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## Best Practices of: Sarbanes-Oxley Act- Section 404 Compliance

### **Practical Approaches to Compliance**

Although Sec. 404 compliance projects are intended to be comprehensive and thorough, they don't need to be overwhelming. Companies ought to use the opportunity to re-engineer and streamline their business processes. As a rule, companies ought to consider the following when they embark on a Sec. 404 compliance project:

1. Make staff available to the SOX project team. Most audit consultants take an integrated project team approach.
2. The integrated project team must include company management, company functional staff and members of the consulting team.
3. The team will apply the COSO framework for the business processes.
4. The team will apply the COBIT framework for its information technology area.
5. The project must have program and project managers who are accountable.

Since companies must work closely with the consultants, they should seek out and engage the right team. A strong consulting team will have experience in creating and auditing internal controls and will use proven frameworks, COSO and COBIT, as the emerging standard for Sec. 404 compliance as it is endorsed by the PCAOB.

A well-planned Sec. 404 project may be segmented into seven phases:

1. Project planning and orientation
2. Corporate level control assessment
3. Process documentation and narratives
4. Develop individual control matrix
5. Develop remediation plan



6. Develop test procedures and test performance
7. Identify and implement remediation, then re-test

**Project Planning and Orientation.** Through a series of interviews with the company management and internal subject matter experts, consultants will review and gain an understanding of the company’s business practices, policies and procedures; code of ethics; complaints handling process; and human resources policies and procedures.

**Corporate Level Control Assessment.** Consultants interview company executives and board members to understand the company’s internal controls and its commitment to its board of directors and audit committee; integrity and ethics; competence; anti-fraud policy; management philosophy and operations; and organizational structure and authority.

**Process Documentations and Narratives.** Project team leaders will develop narratives of the key processes, which are deemed “high” and “medium” complexity. The narratives describe how tasks are accomplished on a daily basis. Additionally, the documentation and narratives address outstanding issues, risks and any initial design remediation that may be required.

**Develop Individual Control Matrix.** Here, consultants develop a control matrix for each of the identified processes. The matrix is part of the COSO framework and will include, but is not limited to cycle identification (Cycle IDs); financial statement assertions; control objectives; control risks; control activities; control type; control frequency; control owner; test procedures; test results; gaps; and remediation needed.

**Develop Early Remediation Plan.** Consultants develop an early remediation matrix for the identified processes. The team then prioritizes and implements the agreed-upon remediation.



**Develop Test Procedures and Test Performance.** Consultants develop test procedures and determine the type of test to be performed for each of the control activities identified in Phase 4. After the tests are developed, the integrated project team performs the test procedures using specialized test templates.

Any gaps or failed tests will be identified and evaluated, and a determination made as to whether or not the gap or failure is significant enough to constitute a material weakness.

**Identify and Implement Remediation, Then Re-test.** Regardless of the severity, the integrated project team recommends actions to close the gaps and pass the tests. This remediation plan prioritizes the agreed upon remediation. The integrated project helps implement the remediation suggestions. Finally, the remediated processes have to be tested.

### **Additional Details of IT General Controls**

IT general controls' scope of work follows the same seven-phase approach identified above, complies with the COBIT framework and covers the following processes:

- IT planning and governance
- Program development and change controls
- Systems management and operations
- Network security and access control
- Application controls (this is typically a joint effort between the IT team and the business process owner)

### **Conclusion**

In summary, the SOX-404 compliance project and its success is highly dependent on the following:

1. The adoption of emerging standards such as COSO and COBIT frameworks.
2. The engagement of senior management and all business functions within the company.



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3. Portraying a positive attitude towards SOX compliance and use the compliance opportunity to re-engineer and streamline the company business processes. I.E. SOX-404 project is one of the enablers for business improvement.
4. The use of a structured and phase approach to take companies from start to finish of SOX compliance. The initiative represents an opportunity that should not be missed. It is the opportunity to re-engineer the business and introduce new ideas for running an effective operation.

#### Acronyms used:

1. Public Companies Accounting Oversight Board (“PCAOB”).
2. COSO is the Committee of Sponsoring Organizations of the Treadway Commission.
3. Control Objectives for Information and Related Technologies (“COBIT”).

#### **About the Author:**

**Robert Putrus, PE, CMC** – is the Principal of THE ROBERTS COMPANY, LLC. He has an advanced M.B.A., M.Sc., Computer Engineering, M.Sc., and Systems Engineering, and B.Sc., Electrical Engineering. Robert is also a certified Professional Engineer (P.E.), and a Certified Management Consultant (CMC).

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