

Sarbanes-Oxley and Performance Management

Sarbanes-Oxley Act Overview

The Sarbanes-Oxley (SOX) Act established guidelines to facilitate the assessment of a public company's financial results and the reporting and tracking of its physical assets. The SOX Act has various sections pertaining to the disclosure of financial and accounting information. In a recent study by the Simon Graduate School of Business Administration, University of Rochester, the net cost of SOX compliance in the United States was projected to be a staggering \$1.4 trillion. Other relevant case studies have confirmed that the number of employee hours spent on SOX compliance will be ten times greater than what the Securities and Exchange Commission (SEC) had projected.

The explanation for these excessive figures lies in the fact that many companies have failed to leverage new methodologies, processes, and readily available technologies.

Using SOX to Improve Performance Management

The requirements and recommendations that were ushered in with the SOX legislation fall within the realm of developing and implementing a forward-thinking performance management plan. In the pursuit of SOX compliance, organizations should investigate available

In the rush to meet SOX deadlines, companies are applying traditional, manual techniques and hiring additional contract and full-time resources to study and appease this legislative requirement. These short-term solutions expose a company to additional risk and are not sustainable from a cost and efficiency standpoint. Companies that relied on manual controls to meet initial deadlines must now re-address their "quick fix" approach to build long-term, sustainable solutions that include automated, streamlined, and secure operations.

This whitepaper provides insight into how corporations can actually use SOX guidelines as a strategic advantage to initiating new performance management methodologies that will reap long-term benefits. Such methodologies proactively identify and replace inefficient processes and alleviate unnecessary overhead costs associated with manual operations.

technologies and examine performance management strategies that will accommodate SOX regulations, as well as yield initial and ongoing measurable hard dollar and soft dollar (i.e. improved customer service) benefits.

SOX and Information Technology Operations

Section 404 of the SOX Act establishes guidelines directly related to a company's Information Technology (IT) operations. Management (CEOs and CFOs) must attest to the adequacy and effectiveness of their internal and IT controls, as they are subject to an external audit. In preparation for the audit, companies must identify their significant financial accounts, the

business processes that support those financial accounts, and the applications and IT systems that support those businesses processes. Next, they must document and test controls at the financial process level, the application level, and the IT infrastructure level.

SOX Requirements

Section 404 of the Sarbanes-Oxley Act includes parts (a) and (b). Section 404(a) states that a public company's annual report will contain management's internal control report, which includes:

- Management's responsibility for establishing and maintaining adequate internal control over financial reporting, and
- An assessment, as of the end of the company's most recent fiscal year, of the effectiveness of its internal control over financial reporting

Section 404(b) states that a company's auditors must attest to and report on the internal control assessment made by management. This verification is to be made in accordance with standards issued or adopted by the Public Company Accounting Oversight Board, which the Act established, and is to be performed by the company's independent auditor.

Management's responsibilities are outlined as follows:

- Identify the framework used in internal controls
- Record and report all financial transactions to allow for the preparation of the registrant's financial statements that conform to generally accepted accounting principles
- Evaluate the effectiveness of the company's internal control over financial reporting using suitable control criteria
- Support the aforementioned evaluation with sufficient evidence, including supporting documentation
- Identify special areas that may require more attention or may raise complex issues, such as multiple business units, foreign business operations, or recently acquired businesses

SOX Requirements (cont.)

- Present a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year
- Make no misstatements pertaining to the effectiveness of internal control over financial reporting during the audit
- Properly disclose any material weaknesses identified in the company's internal control over financial reporting, including any material weaknesses corrected during the period or during the audit

In addition, a statement of control must now appear in annual reports filed with the Securities and Exchange Commission (SEC). This statement, issued in the company's annual report to the SEC, must include the following:

- The internal control framework used by management
- Management's assessment of the effectiveness of internal controls
- Disclosure of any material weaknesses found by the auditor

SOX Summary

Although the SOX legislation only legally applies to public companies, many private companies, government agencies, and healthcare institutions also abide by Sarbanes-Oxley standards, in order to build economic stability and maintain a robust reputation in the business world. The SOX Act does not command that companies modify their processes or use technology or software-based controls, but such controls

and re-examination of business processes ease the compliance process significantly by offering a cost-benefit equation that is superior to manual or paper-based solutions. Companies that utilize appropriate software-based controls ultimately save time, distress, and most importantly, money.