SOX Insights

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Plan Early: Know and Understand Requirements to Implement a SOX Program

FOR NEWLY PUBLIC OR SMALLER ORGANIZATIONS, conducting Sarbanes-Oxley related activities in-house may be overwhelming and impractical.

In such instances, developing a compliance plan, assessing related risks, devising controls, and maintaining documentation or other necessary activities can be outsourced to attain efficiency and optimize internal resources.

The professionals on Weaver's Risk Advisory Services team can assist you in evaluating your SOX sustainability to help improve the internal control structure of your organization. A well-designed SOX program provides management with peace of mind that operating policies are being followed. It is a sound monitoring practice and is a part of good corporate governance.

Whether your business is facing year one of SOX compliance or working on year two and beyond, focusing on remediation, sustainability and scalability allows compliance to become a process that is maintained–and not recreated–from year to year.

By fine-tuning and nurturing SOX compliance throughout the year, you can:

- Effectively manage the project scope
- Avoid potential unforeseen difficulties
- Approach SOX compliance as an on-going process

What Are the SOX Requirements?

THE SOX ACT REQUIRES PUBLICLY TRADED COMPANIES to provide an annual attestation of the adequacy of design and operating effectiveness of internal control over financial reporting. Depending on the size of your company, you may also be required to obtain an opinion from your external financial statement auditor on the design and effectiveness of controls. These requirements are specifically described in sections 404(a) and 404(b) of the Act.

404(a) – Management's Assessment

Management must establish a system of internal control over financial reporting and annually attest that the system of control is adequately designed and operating effectively. This attestation requires that the company's officers, typically the CEO and CFO, sign off on the effectiveness of controls as of the financial reporting date, which is included in the company's 10-K filing.

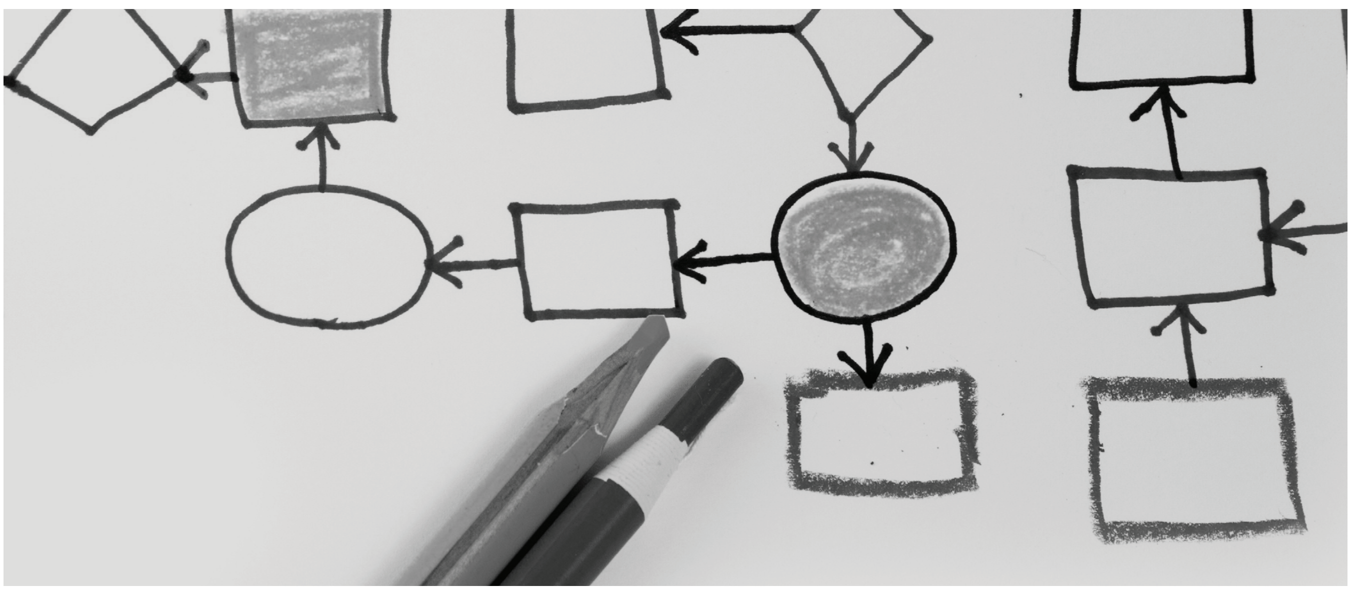
Establishing the control system in the initial years following the IPO can be time intensive and require a cultural change in the approach to executing day-to-day activities from how they were performed as a private company.

Starting early is critical in developing management's assessment. Under current requirements, management's assessment must be included in the company's second annual report (10-K) following the initial public offering.

404(b) – External Auditor's Assessment

This section of the Act establishes the requirements for some companies, based on their size, to undergo an integrated financial statement audit, which includes both an opinion as to the material accuracy of the company's financial statements, as well as the design and effectiveness of internal control over financial reporting.

The external auditor's assessment can be rigorous and costly. Developing a SOX implementation plan that contemplates if and when a company may become subject to the integrated audit requirements of 404(b) is critical. The primary determining factor for companies that are subject to the integrated audit requirement is called "filing status". Historically, publicly traded companies that are classified as Large Accelerated or Accelerated filers are subject to an external audit of internal controls beginning with their second annual filing.



Large Accelerated Filer

= $700 Million aggregate worldwide market value of voting and non-voting common equity

Accelerated Filer

= $75 Million or greater, but less than $700 Million

Recent legislation has provided a reprieve for newly public companies and extended the timeline for which companies may prepare for an integrated audit.

In April 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law. Under these new guidelines, a company may file for status as an Emerging Growth Company (EGC), which provides a 5-year exemption to the integrated audit requirements of SOX 404(b).

A company can maintain its EGC status and integrated audit exemption for five years after its IPO date unless the following are triggered:

- Annual gross revenues equal or exceed $1 Billion
- Non-convertible debt issued over the previous three-year period exceeds $1 Billion
- Achievement of Large Accelerated filer status

The benefits for extending this deadline can be significant as management will have more time to prepare for this step and adequately train employees. Preparing for an integrated audit in a short window is likely to substantially increase the cost of compliance as well as the likelihood for errors and un-remediated deficiencies.

Developing a SOX Compliance Program *

1. Start Early – Implementing a SOX compliance program can be a large undertaking, especially in the initial years of being a public company. Starting early enables the company to integrate changes over time. Even companies with a mature SOX program must revisit their plan annually and evaluate changes for the current year.

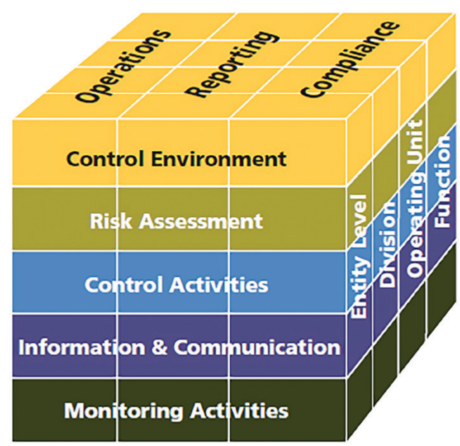
2. Develop a Plan – SOX planning should include both short-term (current year) and long-term goals for changes expected in subsequent reporting years. Know where you stand in the timeline of compliance based on filing status so you can plan for management's assessment and, if necessary, an integrated financial statement audit.

** The extent to which these steps must be performed and implemented is subject to management's discretion in years where they do not have an integrated audit requirement.*

Coordinating efforts with your external auditors is a critical part of the planning process. For companies that are currently subject to an integrated audit or will become subject to one soon, having discussions with your auditor about areas where they can rely on work performed by management's assessment can go a long way to reducing audit fees in total.

3. Identify a Framework – The company must establish a framework as the basis for its assessment of internal control over financial reporting. The most commonly used framework is the COSO Integrated Internal Control Framework, most recently updated in 2013. A framework will provide an underlying methodology for developing and accessing controls.

The COSO (2013) framework takes a risk-based approach, which is the most widely accepted and effective method for assessing internal control.



4. Conduct a Risk Assessment – Identifying the significant processes that are in-scope for SOX is a critical step in the process. This is traditionally accomplished by identifying key financial reporting processes and assessing their inherent risk based on materiality, transaction volume, complexity and fraud. The results of the risk assessment will be used to determine the nature and extent of procedures required to implement and evaluate internal controls for each significant process.

5. Assess Entity-Level Controls – Developing an understanding and evaluating the underlying control environment of the organization is a key step in assessing internal controls. Identifying and implementing entity-level controls that ensure specific cultural, strategic and organizational activities are in place to support process-specific control activities is a foundational component of the control environment.

Internal control is defined as a process effected by an entity's board of directors, management and other personnel, and is designed to provide reasonable assurance regarding is the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

6. Document Significant Processes and Key Controls – Financial reporting processes identified as in-scope for SOX should be documented and evaluated for adequacy and coverage of the internal control design. The process documentation should provide a clear depiction and understanding of the flow of transactions within the process, the separation of responsibilities between the individuals involved in the process, as well as the impact of the process on financial statements and reporting. Controls for each of these processes should be identified and mapped to relevant financial statement assertions and risks, including fraud.

7. Assess IT General Controls – Identification of the IT systems and applications that impact financial reporting processes is a significant step in developing a SOX program. IT general computer controls should be evaluated and implemented to cover the company's network, significant applications and underlying databases. Additionally, properly designed IT general controls will provide validation and support electronic data and reports used in financial reporting and the performance of key controls.

8. Identify Third-Party Service Providers – In some instances, the company may find that significant financial reporting processes have been wholly or partially outsourced to a third party. In these instances, the company must assess the adequacy of the third party's internal control, typically by reviewing a Service Organization Control (SOC) report. The evaluation of a third-party's internal control should include both business / financial considerations, as well as IT controls and processes. If a SOC report is not available, then the company must implement sufficient controls to review and validate outsourced activities.

9. Test the Effectiveness of Internal Controls – Upon completing a thorough design evaluation, the company should test controls to verify they are operating effectively. Both management's and the auditor's assessments require an attestation as to the effectiveness of internal control. Selecting key controls within each process for testing and ensuring that they are operating as designed is required to attest control effectiveness.

10. Evaluate the Significance of Identified Deficiencies Control deficiencies can be identified during the design evaluation or during effectiveness testing. In both instances, management should have a process to evaluate the significance of identified deficiencies. Significant deficiencies must be reported internally, and material weaknesses must be disclosed in the 10-K.

11. Communicate Results – The results of SOX procedures should be communicated routinely to the members of senior management responsible for financial reporting oversight, as well as the company's Audit Committee.

What is New for SOX?

THE SARBANES-OXLEY ACT has been in place in since 2002, but recent guidance has resulted in modifications to the historical approach to assessing internal control over financial reporting, including PCAOB Audit Practice Alert No. 11.

In response to an increase in the volume of failure ratings detected by the PCAOB during their inspections of integrated audits, Audit Practice Alert No. 11 was issued in October 2013.

Due to the PCAOB's inspection results, we have seen a significant shift in the external auditor's focus from substantive procedures to internal controls; and specifically, on management review controls and system generated data and reports.

1. Management Review Controls – The sufficiency of design and operating effectiveness tests over management review controls has been drastically increased in response to the PCAOB's findings. Under current guidelines, management review controls must be documented to a high level of precision. While the actual performance of most management review controls has always been more robust than what is represented or documented for SOX purposes, the current expectation is that all actions and considerations should be documented.

In addition to expanding the precision of the control documentation, management will be expected to demonstrate that each attribute defined within the control activity was performed. Independent re-performance of the attributes is not considered sufficient to determine that the control is operating as designed; therefore, management needs to document each element of the review. For instance, management may need to include tickmarks or notations to indicate that the reviewer performed each attribute (e.g., footed the reconciliation, tied ending balance to trial balance, etc.).

2. System Generated Data and Reports – The sufficiency of test controls over system generated data and reports that support important controls was the second area of focus from the PCAOB. As a result, there is an enhanced expectation for management's control activities to include procedures to verify the completeness and accuracy of system-generated data used in the performance of significant processes and key controls.

This includes the use of spreadsheets, which has created in many companies a requirement for additional review procedures and evidence of review to ensure that spreadsheets are based on valid data, calculating correctly, and linking to accurate information.

How Do We Maintain SOX Compliance?

SOX COMPLIANCE can become an embedded element of normal business operations, extending beyond greater financial reporting accuracy and continual compliance.

SOX is a continual mandate with requirements that must be met year after year.

Sustaining compliance without overextending available resources requires approaching SOX as an ongoing process that is maintained–and not recreated each year.

To keep your SOX universe spinning, each company should identify remediation needs, promote continuous improvement and ensure the same weaknesses do not continually present difficulties. By devising and implementing remediation strategies, compliance efforts can be effectively and efficiently sustained.

What This All Means to You

A TOP-DOWN, RISK-BASED APPROACH focuses on the controls necessary to prevent or detect material misstatements. This approach presents the opportunity to focus the company and its auditors on what is most important and what most impacts the company and its investors. Organizations benefit by reviewing and improving their entity-level controls and risk management processes.

As organizations grow, compliance efforts must be scalable to accommodate that growth or any other change. Making compliance a scalable process requires embedding controls and accountability for compliance throughout the organization.

In addition, by working with the external auditors, companies can focus on fewer key controls and reduce testing, directly impacting their compliance costs. The business benefits from improved risk management will result in enhanced overall organizational performance.

The Risk Advisory Services team at Weaver understands the importance of sustaining compliance and ensuring your company's investment reaps benefits for your organization. We can assist your company in maintaining effectiveness of your internal controls, complying with disclosure controls requirements, integrating internal control testing and internal audits, and leveraging the company's overall SOX investment.

How Can Weaver Help?

THE RISK ADVISORY SERVICES TEAM at Weaver has extensive experience in implementing SOX programs within a vast array of businesses. We can help a new public company develop and implement a SOX program, as well as assist in the development of an initial or ad-hoc SOX program into a mature function.

Weaver can enhance your SOX effort in a co-source manner by assisting other internal individuals with implementation, or by owning the SOX effort through full outsourcing. In either model, we would assist the organization with:

1. Developing a Plan and SOX Strategy

- Select a champion for the project
- Organize the committee/project team
- Develop a project plan with short-term and long-term goals

2. Preliminary Risk Assessment

- Define expectations
- Identify business processes and risks
- Solicit management's concerns

3. Evaluation of Controls

- Identify how management is controlling risks
- Identify business control processes
- Assess the control environment
- Communicate and validate issues
- Define the testing strategy

4. Measurement of Effectiveness of Controls

- Execute test programs
- Evaluate transactions
- Analyze the results
- Conclude on sufficiency of the control environment

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**For SOX services,
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