



# THE SARBANES-OXLEY ACT, 2002

**“Our greatest fear should not be of failure but of succeeding at things in life that don’t really matter.”**

**INTRODUCTION**

**ENRON SCANDAL**

- Enron was an American energy Company, mainly engaged in Production of Energy, gas and Pulp and Paper.
- 7th Fortunes 100 best American Companies of U.S.
- It claimed revenue of 111 Billion.
- Assets and Profits inflated.
- Profits and Revenue generated due to transactions with related parties.
- Understatement of Liabilities.
- Insider Trading.
- Sherron Watkins (Whistle blower).
- ‘Kenneth Lay’ (CEO) and ‘skilling’ were mainly charged for fraud.
- Arthur Anderson (Name of firm) was their Auditor and Consultant both. They were charged for negligence in performing Professional duties.
- Price of share of Enron dropped from \$90 to \$50. Bankrupt in late 2001.
- Arthur Anderson facing many Civil and Criminal cases against them.

**WORLDCOM SCANDAL**

- US Second largest long distance Phone Company.
- It showed false financial growth and Profitability to raise its share price.
- Expenditure of \$7 billion had been capitalized.
- Its revenue was inflated by \$2 billion.
- Assets were inflated by \$ 11 Million.
- Security Exchange Commission started Investigation in 2002.
- As a result, Major frauds were revealed and finally in 2004. it was declared Bankrupt.

**EFFECT**

- These scandals resulted in decline of public trust in accounting and reporting practices.
- The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting reform and Investor Protection Act of 2002 and commonly called SGX or Sarbox is a United States federal law passed in response to a number of major corporate and accounting scandals including those affecting Enron and Worldcom.
- The Act establishes a new quasi-public authority, the Public Company Accounting Oversight Board for overseeing, regulating, inspecting and disciplining accounting firms in their roles as auditors of public companies.
- The Act covers issues such as auditor independence, corporate governance and enhanced financial disclosure.

**MAJOR PROVISIONS OF SOX**

The Sarbanes-Oxley Act’s major provisions include the following:

- Creation of the Public Company Accounting Oversight Board (PCAQB);
- A requirement that public companies evaluate and disclose the effectiveness of their internal controls, as they relate to financial reporting and that independent auditors for such companies “attest” to such disclosure.
- Certification of financial reports by chief executive officers and chief financial officers;
- Auditor Independence;

- A requirement that companies listed on stock exchanges have fully independent audit committees;
- Ban on most personal loans to any executive officer or director;
- Accelerated reporting of insider trading;
- Prohibition on insider trades during pension fund blackout periods;
- Additional disclosure;
- Enhanced criminal and civil penalties for violation of securities law.
- Significantly longer maximum jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements;
- Employee protections allowing those corporate frauds whistle blowers who file complaints with OSHA within 90 days.

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## SOX 404 REQUIREMENT

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### Client Management must

- Document and test the Internal Control over financial Reporting.
- Issue an annual assertion on the effectiveness of Internal Control over Financial Reporting.

### External Auditor must

- Determine nature, timing and extent of testing.
- Review work performed by Management.
- Perform some Independent tests of control.
- Attest and report on:
  - Management 404 assertion process.
  - Design and effectiveness of Internal Controls.

In order to make the assertion, the client must:

- Document and evaluate the design of controls.
- Evaluate the operating effectiveness of significant control.
- Document the result of the evaluation.
- Identify significant deficiencies or Material weakness.
- Communicate the findings (Material Weaknesses) to Independent Auditors.

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## INFORMATION TECHNOLOGY AND SOX 404

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### RELATION

- The financial reporting processes of most organizations are driven by IT systems.
- Few companies manage their data manually and most companies rely on electronic management of data, documents and key operational processes.
- Chief information officers are responsible for the security, accuracy and the reliability of the systems.
- ERP (Enterprise Resource Planning) are deeply integrated in the initializing, authorizing processing and reporting of financial data.



## **COSO FRAMEWORK**

The COSO framework defines five areas. The objectives of COSO Framework aim at:

1. Operational Effectiveness.
2. Financial Reporting (Better and in timely manner).
3. Compliance with Regulatory Requirements.

Components of internal Control Framework as defined by COSO are as follows:

1. **Control Environment:** As per the Requirements of COSO framework, the control environment in the organization should be such that the top Management should assume 'its full responsibility for entire Internal Control structure.
2. **Risk Management:** The Management should undertake the Risk Assessment Procedure. It means that they should evaluate Internal and External factors that may have an Impact on the organization.
3. **Control Activities:** The Control Activities are specific Policies and Procedures which are undertaken to ensure correctness of some specific assertions. It helps the management to reduce the risk to an acceptably low level.
4. **Information and Communication Monitoring:** Monitoring refers to the process undertaken by Management to determine whether I.C. System is adequate or not.

## **INFORMATION TECHNOLOGY & SOX 404 SUMMARY**

Section 404: Requirement

1. I.C. Report by Management.



Attested by Auditor



Filed in SEC

2. Now-a-days most of the Companies maintain their accounts in CIS.
3. Those Internal Controls are different from those in Manual System.
4. I.C. →  
General I.C.  
Application I.C.
5. Thus management should evaluate whether their I.C. relating to financial Reporting in CIS are adequate.
6. In CIS → 5 factor as per COSO framework to be ensured.

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## ***IMPLEMENTATION OF DISCLOSURE CONTROLS AND PROCEDURES***

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- Disclosure Controls and Procedures are meant to ensure that all the information required by law to be included in the periodic reports filed with the SEC is made available to those responsible for preparing them in a complete and timely fashion.
- The Disclosure Controls and Procedures should be crafted in such a way that they are easy to follow and practical to implement.
- They should be in writing and should be customized to reflect the operations of the company and its particular risk profile.
- A list of suggestions is given below:
  - **Disclosure Committee:** A disclosure committee may be established charged with assisting the CEO and CFO in developing, writing and overseeing Disclosure Controls and Procedures.

- **Inventory of Current Procedures:** To take an inventory of the company's existing practices and weaknesses with regard to:
  - preparing annual reports;
  - the handling of whistle blowers complaints with respect to the company's disclosure;
  - the review of any matters raised by the company's independent auditors ,and
  - the retention of relevant documents.
- **Identification of Personnel:** The disclosure committee should identify persons both inside and outside the company whose input is critical to the disclosure process.
- **Preparation of Controls and Procedures Timetable and Check list:** The disclosure committee should disseminate internally a Control and Procedures check list which fills in any gaps and fixes any weaknesses discovered by the inventory.
- **Backup Certifications:** Companies may wish to consider obtaining "backup" support certifications from certain officers that confirm the certifications of the CEO and CFO.



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