



# SOX Snippets and Audit the Auditors

By John Landreth, CPA

As I write this article, it's summer in the Midwest. Baseball and soccer are well underway. It's also time for my college freshman son to come home. He said on the phone he was worried about finding a summer job, his mother and I assured him that he shouldn't have these concerns. As he walked up the driveway this morning with a bright blue Mohawk haircut - we now had a deeper understanding of his concerns...which leads us into a deeper understanding of our concerns for our first topic...Sarbanes-Oxley (SOX).

Your LTA editorial staff has been on the road in recent months attending a variety of conference and seminars, many of which have had sessions on this historic legislation.

In the same way that my son found a new way to introduce himself, I will use a different device than our standard "letter from some reader" format. These are short comments, thoughts and perspectives that I have heard that you might find interesting. We'll just call them "Sarbane's Snippets."

### Snippet #1: Will it Float?

In much the same way that David Letterman asks whether an object will float or sink in a tub of water, I've been in search of this answer. Will the Sarbanes-Oxley legislation work? Will it be successful in giving the common investor the confidence to jump back into the market? Will it prevent an Enron, WorldCom or Healthsouth from happening?

I raised this question at the Chief Audit Executives (CAE) roundtable in Chicago. These CAE's come from major Fortune 500 companies who all had to comply with these new regulations. I've attended these meetings regularly over the last two years

and listened to their frustration, angst, and bewilderment, with a smirk of gratitude that it was not me.

At the last meeting as their efforts for Sarbanes are winding down, I asked them: "Will it Float?" They were slightly taken aback. In essence, I was asking them if all their effort and toil would have the desired result, would it be worth it? Their eloquent reply was "it won't prevent it, if it does happen, the fraud won't be as widespread and pervasive". These frauds will be detected earlier because the awareness is there. Employees feel empowered now to report and do the right thing.

At a local public accounting firm symposium for internal audit directors, I asked the same question of Chuck Bowsher, the former chairman of the Public Company Accounting Oversight Board. He was one of the conceptual founders of Sarbanes. He said the same thing. It won't prevent them, or eliminate them. As long as there are greedy, egotistical and unethical business leaders, they will find a way. But, it won't be as broad and deep. It will be caught earlier.

Finally, at the April 2005 Institute of Internal Auditors annual seminar in Chicago. Cynthia Cooper, the Internal Audit Director for WorldCom, who was responsible for bringing that fraud to the public eye had some interesting comments. She told close to 650 internal auditors in attendance, that she believed it would be effective, but had concerns about the "pendulum" effect. How far will the "return swing" of the pendulum, the reverse momentum set us back? The risk ahead will be how management's expectations are "managed" to understand that this is not a "one time" event; it's forever.

### Snippet #2: Frequent Deficiencies Found in SOX Work this Year

(Hint: Look for these in your external auditor's plans and future management letters)

- Information Technology (IT) program change control.
- IT system access controls.
- IT segregation of duties.
- Manual intervention in legacy IT systems.
- IT user controls at service providers.
- Review and approval of manual journal entries.
- Timely completion of account reconciliations.
- Timely reconciliation of suspense accounts.
- Financial statement closing.
- Tax related matters.

### Snippet #3: Lessons learned for Future SOX Projects

"Don't implement a new system in the fourth quarter of your fiscal year." Why? There won't be enough time to fix it and prove that the fix is effective to prevent a deficiency finding"

"Don't implement a new system in the first quarter of the new fiscal year" Why? "You'll be too busy to test it with the year-end activities

*Comment:* There is never a good time to implement a system, is there? I am sure that over time IT organizations will adapt by insuring that they have more bullet-proof systems.

#### **Snippet #4: Anecdotal Comment Political Underpinnings SOX and HIPAA Privacy legislation**

"So the Democrats brought us HIPAA and the Republicans brought us Sarbanes-Oxley?"

#### **Snippet #5: Best Prediction as to Whether SOX will be Required for Not-For-Profits**

"If there's a big scandal for the not-for-profits, it will be a slam dunk for Congress to require compliance with Sarbanes."

#### **Snippet #6: Statement Overheard at IIA Seminar**

"Internal Auditors are no longer the Rodney Dangerfield of business...now we get respect!"

#### **Snippet #7: Best Mitigating Control Idea Heard So Far.... (And SOX missed it.)**

Audit directors are always performing a "balancing act" of professional independence, objectivity and keeping the kids fed and the mortgage paid. We are expected to be the independent "conscience" of our organization, yet we are supposed to "be unafraid" of the potential loss of our jobs and security of families for "doing the right thing" for the good of the public (and the Board of Directors D&O coverage.)

At another roundtable, an audit director (non-healthcare) told how he addressed this when he was hired. He insisted on having a severance package agreed to "upfront" that was the same as that of the executive team. If they could have the same financial assurance and security in their jobs, then he should too. He got it!

*Comment:* Maybe this Monday I'll ask for that same severance package to maintain my independence and domestic security. How about you?

Okay, time to remove the Mohawk and get back to our standard *Letters to the Auditor* format. Our letter this week comes from an audit director who's heard about the IIA's Quality Assurance Review requirements....

#### **Dear LTA,**

I have been reading and hearing a lot about the new IIA standards that require each internal audit department to have an audit of their department. I have been aware of this concept for a number of

years, but never really felt ready for it.

My team is currently too busy helping other people get their department operations and controls in shape. In addition, we have a very busy schedule in the year ahead and would never have time for the disruption of an audit. Maybe I can buy some time until I get through the next few plan years before my Audit Committee chairman or CEO bring it up.

Although I'm not ready for a review immediately, I'm thinking about what I can do to make sure that I am prepared when the time comes. What are some of the ways in which I can gradually get prepared for a quality assurance review of my department?

Signed,

#### *Querulous about QAR's in the Quad-Cities*

#### **Dear Querulous,**

It never ceases to amaze me that requests come from our readers about topics where I have had recent experience. What a coincidence! Let's address the facts before we deal with preparation.

According to the IIA's International Standards for the Professional Practice of Internal Auditing, Attribute Standards Section 1300,

"The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring."

Section 1312 states: "External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team outside the organization."

This means that every internal audit department needs to have a quality assessment review completed by January 1, 2007. That means that for your department to be compliant with our professional standards, you will need to have this completed in about one and a half years.

As Judy Collins sang, "I've looked at cloud from both sides now". Over the last few months I have been on both sides of a Quality Assurance Review- both a giver

and a receiver. Both experiences have been very positive and worth the effort.

#### **Getting Ready Emotionally**

Although your procrastination style may be get it done *later* or *much much later*, I'd encourage you to get your department's QAR preparations started as soon as possible. You should decide to take the initiative. Make it look like your idea; at least appear to be proactive.

It's just a matter of time before your Audit Committee chairman, CFO or CEO will read some "best practices in governance" article, or your external auditor will be in search of additional consulting revenue and will raise it as a management letter comment.

*IIA Standards,  
Section 1312  
calls for QAR  
of ALL aspects  
of internal  
audit by  
1/1/2007.*

If you take charge of the project, it will be less likely that one of them will take the lead. You can keep the project on task and not let it get out of control. Take my advice; just stick to the standards.

Any resistance you appear to put forward will make you look like you are the organization's biggest hypocrite - they will say that you can dish it out, but you can't take it. You can see your credibility going down the drain. Set a good example for the rest of the organization. It's better than running out of the audit committee meeting shouting "Never! Never! Over my dead body!" It's just more professional.

We all know the many reasons why an audit can't be done, we've heard them all: "This is a busy time." "We just got through a busy time." or "A busy time is coming up."

Think of it this way, you've been successful at deferring this review for

this many years, its time to take your lumps like everyone else. Your clients have been tolerating your audits for a long time. Be prepared to walk a mile in their shoes. Although we try very hard to be sensitive to our clients concerns and think we understand them, there is nothing like being the subject of an audit to know really know it feels.

Here are some thoughts that went through my mind when my department went through our QAR. You might:

- Feel a little nervous when the QAR team asks a sensitive question you did not expect, or where you know things aren't perfect. You might ask yourself, "Do I tell them now, or will I let them find it".
- Have an unhappy client who always gripes about your long reports, when the QAR team asks a question about report length, you might feel yourself internally seething.
- Be busy and you might not have time to get the QAR team everything they want. You might find yourself annoyed by their reminders and deadlines.
- Be commenting on the draft report and discussing the use of certain words and phrases; hear the "voices of auditees past" saying the same things.

### Preparing for a QAR

Your preparation for a QAR will be somewhat guided by the QAR you select to do. QAR's can take several forms and can be done in a number of ways. They can be performed by external consultants, by the IIA, or even by your peers under certain circumstances. Generally, the IIA QAR's are much less expensive and are completed in a faster time frame – usually within two weeks. You can even do an internal review on your own and have it verified by an external reviewer. There are several "pro's" and "con's" to each of these. I would suggest talking to the IIA, fellow audit directors, or give me a call.

You asked about how to prepare for the review. Here are some suggestions:

- Order a copy of the IIA's professional standards (a.k.a. "The Little Red Book), *The Professional Practices Framework* (Mar. 2004). You probably

already have it. (You'll just need to find another book of the same size to keep your conference table propped and balanced.) This will give you a ready reference for the actual standards.

- Self-review materials. My recommendation is the IIA's *Quality Assessment Review, Fourth Edition*. This manual is used by the IIA reviewers in conducting QAR's; it walks you through each standard, has template workpapers, and shows you step-by-step how the reviewer determines compliance.
- If you find that a more interactive approach would be more helpful, there are also some excellent local chapter and national IIA seminars.

However, personally, in my opinion the *best* way to prepare for your QAR is to participate in one and experience the entire process for yourself. It is an extraordinary educational experience.

The IIA QAR process involves volunteers from internal audit department management. You submit your name and experience and they will notify you of scheduled QAR's and the company's name and industry. (Most engagements last two weeks and this can be a challenge for your schedule.) You are reimbursed for all expenses for the QAR engagement, but you are not compensated for your time. You received CPE credit for your participation and receive credit for a free IIA seminar. In addition, you are provided and retain the IIA standards book, and the QAR manual. Please refer to the IIA website for more details. By far, the experience is the greatest value you will receive.

First, it is true hands-on experience. It is one thing to review the standards and examples in textbook or classroom experience. Application of these standards to real life examples is much more interesting. It's similar to a consulting experience. You have the opportunity to examine another audit department's processes, procedures, work papers, reports, etc. You can see what that audit department does well and does not do so well. You can share your experiences and practices with them, too. In like manner, you get to see how other audit shops do things and can bring those ideas back to your department.

Interviews are an important part of any QAR. These are conducted with the audit department's clients: the audit committee chairman, CEO, CFO, and department heads, as well as each member of the internal audit department. These usually involve 15-20 people. The QAR team talks to your customers about how your department serves their needs. These interviews can provide very frank and honest comments and feedback. I must compliment the IIA for this rigorous aspect of the QAR process. I cannot think of any profession that exposes itself to such an invasive examination process.

I know that we all value our relationships with our internal customers and work to keep these relationships strong. But, when you listen to the positives and negatives in these interviews, you cannot help but ask yourself "What would my customers say?" This experience in itself can provide you with motivation to work even harder on these relationships when you get back home to your department.

Another great benefit in participating with the IIA QAR team is the opportunity to work with the IIA team leader. These individuals are experts in the IIA standards. They can be your "audit Yoda". They are retired CAE's and have a bounty of knowledge, practical solutions, and excellent audit stories. My QAR leader and I had many discussions about the standards and their application to the QAR client.

I learned more about the IIA standards during my QAR experience than I have ever learned in any classroom setting. There were times that I thought I should be paying for this experience; it's that good. I think that volunteering members of your audit staff for a QAR would also be a great opportunity, too. They could get out of the office, make a contribution to their profession, and further learn about the IA standards. (In addition, they get CPE credit and you can save on your training budget with the free course.)

Well that's it for this issue. You can send your questions to *Letters to the Auditor* via mail to: *Letters to the Auditor*, c/o John Landreth, 1810 W. Birch Lane, Park Ridge, Illinois 60068, or via email to: prflag2004@aol.com or via phone 847-525-6529. ■