



Sustaining Sarbanes-Oxley Compliance

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Agenda

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Introduction

Polling Question

With regard to your knowledge of Sarbanes Oxley, do you consider yourself to be:

- Master
- Generalist
- Beginner

Polling Question

How were you involved in the SOX initiative at your company?

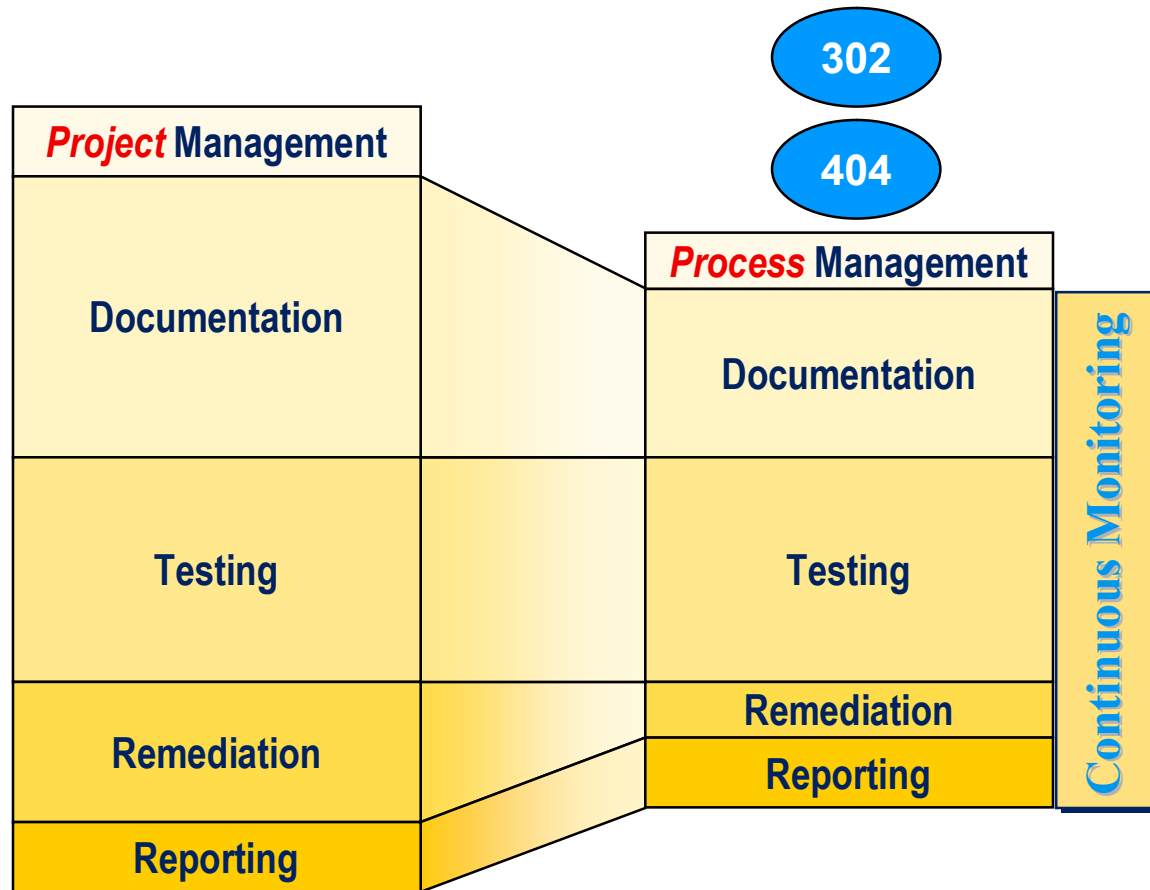
- SOX Project Leader
- SOX Team/PMO
- Management Tester
- Cycle Owner
- Tested
- Other

Polling Question

What would you consider to be the primary consideration of your SOX efforts?

- Reduce Cost
- Reduce Internal Resource Requirements
- Improve the Control Environment
- Automate to Reduce Manual Effort
- Improve Business Processes

The Challenge – Sustaining Compliance



- S404 - The need to re-evaluate the effectiveness of controls - every year
- S302 - Quarterly reporting of significant changes in internal controls over financial reporting requires **active monitoring** of changes--systems, processes, business combinations, people, etc.

Key Challenge – Turning SOX project's into a sustainable process

Key Questions For Sustainability

- How does newly issued regulatory guidance affect our approach?
- How do you move from a Project to a Process?
- How can you reduce the scope and better focus on the risk areas?
- How will you manage and monitor change from a 302 perspective?
- What is the linkage to Internal Audit and other Risk Functions?
- What are the implications for my external audit (timing, relationship, cost, etc.)?
- What tools and enablers are available to eliminate manual compliance efforts?
- How can we make management testing more effective and less burdensome at the same time?
- **Can you really use SOX to drive Operational/Process Improvement?**

SOX Regulatory Update

Overview of Recent Regulatory Direction

- Identify and evaluate **entity-level controls** early in the audit so that the audit strategy might incorporate the benefit of strong entity-level controls
- Lower risk should be reflected in the nature, timing, and extent of the procedures applied by management and auditors (i.e., **risk-based approach**)
- Opportunities to realize efficiencies by using the **work of others** should occur as management continues to refine its approach and those performing the testing become more proficient through experience

SEC Statement - May 16, 2005

- Reasonable assurance (i.e., a high level of assurance), but more flexibility in getting there
- Top down, risk-based approach
 - Avoid giving all significant accounts equal attention without regard to risk
 - Qualitative factors should also be considered in the determination of whether or not an account is significant
- Material weakness does not necessarily exist in every case of restatement resulting from error
- Management discussion of accounting and auditing issues with their auditors is not of itself indicative of a deficiency
- No expectation for testing IT general controls that do not pertain to financial reporting
- Will continue to assess effect of reporting on internal control to smaller public companies and foreign private issuers

PCAOB Policy Statement - May 16, 2005

- Integrate the audits
- Exercise professional judgment
- Top-down, risk-based approach
- Flexibility in using the work of others
- Auditor's ability to provide advice to clients

Top Down Approach

- Start with **company-level controls** and then drive down to significant accounts, significant processes, and finally, individual controls at the process, transaction, or application levels
- Identify, understand, and evaluate the design of company-level controls first because of their **pervasive effect**

Risk-Based Approach

- **Risk assessment** underlies the entire process and has a pervasive effect on the amount of work we perform
- Consistent with the responsibility to plan the audit of internal control so that the risk of failing to identify a material weakness is low
- Risk assessment affects:
 - Identification of significant accounts and relevant assertions
 - Nature, timing and extent of the tests of controls
 - Use of the work of others

Identification of Significant Accounts

- Quantitative measures alone are ***not*** determinative of whether an account should be identified as significant
- Qualitative risk factors should also be considered
 - Those accounts that have only a remote likelihood of containing a material misstatement may be eliminated from further consideration
- The auditor should design control testing strategy to be responsive to his or her assessment of the risk related to the account

Identification of Significant Controls

- Management may identify and test more controls than necessary for the purpose of its assessment of internal control over financial reporting
- Auditor needs to walk-through and test only those controls that are critical to achieving the relevant assertions related to significant accounts

Using the Work of Others

- Reliance on the work of others should be **responsive to the degree of risk** associated with the testing of the area
- The evaluation of whether or not we have obtained principal evidence should be primarily ***qualitative***
- The auditor should perform work in areas that represent higher risk and ascribe more weight to the work performed in those areas

Benchmarking Controls

- Benchmarking strategy for testing automated application controls can be used
- The Auditor may vary from year to year the use of the work of others, the time period over which controls are tested, the number and types of procedures performed, and the combination of procedures used in a particular area

Extent of Management's Testing

- The auditor need not evaluate the adequacy of management's assessment by comparing, on a control-by-control level, whether management's testing was at least as extensive as their own
- Management's testing should be sufficient to support their conclusion (i.e., assertion about the effectiveness of internal controls) but does not need to be approached in the same manner as the auditor

Various Topics

- Question 52—It is inappropriate for the auditor to conclude that management should not implement changes to IT systems for some arbitrary period of time before year-end
- Question 53—A control is not ineffective solely because there is no documentation evidencing the operation of the control

PCAOB Auditing Standard No. 4

Reporting on Whether a Previously Reported Material Weakness Continues to Exist

- Adopted July 26, 2005; will not take effect until it is approved by the SEC.
- Applies when an auditor is engaged to express an opinion on whether a previously reported material weakness continues to exist.
- Board expects that these engagements will be best suited for smaller problems.
- Reporting on material weaknesses that have a pervasive effect on the company's financial reporting could require so much work that the Board anticipates that a company would choose to wait for the auditor's annual audit to obtain assurance that the weakness no longer exists.

Recent SEC Activity: September 21, 2005

- Ruled: Non-Accelerated Filers and Small Foreign Issuers
 - 404 compliance date extended - effective for fiscal years ending on or after July 15, 2007
 - Larger foreign private issuers with over \$75 million market capitalization are still required to comply with Section 404 for fiscal years ending on or after July 15, 2006
- Proposed: Large accelerated filers—companies with more than \$700 million in market capitalization
 - Must file their Form 10-K, including audited financial statements, by 60 days after their fiscal-year end (75 prior)
 - Form 10-Q deadlines for all accelerated filers would remain at 40 days after each fiscal quarter end
 - The SEC proposal would not affect non-accelerated filers; for them, Form 10-K is due 90 days after fiscal-year end and Form 10-Q is due 45 days after quarter end

PCAOB Chairman McDonough Resigns

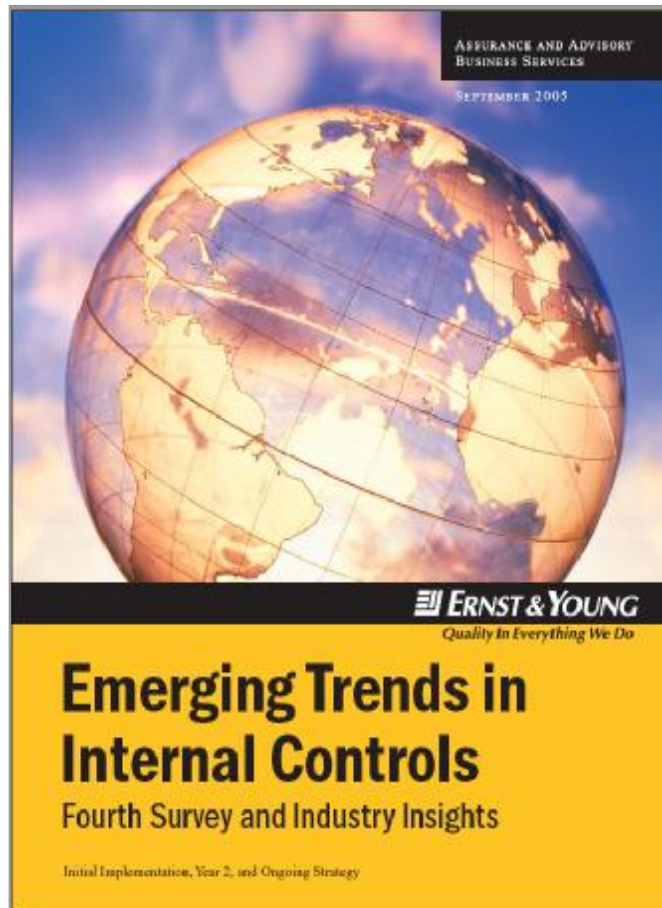
September 23, 2005

- Regarding his future plans, Mr. McDonough added: “I have a wide range of interests in corporate governance, finance and international affairs and will explore one or a variety of activities in those fields; I enjoy perfect health and have not the slightest interest in retiring, now or ever.”
- Impact TBD

Ernst & Young 404 Survey Results

Emerging Trends in Internal Controls

A Valuable Reference

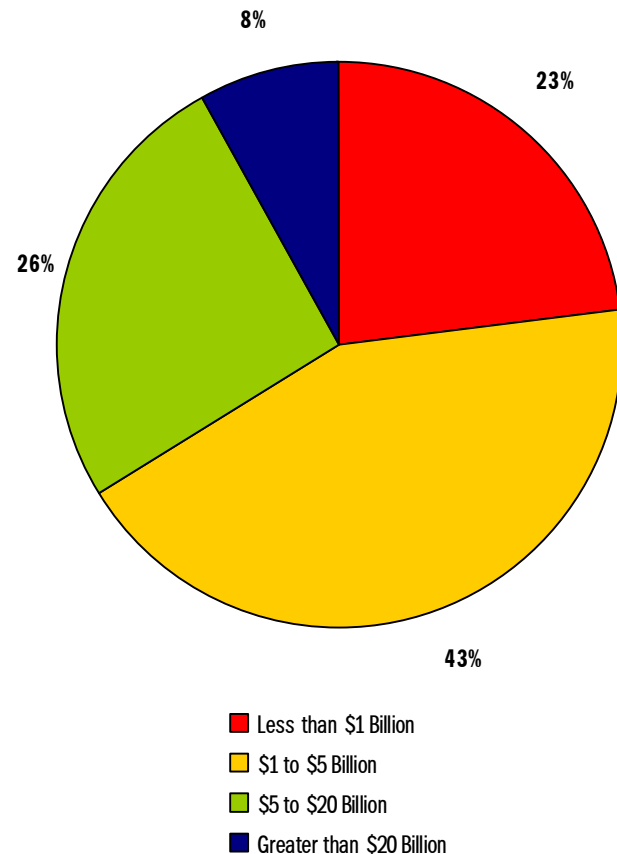


- Issued May 2005
- A valuable reference for audit committees, chief executives, 404 program managers, controllers, internal audit directors, etc.
- Relevant in 2005, 2006 and beyond
- 131 pages
- 19 industry sectors
- Covering
 - Initial Implementation
 - Year 2 Considerations
 - Ongoing Strategy
 - Significant Account Considerations (by Sector)
- Available through:
 - Dan Craft - 248-457-3915
 - Your local Ernst & Young representative

Emerging Trends in Internal Controls

Survey 4 Overview

Annual Revenues of Companies Surveyed (\$US)



- Over 250 accelerated filers
- Spans 19 industry sectors, companies of varying sizes
- **Survey data collected in May and August 2005**
- Respondents included company executives, E&Y engagement team members
- 40 pages of observations, lessons learned, and emerging practices for Years 1, 2, and beyond
- Relevant for non-accelerated filers and U.S.-listed foreign private issuers

Year 1 Overview

- **Many opportunities to enhance controls over financial reporting were revealed and addressed... although the effort was larger than most anticipated.**
 - Over one-fourth of companies with revenues greater than \$5 billion remediated more than 500 individual controls prior to initial compliance.
 - Over 70% of companies conducted significant remediation of IT systems and controls prior to initial compliance.
 - Among 70% of companies, Section 404-related costs were over 50% higher than original estimates.

Year 2 Considerations

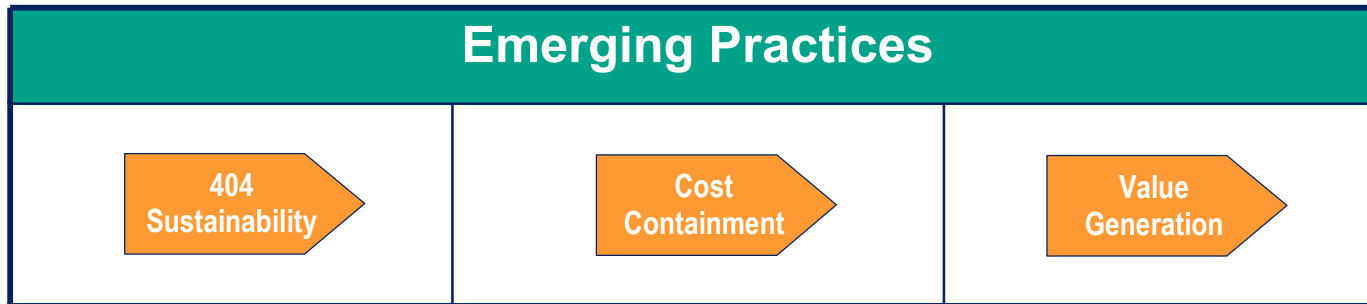
- **It's still big...continuing to challenge resources... particularly near year-end.**
 - Over 80% of companies still expected to test 75% or more of the controls identified in Year 1.
 - 58% of companies with revenues less than \$5 billion will dedicate more than half of all internal audit resources to Section 404-related activities.
 - A significant portion of Year 2 management testing will be performed in Q3 and Q4, including entity-level controls.

Ongoing Strategy

- **As companies move forward, sustainability and value will be key points of interest.**
 - 76% of companies anticipate using some form of control self-assessment (CSA) to support ongoing Section 404 compliance.
 - 53% anticipate deploying an enterprise risk management (ERM) program within one year.
 - 87% anticipate value simply through the enhanced accountability and ownership of controls promoted by Section 404.
 - A risk-based, top-down approach to establishing scope and testing strategies should help reduce required hours, although the shift may require several years to fully implement.

Emerging Trends

Approaches to Reducing Cost & Enhancing Value



1. Optimization of Key Controls
2. Optimization of Application Controls
3. Implementation of Continuous Control Monitoring
4. Control Redesign
5. Process and System Rationalization

Optimization of Key Controls

The **number of key controls** identified across your business processes has a significant impact on the scope of management's and the external auditor's testing. Testing **right** controls is what's important.

Optimization of IT Application Controls

IT Application Controls, when operating effectively, typically provide **more effective risk mitigation and are more efficient to test** (sample size and leverage). The ability to leverage such controls can significantly reduce costs.

Control Redesign

In effort to comply with SOX in **Year #1**, many **companies relied on or implemented inefficient controls**. These controls are typically more expensive to operate and test. A rigorous process should be deployed to redesign such controls to enhance their effectiveness and efficiency.

Continuous Control Monitoring

Continuous control monitoring is defined as the process of **identifying exceptions to business rules or policies on a “real time” basis.** Continuous monitoring may provide a **more efficient and effective** approach to addressing certain types of key controls.

Process or System Rationalization

Complexity and lack of standardization have a significant impact on the cost of compliance. Reducing complexity in processes and moving towards standard systems and processes enhances the overall effectiveness of the control environment and reduces the cost to comply with SOX 404.

Questions and Answers

Thank-You,

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