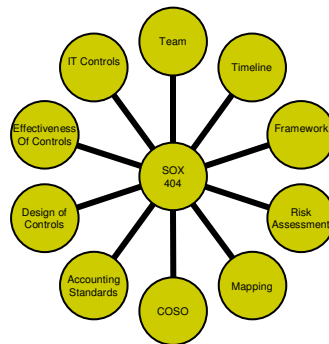
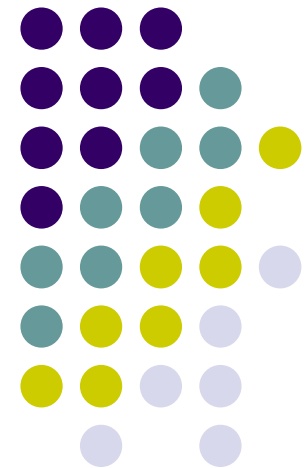




Presented by: Bob Benoit
Lord & Benoit, LLC
One West Boylston St.
Worcester, MA 01605
(508) 853-6404

Ten Steps to SOX Compliance *for Smaller Public Companies*



Source: Lord & Benoit, LLC www.Section404.org



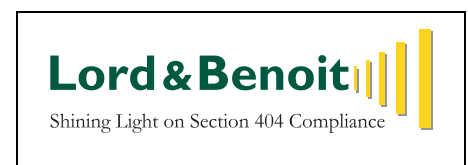
Objective

The following presentation was prepared to assist with the SEC with its Concept Release for helping Smaller Public Companies comply with the requirements of Sarbanes-Oxley Section 404. We believe this framework meets all of the PCAOB of Auditing Standard #2 – Internal Controls over Financial Reporting, however it is prudent for company management to have their outside audit firm approve frameworks in advance.

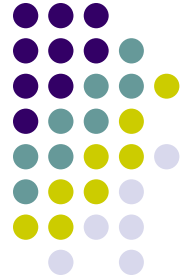
“Having met with and spoken to partners of smaller PCAOB registered CPA firms and CFOs of smaller public companies, the main concern with complying with Sarbanes-Oxley Section 404 seems to be a lack of understanding of the requirements.” says Bob Benoit, President and Director of SOX Research at Lord & Benoit, LLC. Lord & Benoit is a SOX compliance and research firm focused on smaller public companies.

In the public interest and in the interest of continuing to be a thought leaders in SOX 404 compliance and research for smaller public companies, Lord & Benoit is sharing its summary outline of the requirements of the Act (from SEC, PCAOB, AICPA, COSO and IT perspective). Please feel free to contact Bob should you have any questions at (508) 853-6404 x204.

Source: Lord & Benoit, LLC www.Section404.org



Background



Bob Benoit has been teaching Complying with Sarbanes-Oxley Section 404 throughout the country and through the State CPA Societies. He has also served on the AICPA Peer Review Acceptance Board for the past ten years in Massachusetts.

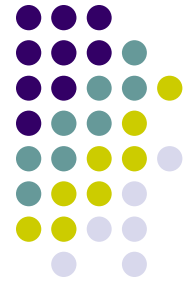
Bob's research on smaller public companies has been quoted by the Wall Street Journal and over one hundred other influential SOX trade journals, legal organizations, educational institutions, SEC Staff, Commissioners and Advisory Committees, PCOAB Board members and all of the Big 4 CPA firms.

Links to some of Bob's teachings and research are in the Appendices section of this this presentation.

Source: Lord & Benoit, LLC www.Section404.org



Ten Steps



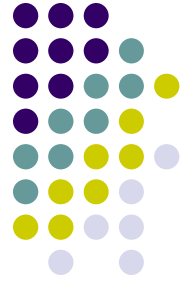
The following are ten steps that a smaller public company could follow to implement a complete a SOX 404 project.



Source: Lord & Benoit, LLC www.Section404.org



What comprises SOX Section 404?



The practical application of SOX 404 requires an understanding of many different frameworks and auditing standards. For instance, it requires and understanding of all of the following:

- Sarbanes-Oxley Act
- PCOAB Auditing Standard #2
- SEC Q&A Standards
- AICPA/FASB Standards
- CoBIT or ITGI or SAS 55 for IT
- COSO or Small COSO for Internal Control

Source: Lord & Benoit, LLC www.Section404.org

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Step 1

The first step is to “Line Up Your Team”

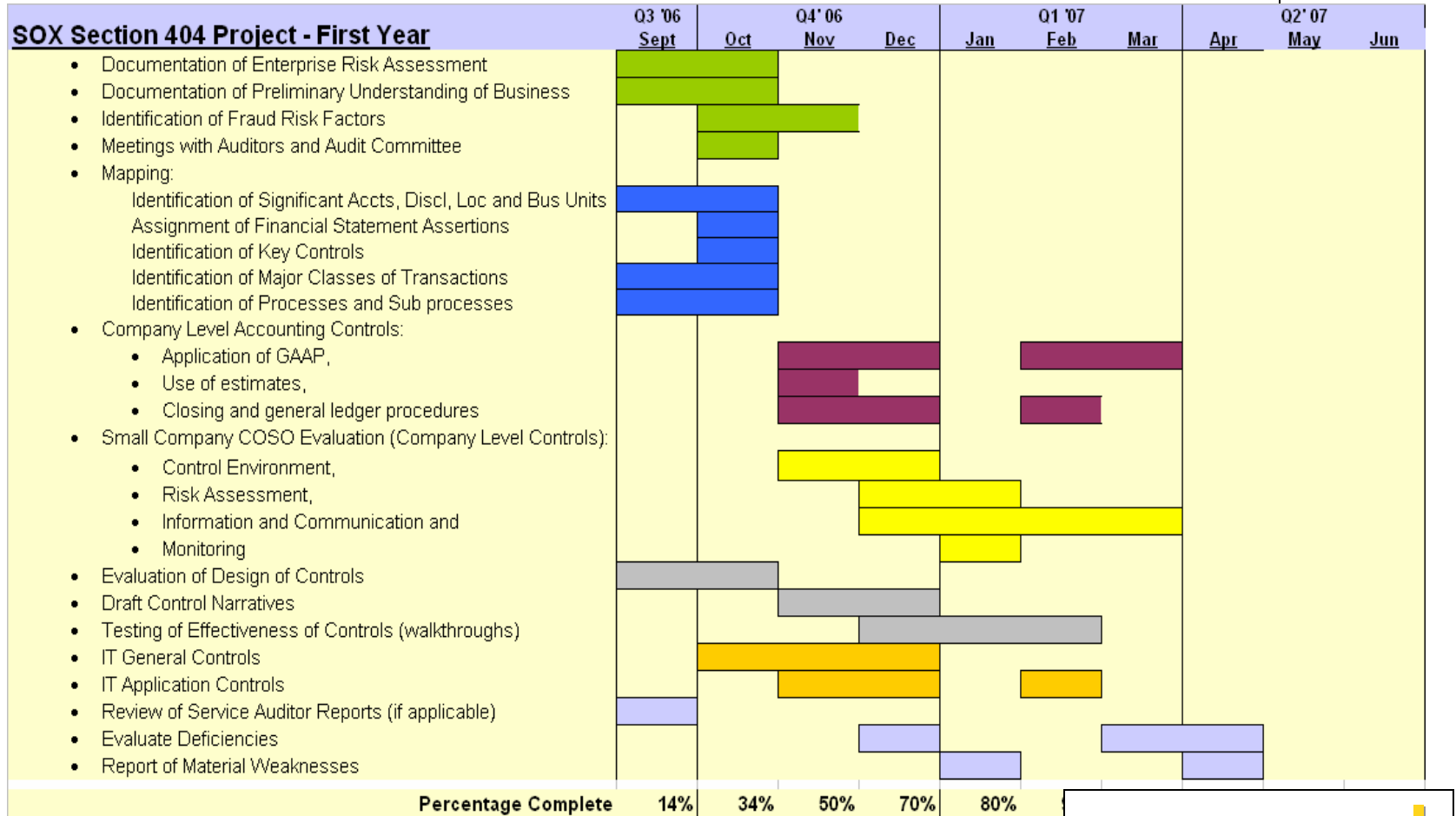
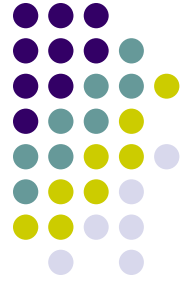


- In house team and their resumes
- External and their qualifications
- Include the outside auditors in the control concepts, but not testing
- Ensure management and upper management are on board
- Prepare audit committee
- Expect much improvement and redesign in year one. Consider starting soon

Source: Lord & Benoit, LLC www.Section404.org

Step 2

The second step is to “Establish a Timeline”



Source: Lord & Benoit, LLC www.Section404.org



Step 3

The third step is to “Select the Frameworks”



Internal Control Frameworks:

- COSO
- COSO for Smaller Public Companies

IT Frameworks:

- CoBIT
- ITGI Control Initiative for Sarbanes-Oxley
- SAS 55

We highly recommend the new COSO for Smaller Public Companies. It clarifies the larger picture of SOX 404 beyond the original COSO. Regular COSO primarily addresses the 5 Elements of Internal Control with little guidance on risk assessment, which is key in SOX 404 compliance process.

Source: Lord & Benoit, LLC www.Section404.org

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Step 4

Macro Level Risk Assessment



Although not required by professional standards, we recommend a **Macro Level Risk Assessment**. It summarizes ALL of the adverse Section 404 weaknesses that peer companies reported in their compliance efforts. This is a sample of all of the first year adverse reports of companies in the Biotech, Pharm and Life Science industries. Macro Level Risk Assessment helps us understand the risks in our peer industries with the end goal in mind.

<u>Accounting Material Weaknesses</u>	<u># Co.s</u>	<u>%</u>
Revenue recognition issues	11	45.8%
Inventory, vendor and cost of sales issues	8	33.3%
Tax expense/benefit/deferral/other (FAS 109) issues	8	33.3%
Accounts/loans receivable, investments & cash issues	7	29.2%
PPE , intangible or fixed asset (value/diminution) issues	7	29.2%
Foreign, related party, affiliated and/or subsid issues	5	20.8%
Liabilities, payables, reserves and accrual est failures	4	16.7%
Debt ,quasi-debt, warrants & equity (BCF) security issues	3	12.5%
Fin Stmt/ footnote/ US FASB, segment disclosure issues	3	12.5%
Acquisition, merger, disposal or reorganization issues	2	8.3%
Income statemt classification, margin and EPS issues	2	8.3%
Lease, FAS 5, legal, contingency & commit issues	2	8.3%
Deferred, stock-based or executive comp issues	1	4.2%
Depreciation, depletion or amortization issues	1	4.2%
Gain or loss recognition issues	1	4.2%
Intercompany/Investment w/ sub/affil issues	1	4.2%

<u>Internal Control Material Weaknesses:</u>	<u># Co.s</u>	<u>%</u>
Accounting documentation, policy and/or procedures	22	91.7%
Material and/or numerous auditor /YE adjustments	14	58.3%
Accounting personnel resources, competency/training	12	50.0%
Restatement or nonreliance of company filings	12	50.0%
Segregations of duties/ design of controls (personnel)	10	41.7%
Untimely or inadequate account reconciliations	6	25.0%
Information technology, software, security & access issues	4	16.7%
Restatement of previous 404 disclosures	3	12.5%
Senior management competency, tone, reliability issues	3	12.5%
Ethical or compliance issues with personnel	1	4.2%
Ineffective or understaffed audit committee	1	4.2%
Insufficient or non-existent internal audit function	1	4.2%
Scope (disclaimer of opinion) or other limitations	1	4.2%

Source: Lord & Benoit, LLC using AuditAnalytics.com

4

Risk Assessments

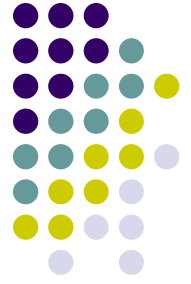
The following risk assessments are required. Enterprise Risk Assessment and Fraud Risk Assessment should be performed in the early stage of SOX 404 compliance. We recommend starting here to focus our attention to the high risk areas early in the project.



Enterprise Risk Assessment	Fraud Risk Assessment
Risk	Fraud Risk (Reporting and Misappropriation of Assets)
1. Major Assets and Liabilities	1. Susceptibility of the client's financial statements to material misstatement
The nature of the company's inventory (for example, whether commodity, protected by patents, subject to rapid obsolescence)	How and where the company's financial statements (for example, which accounts or transaction classes) might be susceptible to material misstatement due to fraud.
Significant asset or liability amounts subject to estimation procedures	How management could perpetrate and conceal fraudulent financial reporting.
Significant assets likely to be impaired.	How the company's assets could be stolen.
Significant self-constructed assets.	External and internal factors that might create incentives/pressures, provide opportunities, or enable rationalization of fraud.
Whether the company is subject to significant product warranties	The nature and risk of management override of controls.
Potential liabilities from litigation or other significant contingencies	
2. Company's Revenues and Marketing Methods	2. Inquiries of Company Management, Employees +/or Audit Committee
The nature of the company's lines of business and whether there have been significant changes.	Their knowledge of any actual fraud or suspicions of fraud affecting the company.
Whether revenues are dependent on primarily a few large customers	Their awareness of any allegations of fraud or suspected fraud affecting the company.
Whether the company does significant business with customers in highly competitive markets	
Whether the company has noted a significant slowdown in customer orders	
Significant changes in the company's bad debt experience.	
Whether revenues are increasing or decreasing (provide reasons such as aggressive marketing, economic conditions, loss of major customers)	
Whether the company has difficulty meeting demand or in generating sales orders.	

Step 5

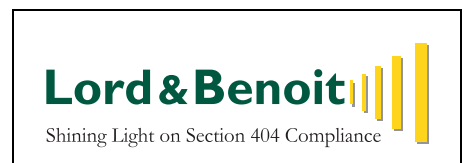
The fifth step is “Mapping”



“Mapping” requirements are defined
in PCAOB Auditing Standard No. 2.

- Identify significant accounts and disclosures
- Identify significant business units and locations
- Indicate relevant financial statement assertions
- Determine major classes of transactions
- Document significant processes and sub processes
- IT Infrastructure
- Identify internal controls over major classes of transactions
- Evaluate likelihood, magnitude and other controls.
- Determine which controls should be tested

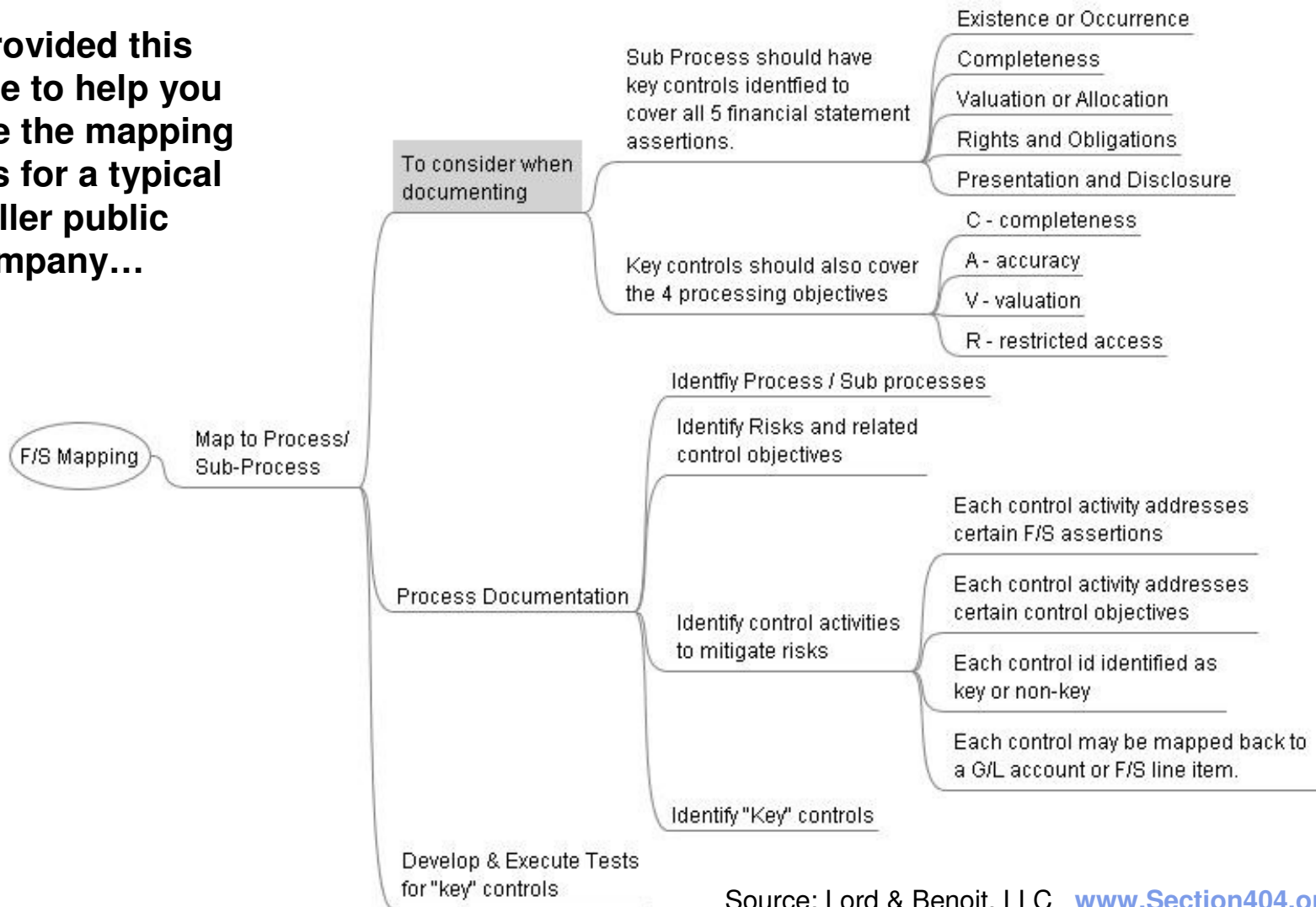
Source: Lord & Benoit, LLC www.Section404.org



Another Look of “Mapping”



We provided this template to help you visualize the mapping process for a typical smaller public company...



Step 6

The sixth step is evaluating “Company Level Controls”



COSO “Control Environment”

We start the company level control documentation process early by looking at COSO requirements.

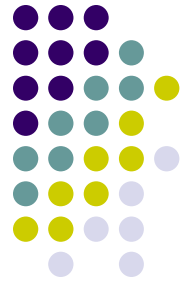
- Integrity & Ethical Values
- Commitment to Competence
- Board of Directors/Audit Committee
- Management’s Philosophy and Operating Style
- Organizational Structure
- Assignment of Authority & Responsibility
- HR Policies and Procedures

Source: Lord & Benoit, LLC www.Section404.org

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6

Company Level Controls



COSO “Risk Assessment”

8. Financial Reporting Objectives - Management specifies financial reporting objectives with sufficient clarity and criteria to enable the identification of risks to reliable financial

Do financial reporting objectives align with the requirements of generally accepted accounting principles?

Are the accounting principles selected appropriate in the circumstances?

Are financial statements informative of matters that may affect their use, understanding, and interpretation?

Is information presented classified and summarized in a reasonable manner, neither too detailed nor too condensed?

For each significant account and disclosure, are financial reporting objectives supported by financial statement assertions that underlie a company's financial statements?

Does the financial statements presentation reflect the idea of materiality?

9. Financial Reporting Risks - The company identifies and analyzes risks to the achievement of financial reporting objectives as a basis for determining how the risks

Does the company's risk identification include consideration of the business processes that impact financial statement accounts and disclosures?

6

Company Level Controls



COSO “Information & Communication”

COSO “Monitoring”

Source: Lord & Benoit, LLC www.Section404.org

Step 7

The seventh step is testing “Company Level Accounting Controls”



Company Level Accounting Controls

- Period End Closing Activities
- Significant Estimates
- Application of GAAP
- General Ledger
- Significant Disclosures

Source: Lord & Benoit, LLC www.Section404.org

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Step 8

The eighth step is the “Design of Internal Controls”



This is the area we think of most when we think of internal controls.

Although in a smaller public company this area often represents the least risk.

However, it needs to be documented to satisfy SOX 404.

1) Assessing Design of Controls

2) Documenting Control Narratives

Source: Lord & Benoit, LLC www.Section404.org

Lord & Benoit

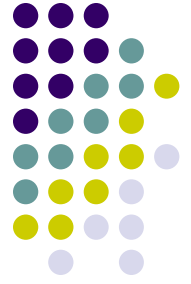
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Step

9

Step nine is “Testing Operating Effectiveness” *(also called Activity Level Controls)*



This is what accountants would affectionately call the “test of transactions”. It includes testing of expenditures, treasury, revenue, payroll, property, debt/equity, etc. Activity level control tests should be tested after controls are re-designed. However the company must be sensitive to the sustainability aspect of SOX 404, so activity level control testing should not be completely ignored at the outset. Conversely, documenting activity level control tests before addressing design deficiencies leads to redundancy, because the controls will need to be retested after the redesign.

Source: Lord & Benoit, LLC www.Section404.org

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9

Sample sizes and significant controls should be identified at the risk assessment process level mentioned earlier.

It is also wise to coordinate and determine what constitutes a significant control with outside auditors to minimize both over and under testing.



Testing of Controls

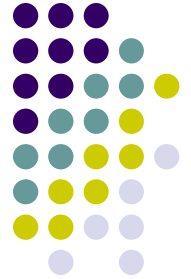
- Daily
- Weekly
- Monthly
- Quarterly
- Once a year
- Establish sample size
- Test Key Controls

Inquiry
Observation
Inspection



Step 10

The final step is “IT Controls”



Although presented last in this ten step process, IT should be assessed concurrently with the other tests, including the IT risk assessment process.

Two areas need to be tested and documented in the area of IT; general computer controls and application controls.

General IT Controls

- Design of IT environment

IT Application Controls

- Effectiveness of controls

Source: Lord & Benoit, LLC www.Section404.org

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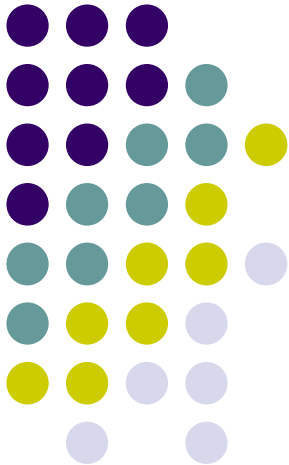




Presented by: Bob Benoit
Lord & Benoit, LLC
One West Boylston St.
Worcester, MA 01605
(508) 853-6404

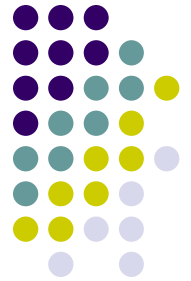
Please feel free to contact
Bob Benoit with any
question at (508) 853-6404.

Ten Steps to SOX Compliance *for Smaller Public Companies*



Source: Lord & Benoit, LLC www.Section404.org

Appendix: Bob Benoit's Education & Training classes



- [KPMG's SOX 404 Institute \(coming this fall\)](#)
- [Center for Business Intelligence \(Sept 28, 2006\): SOX Conference – Biotech/Pharm](#)
- [Marcus Evans \(Nov 14-15, 2006\): \(Miami\) COSO for Smaller Public Companies](#)
- [Marcus Evans \(Dec 7-8, 2006\): \(San Jose\) COSO for Smaller Public Companies](#)
- [Compliance Online \(Aug 2, 2006\): 10 Pre-SOX Tips for Smaller Public Companies](#)
- [Compliance Online \(Jul 18, 2006\): Risk Assessment for Biotech/Pharm/Life Science](#)
- [Ohio Society of CPAs \(2005\): Cleveland](#)
- [Ohio Society of CPAs \(2005\): Columbus](#)
- [Ohio Society of CPAs \(2005\): Cincinnati](#)
- [Arizona Society of CPAs \(2005\)](#)
- [Texas Society of CPAs \(2005\): Dallas](#)
- [Texas Society of CPAs \(2005\): Houston](#)
- [Wisconsin Institute of CPAs \(2005\)](#)
- [New Jersey Society of CPAs \(2005\)](#)
- [Michigan Association of CPAs \(2005\): Troy](#)
- [Michigan Association of CPAs \(2005\): Grand Rapids](#)
- [Michigan Association of CPAs \(2005\): Detroit](#)
- [Nevada Society of CPAs \(2005\)](#)

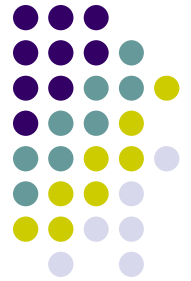
Source: Lord & Benoit, LLC www.Section404.org

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Appendix: Recent Lord & Benoit Research referenced in Newspapers, Research & Trade Publications

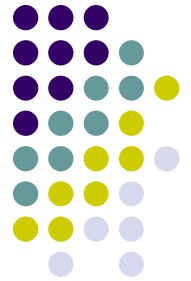


- [Wall Street Journal](#) (May 8, 2006): Lord & Benoit Report “Checks on Internal Controls Pay”
- [CCH Public Accounting Report](#) (March 2006): “Financial Restatements”
- [BNA](#) (May 2006): Sarbanes-Oxley and Small Business
- [Thomson Financial](#) (May 11, 2006): “Investment Research”
- [ADP](#) (2006) “HR's Role in Ensuring Compliance and Driving Cultural Change”
- [BNA](#) - Article about restatements research
- [FEI](#) (May 8, 2006): “Cost, Benefits of 404 to Investors”
- [RIA Thomson/Southwest Learning](#): reprint of WSJ article
- [Sarbanes-Oxley Compliance Journal](#) (April 25, 2006):
- [Sarbanes-Oxley Compliance Journal](#) (May 12, 2006): “Share Price Increases”
- [FEI](#) (June 13, 2006): AuditAnalytics Presentation
- [Top 40 Accounting Firms](#) (2007 Edition): Lord & Benoit SOX research
- [CFO.com](#) (April 14, 2006): “A Question of Scale Not Exemption”
- [SOX First](#) (April 25, 2006): “Getting Even with Accountants”
- [Securities Fraud Monitor](#) (2006): “Strong Internal Controls Benefit Shareholders”
- [CMA Conference](#) (June 1-2, 2006): “Internal Control - SOX Certifications”
- [Counsel of Institutional Investors](#) (May 17, 2006): letter to Chairman SEC and PCAOB
- [CFO.com](#) (May 16, 2006): comment about “Do Benefits Exceed Cost?”

Source: Lord & Benoit, LLC www.Section404.org



Appendix: Recent Lord & Benoit Research referenced by “Big 4”

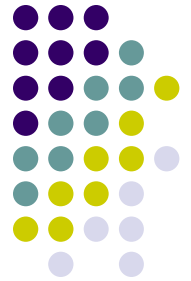


- [PWC Training Materials \(May 16, 2006\): “Navigating the New World”](#)
- [Ernst & Young \(June 2006\): “Finance-Magazine, Risk Matters”](#)
- [KPMG website \(May 30, 2006\): requested both research reports on their client website](#)
- [Grant Thornton \(June 20, 2006\): Trent Gazzaway, at Capital Hill in Washington, D.C.](#)
- [Deloitte \(June 1-2, 2006\): Presentation materials at CMA Conference](#)
- [Protiviti \(May 12, 2006\): Their Newsletter](#)
- [Deloitte Germany \(June 2006\): “Business-IT-News”](#)
- [Ernst & Young: “Key S404 Events and Releases” \(April/May 2006\)](#)
- [Deloitte \(April 3, 2006\): Their letter to SEC Advisory Committee](#)
- [Deloitte LINK \(April 14, 2006\): Bridging the Sarbanes-Oxley Disclosure Control Gap](#)
- [PWC: CFO Direct Website \(May 10, 2006\) transcript of “2006 Internal Control Roundtable”](#)
- [Ernst & Young Ireland \(May 25, 2006\): Steering Committee Meeting of Bank of Ireland](#)
- [Big 4.com \(May 2006\): Volume 1 “Bridging the SOX Disclosure Control Gap”](#)
- [Deloitte \(May 11, 2006\): newsletter about PCAOB/SEC Internal Controls Roundtable](#)
- [Big4 Alumni Magazine \(May 2006\) Volume 1 Issue 5](#)
- [Deloitte Canada \(May 2006\): posted report on their website](#)
- [Big4.com \(May 2006\): Volume 4 “Share-Price-Movements”](#)

Source: Lord & Benoit, LLC www.Section404.org



Appendix: Recent Lord & Benoit Research references by SEC and PCOAB



- [SEC Commissioner Glassman's \(May 8, 2006\): "CFO Summit: Putting Sarbanes-Oxley Section 404 in Perspective"](#)
- [PCAOB Standing Advisory Group Meeting \(June 13, 2006\) : "Implications of ICFR Reporting"](#)
- [PCAOB Board Member Neimeier \(May 4, 2006\): "Confronting the Challenges of Change"](#)
- [PCAOB Chief Auditor Thomas Ray \(June 8, 2006\): "25th Annual SEC and Financial Reporting Institute Conference"](#)
- [SEC Staff \(April 7, 2006\): their letter to SEC Advisory Committee](#)
- [PCAOB/SEC Internal Controls Roundtable \(May 10, 2006\): Mr. Johnson from Calpers mentions research about share price movement](#)
- [AICPA - Center for Public Company Audit Firms \(May 15, 2006\): mentioned report in Summary of SEC 404 Roundtable](#)
- [PCAOB/SEC Internal Controls Roundtable \(May 10, 2006\): unedited transcript](#)
- [SEC Advisory Committee \(April 18, 2006\): Discussion Draft](#)
- [SEC Advisory Committee \(April 12, 2006\): Proceedings](#)
- [SEC Advisory Committee \(April 23, 2006\): Final Report](#)

Source: Lord & Benoit, LLC www.Section404.org

