

The Sarbanes-Oxley Act: Lessons Learned for First Time Filers

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- Public Company Filings - What we have seen in the market
- The Five Stages of the SOX 404 Experience
- Where are 404 regulations today?
- Common experiences of December 31, 2004 404 filers
- Lessons Learned – Key Points of Focus
- Thinking ahead

Public Company Filings

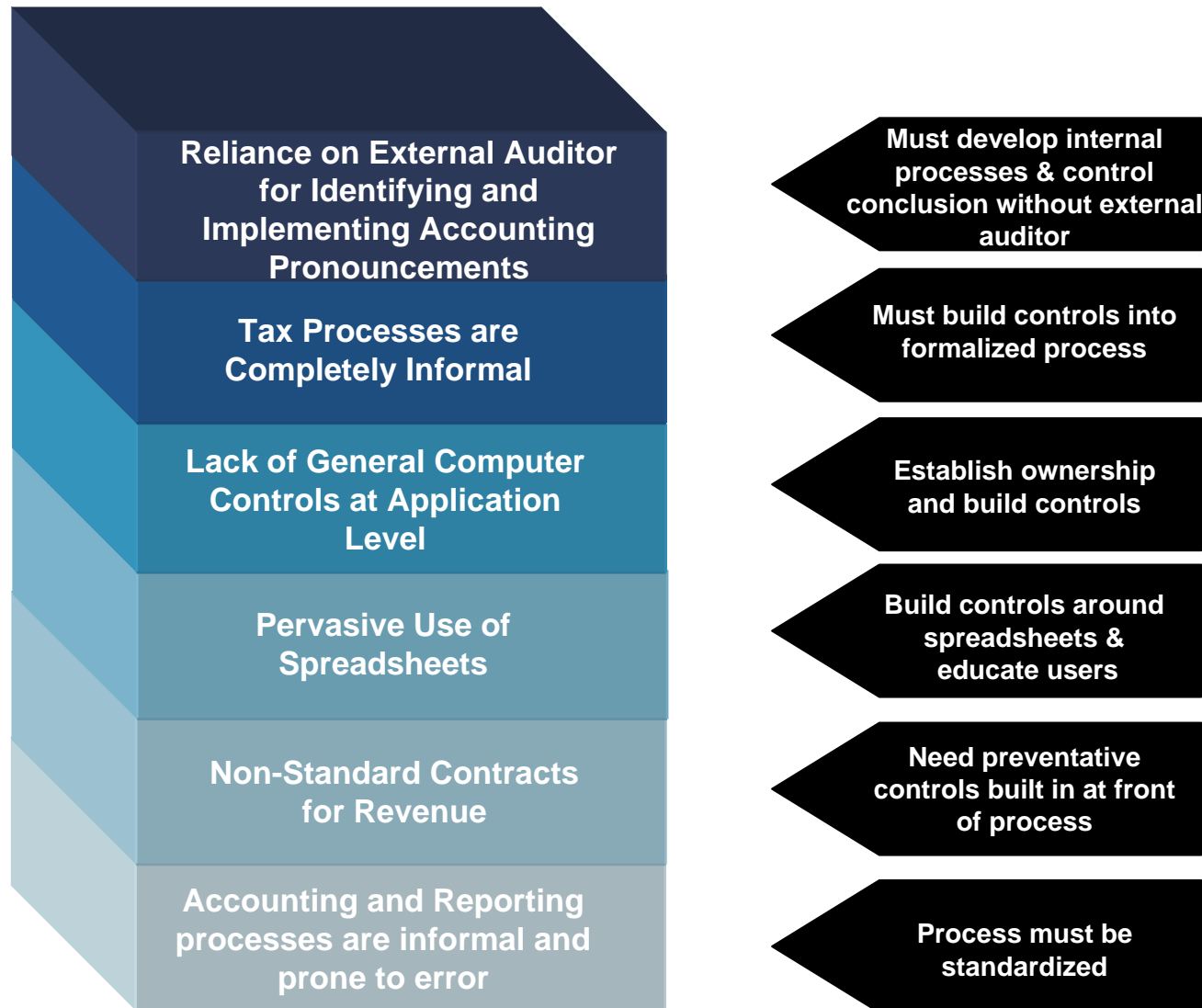
- Per PwC analysis as of March 9th 2005, 667 companies had filed their annual statements with the SEC with 7 total adverse opinions on internal controls. We expect many more to come over the next few weeks.

- Per *Compliance Week* as of February 28th 2005, 18 companies reported material weaknesses in their internal controls and 5 more reported other deficiencies per company press releases in February.

Of these companies reporting:

- 16 had total revenues less than \$1B USD.
- 11 reported failures in financial systems and procedures
- 6 reported inadequate accounting personnel or supervision
- Others cited documentation and IT control deficiencies
- During 2004, 582 weakness and deficiency disclosures were made by public companies.

Examples of Common Deficiencies Found



Why did we have so many reported issues?

The Five Stages of the SOX 404 Experience

#1 – Innocence

“We’ve got the best Controls on the Planet – I can sleep at night !”

#2 – Skepticism

“This shouldn’t be a big project, we have tons of policies & our external auditors found only minor adjustments last year.”

#3 – Anger

“The amount of documentation required is ridiculous. This entire exercise is form over substance.”

#4 – Fear

“500 control deficiencies ! Are we going to get a clean opinion?”

#5 – Value Awakening

“As a result of this process we are now much more efficient because we make fewer errors and have fewer last minute surprises.” **COMPETITIVE ADVANTAGE!**

Where are 404 Regulations Today?

PCAOB and SEC continues to provide additional “clarity/guidance” in the form of FAQs. The market is now more mature, and they continue to provide enhanced definitions

Scope

- More all-inclusive business unit scope
- More all-inclusive financial statement line item scope
- More all-inclusive process scope
- Defined “materiality” lower than what many expected

Company Controls

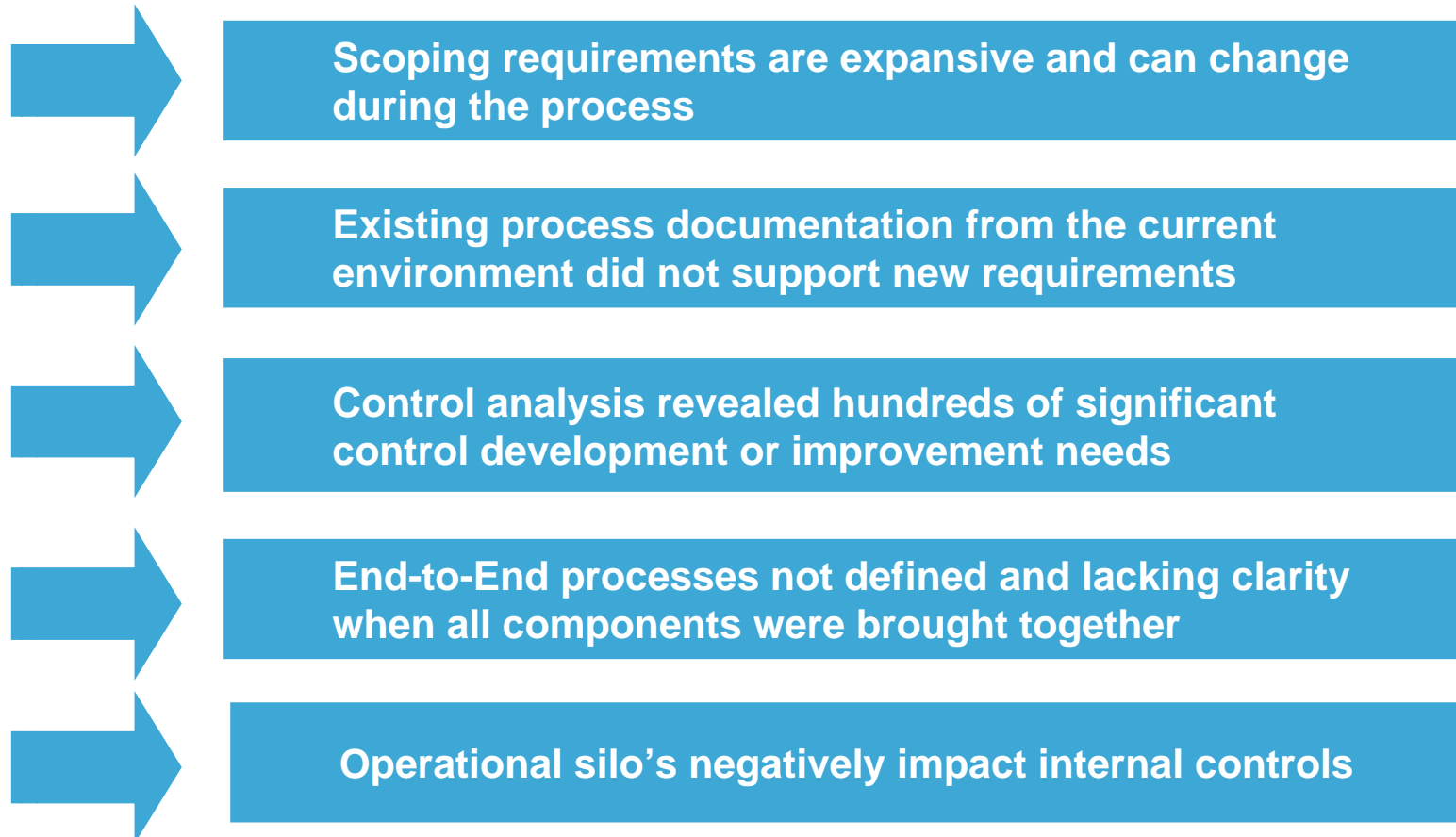
- Expanding expectations (General Computer Controls “GCC”, System Configurable Controls, Segregation of Duties, Company-Level Controls, Electronic Spreadsheets)

Reporting Deficiencies

- Guidance (released October and November 2004)
 - Evaluating aggregated deficiencies
 - Evaluating GCC related deficiencies
 - Evaluating process/transaction level deficiencies
- Judgmental process

Common Experiences of 12/31/04 Filers

The SOX 404 compliance project is substantially **bigger, broader** and more **expensive** than anticipated.



Common Experiences of 12/31/04 Filers

1) Level of effort dramatically underestimated for finance/operating staff, external accountants and advisors

- **Estimated cost/hours for external accountants**
- **Estimated cost/hours for third party advisors**
- **Complexity and lack of discipline in project management**
- **Lack of oversight of foreign (non-US based) operations**
- **Lack of focus and attention and known problem areas**

2) Inappropriate assumption that all responsibility lies with financial staff. Operational staff will have significant involvement and responsibilities

- **Documentation and testing requirements required within**
 - **virtually all operating processes**
 - **all significant business units**
- **Lack of aggressive remediation plans**

Common Experiences of 12/31/04 Filers

- 3) Employees did not understand the reasons and objectives behind the tasks they are asked to perform (lack of adequate training on what needs to be done)
- 4) Many companies in “panic” mode in during the last quarter through the filing date

In retrospect, significantly more efforts should have been performed in 1st and 2nd quarters of the company’s fiscal year through:

- **Agreement of the definition of key controls with external auditors**
- **Coordination of the project with the external auditors to avoid expectations gaps**
- **Late focus on IT general controls, configurable controls, and segregation of duties**
- **Late Focus on “softer” COSO components (may be the most important)**
- **Identifying and requiring from outsource providers SAS 70 type II reports**

Lessons Learned – Key Points of Focus

Need for Enhanced Project Management

- We have found that companies need a **full-time/100% dedicated and qualified project leader** with real authority and respect in organization, as well as a clear and obvious channel to and support from the CEO, CFO and Audit Committee
- Detailed project plan(s) by location, by all components, by person, by date – more than just a GANTT chart.
- Monitor progress continuously – no tolerance for delays, poor attitudes, or people refusing to “get on board”
- Ensure company methodologies are fully understood between company/accountants/3rd party providers
- Continuous communication with Audit Committee and external auditor
- Plan on a **significant** remediation effort in both the length of **time** required and **resources** needed.

Lessons Learned – Key Points of Focus

Enhanced Management Responsibility

- Need for management to convey an overlying sense of urgency to complete/remediate to all staffing levels. The tone that management sets is extremely important.
- Organizational “buy-in” as to the importance to the company of compliance – all parties must understand the tasks that need to be performed.
- Ensure timely and candid reporting to the Audit Committee. Allow for the “dirt” to come out.
- Remote location management
 - Requires “hands-on” home office oversight and involvement
 - Do not understand the level of controls needed to monitor remote locations

Lessons learned – Key Points of Focus

- Do not underestimate the need for good project management
- Management's tone, visibility in the process, and promoting a sense of urgency will affect employee attitudes and commitment levels
- Plan for extensive remediation efforts
- Even though the timeline has been recently delayed.....
DO NOT STOP!
- Test your controls this year – most issues arise out of testing.

Thinking Ahead – After Year 1 of 404 compliance

- Sarbanes Section 404 is not a one-time event
- A more efficient and effective process must be developed to sustain compliance as the cost in terms of resource commitment and third party expenses cannot be sustained
- Comply with Sections 302 and 404 of the Act by designing and sustaining a process that:
 - Provides for management reliance for quarterly and annual attestations
 - Is seamlessly embedded with other business processes
 - Achieve efficiency and effectiveness in documenting, updating, archiving and assessing company control documentation, as well as company policies
 - Reduces administrative burden in assuring compliance
 - Enables teams to identify, report and remediate failures in a timely manner
 - Proactively deals with change in people, processes and technology



**Good internal
control
is no longer
just a best
practice...**

it's the Law!

Q & A