



“The Internal Audit Professionals”™

SARBANES-OXLEY OVERVIEW

With the issuance of its final rule on Section 404 compliance in early June, 2003, the SEC clarified its position on external auditor independence. Although the final SEC rule does not completely prohibit external auditors from documenting internal controls over financial reporting, the IIA recommends to its members that they proceed with caution when engaging external auditors to participate in any phase of documenting internal controls over financial reporting that lead to management’s assertion about internal controls.¹ With better options available, why risk violating the intent of Sarbanes-Oxley by relying on your external auditors to document internal controls?

It goes without saying that allowing external auditors to document internal controls violates all professional tenets of independence, judgment, common sense and public trust. External audit firms have one primary purpose – to attest to the accuracy of published financial statements. The providing of additional services, such as consulting, tax, and internal auditing, and the conflicts of interest and financial abuses that followed, led to the passage of Sarbanes-Oxley and the requirement to implement many new procedures. .

The Public Company Accounting Oversight Board (PCAOB) may provide much needed oversight to a profession that the public believes has lost its way and ultimately help restore its integrity and the trustworthiness of published financial statements. The PCAOB has indicated that closer scrutiny of internal controls is one of its highest priority items. Existing guidelines on internal control documentation will most likely not be changed by PCAOB. Section 404 requires management of publicly traded companies and federally insured depository financial institutions with assets in excess of \$500 million to:

- 1) State that they are responsible for establishing and maintaining adequate internal controls over financial reporting;
- 2) State that they have assessed the effectiveness of internal controls, and state whether they are effective;

3) Identify the framework, such as “COSO”, that is being used to evaluate the effectiveness of internal controls; and

4) State that, as part of its normal engagement, the external auditor issued an attestation report on management’s assessment of internal controls.

Increased forensic auditing is also high on PCAOB’s priority list. For example, elimination of management’s ability to override accounting controls, such as the preparation of bogus manual journal entries, should be built into all internal control systems and all manual journal entries should be reviewed by internal auditors on subsequent audits. SAS 99, which requires external auditors to approach each audit with “professional skepticism” and brainstorm how fraud could occur, should also be incorporated by internal auditors. Internal auditors should also design audit programs to be unpredictable and test areas that normally would not be tested.

Sarbanes-Oxley Compliance requires more than adoption and implementation of Section 404 obligations for reporting on the adequacy of internal control systems that are in place. Sections 302 and 906 of Sarbanes-Oxley require that quarterly and annual SEC financial report certifications, signed by the CEO and CFO, indicate that the financial statements are accurate to the best of their knowledge, and provide for criminal penalties for knowingly filing a false certification. Section 401 of the Act requires all material off-balance sheet liabilities and transactions to be disclosed in the financial statements. Section 409 requires that material changes in financial condition or operations be immediately disclosed to the public in terms that are easy to understand

Although Sarbanes-Oxley requires additional internal control documentation and may require the use of external resources, it need not consume you or your staff. PRI has extensive experience documenting, testing and remediating both IS/IT and internal controls for Fortune 1000 companies throughout the United States and in Europe and Asia/Pacific.

PRI AUDIT & CONTROL is a full-service professional internal auditing firm with experience and expertise in all areas of internal audit. We are committed to restoring public confidence in the financial and operational auditing process.

For more information on PRI’s approach to Independent Internal Auditing, or any of our other Risk Management or Consulting services, please contact:

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¹ “SEC Issues Last Word” CAE Bulletin: June 10, 2003.