AN ASSESSMENT OF THE COSTS AND BENEFITS ASSOCIATED WITH THE IMPLEMENTATION OF SARBANES OXLEY SECTION 404 IN A SOUTH AFRICAN CONTEXT

by

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Abstract

This research report examines the cost and benefits of the Sarbanes-Oxley Act of 2002 (SOX) on South African companies who have had to comply due to them or their holding companies being listed on the New York Stock Exchange (NYSE) as well as voluntary adaptors of the code. This report further seeks to identify best practices implemented by these companies.

Five South African companies participated in this research and the following key findings were identified:

• Implementation and management of SOX was a time consuming and expensive exercise for all the companies.
• There are significant consistencies amongst all the companies regarding the implementation of SOX, such as making use of a top-down risk based approach and the COSO framework.
• The major differences between the companies were specifically regarding the software solutions used and the impact of the companies’ internal audit departments on SOX implementation and management. It is clear that companies don’t agree on the most efficient and effective way forward with regards to software and the role of the internal audit department.
• All companies involved in the research expressed the opinion that they had not yet “arrived” in terms of SOX implementation, and that many measures still needed to be implemented to ensure that the processes work exactly as intended and as efficient and effective as possible.
• All were of the opinion that the benefit and worth of implementing and managing SOX outweighed the significant costs and time associated therewith. SOX increased awareness of and ownership of governance controls at ground level in these companies. It led to a greater appreciation for critical governance policies and procedures and a continued focus on the expansion and updating thereof. But most notably, SOX does give company executives a greater comfort that the numbers being produced and reported are accurate and can be relied upon.
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Table of Contents

Chapter 1: Orientation..............................................
  1.1 Introduction ..............................................
  1.2 The reasons for the Sarbanes-Oxley Act being brought into being...
  1.3 Objectives of this research ..............................
  1.4 Statement of the problem and sub-problems
  1.5 Delimitation of the study ................................
  1.6 Importance of the study .................................
  1.7 Outline of the research report ............................

Chapter 2: Literature Review ......................................
  2.1 Theoretical base: Need for of accurate financial reporting
  2.2 The Sarbanes-Oxley Act ...................................
  2.3 Comments in literature about the Act ...........................

Chapter 3: Research Methodology ...................................
  3.1 Problem Statement ..........................................
  3.2 Research Methodology .......................................
  3.3 Sampling Method .............................................
  3.4 Design of the research .....................................
  3.5 Target Population ...........................................
  3.6 Sampling frame ..............................................
  3.7 Data collection method .....................................
  3.7 Measuring instrument method ..............................

Chapter 4: Research Results ...........................................
  4.1 Section 1: Demographics of respondents
  4.2 Section 2: Implementation Resources
  4.3 Section 3: Implementation costs
  4.4 Section 4: Internal Audit involvement
  4.5 Section 5: Risk Management Process
  4.6 Section 6: Methodology
  4.7 Section 7: Software
  4.8 Section 8: Control Environment
  4.9 Section 9: The utilisation of spreadsheets for key processes
  4.10 Section 10: Continuing with SOX efforts
  4.11 Section 11: General

Chapter 5: Outcomes ..................................................

Chapter 6: Conclusions ..............................................
  6.1 Effort and resources ........................................
  6.2 External consultants ........................................
  6.3 Internal governance prior to SOX.........................
  6.4 Role of Internal Audit departments
6.5 Impact on risk management.............................................. Error! Bookmark not defined.
6.6 Top down risk approach............................................... Error! Bookmark not defined.
6.7 Over-compliance............................................................. Error! Bookmark not defined.
6.8 Change control............................................................... Error! Bookmark not defined.
6.9 Status of internal control environments...... Error! Bookmark not defined.
6.10 Number of testing cycles.............................................. Error! Bookmark not defined.
6.11 Centralised SOX functions............................................ Error! Bookmark not defined.
6.12 Control owner self-assessment...................................... Error! Bookmark not defined.
6.13 Cascading approach.................................................... Error! Bookmark not defined.
6.14 Use of software............................................................. Error! Bookmark not defined.
6.15 Improvements in control environment .... Error! Bookmark not defined.
6.16 Reduction in number of controls......................... Error! Bookmark not defined.
6.17 Business process knowledge........................................ Error! Bookmark not defined.
6.18 Annual walk through tests ......................... Error! Bookmark not defined.
6.19 Unnecessary and/or duplicated controls ........................................ Error! Bookmark not defined.
6.20 Ownership of controls ............................................. Error! Bookmark not defined.
6.21 Trust in numbers reported........................................... Error! Bookmark not defined.
6.22 Standardised processes and controls............ Error! Bookmark not defined.
6.23 Contributors to control deficiency ................ Error! Bookmark not defined.
6.24 Typical problems remediated towards SOX compliance.......... Error! Bookmark not defined.
6.25 Elimination of significant deficiencies ..... Error! Bookmark not defined.
6.26 Use of spreadsheets.................................................... Error! Bookmark not defined.
6.27 Additional value add.................................................... Error! Bookmark not defined.
6.28 Benefits vs. Costs.......................................................... Error! Bookmark not defined.
6.29 Means to increase effectiveness of SOX complianceError! Bookmark not defined.

Chapter 7: Recommendations................................. Error! Bookmark not defined.
7.1 Use of Internal Audit.................................................... Error! Bookmark not defined.
7.2 Involving the Risk Management function...... Error! Bookmark not defined.
7.3 Use of COSO................................................................. Error! Bookmark not defined.
7.4 Use of entity level controls................................. Error! Bookmark not defined.
7.5 Risk based approach towards evidence ... Error! Bookmark not defined.
7.6 Use of automated controls................................. Error! Bookmark not defined.
7.7 Base lining approach to testing automated controlsError! Bookmark not defined.
7.8 Document management for SOX................. Error! Bookmark not defined.
7.9 The role of Information technology............. Error! Bookmark not defined.
7.10 Solution to manage segregation of duties and system access...... Error! Bookmark not defined.
7.11 Use of ISAE 3402 Report ......................... Error! Bookmark not defined.
7.12 Reducing the use of spreadsheets....... Error! Bookmark not defined.

Chapter 8: Overall Conclusion........................................... Error! Bookmark not defined.

Chapter 9: Recommendations for a future study..... Error! Bookmark not defined.

List of References.......................................................... Error! Bookmark not defined.

List of tables and figures ................................................. Error! Bookmark not defined.
Appendix I: Questionnaire............................................Error! Bookmark not defined.
Glossary of Terms

- **CEO: Chief Executive Officer**
  Typically the highest ranking officer of a company

- **CFO: Chief Financial Officer**
  Normally the top financial officer of a company

- **Control Owner Self Assessment**
  A sustainable process whereby each individual SOX control owner within a company performs effectiveness testing to verify that key controls are functioning properly, resulting in the detection or elimination of material misstatements

- **ERP: Enterprise Resource Planning**

- **FASB: Financial Accounting Services Board**
  A non-governmental organisation that sets accounting standards in the United States of America

- **FPI: Foreign Private Issuer**
  Companies not resident in the US who have listed on a US Stock Exchange

- **FMCG: Fast Moving Consumer Goods**

- **GAAP: Generally Accepted Accounting Practices**
  The standards constituting defined accepted practices for the preparation of financial statements. The FASB has primary responsibility for defining GAAP in the US

- **IFRS: International Financial Reporting Standards**
  Is a collection of accounting rules compiled by the International Accounting Standards Board a non-profit organisation and is used by most countries outside of the US and Canada in order to complete their financial reporting
An assessment of the costs and benefits associated with the implementation of Sarbanes Oxley Section 404 in a South African context

- **ITGC**: Information Technology General Controls
  General controls in the Information Technology portion of a company’s business

- **ISAE**: International Standard on Assurance Engagements

- **JSE**: Johannesburg Stock Exchange

- **KPA**: Key Performance Indicators
  In this research report Key Performance indicators relate to targets that are set (normally annually) with employees and which in most cases influence their bonuses and annual increases

- **LLP**: Limited Liability Partnership
  Often used by professional associations such as law and accounting firms. The owners of the company’s liability is limited to the amount of capital that they have contributed

- **NYSE**: New York Stock Exchange

- **PwC**: Price Waterhouse Coopers

- **PSG**: Professional Standards Group
  Body within Arthur Andersen that was responsible for accounting advice and guidelines

- **SEC**: Securities and Exchange Commission
  Organisation founded in 1923 in America in order to regulate financial reporting and accounting in that country. Has gained increased prominence since the passing of the Sarbanes-Oxley Act with increased funding and wide ranging powers and penalties for those who do not follow its rules
• **Sarbanes-Oxley: Sarbanes-Oxley Act of 2002**
  The Public Company Accounting Reform and Investor Protection Act signed into law on July 30, 2002. The Act enforces financial reporting and disclosure requirements, of which the most onerous is the CEO and CFO certification of the correctness of financial results. The Act is enforced by the SEC

• **SOX: Sarbanes-Oxley Act of 2002**
  See definition for SOX

• **SOX 404: Section 404 of the Sarbanes-Oxley Act**
  This section of the Act requires certification by the specific company’s management that:
  - It acknowledges that it is responsible for establishing and maintaining the system of internal controls and procedures for financial reporting
  - An assessment as at the end of the most recent financial year end of the effectiveness of the firms internal controls has been performed
  - An attestation by the firms external auditors confirming the adequacy and accuracy of the companies controls and procedures has been completed

• **SOX Location**
  A geographic business location of a company where the nature and size of the operations at such location requires the implementation, management and testing of SOX controls.

• **SPE: Special Purpose Entity**
  A separate legal entity created by a company for a special purpose or to carry out a specific activity. Was used by Enron in order to remove loss making operations from the company’s income statement and balance sheets; however a tightening in accounting rules will make this virtually impossible in future.

• **US: United States of America**