AFP® Annual Conference

ORIGINAL ESSENTIAL UNBIASED INFORMATION

Association for Financial Professionals®

Rationalizing SOX Controls

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When SOX began

A lack of transparency in the financials and a view that senior management was not involved enough in ensuring the accuracy and completeness of their financial situation

Requires:

- Documenting controls
- Management representation on controls
- Auditor review, testing, and sign-off on controls

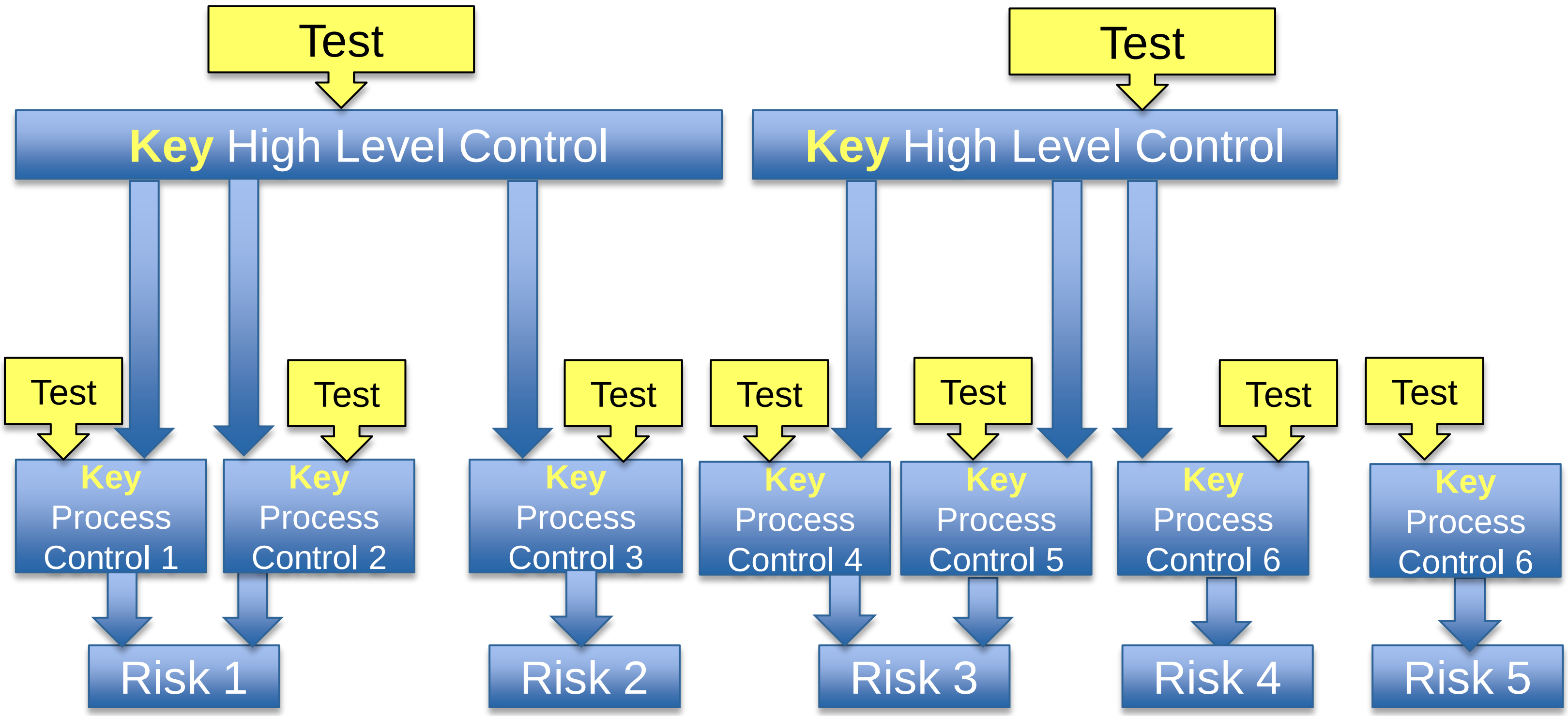
Initial Implementation

- **When enacted, there was no roadmap for implementation. Each company implemented differently.**
  - Intent of bill was to require companies have processes and controls in place to ensure accurate financial statements
- **Companies used a bottoms up approach to implementation**
  - Process-focused
  - Financial Risk-focused rather than reporting-focused

The issues of initial implementation

- **Approach was bottoms up**
- **Key control structure addressed financial risks, not reporting risks**
- **Internal Audit departments focus solely on SOX compliance efforts**
- **Too many key controls that did not effectively address specific financial statement risks**
- **Low percentage of reliance on Internal Audit work by external audit firms in the beginning because no concrete road map existed.**
- **RESULTS:**
  - Manually intensive
  - Costly

Initial implementation



Most controls were considered "key"
There were multiple key controls for each risk

Changes in 2007

- As a result of feedback from companies regarding cost and administration, the Government made changes to SOX in 2007
- Moved to a financial statement risk-based approach

Difference between Risks

Original Implementation	Current risk-based approach	Treasury mindset
•Process driven •Financial Risk focus	•Risks to proper financial reporting at the *assertion* level	•Safeguarding of assets •Financial Risk – risk of loss

SOX was meant to address financial reporting risks, but Treasury also must address financial risks

Key controls from a reporting standpoint may not be key controls from a financial risk standpoint

Steps along the way

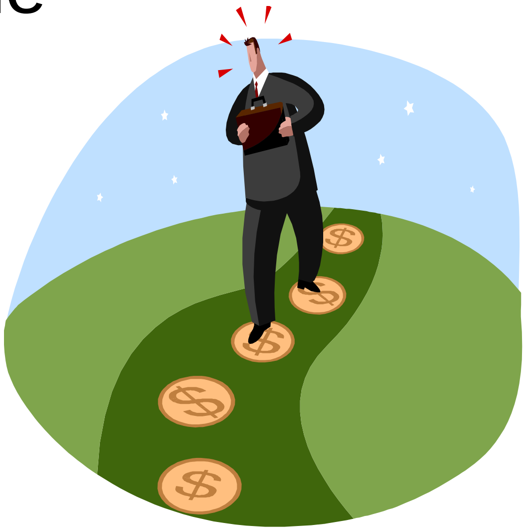
- Take a strategic focus of key controls around specific financial statement risks – starting point is the financial statements
  - Assertions
    - Completeness
    - Existence or Occurrence
    - Valuation
    - Rights & Obligations
    - Presentation & Disclosure

Steps along the way

- Top Down vs. Bottom Up Key control focus
  - Higher level monitoring of key controls within the business
  - Optimization – reliance on higher level company wide controls that set the tone of the organization from top down. (need examples)

Steps along the way

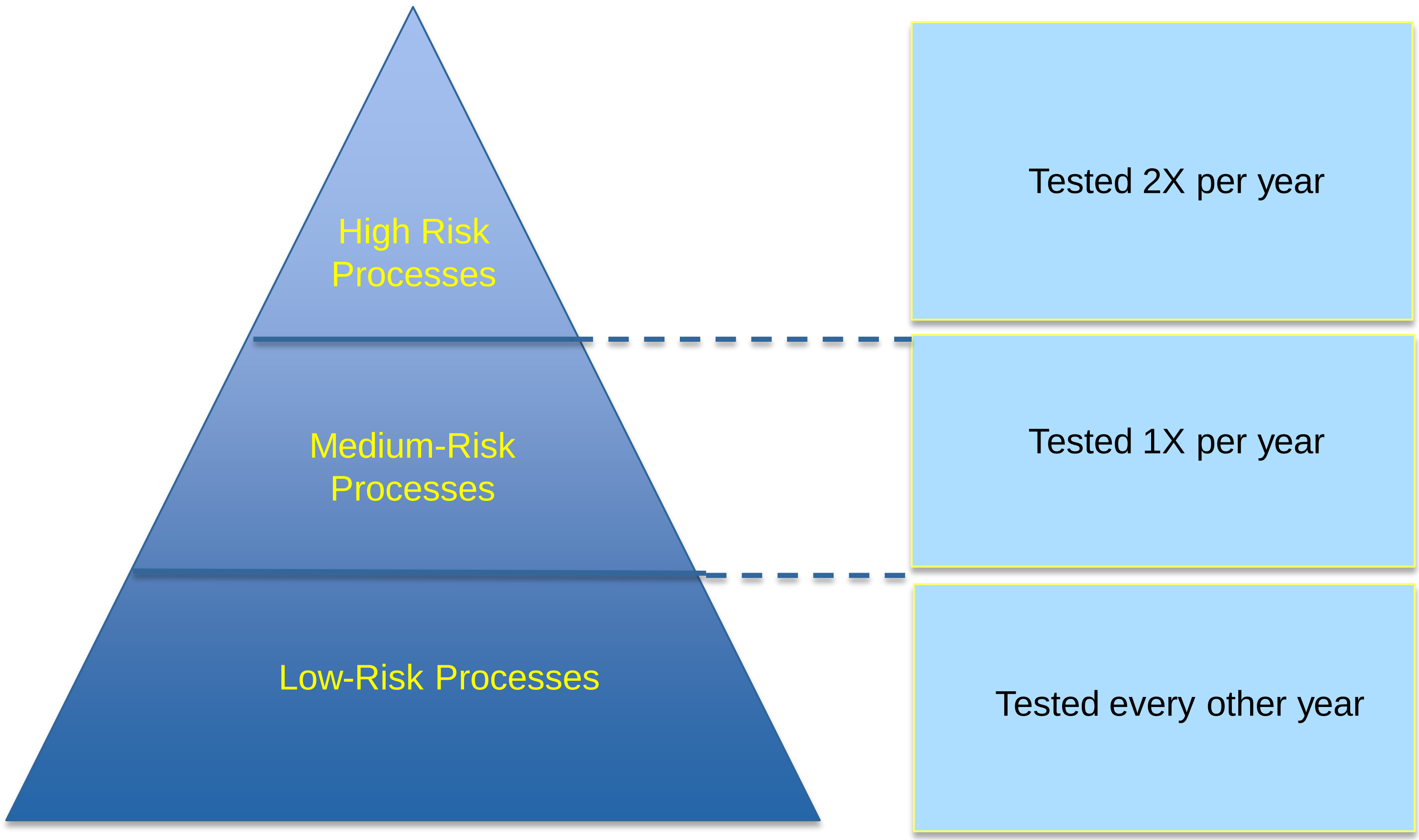
- Understand controls as being
  - Manual vs. Systematic
  - Routine vs. Non-Routine
  - Predictable vs. Non-Predictable



Steps along the way

- Prioritize key controls depending on level of management estimates involved
  - Example: if a key control is reconciliation, prioritize accounts with the highest volume and impact

Risk-Rated SOX Process Testing



SOX control view

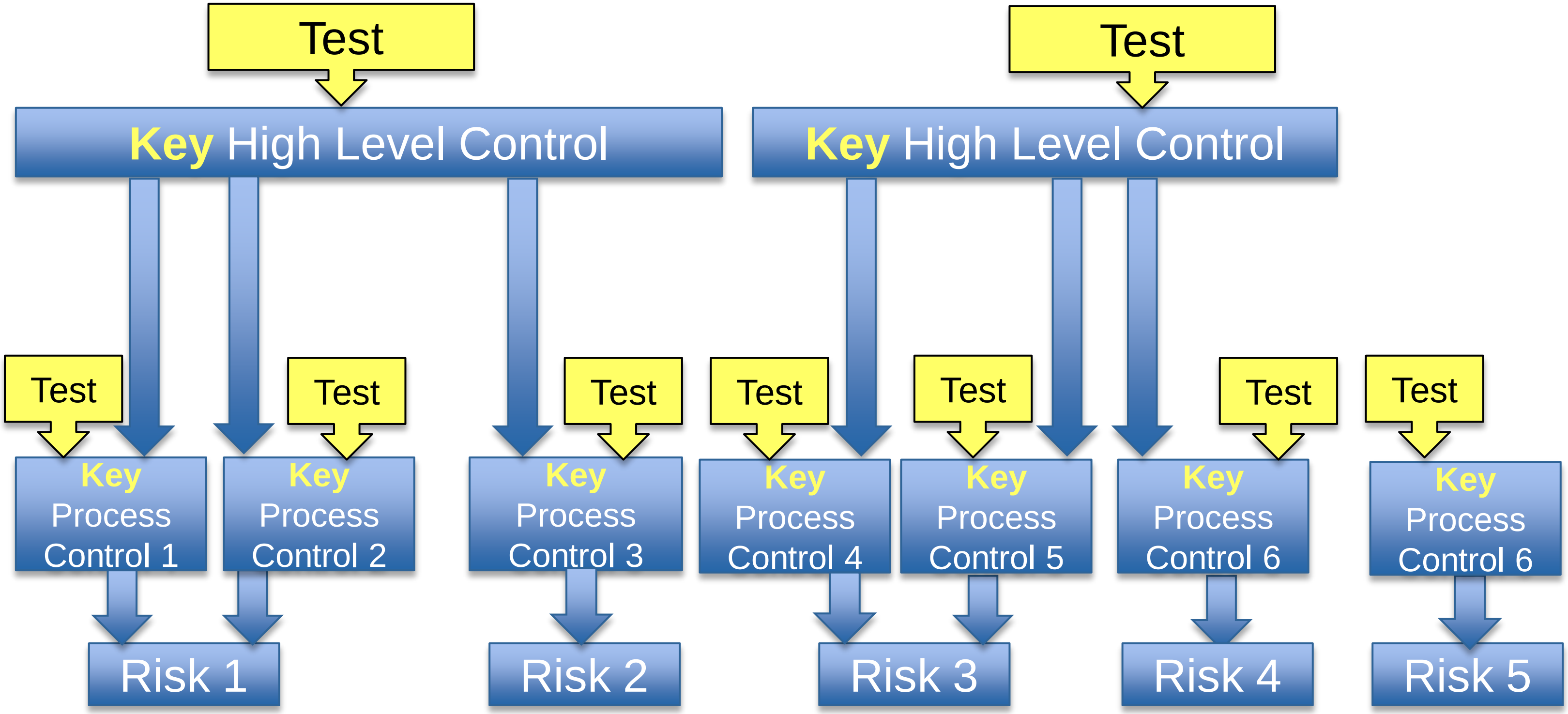
- Financial Reporting Risk - risks of a material misstatement
- Entity Level Controls reduce the risk of financial misstatement
- Automated controls improve efficiency
- Testing on basis of the strength of entity level controls

Signals – Company should reduce SOX key controls

- Company has a lot of process level controls that are "important"
- No or few ELC's
- High number of testing hours
- Company has recently or plans to change its organization structure or processes
- Manages SOX as a project, not a process
- Operates in a highly regulated industry

The Result……………………….

Initial implementation



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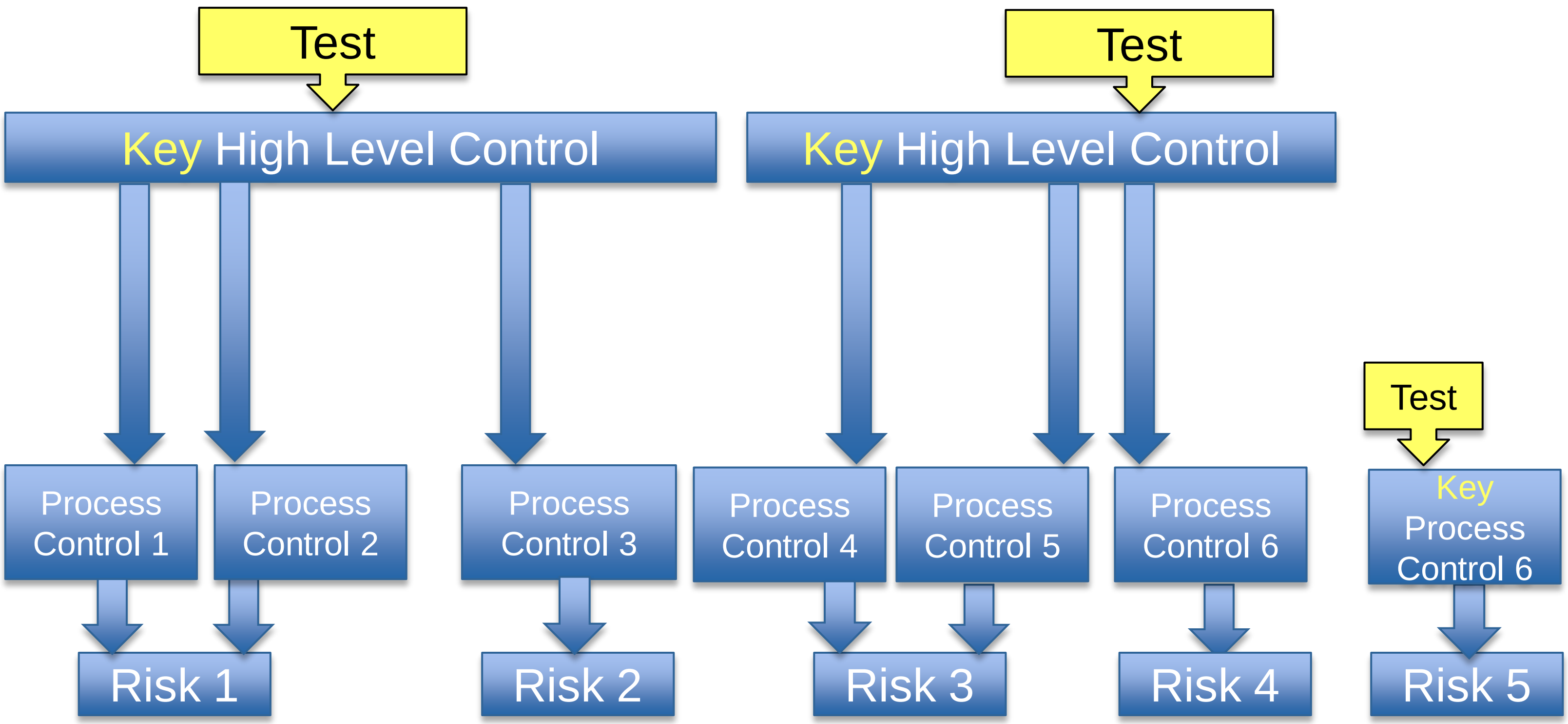
Re - implementation



Treasury Risks

- Financial data contained within the Treasury systems is not complete, accurate, or appropriate
- Financial data in respect of cash receipts and payments and loan movements in the GL is not complete accurate, or appropriate
- Payments made/processed are not complete, accurate, or appropriate
- Inappropriate or invalid Treasury transaction deals executed with 3rd parties resulting in misappropriation of business assets
- Inappropriate or inaccurate hedge accounting
- Inadequate financing facilities exist at year end to support a company's going concern assumption

Example: Banking/Payment Controls

- Bank mandate/resolution defining authorities
- Bank mandate/resolution authorizing opening/closing/amending account
- Segregation of duties – initiation, authorization, processing, recording and reporting
- Authorized wire personnel review wire requests for proper approval
- Each wire template is approved and signed off by the Treasurer or Controller
- Access to wire system is limited to authorized users
- A daily bank balance reconciliation is performed by Treasury
- All instructions in respect of payments must be executed in line with the pre-determined bank execution instructions
- The Treasury reports are reviewed prior to submission to Financial reporting
- Bank reconciliations are reviewed by the Director-Financial Reporting

- Entity Wide Control: a set up policies and responsibilities exist which have been approved by the board
- Independent deal matching on all 3rd party trades
- Management review- on a weekly basis, an activity audit report is reviewed by the controller
- Management review-SAS70/SSAE16 is obtained on systems annually

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11 Key Controls!

Example: Banking/Payment Controls – After Optimization

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7 Key Controls

Example: Debt/Compliance Controls

- **The Board approves all proposed issuance of new debt instruments**
- **When plans/forecasts are completed, Treasury runs proforma financial covenants**
- **A Transaction Approval Request is submitted to and must have prior approval by Treasury. The TAR lays out the details of the transaction for evaluation regarding the company's ability to enter into the transaction given restrictions in the debt agreements.**
- **Each quarter, representations roll up from each legal entity to each country director to each regional director to Treasury.**
- **Each quarter, the Compliance Committee meets and the Director of Compliance presents the status of compliance with covenants and restrictions**
- **Each quarter, a compliance certificate is sent to the banks/trustees representing compliance with the covenants and restrictions**

Which are key?

Example: Debt/Compliance – Before optimization

- The Board approves all proposed issuance of new debt instruments
- When plans/forecasts are completed, Treasury runs proforma financial covenants
- Prior to execution of any transactions (debt, leases, liens, investments, etc) a Transaction Approval Request is submitted to and must be approved by Treasury laying out the details of the transaction for evaluation regarding the company's ability to enter into the transaction given restrictions in the debt agreements.
- Each quarter, representations roll up from each legal entity to each country director to each regional director to Treasury.
- Each quarter, the Compliance Committee meets and the Director of Compliance presents the status of compliance with covenants and restrictions. (EW)

Which are key? 4 of 5

Example: Debt/Compliance – After optimization

- The Board approves all proposed issuance of new debt instruments
- When plans/forecasts are completed, Treasury runs proforma financial covenants
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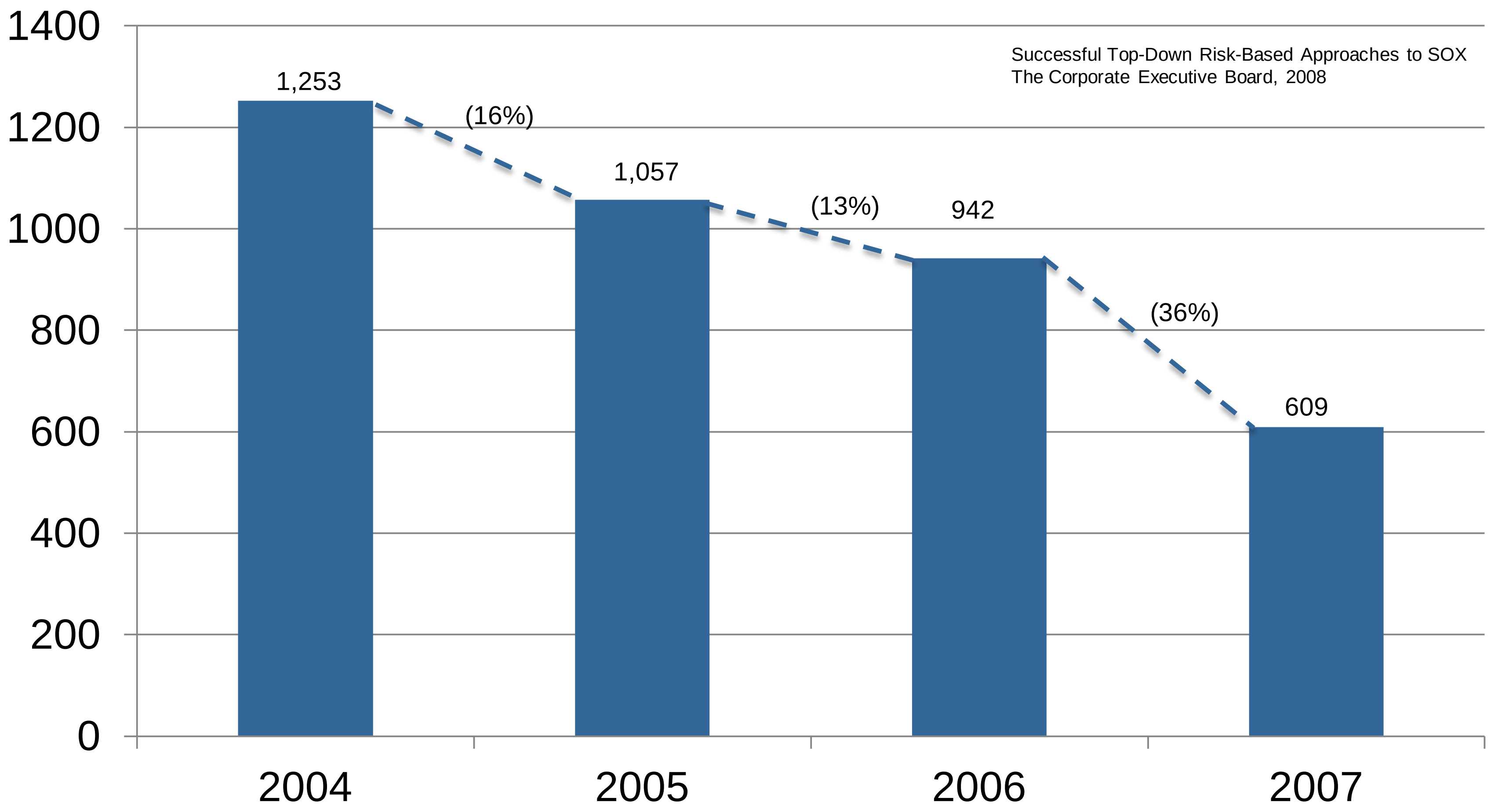
Which are key? ONLY 1!

Number of key controls tested



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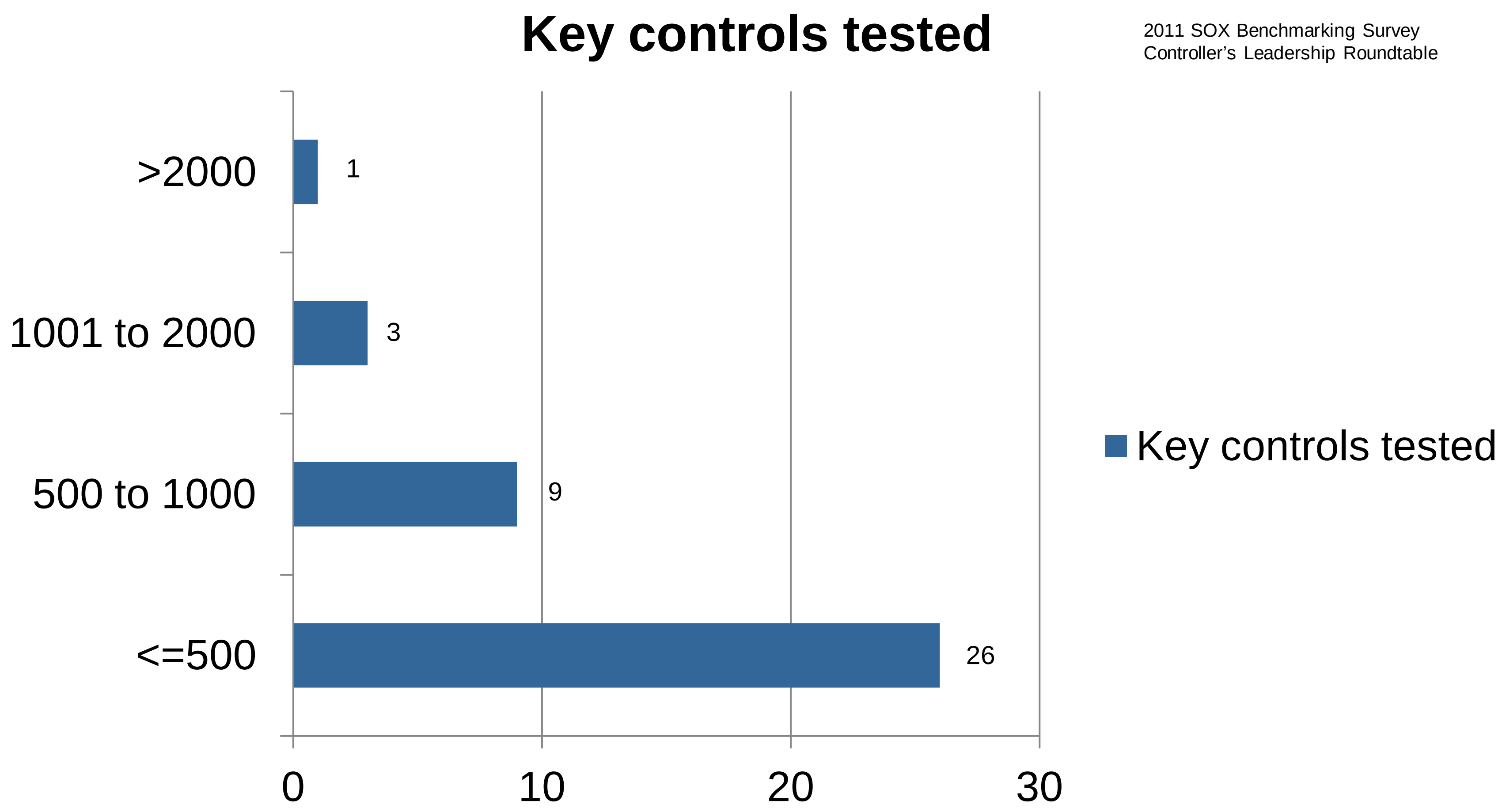

Summary

- Hard look at last control before statements
- Fraud/treasury risk vs. financial reporting risk
- Reduced complexity
- Increased “precision”
- Lower costs
- Less risk of material weakness

Example - RISK Segregation of Duties analysis

Significant Processes	#	Activity	System / Manual	Authorization	Custody of Assets	Recording	Reconciliation / control activity
				Approving of transactions, documents, and procedures, & access to programs & files.	Having access to physical and non-physical assets of value (non-physical = access to a financial asset via any other means)	The process of inputting information into the financial books and records (ie ends up in financial statements)	Reconciliation or review/control activities which are relied upon to confirm the process has operated correctly (ie bank reconciliation)
Bank Accounts	1	Opening New Bank Accounts	Manual	Company Board Resolution [Manual, Financial] Control #1			
	2	Bank Signer Changes	Manual	Board of Relevant Company: 2 Directors or 1 Director & the Company Secretary [Manual, Financial] Control #2			
Cash Management	3	Deal Transaction	TWS / Manual	FX hedging deal prepared by Treasury Manager Reviewed by Director/Treasurer [Manual, Financial]			Accountant performs deal matching and Controller reviews. [Manual, Financial] Key Control #3
	4	Analysis / Reconciliation	Manual			Accountant records in books. Sr. Accountant performs quarterly procedures to record gains/losses related to deal transactions. [Manual, Financial] Key Control #4	
Risk Management	5	Currency/ Commodity Deals (Hedge Documentation)	Manual	Prepared by Treasury Manager Reviewed by Director/Treasurer [Manual, Financial] Key Control #5			
Signet Payments / Wire Transfers	6	Process Payments	GL System	A/P Department for GL System [System, Financial]			
	7	Initiates transfers	Bank System		(List names of individuals authorized to initiate) [System, Financial] Key Control #6		
	8	Approve / release transfers	Bank System	(List names of individuals authorized to approve/release wires) [Manual w/ system component, Financial] Key Control #7			
	9	Reconciles Bank Accounts	Manual				Staff Accountant [Manual, Financial] Key Control #8
	10	TWS and Bank Wire Systems	TWS/Bank System				TWS Access: Admin. - (names) [System, Financial] (IT - Certification of authorized admin. to grant access) Control #9 and #10 Wires Access: Admin. (names) Key Control #11
Reconciliations		Key SOD risks:		Individuals who initiate wire transfers should not be able to release transfers.			

Significant Processes	#	Activity	System / Manual	Authorization	Custody of Assets	Recording	Reconciliation / control activity
System Control				Individuals who initiate wire transfers should not be able to release wire transfers.			