

Year 2 debrief & ongoing sustainability initiatives

How are you progressing from project to process?



U.S. Banking & Capital Markets Industry Webcast – SOX 404 Recap | June 6, 2006

PricewaterhouseCoopers' US Banking & Capital Markets Practice held its Sarbanes-Oxley 404 webcast on June 6, 2006, the eighth event in its 404 series. Since commencing in 2004, these events have been part of PwC's strategy to create a networking forum for our clients to exchange ideas and practices as well as learn about new topical developments to enhance 404 efficiency and effectiveness. We continue to receive positive feedback and are planning a ninth update in the Fall. Information will be provided as soon as it is available.

We had approximately 350 participants on the webcast, including compliance, internal auditor, finance, treasury and legal professionals. Discussions included developments from the second SEC and PCAOB roundtable held in May, Year 2 observations, suggestions for Year 3 and PwC field observations.

Specifically, the webcast focused on:

- SEC and PCAOB Developments
- Year 2 Reported Results
- Overall Year 2 Observations
- Year 3 and Beyond ("Migration to Sustainability")
- Information Technology General Controls
- Primary Areas of Tactical Efficiency

The following PwC subject matter professionals hosted and shared their insights and answered questions during the call:

- **Bill Lewis**, Managing Partner, Leader of the U.S. Banking & Capital Markets Practice
- **Jorge Milo**, Partner, National Office Assurance Policy
- **Rick Bennett**, Partner, Banking and Specialty Finance Practice
- **Rick Moyer**, Senior Manager, National Office Assurance Policy Practice
- **Brian Kinman**, Partner, Partner, 404 Sustainability Leader
- **John Oliver**, Partner, Banking and Specialty Finance Practice
- **Donna DiGiacomo**, Partner, Systems and Process Assurance

To access the webcast and webcast materials:

Please go to www.pwc.com/conf and click on US Banking & Capital Markets Webcast | SOX 404.

Please contact Catherine Hay at 646.471.8366 with any questions regarding this webcast.

Following are key highlights from the call that you might find helpful as you evaluate your current status and your ongoing efforts to refine your Section 404 process as you enter Year 3. More detailed insights are included in the conference call replay.

SEC and PCAOB Developments:

On May 10, 2006, the SEC and PCAOB hosted the second roundtable on the implementation of SOX 404. The roundtable was attended by various stakeholders, including issuers, attorneys, analysts and auditors. On May 17, 2006, the SEC and PCAOB issued separate press releases to communicate their plans for increasing SOX 404 efficiency. The PCAOB plans to: (i) possibly amend AS 2; (ii) focus on audit efficiency during this year's inspection process; (iii) provide additional implementation guidance for small company issuers; and (iv) continue to host forums for auditing in the small business environment. The SEC plans to: (i) issue a Concept Release on management's assessment process, including the role of the external auditor; (ii) work with the PCAOB in amending AS 2; (iii) oversee the PCAOB inspection process to ensure efficiency is being achieved; and (iv) expects to issue a short postponement of the effective date for non-accelerated filers. It is not expected that such a postponement would effect December 31, 2006 filers.

Year 2 Reported Results:

As of May 1, 2006, 199 accelerated filers issued adverse reports for 2005 (representing 7% of total 404 reports). This compares with 566 adverse reports issued by accelerated filers in 2004 (which represented 16% of total 404 reports). Common Significant deficiencies within the banking and financial services industry relate to: (i) information technology, specifically security and access; (ii) spreadsheets; (iii) models; (iv) application of GAAP, specifically around FAS 91, FAS 140 and FIN 46; (v) subjective areas of estimate and judgment (ALLL; MSRs; and litigation reserves); and (vi) accounting for non-routine transactions. Common Material Weaknesses within the banking and financial services industry relate to: (i) preparation and presentation of the statement of cash flows; (ii) accounting for derivatives (specifically the application of the shortcut method); (iii) deferred income taxes; (iv) the application of GAAP; and (v) the monitoring of SEC developments.

Overall Year 2 Observations:

Management and the external auditors made process and efficiency improvements in Year 2. Management benefited from a reduction in project management hours, a more efficient documentation effort (i.e., control documentation needed to be updated vs. created) and a focused effort to significantly reduce key controls. The external auditor also improved efficiency by reducing key controls, relying more on management testing, adjusting the nature of its testing (e.g., reduction in the amount of auditor re-performance) and by having a better understanding of required year-end updated testing. In order to sustain the SOX 404 effort going forward, it is critical that management move from a "project" mode to a "business as usual" mode.

Year 3 and Beyond ("Migration to Sustainability"):

Sustainability means managing a process that will allow a company to meet its assertion and reporting requirements under both 404 and 302, and maintain effective internal control over financial reporting each year. In order to effectively manage SOX 404, and to create a sustainable effort, accountability within each company must be defined. Oversight begins and ends with the Board and the Audit Committee. The CEO and CFO must own the effort by setting the right tone. Facilitators, such as a Chief Internal Control Officer and/or Risk and Control Specialist, must be empowered. In addition, checks and balances should be built into the system – via Internal Audit or the Disclosure Committee – to challenge the process and keep it on track. Technology tools can help with sustainability, but technology will never be a "silver bullet".

Information Technology General Controls:

Why are Information Technology General Controls (ITGC) so important? The answer is simple: ITGC form the foundation for specific controls over the processing of transactions and provide assurance that financial information generated from a company's systems can be relied upon. Many IT control deficiencies are related to access (more access than required to do your job; access to production; or access to standing data files); segregation of duties (programmer has unnecessary access to the production environment, a business transaction or to staging) and program change control (lack of consistency and evidence of compliance with company requirements). Effective ITGC can be achieved by focusing on security, program change, program maintenance, data center operations and the IT control environment.

Primary Areas of Tactical Efficiency:

Management wants to create a sustainable SOX 404 process and reduce the associated costs. It is critical to build the day-to-day process and leave the "project" mode behind. Company Level and General Computer Controls should be tested early in the year – maximizing the leverage that can be placed on effective controls in these two areas. Business process owners should be accountable for documentation. A risk assessment should be used to determine testing techniques that will vary the nature, timing and extent of testing. Deficiencies should be evaluated real-time so that the year-end analysis is more manageable. Technology tools should be employed where they make sense; remember, don't work for the technology, let the technology work for you. And finally, look within your organization to leverage other risk and compliance work.