

From Zero to SOX

Sarbanes-Oxley Compliance Workbook

SENSIBA SAN FILIPPO

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Zero to SOX – An Overview

The goals of a program to meet SOX 404 requirements go far beyond compliance. The process of building a sustainable, comprehensive internal control environment to comply with SOX also provides the company with a foundation for sound and sustainable governance.

The challenges faced by a privately held organization as it embarks on the journey to IPO are myriad. This Sensiba San Filippo (SSF) InfoCast provides a step-by-step deconstruction of the **“Zero to SOX”** process to assist Management in this challenging endeavor. In the following pages, you’ll find an overview of each step, a suggested timeline and a project milestone checklist to confirm scope and successful Zero to SOX adoption.

SOX Compliance – Timing

The most critical SOX 404 compliance date is the filing of the company's second Form 10-K annual report. This is when, in conjunction with the external auditors' review, the CEO and CFO must certify that their internal controls over financial reporting are effective. However, the first-year exemption from SOX compliance does not mean that a company should delay addressing their SOX 404 requirements until their second year as a public company. Rather, this is a window of opportunity that the U.S. Securities and Exchange Commission (SEC) has created specifically for newly-public companies to develop and implement a comprehensive internal control environment sufficient to meet SOX 404 requirements.

Sensiba San Filippo recommends a six-quarter lead time to fully implement a comprehensive internal control environment for those companies beginning the process with an informal control environment. A prototypical timeline assuming an initial public offering date during Q4 2011 would be:

Zero to SOX Suggested Timeline

Zero to SOX Project Plan Q4 2011 IPO	2011 Pre-SOX Filing Year			SOX Filing Year 2012				Post Filing
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Implementation Plan Activity								
Planning and Scoping	■							
Documentation of Processes and Controls	■	■						
Control Design Assessment		■						
Control Testing		■	■					
Remediation of Design and Testing Deficiencies			■	■				
First Form 10-K Filing				■				
Filing Year Control Testing Round 1					■			
Filing Year Remediation of Design and Testing Deficiencies Round 1					■	■		
Filing Year Retesting						■		
Filing Year Remediation of Design and Testing Deficiencies Round 2							■	
Year-end Certification								■
Second Form 10-K Filing w/404 Certification								■

Zero to SOX Implementation Process

At SSF we have broken down the Zero to SOX implementation process into seven phases. The activities and milestones in each phase are designed to build upon previous phases, resulting in an efficient and integrated process. A discussion of the objective, elements of each phase and tools to document progress can be found on the following pages of this interactive PDF.

1

Phase 1: Planning and Scoping

In the first phase of the Zero to SOX implementation, Management's team assesses the key financial reporting accounts and footnotes, including supporting processes. This phase will include evaluating quantitative and qualitative factors to determine in-scope processes and applications for SOX 404 compliance, as well as the risk of misstatement associated with these processes and applications.

A critical aspect of the initial preparation is the development of a top-down, risk-based approach consistent with SEC guidance on SOX 404 and the Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5. This approach helps to ensure that the SOX 404 program focuses on the highest risks that could have a material effect on financial statements. In this way, the company avoids expending resources on a comprehensive SOX program that seeks to evaluate every risk, regardless of its likelihood or potential impact.

Planning and Scoping Milestones

Date completed:

- | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| <input type="checkbox"/> Identify project manager and implementation team members Defining clear project management responsibilities and multi-departmental project team membership is key to an integrated and effective project. | _____ |
| <input type="checkbox"/> Identify significant accounts To maximize the efficiency of Management's 404 compliance efforts, it is essential to identify the accounts that have a material impact on Financial Reporting. Utilizing AICPA guidance on materiality, calculate the significant account threshold and utilize this, along with qualitative factors, to identify the significant accounts at the trial balance level. | _____ |
| <input type="checkbox"/> Identify in-scope process and application Utilizing the Significant Account listing, identify the underlying business transaction cycles and automated processing applications that impact the significant accounts. These are the processes and applications that will be documented and assessed in Phases 2 and 3. | _____ |

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Phase 2: Documentation of Processes and Controls

Management's team determines the risks of material misstatement for each process identified in Phase 1, documenting the current control environment and assigning the ownership of certain processes and controls to key internal stakeholders. The control environment consists of those entity-level, transaction-level and general IT controls that affect the financial statement accounts and footnotes that were defined during Planning and Scoping (Phase 1).

This documentation typically takes the form of flow charts and/or narratives that capture the control processes. Risks and controls are identified and captured in matrixes to allow for a full evaluation of how well risks are controlled. Documenting existing policies and procedures is helpful for understanding the business process and control environment, but because such documentation typically covers information that is not relevant to SOX compliance, it is not used in lieu of SOX-specific documentation.

Documentation of Processes and Controls Milestones

Date completed:

- Document the current control environment-transaction cycles** Utilizing standardized internal control walkthrough procedures, create a narrative document of the in- scope business transaction cycles identified in Phase 1.
- Document the current control matrix** Analyze the process documentation created in the previous step to identify existing controls that address the risk of misstatements for the significant accounts identified in Phase 1. These controls will be summarized by transaction cycle and presented in a COSO Risk Control Matrix for overall control evaluation.

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Phase 3: Control Design Assessment

Management's team evaluates the design of the controls identified in Phase 2. Proper control design should help ensure the effective mitigation of the risks of material misstatement and achieve the control objectives that have been defined for each process. Effective control design will usually include controls with a variety of characteristics (preventive, detective, automated, and manual, for example). During this phase, Management's team identifies controls that are missing or designed improperly to achieve the objectives.

Control Design Assessment Milestones

Date completed:

- | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| <input type="checkbox"/> Evaluate existing control design by transaction cycles Analyze the COSO Risk Control Matrix created in Phase 2 and evaluate the sufficiency of current control procedures for each transaction cycle and significant accounts documented in Phase 1. | _____ |
| <input type="checkbox"/> Provide control design recommendations by transaction cycle Recommend procedural changes for business processes where it is determined that existing controls are either deficient in design or in application. Recommendations will be specific to process, frequency and control owner. | _____ |
| <input type="checkbox"/> Observe control design recommendation implementation Oversee the implementation of all procedural changes and observe at least one cycle of operation prior to commencement of Phase 4. | _____ |
| <input type="checkbox"/> Document revised COSO key control matrix and update transaction cycle narratives Update the key control matrix and revision of transaction cycle process documentation to reflect the implementation of procedural changes identified above prior to commencement of Phase 4. | _____ |

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Phase 4: Control Testing

Once the processes, risks, and controls have been defined and assessed, focus shifts to testing the operating effectiveness of internal controls. A testing regimen is developed that is consistent with the risk-based approach established in Planning and Scoping (Phase 1) and with the most recent SEC guidance. Typically, the team establishes a testing standard consistent with the guidance and input from the external auditor that articulates transaction sample sizes based on risk and control characteristics.

Testing should be performed early enough in the year to enable Management to remediate control failures so that the controls can be retested with sufficient transaction population sizes later in the year. Test results should be documented and shared with all stakeholders so that plans for remediation can be made.

Preliminary or pre-SOX 404-filing year testing should be performed prior to the year in which the company must be in compliance and issues its second Form 10-K. This timetable allows more time to work with process owners and allows process owners the opportunity to perform a dry run of the SOX process and understand the formality and evidence required of a public company.

Control Testing Milestones

Date completed:

- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| <input type="checkbox"/> Prepare key control test plans Prepare control test plans for all key controls identified in Control Design Assessment (Phase 3). These will include the intended test procedures and timetable for all key controls for review with external auditors to insure coordination with their efforts. | _____ |
| <input type="checkbox"/> Coordinate testing timeline with external auditors Present control test plans and timeline to external auditors for coordination with external audit procedures. | _____ |
| <input type="checkbox"/> Execute testing Execute test procedures for all controls selected for testing. | _____ |
| <input type="checkbox"/> Summarize test results and report to project manager Report results of testing to project manager. Emphasis will be placed on failed controls requiring remediation. | _____ |
| <input type="checkbox"/> Provide remediation plans for failed controls Provide remediation plans to the project manager and external auditors for all key controls that failed testing during Interim Round 1. Remediation plans will address procedural and resource requirements. | _____ |

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Phase 5: Remediation of Design and Testing Deficiencies

Remediation is the fixing of controls deemed weak or ineffective.

A deficiency **in design** exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met.

A deficiency **in operation** exists when (a) a properly designed control does not operate as designed or (b) when the person performing the control does not have the authority or competence necessary to perform the control effectively.

Once deficiencies in the design evaluation are identified or failures in the control testing are found, they are reported to Management's team and process owners to develop a plan for taking timely corrective action.

Remediation of Design and Testing Deficiencies Milestones

Date completed:

- | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| <input type="checkbox"/> Implement Remediation Plans Work with affected process owners to establish timelines and metrics for the implementation of the approved remediation activities. | _____ |
| <input type="checkbox"/> Monitor Remediation Plans Work with process owners to monitor the progress of remediation efforts and revise timelines or processes as required. | _____ |
| <input type="checkbox"/> Summarize results and report to project manager Report results of remediation activities to project manager. | _____ |
| <input type="checkbox"/> Summarize results and report to external auditors Project manager will report results of remediation activities to external auditors consistent with their requirements. | _____ |

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Phase 6: Filing Year Control Testing and Retesting

Testing should be performed early enough in the year to enable Management to remediate control failures so that the controls can be retested with sufficient transaction population sizes later in the year.

The SOX team documents and shares the test results with all stakeholders so that plans for remediation can be made.

Following up and retesting failed controls is equally critical. As noted earlier, once a failed control has been remediated, it must be retested to demonstrate its operating effectiveness. Retesting of failed controls should be performed after a post-remediation population of sufficient size has been accumulated. The final two quarters of the filing year are critical. Retesting results must be positive in these two quarters to allow the CEO, CFO, and external auditors to state that the control environment is effective “as of the fiscal year-end.” The SOX certification validates the controls’ effectiveness at a point in time (at year-end) not over a period of time. Thus, once the control has been retested and found effective, the failures that were identified before remediation no longer factor into the company’s conclusions.

Filing Year Control Testing and Retesting Milestones

Date completed:

- | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| <input type="checkbox"/> Update key control test plans Evaluate control test plans in light of previous test results for all Key controls identified in Control Design Assessment (Phase 3). All changes will be reviewed with external auditors to ensure coordination with their efforts. | _____
_____ |
| <input type="checkbox"/> Execute testing Execute test procedures for all controls selected for testing. | _____
_____ |
| <input type="checkbox"/> Summarize test results and report to project manager Report results of testing to project manager. Emphasis will be placed on failed controls requiring remediation. | _____
_____ |
| <input type="checkbox"/> Provide remediation plans for failed controls Provide remediation plans to the project manager and external auditors for all key controls that failed testing. Remediation plans will address procedural and resource requirements. | _____
_____ |

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Phase 7: Year-End Certification

Once the fiscal year is complete, activities to complete the SOX 404 compliance program remain. Any additional processes and controls that occur after or in conjunction with the Form 10-K preparation will require testing along with year-end closing procedures and disclosure processes. The external auditor and Management's team must also evaluate and rate any un-remediated deficiencies based on how much impact they could have on the financial statements.

Year-End Certification Milestones

Date completed:

- | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| <input type="checkbox"/> Update key control test plans Evaluate control test plans in light of previous test results for all Key controls identified in Control Design Assessment (Phase 3). All changes will be reviewed with external auditors to insure coordination with their efforts. | _____ |
| <input type="checkbox"/> Execute testing Execute year-end test procedures for all controls selected for testing in conjunction with year-end. | _____ |
| <input type="checkbox"/> Summarize test results and report to project manager Report results of testing to project manager. Emphasis will be placed on failed controls requiring remediation. | _____ |
| <input type="checkbox"/> Evaluate failed controls Prepare an evaluation of the impact of any failed controls on financial reporting. This will be coordinated with the external auditors to support their evaluation as well. | _____ |
| <input type="checkbox"/> Report to Audit Committee Provide report to the Audit Committee summarizing the annual compliance efforts and results of testing as well as recommendations for future periods. | _____ |

Notes:

Attributes of a Successful Zero to SOX Process

In addition to timing, successful projects have certain features in common:

- Management sets the right tone from the top. It provides visible support and multiple communications to the organization on the program's importance and sets the proper expectations of the organization at the steering committee and audit committee levels.
- The Board – in particular the Audit Committee – is actively involved in understanding significant issues and expects regular communication from management on progress and results.
- Management's compliance team coordinates all events and participants to keep the compliance program focused. SOX compliance involves senior management, process owners (from accounting, finance, IT, HR, operations, legal, and across operating units) along with board members, and external auditors and external consultants supporting management's implementation.

To minimize the chance of unforeseen expectations or unfulfilled audit requirements, external auditor collaboration should occur at every step of the process. This includes collaboration on scoping, control design, remediation plans, testing results, and steering committee meetings.

In Conclusion

Imbedded in these 7 steps are myriad paths to SOX compliance and building a sustainable, comprehensive internal control environment. An effective, efficient Zero to SOX process with clearly defined goals, active and informed team members and appropriate milestones will help lay the foundation for your company's governance future.

For more information, please contact Sensiba San Filippo's SOX team at SOX@ssflp.com.

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Sensiba San Filippo is a high-touch, multi-service public accounting firm. We seek to bring actionable business solutions to our clients, while sharing information and knowledge with our clients and friends through publications such as this SOX Compliance Workbook.

We've served the Bay Area business community for over 30 years, and recognize that when businesses choose an accounting firm, they seek a professional partner. Sensiba San Filippo's unique brand of client service, technical expertise, commitment and knowledge can bring this level of dedication to your organization.

This SOX Workbook PDF can be found [in our online SSF Knowledge Series at www.ssflp.com/knowledgeseries](http://www.ssflp.com/knowledgeseries).

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sox@ssflp.com
www.ssflp.com



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