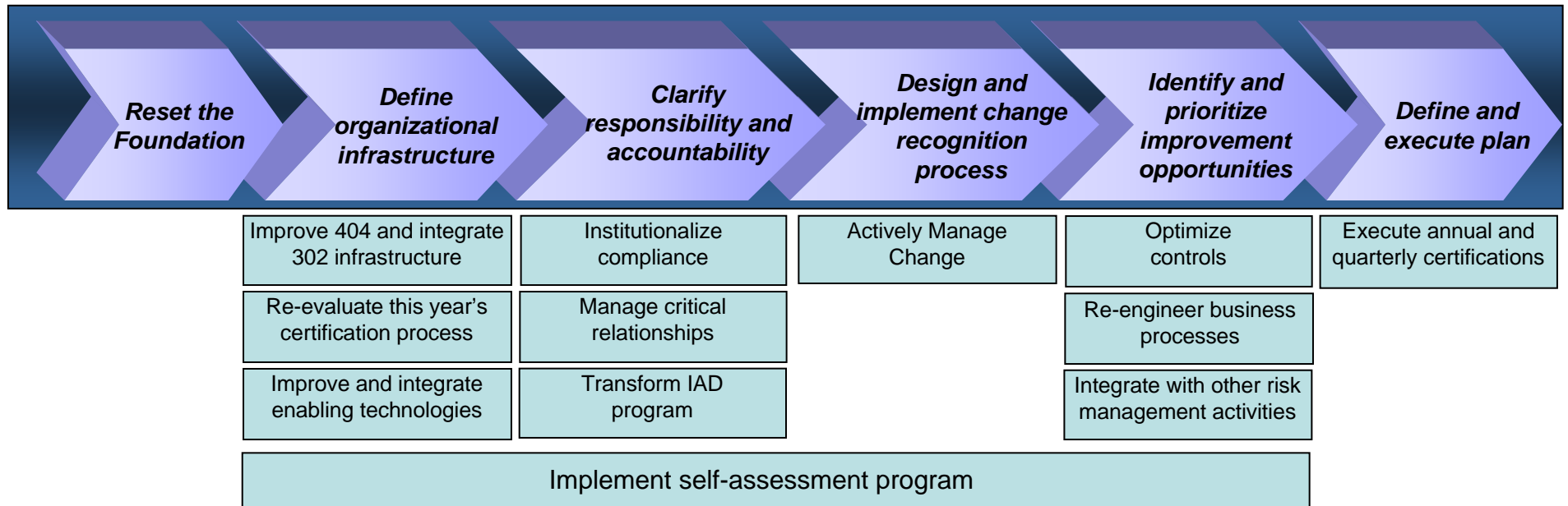
1. Quality, time and cost performance, and
2. Strengthening the effectiveness of internal controls over financial reporting

***However, most companies have not had sufficient time to explore the relationship between business process performance, internal control quality and compliance cost-effectiveness.***

### ***Ten Indicators of Value-Add Opportunities:***

1. General ledger close cycle times
2. Increasing demand for more timely analytical information
3. High error rates in financial transaction processes
4. High cost activities
5. Unusually high number of manual journal entries
6. High dependency on spreadsheets
7. Decentralized business units with duplicate functions
8. Limited return on investment in IT
9. Pressure on the finance organization to reduce costs
10. Increased costs arising from addressing complicated segregation of duties issues

Institutionalize the Existing Internal Control Structure	Improve the Quality of the Internal Control Structure
Leave financial reporting process as is	Improve process quality, time and cost performance
Apply manual “find and fix” controls with unacceptable error rates	Improve the process upstream to eliminate defects at the source
Underutilize programmed controls	Optimize programmed controls
Design and implement test plans around EXISTING controls	Design and implement test plans around IMPROVED controls
Apply a quantitative, coverage approach to scoping	Apply a risk-based approach to scoping
Test most of the controls tested last year	Improve filtering to focus primarily on the key controls and rotate independent testing in low-risk areas
Apply detailed testing almost exclusively to validate effectiveness	Also apply self-assessment and entity- and process-level monitoring
Focus risk assessment on financial reporting risks	Focus risk assessment more broadly on business risks (ERA)



### *The Message: Integrate Section 302 and 404 Compliance*

***Reduce risk  
of headline  
exposure to an  
acceptable level***

We recommend organizations:

- Achieve sustainability through integrating Section 404 compliance with Section 302
- Identify process owners and hold them accountable
- Set quality, cost and time goals and metrics to leverage opportunities to improve repeatability and cost-effectiveness
- Understand the change management implications
- Considering alternative structures for continued compliance
- Move beyond compliance with Sections 302 and 404 to advance capabilities around managing critical risks

*The Message: Take a Fresh Look at Your Approach*

***Evaluation of  
management's  
Section 404  
assessment  
process should be  
this year's priority***

- Formulate lessons learned from your first year experience – obtain input from:
  - Certifying officers
  - Operating managers
  - Process owners
  - Internal auditors
  - Audit committee
  - External auditors
- Build on “lessons learned” by migrating to the desired permanent structure according to management’s chosen time table
- Continuously refine and improve the assessment process going forward

### *Management should:*

- Evaluate the nature and extent of segregation of duties issues within the organization and determine whether changes are necessary and/or feasible.
- Review entity-level controls, including entity-level monitoring in areas where improvements have been suggested either by the external auditors or others.
- Strengthen the anti-fraud program with emphasis on prevention and deterrence.
- Review the period-end financial reporting process for opportunities to compress closing cycle time and strengthen controls over management override.
- Align the internal audit plan with Management's Section 404 test plan, consistent with the demands of the function.
- Improve the change recognition process and define responsibilities for evaluating the reporting implications of change.

***Is your organization:***

- Confident it is aligning the compliance process with a risk-based approach?
- Avoiding the trap of wading through and independently testing too many controls?
- Deploying system-based controls embedded within financial management ERP solutions?
- Using effective entity-level monitoring?
- Maximizing the use of automated monitoring tools and data analytics?
- Pushing down accountability for controls effectiveness to process owners?
- Utilizing self-assessment to keep process owners engaged?
- Moving toward a more holistic view of all compliance and risk management activities?
- Ready for the oncoming accelerated filing requirements, if applicable?

All those who need to know they have a repeatable, cost-effective and sustainable process for complying with Sections 404 and 302...



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