

PART I

Sarbanes-Oxley for the Finance Professional

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Scope and Assessment of the Act

Some pervasive themes emerge from the Sarbanes-Oxley Act, which is built on the following basic and key principles:

- Integrity
- Independence
- Proper oversight
- Accountability
- Strong internal controls
- Transparency
- Deterrence
- Corporate process management

INTEGRITY

The process of reporting and disclosing material information to stakeholders must be honest and truthful. The stability of the U.S. market depends on investor trust in the corporations and the systems in which they operate; Sarbanes-Oxley is the means to guarantee trust and integrity.

INDEPENDENCE

For a system to function reliably, it must have a certain degree of autonomy. For corporations, this means that the people entrusted to ensure fair and accurate representation must be impartial and independent. The auditors and board members must be free to operate objectively and in the best interests of investors to maintain stability in, and accuracy of, corporate reporting.

PROPER OVERSIGHT

Guidance and supervision are key elements at any level of management. This means that the executives (CEO, CFO, CIO, COO), the board, and the auditors need to have explicit means to evaluate the effectiveness of their governance and compliance systems. This also means ensuring that all systems are linked and that all departments and functions have effective methods of sharing compliance information.

ACCOUNTABILITY

All stakeholders, from investors to employees to customers, deserve accountability from the executives who manage the corporation in which they have a vested interest. Accountability breeds responsibility, and the tough, new standards of the Sarbanes-Oxley Act ensure that someone is accountable for the daily operations of the company and disclosure of the company's performance.

STRONG INTERNAL CONTROLS

To be effective, any system requires assiduous control systems. Internal controls are the measures against which corporate effectiveness is judged. Essentially, controls are the framework that an auditor will use to determine compliance, and Sarbanes-Oxley makes it absolutely necessary for corporations to design and implement explicit, effective internal controls that will guarantee that compliance.

TRANSPARENCY

The corporation's movements must be open to scrutiny from all angles. When all transactions are subject to public disclosure, transparency of the system acts as its own control system. Sarbanes-Oxley mandates transparent operations, which enhance corporate responsibility and governance.

DETERRENCE

Unfortunately, corporate executives, officials, and employees are human; thus, suitable and significant deterrents are required to discourage unacceptable behavior. Sarbanes-Oxley has introduced strong, new measures that introduce harsh penalties for white-collar crime and criminalize activity intended to obstruct justice or commit securities fraud.

CORPORATE PROCESS MANAGEMENT

Who is best suited to ramp a company up for Sarbanes-Oxley compliance? Is it the CFO, the CIO, both, or neither? See Exhibit 1.1.

The notion of IT irrelevance is at the core of who is best suited to lead the Sarbanes-Oxley challenge. The CIO is the keeper of the corporate data and it is the IT systems that will determine how financial information is recorded, tracked, and disclosed—yet many executives (CIOs included) view compliance with Sarbanes-Oxley as a finance issue, not a systems issue. Some recognize that IT has a role to play, but the focus is still on the finance department to lead the way.

EXHIBIT 1.1 Who Leads?

Joe, the CFO at XYZ Corporation, has been charged with implementing the changes necessary to comply with Sarbanes-Oxley and the new regulations imposed by the SEC. The current financial systems rely on spreadsheet solutions and, after much research, Joe has decided that the financial information must be consolidated and the whole process sped up. He knows he will need IT support to create the changes necessary and provide the software and hardware, but he is confident that he can design a control-system framework that IT can work with. He does not want to bother the CIO with his finance problems related to Sarbanes-Oxley, so he goes about the process of creating a wonderful, theoretical system that will allow information to flow through the company accurately and quickly. He presents his findings to the CEO, who is delighted, but when it comes times for application, the CIO comes up with many reasons why the plan is not practical or doable. “Trust IT to always be the stick in the wheel,” Joe says.

Role of IT

Sarbanes-Oxley is financial legislation, but its implementation and compliance rest with the IT department. Sarbanes-Oxley requires a sophisticated set of internal controls that guide the creation of financial documents and disclosure of financial information in a timely and accurate manner. Because IT systems are used to generate, change, house, and transport that data, CIOs have to build controls that ensure that the information stands up to audit scrutiny.

If CIOs are considered ancillary to the process, how will the necessary systems be developed and controls put in place? It is imperative that IT be an integral component of Sarbanes-Oxley compliance; hence, the CIO will need to demonstrate a thorough understanding of the issues related to Sarbanes-Oxley. CFOs may resist letting the technology department play a central role in implementing the changes necessary to ensure data integrity. From finance's perspective, IT is a cost center, and therefore the CFO needs to manage this process in terms of value to the corporation rather than simply spending money on some requisite system upgrades. The CIO is in the unique position of understanding the importance of stringent controls and the functional difficulties of attaining them. Finance and IT are tightly bound in this process, so it is important that the corporation enable the two departments to work together to address the challenges of Sarbanes-Oxley.

Note: The idea that a 404 is a clueless person (as in a 404 message, meaning "file not found") is rapidly being replaced by the notion that being a 404 means you need to find the information fast, to comply with Section 404 of Sarbanes-Oxley.

Companies spend an enormous amount of time developing business plans and forecasts on which to base important decisions. It is critical that the information that drives their strategic decision making be accurate and timely. A 2003 survey by the Hackett Group found that 47 percent of companies used stand-alone spreadsheets for planning and budgeting.¹ Considering the importance of the information that comes out of these spreadsheets, it is alarming that a study by Rajalingham, Chadwick and Knight² found that 90 percent of the spreadsheets analyzed had significant errors. Actual or potential spreadsheet error will be unacceptable to CEOs and CFOs who must personally certify that the information in financial reports is true.

A critical challenge for Sarbanes-Oxley compliance will be to reduce the reliance on human processes in the flow of information and record management. This responsibility falls firmly on IT's shoulders, and the CIO will have to document usage rules and an audit trail for each system that contributes financial information. CIOs need to work closely with the Sarbanes-Oxley auditors to make sure that they know what their companies' weaknesses are and then take immediate action to remedy any problematic situations.

Analyst's Opinions and Recommendations

According to analysts, to meet compliance requirements, companies will want to:

- Determine whether the members of the audit committee and the majority of the board of directors meet the definition of *independent*.
- Review the existing code of ethics, making changes to meet Sarbanes-Oxley standards, if necessary.
- Put a code of ethics in place if one does not already exist.
- Determine the financial expertise of the members of the audit committee.
- Ensure that the company's benefit plans comply with restrictions during blackout periods.
- Ensure that any nonaudit services being performed do not violate Sarbanes-Oxley.
- Ensure that the CFO outlines what information must be reported and how quickly it must be reported.
- Ensure that computer technology has the ability to get information to the CFO in a timely fashion.
- Establish a process whereby the CFO will be able to inform the IT department of compliance issues in a timely manner.
- Identify internal processes that could possibly pose risks for the company.
- Consider having all directors, officers, and their families go through preclearance procedures before conducting transactions.
- Appoint an executive(s) to receive a power of attorney, which will allow him or her to sign off on reports.

- Appoint a disclosure committee, if one is not already in place, to help ensure that disclosures are accurate and complete. Appoint an individual from each part of the company, so all departments are covered. Then ensure that:
 - Everyone understands what the committee is accountable for.
 - A committee charter has been written and communicated to the appropriate personnel.
 - The committee has an agenda.
 - All committee members know their specific responsibilities.
 - The company is aware of the specific roles of members of the committee.
 - A process for resolving disputes is instituted among the disclosure committee, the CEO, and the CFO.
- Create a disclosure policy that is tailored specifically to meet the needs of the company.
- Ensure that if a policy is adopted, it will be adhered to.
- Ensure that the company practices and written policies are compatible. If you are doing something as a company practice that is not in the written form, change the written form so that you are in compliance.
- Test the effectiveness of controls and assess how they are doing overall.
- Have an internal audit function in place.
- Create and put into place a process, in compliance with the whistleblower mandate, that will allow employees to voice their concerns about possible company violations; this process should also allow them to express concerns about financial or business practices.
- Have the executive officers and audit committee ensure that the internal controls are effective and make efforts to correct any weaknesses.
- Implement dates by which completion of strengthening of weaknesses should be achieved; also, identify the plan of action that will lead to completion.
- Inspect liability insurance and coverage to ensure proper coverage and protection.
- Have the CFO outline, as clearly as possible, the internal processes of financial reports. This will allow the CFO to make determinations on where the company needs to improve its per-

formance to comply with Sarbanes-Oxley. According to one analyst, “The level of detail you have to get down to is pretty significant. You have to get down to the level of Excel spreadsheets and determine whether the people using them know what they are doing and whether or not they are being appropriately monitored and reviewed.”

- Create a protected hotline that will allow whistleblowers to call in with information.

ENDNOTES

1. The Hackett Group, Press Release, “Hackett Group Survey Reveals That Nearly Half of All Companies Ignore IT in Critical Elements of Sarbanes Oxley Compliance Efforts,” December 16, 2003, Atlanta, GA.
2. K. Rajalingham, D. Chadwick, B. Knight, and D. Edwards, *Quality Control in Spreadsheets: A Software Engineering-Based Approach to Spreadsheet Development*, Thirty-Third Hawaii International Conference on System Sciences (Maui, Hawaii, January 4–7, 2000).