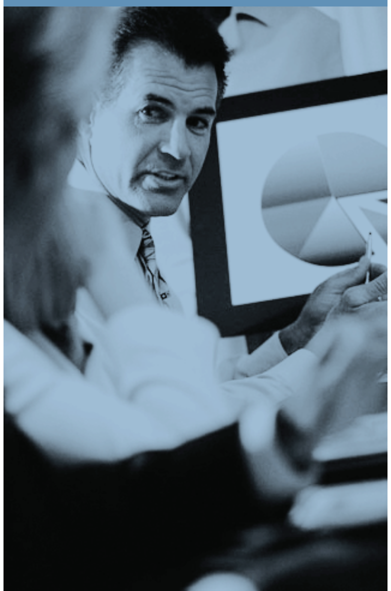

Internal controls: from SOX 404 compliance to mastery.

Those familiar with Section 404 of Sarbanes-Oxley (SOX) know that it requires management of public companies to assess the effectiveness of the internal control structures and procedures for financial reporting in annual reports. In addition, the company's independent auditors must "attest to, and report on" management's assessment.

The consequences of reporting internal control deficiencies can be severe. According to a study by shareholder-advisory firm Glass, Lewis & Co., companies disclosing internal control deficiencies in their annual reports experienced gradual negative stock performance (see sidebar).

However, focusing strictly on compliance will ensure your company remains reactive and committed only to meeting the minimum standards.

To date, adherence to SOX provisions at forward-thinking companies have led to significant improvements in the control process, including:

- Better documentation
- Closer monitoring
- Improved audit trails
- Greater individual responsibility
- Lower risk of fraud

These are all worthwhile outcomes, but why only look at internal control issues from a compliance standpoint? Your company can and should look at compliance not as a repetitive, annual exercise, but an ongoing, fluid process that can unlock information and allow quicker, better decision-making.

According to a study by shareholder-advisory firm Glass, Lewis & Co., companies disclosing internal control deficiencies in their annual reports, as required under Sarbanes-Oxley, Section 404, experienced gradual negative stock performance. Glass Lewis analyzed companies with a market cap greater than $75 million, 11% of which reported a control deficiency, from 1Q 2004 to 2Q 2005.

The first day after disclosing a material weakness in financial controls, companies' share prices dropped an average .67% relative to the market. After seven days, share prices dropped 0.90%; after 30 days, 1.96%; after 60 days, 4.06%.

Improved information flow opens a world of possibilities when it comes to analyzing performance and informing strategy. In addition, it enables you to identify and control risk more effectively.

move up in the world.®

Ajilon FINANCE SOLUTIONS

SENIOR FINANCE & OPERATIONS PROJECT PROFESSIONALS

The critical factor in mastering internal controls enterprise-wide — for compliance and competitive purposes — is the staff directly charged with executing the new processes and procedures on a day-to-day basis. The ability of individuals to move beyond the compliance mindset, where only the minimum standards are met, and become proactive managers is essential.

To help public companies advance from a compliance-based approach to a performance-driven one, Ajilon Finance Solutions identified the following areas in which to help build the right mindset among accounting and finance staff.

Reassess weak spots.

As companies move toward more of a "continuous compliance" model, it's a good time to reassess the relevant risks. Over the past few years, the quality of financial reporting has generally improved and accounting industry observers agree we are less likely to witness a major audit failure moving forward.

Yet, whenever new processes and procedures — not to mention regulations — are introduced, new and unanticipated risks emerge. While companies may feel more confident and in control of financial reporting, it is a mistake to assume that the risks have necessarily diminished.

Begin by conducting a risk-based analysis of internal controls to identify the accounting and finance department's greatest vulnerabilities. Augment compliance tests previously employed by external auditors to include performance metrics desired by senior management. For best results, design a mechanism that will allow for periodic, non-intrusive testing that provides meaningful data.

Getting a fresh assessment of strengths and weaknesses will show exactly where your company still needs to improve in order to realize the full value of the investments made in SOX compliance. Ongoing testing is a part of the continuous compliance concept.

Upgrade staff skills.

Given the intensity of the past few years, accounting and finance staff understandably feel increased pressure to perform and avoid even the smallest mistakes.

However, we do not live in a zero-defect world and even top performers will make the occasional error. That is why it is important to hire strong professionals at every level and, further, to provide regular training that adds to internal proficiencies and creates more staff capable of handling an even wider set of responsibilities.

To begin, develop training modules that clearly explain all functions, starting with core compliance and moving quickly to specific areas where senior management wants to improve operational efficiencies. Depending on the size of your company, the curriculum can be developed internally or in partnership with a third party, such as a professional association, accredited training firm or consultant.

Conduct initial assessments to catalogue and benchmark the skill sets of individual employees at every level. Establish a year-round "university" to improve and expand the skills of staff in specific areas. This can be accomplished efficiently and effectively at any size company using self-learning modules.

Making an investment in professional training will not only reduce errors and improve the speed of financial reporting, but also signal to accounting and finance staff that your company cares about individual development.

Teach ethics.

In a fluid environment where countless transactions occur each day, it's important to have the confidence that individuals in decision-making roles have a sound ethical background. This confidence provides a measure of assurance that any errors made are honest ones.

Of course, the question is how to attain that assurance. Ethical lapses generally occur when accounting and finance staff feel pressured to green light a questionable decision or disregard a dubious act.

Start by forming a code of ethics for the department. Then, devise a simple, self-test to help individuals guide decision making when faced with a challenging situation. For example:

- Is it the right thing to do?
- Can I defend the decision?
- How comfortable am I as a professional with this?

Staff displaying the knowledge and confidence to consistently make the right call should be supported at the highest levels. Simple acts of validation in everyday situations will signal to others throughout the department that high ethical standards are genuinely valued.

Process improvement.

As mentioned, a big part of moving from a compliance-based to a performance-driven culture is establishing the right tone with staff. Today, there are entirely new procedures and practices that are a direct result of recently introduced regulations. Amid such change, it's important to move staff from a "have to" to a "want to" mindset.

The difference can't be understated. The breadth and depth of new regulations have accounting and finance staff on the defensive. Many surmise they can only fail in such an environment.

Combat this negative way of thinking head on. Talk about the operational value of business process improvement. Demonstrate how improved, real-time information flow allows senior management to make smarter decisions. Instruct them specifically how to achieve greater efficiencies through the automation of manual processes, consolidation of discrete or duplicative work flows and reporting standardization.

The primary goal is to help staff understand that the conventional thinking about the accounting and finance role, as an internal reporting cost center, is transitioning. In fact, their most important role, moving forward, is to provide value-added, actionable intelligence.

Leverage knowledge globally.

While financial reporting regulations vary from market-to-market, the need for faster, more accurate financial information is universal and never-ending.

Take measures of standard practice in all markets. Survey senior management not simply on what the department can do to improve, but how financial information informs their day-to-day decision-making.

Also, look at the software and hardware technology systems that teams use in different markets. Can the platforms be harmonized to improve information flow? Should the company eventually reengineer systems to work on the same platform?

Finally, do accounting and finance staff in one market even know their counterparts in other markets? Foster interactions between key staff from different markets to unearth new ideas and fresh thinking on how to improve information flow.

Make your SOX investments pay off!

Quite understandably, companies have been re-working standards and practices for financial reporting in order to comply with new regulations — and avoid the numerous civil and criminal penalties that result from non-compliance! Now, however, it's time for companies to adopt a more forward-looking approach. To make investments in SOX compliance pay off, engage staff on assessment, training and re-engineering to make the leap from simple compliance to mastery of internal controls. The benefits of improved information flow to senior management are incalculable.

For more insights on Sarbanes-Oxley and how to make your company's compliance programs deliver a better ROI, contact Ajilon Finance Solutions today at 1.866.GO AJILON or visit ajilonfs.com.

move up in the world.®

Ajilon FINANCE SOLUTIONS

SENIOR FINANCE & OPERATIONS PROJECT PROFESSIONALS