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Sarbanes-Oxley

Smart Companies Are Figuring Out How to Find the Silver Lining

Complying with the Sarbanes-Oxley Act of 2002, though still a significant challenge is also a way to effect much-needed change throughout your company. Our group of SOX players gathered to note the trials and tribulations of compliance efforts. Their consensus, excerpted here, may surprise you.

How have the realities of SOX compliance matched expectations?

Lee Dittmar: As year one ended, we expected companies to undertake improvements to make compliance easier, make their controls better, and address the efficiency and effectiveness opportunities. Instead, we observed almost a slowing-down of activity after the first attestations cycle. People had worked very hard, literally for years, to comply with Section 404 of Sarbanes-Oxley, and there clearly was a lot of fatigue. Over time, though, people started to realize that, "If we keep doing what we're doing, we'll keep getting what we're getting." As a result, we've seen an increase in the amount of effort around the improvement of controls, streamlining of compliance programs, and a significant focus on the scope of the 404 assertion and attestation.

How are companies moving from theory to a more practical application?

Stephen Masterson: In year one, everyone was trying to understand what the Sarbanes rules were. The Securities and Exchange Commission hadn't given a lot of guidance, and there was a lot of interpretation from the auditing firms. But the industry erred on the side of "more is better." Over the last year

or two, management has begun asking, "What are the laser-focused risks for financial reporting?" And today companies are automating the control environment, because a manual control environment is never going to be efficient in this new world of internal control reporting.

Sun Microsystems has had a lengthy journey toward compliance.

Ira Bloom: Because of our June 30 fiscal year end, we were expecting to be in the first wave of compliers, so we had to get up and running very quickly. It was immediately communicated by senior management that this was our number one priority. Right away we realized that our process documentation was of inconsistent quality, so we hired a Big Four firm to help document our processes, while mobilizing our finance and IT organizations to participate in both documentation and testing of controls. Then, in February of '04, the implementation date was postponed. Although we continued to remediate and test the most important controls, we focused on designing the next fiscal year's program. We concentrated on making the compliance process itself more manageable and predictable. It wasn't until planning for our current fiscal year that we could focus on reducing the number of key controls, and so our workload in year one was still enormous for everybody.

For a podcast of the complete roundtable: <http://www.deloitte.com/us/consulting>

Do companies need to rationalize these controls?

Dittmar: Yes, companies have to take a hard look at the opportunities to make their controls more efficient and more effective. This is traditional re-engineering work — good old process re-engineering. Companies now need to look at their controls through a risk-based lens: what really matters, what are the risks, what are the things that could go wrong, and what's the most efficient and effective way to address the risk? That takes work, expertise, time, and effort. But in the end it can and will reduce costs, increase the effectiveness of the controls, and improve the quality of the financial information produced by the organization.

How is technology supporting compliance efforts?

Renee Lorton: After the scramble that customers went through to achieve their Section 404 goals, they have a mountain of data about business controls to sort through and make sense of. So we're seeing our customers use business intelligence capabilities like planning, reporting, analysis, or scorecarding on top of this data to get their arms around this immediate challenge. Customers need the ability to sort through the complexity of this multidimensional challenge in order to intelligently reduce the number of controls, to find out where they're over-controlling and testing too many controls, and where they have possibilities of re-engineering their processes for compliance efficiency and productivity.

What is the state of the market for tools?

Masterson: We're entering an era where some software tools that manage, track, and test the controls and automate the internal reporting of control results are starting to be very good. In year one, not all of the tools were as good as they are today. Over the last two years, software companies have spent a lot of time refining and enhancing the tools and fixing problems. Now the tools are becoming much better.

It's not just large companies involved in Sarbanes-Oxley compliance.

John Hagerty: No, the next wave of companies who will be addressing this for their first year will be foreign registrants — companies based outside the U.S. that trade stock or issue debt here. Then we still have small-cap companies, those firms that are \$75 million or less in market cap, whose deadline has been pushed out further and further. I know there's a lot of conversation right now to figure out what this might mean to small companies.

Gerry McGrath: There are smaller companies that will not pursue 404 compliance efforts. They will seek to go private or go dark — in other words, remove the SEC reporting obligation and, accordingly, the obligation to have to comply with Section 404. They admit in their SEC filings that the cost of compliance is too great. Also, some accelerated foreign private

issuers are running into the 404 obligations for fiscal years after July of this year. They are looking hard at whether they can take actions to remove themselves from SEC reporting obligations.

How much will companies spend on compliance going forward?

Hagerty: What we heard is that, by 2007, about \$28 billion is going to be spent on compliance overall. What that brought to the forefront is that compliance is everywhere in an organization — the way you make products, the way you deliver products, what you tell people or can't tell people, privacy issues, and so on. It's everywhere.

What business benefits are companies gaining from SOX compliance?

Hagerty: Streamlining of business processes on both the business and IT sides has been the key benefit of compliance so far. But they're also getting better quality — both better-quality products as well as better quality of information; a more secure environment; better visibility into operations. Compliance is becoming the lever that will force other change in the business.

Has Sun also experienced significant benefits?

Bloom: Yes, our teams are executing their processes and performing controls better. We're seeing fewer deficiencies in our testing this year than we saw year one. In general, people are getting smarter about process and internal control design, with control considerations being addressed much earlier than in the past. Additionally, a lot of work is taking place to address long-standing process inefficiencies that were previously not considered high priorities.

Ed Glover: From an IT side, one of the benefits of our early SOX efforts resulted in identifying some of the hidden issues left over from our evolving organizational structure and legacy processes. It became very apparent why certain processes or lack of documented processes were causing failures. We were able to streamline our processes and organization, which resulted in the IT organization becoming more efficient and effective in developing and implementing solid processes with strong controls built in. Another benefit of our SOX efforts was to understand how SOX fits into our new initiatives and projects. The IT SOX team is now being asked to participate in our major business/IT initiatives to make sure that controls are being built into the architecture, instead of bolted on later. I'm seeing a much closer cooperation among the groups within the IT and business organizations. This will result in improving our business/IT processes and internal control framework within both organizations.

Are there benefits from creating a better partnership between CFOs and IT?

Lorton: Yes, there is a direct association between the CFO's goal of achieving compliance excellence and the CIO's goal

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of automating and making the organization more efficient. CFOs need to reach beyond the walls of finance to other functions in the organization. If you're in a large organization, you can't just do that by relationship. You have to depend on systems infrastructure to pull functions together to support cross-functional processes like budgeting and planning, performance measurement, and management of the organization.

So there can be a performance dividend?

Lorton: Yes, absolutely. We have one customer that unearthed the fact that they have 42 different ways of achieving the same process globally in their organization. Think about the efficiencies they'll achieve now by narrowing this down to one common process. So much of the challenge of Sarbanes-Oxley is ending in a performance dividend, with very good results for organizations and business in general.

How great is the need for change management?

Masterson: We need a process so that each month, each quarter, if we change significant key controls in the business units or in the processes, those changes are elevated through a reporting mechanism. That way, in the assessment of internal controls and the certifications that CFOs and CEOs make quarterly and annually, they know what those changes are. We need a similar change control process or a notification process of change for internal controls over financial reporting similar to what we do in the IT world.

Anything new that executives should consider?

McGrath: One important development should keep people focused on the importance of this issue. The SEC recently announced it has settled an enforcement proceeding against a public company for violating requirements relating to internal controls over financial reporting. The company admitted that it violated the internal control over financial reporting requirements due to, among other things, failure to maintain appropriate accounting practices. The announcement shows the SEC is very focused on this issue, and, hopefully, it encourages companies to continue compliance efforts.

What is AMR's best advice going forward?

Hagerty: Use technology judiciously. Use it to automate those activities that will become more mundane, but also to balance the investment to improve your business and meet compliance requirements. If you can streamline activities in terms of business systems and/or business processes, that's a great benefit of compliance.

The benefits are clearly significant.

Dittmar: Absolutely. Compliance forces you to look at your data, your processes, and your systems related to the turning of data into financial information. Good controls and high-quality information are good business. This is a way to turn the focus away from mere compliance costs and to really leverage the compliance efforts — to improve the value of the business and the performance of the business and to increase overall enterprise.

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