ISRC Notes---November 2003
Impact of Sarbanes-Oxley on IT
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In November, the ISRC welcomed a panel of experts including Dr. Gary Richardson, Visiting Assistant Professor and Coordinator of the IT Project Management Certificate Program, University of Houston; Ray Slocum, Partner, PricewaterhouseCoopers; George Jones, President, ChangeMakers, Inc.; and Walt Wolenski, Principal, EDS to discuss the impact of the Sarbanes-Oxley Act of 2002 on IT.

Following an overview of the contents of the Sarbanes-Oxley Act by Barry L. Rupert of the ISRC, Dr. Gary Richardson introduced the panelists and set the stage for the presentation portion of the session.

George Jones delivered the first presentation entitled, "Where was IT? The Implications of the Sarbanes-Act of 2002." In the aftermath of the various corporate implosions that led to enactment of Sarbanes-Oxley, investigators focused on the executives, the boards, the auditors, and the lawyers. However, no one yet has focused on IT. According to George, it is only a matter of time. George gave, as an example, the recent allegations leveled at the mutual fund industry. In summary, certain mutual fund companies have been accused of permitting some hedge fund customers to buy and sell mutual funds after the market closed using today's closing price. Trades that take place after the market closes are supposed to be held and priced when the market closes on the following day. Mutual fund IT systems date and time stamp every trade. Trades are held until the market closes and the net asset value of the fund is calculated. The trades are then executed using today's market closing price. In order to circumvent this process, the systems are potentially being modified to allow certain trades to use today's closing price even though the trades have been posted after the close of the market. Consequently, it would appear that IT and the systems that they maintain are not simply bystanders in this illegal activity. George then went on to discuss some of the implications of Sarbanes-Oxley and why these implications argued for what he termed a "Better" IT organization. He described a better IT organization as one that is able to help prevent and detect financial abuse and respond to the requirements of Sarbanes-Oxley. Specific characteristics of "Better" include an IT organization that has:

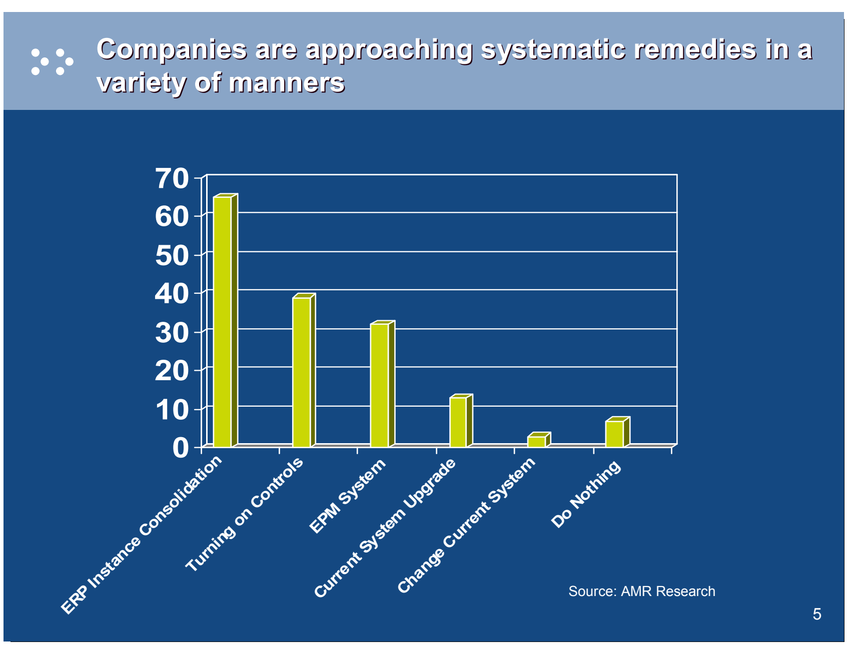
- Expertise in financial controls;
- Knowledge of the company's business;
- Collaborative relationships with internal accounting, internal audit, and the outside audit firm;
- Familiarity with the requirements of Sarbanes-Oxley;
- Knowledge of the legal environment, contractual obligations and design and implementation of financial controls; and
- Knowledge of business and professional ethics.

According to George, the culture within most IT organizations will have to change to be more open. Bad news will have to travel upward. This may be the hardest objective to accomplish in the Sarbanes-Oxley era.

Walt Wolenski of EDS delivered the second of the three panelist presentations. Walt described the six major themes of Sarbanes-Oxley as:

- Increased oversight,
- Auditor conflicts of interest,
- Whistleblower protection,
- Disclosure accountability,
- Management assessment of controls, and
- Acceleration of disclosures.

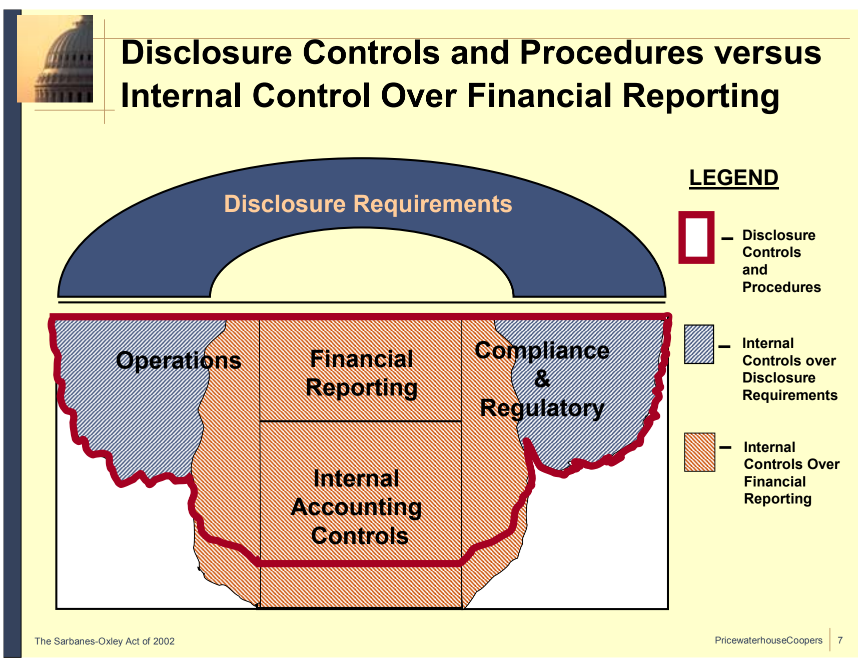
Meeting the requirements of these six major themes of Sarbanes-Oxley will require significant effort, should be viewed as an opportunity and must be approached from a strategic perspective. The following chart, presented by Walt, summarizes a finding by AMR Research on the approaches companies are pursuing to implement support for Sarbanes-Oxley.



Of note, are the first two categories. The first, ERP instance consolidation, represents efforts by companies to reduce the complexity of their accounting environments by consolidating multiple ERP systems. This can be an expensive, lengthy and difficult effort but it can greatly simplify the complexity of and reduce the time required for the close process. The second category involves turning on controls in ERP systems that might have been left off during implementation due to time constraints or concerns about the value that these added controls would provide.

Walt envisioned companies approaching support for Sarbanes-Oxley through an integrated cross-functional and cross-organizational team. A team oriented approach along with providing visibility into Sarbanes-Oxley related activities through status reports and potentially a real-time dashboard can create near and long term benefits.

The final presentation was delivered by Ray Slocumb of PricewaterhouseCoopers. He focused on the controls requirements and verification processes associated with Sarbanes-Oxley. Ray used the following chart to describe the relationship between disclosure controls and procedures and internal controls over financial reporting.



He then described the difference between assessing internal controls in the context of a financial statement audit versus a Sarbanes-Oxley stipulated attestation of management's assessment of internal controls. In the former, consideration of internal controls is used as a basis for developing an audit approach. In the later, controls are tested and evaluated across relevant business and functional areas in a process that is both broad and deep.

Ray presented the COSO framework of internal controls as the one that was likely to be used by most companies as the basis for internally assessing the effectiveness of controls.

Addressing specifically the impact of Sarbanes-Oxley to IT, Ray summarized comments from both the Public Company Accounting Oversight Board (PCAOB) and a COSO report on internal controls. Generally, both suggest that IT controls should be very broad in their application. For example, the PCAOB states that IT general controls should include controls over such activities as program development and changes and computer operations. COSO identifies general IT controls as those that help insure the proper operation of applications and application controls as those controls that insure the proper processing of various types of transactions.

According to Ray, because most business processes are enabled by IT, the ability to achieve control objectives is often dependent on IT based controls. As discussed above, this requires two levels of controls. First, general controls over the IT environment which include information security, program change control, control over computer operations and control over the development and implementation of new systems. Second, application level controls which include controls over financial transactions and data that insure completeness, accuracy, validity and appropriate access restrictions.

Ray described the linkage between controls and financial statements and then discussed the need for documenting front-to-back those transactions than can have a material impact on the financial statements.

Ray then summarized the view that IT is key to compliance with Sarbanes-Oxley by making the following points:

- IT plays a key role in a company's internal control framework, and therefore has a key role to play in compliance with Sarbanes-Oxley.
- IT controls include general controls, which ensure the continued, proper operation of computer systems, and application controls, which control the processing of transactions within computer applications.
- General controls have a pervasive impact on the overall control environment, and are therefore very important.
- Automated application controls must be considered as part of the relevant business process, requiring communication between IT and the business.

At the conclusion of the panelists' presentations, Dr. Gary Richardson led the all too short question and answer session.

To view slides from the panelists' presentations visit our website at: http://www.uhisrc.com!

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