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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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

- **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**