

Lord & Benoit, LLC, a SOX 404(a) Consulting Firm
focused on small to mid-sized public companies.

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Rebuilding our Economy
How SOX Helps to Build Trust

Lord & Benoit 
Shining Light on Section 404 Compliance

Continuing Professional Education

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- There will be instructions at the end of this seminar on obtaining CPE credit* for this webinar.
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- * *Please note: State Boards of Accountancy have final authority on the acceptance of individual courses for CPE credit.*

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Presenter

Bob Benoit is President of Lord & Benoit. He served on the most recent COSO Monitoring Project Task Force. He also served on AICPA Peer Review Acceptance Board for ten years. He is the author of the Lord & Benoit Reports, which have been referenced by the SEC, PCAOB, Wall Street Journal, Business Week, all Big 4 firms and over 150 newspapers, magazines, legal, educational and trade journals worldwide. Bob is also the first evaluator to use the 2006 COSO Guidance for Smaller Public Companies, and the inventor of Virtual SOX.



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Today's Webinar

Regulatory Update on SOX 404

What Does SOX 404 Have to do with Trust?

What role does the COSO Guidance play?

Long Term Personal Benefits of Integrity and Trust

Rules Based vs. Principles Based Ethics Programs

Regulatory Update

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Update on SOX 404

- The logo of the U.S. Securities and Exchange Commission (SEC), featuring an eagle with wings spread, holding an olive branch and arrows, with a shield on its chest. The text "U.S. SECURITIES AND EXCHANGE COMMISSION" and "1934" are visible around the eagle.
- The logo for the Public Company Accounting Oversight Board (PCAOB), consisting of the letters "PCAOB" in a bold, serif font, with a small registered trademark symbol (®) to the upper right.
- The logo for the Committee of Sponsoring Organizations of the Treadwell Commission (COSO), featuring the word "COSO" in a bold, italicized, sans-serif font, followed by a stylized flower-like graphic.

Securities & Exchange Commission

“Since there will be no further Commission extensions, it is important for all public companies and their auditors to act with deliberate speed to move toward full Section 404 compliance.”

SEC Chairman Mary L. Schapiro



Securities & Exchange Commission

“The Commission is for the first time resolving that uncertainty by making it clear that all public companies, regardless of size, will be required to comply with Section 404(b) of the Sarbanes-Oxley Act.”

Commissioner Luis A. Aguilar



Securities & Exchange Commission

The management reports on internal controls filed under Sarbanes-Oxley Section 404(a) will be classified as filed rather than furnished to the SEC.

This will cause non compliance with 404(a) to become a legal liability.

Tax & Accounting of Thomson Reuters

Public Companies Accounting Oversight Board

“In its latest summary of its inspections of the eight largest audit firms — covering four years of reviews — the Public Company Accounting Oversight Board pings the auditors for failing to use enough professional skepticism in their audits of companies' financial statements...

CFO Magazine

PCAOB[®]

Public Companies Accounting Oversight Board

“A second area reviewed, actually a subset of the first, was the assessment of fraud risk.”

“In a minority of audits, the board found failure to do more rigorous testing in areas of greater risk, and failure to test compensating controls.”

CFO Magazine

PCAOB[®]

Public Companies Accounting Oversight Board

“The board also evaluated auditors' use of the work of others to cut down on their own work, a practice that AS5 specifically allows. But some audits didn't sufficiently assess the competency or objectivity of others' work, particularly when the work was performed by company personnel other than internal auditors.”

PCAOB[®]

ALL Governing Boards

Smaller companies have a harder time performing SOX inhouse, because evaluators must be competent AND objective. Objectivity requires a person to be uninvolved in the process altogether. Otherwise they would be reviewing their own work, which is not considered a valid monitoring evaluation. Competence and objectivity are required by COSO, SEC Interpretive Guidance and PCAOB Standard 5.

PCAOB[®]



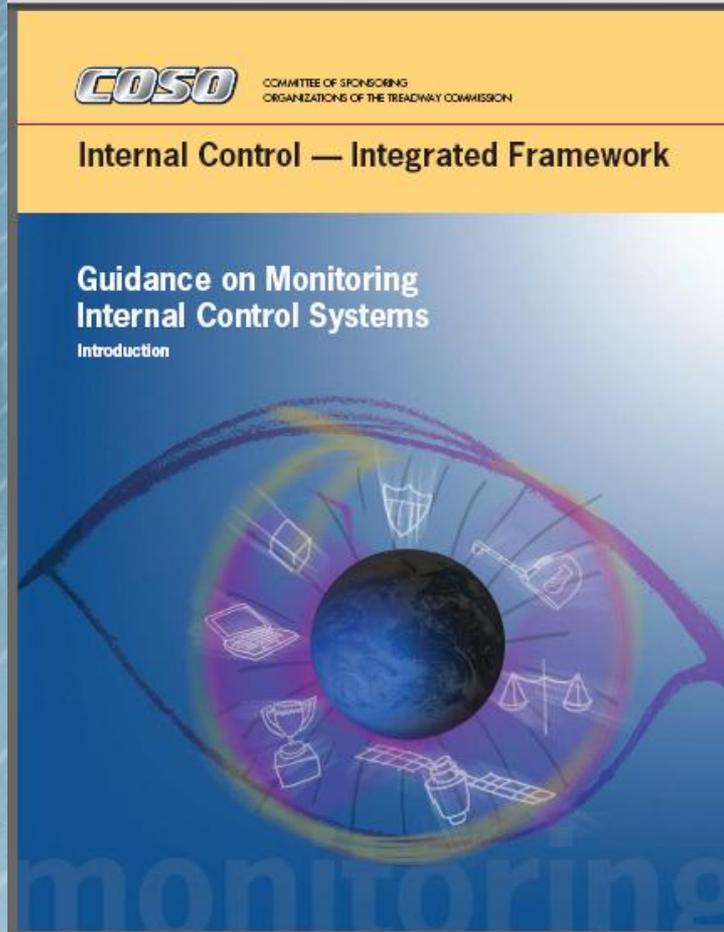
ALL Governing Boards

Smaller companies rarely have competent repeat skill sets in house. This is particularly apparent in Information Technology. A complete review of the IT function is required each year. Smaller companies typically have only one or two internal IT staff. Therefore it is difficult if not impossible to effectively objectively assess IT, since the assessor is probably the one doing the work.

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House of Representatives

H.R. 4173, Wall Street Reform and Consumer Protection Act would exempt companies with market caps of \$75 million or below from Sarbanes-Oxley Act's Section 404(b). Section 404(b) requires a company's auditors to document and test its internal controls over financial reporting (ICFR).

What Does SOX 404 have to do with Trust?

Priority of Ethical Values in COSO Framework

Ethical Values - COSO Framework

Integrity and Ethical Values - Sound integrity and ethical values, particularly of top management, are developed and understood and set the standard of conduct for financial reporting.

Ethical Values - COSO Framework

Top management –

#1 Has top management developed a clearly articulated statement of ethical values that is understood at all levels of the organization?

Rules based, Principles based
Example website

Ethical Values - COSO Framework

Top management –

#2 Are processes in place to monitor adherence to principles of sound integrity and ethical values?

Ethics courses, Performance appraisals

Ethical Values - COSO Framework

Top management –

#3 Are deviations from sound integrity and ethical values identified in a timely manner and addressed and remedied at appropriate levels within the company?



Whistleblower hotline
Example Tipping Point

COSO Guidance

Tone at the Top

COSO Guidance – Tone at the Top

Board of Directors - Understand and exercise oversight responsibility related to financial reporting and related internal control.

Example now defunct company

COSO Guidance – Tone at the Top

Board of Directors –

- Does the board of directors *actively* evaluate and monitor risk of management override of internal control and consider risks affecting the reliability of financial reporting?

Effect on D&O insurance

COSO Guidance – Tone at the Top

Board of Directors –

- Does the audit committee actively monitor the effectiveness of internal control over financial reporting and financial statement preparation?

Cease and desist order SEC

COSO Guidance – Tone at the Top

Board of Directors –

- Does the audit committee meet privately with the INTERNAL and external auditors to discuss relevant matters?

COSO Guidance – Tone at the Top

Human Resources - Policies and practices are designed and implemented to facilitate effective internal control over financial reporting.

Smaller Company Application

COSO Guidance – Tone at the Top

Has management established human resource practices that demonstrate its commitment to integrity, ethical behavior, and competence?

Sample values, Sample performance appraisals

SEC and PCOAB Guidance Emphasis on Fraud

SEC/PCAOB Guidance – Fraud

- All had two or more means of committing fraud through check signing, wire transfers, cash receipts and fictitious employees.
- 95.8% had ability to commit fraud through IT Operations.

Acquisitions

SEC/PCAOB Guidance – Fraud

- 79.2% had Financial Reporting fraud capabilities.
- 1,338 Control Deficiencies were found, an average of 56 per company. One company had ways of committing fraud.

Tipping point

Long Term Benefits of Integrity and Trust

Lord & Benoit 
Shining Light on Section 404 Compliance

Presenter

Drew Crandall is a Principal and in charge of Marketing/Customer Service at Lord & Benoit. He also serves on the Executive Committee of the Better Business Bureau of Connecticut, is a recipient of a BBB Torch Award for Marketplace Ethics, and has been active in the BBB for over 20 years.



Benefits of Integrity and Trust

- We are surrounded by very well-educated, smart men and women, in executive positions at a diverse spectrum of public companies, consulting firms, and government entities.
- We are used to carefully assessing, analyzing, counting the cost, and making executive-level decisions.

Benefits of Integrity and Trust

- We've had careers that span many years. We've learned many things through osmosis, by observing the choices and experiences of our peers.
- Some of us have top-level responsibility for our organizations and others can influence corporate integrity.

Benefits of Integrity and Trust

- In our marriage and family life
- In our career success
- In our financial health
- In our emotional, mental, physical health
- In our stress level
- In our overall enjoyment of life

Consequences of Poor Behaviors

- For this webinar, we studied the lives of CEOs, VPs of Finance, CFOs, and CIOs at public companies who succumbed to the pressures of CEOs and Board Members

Consequences of Poor Behaviors

The Result:

- Time in prison
- Probation
- Home detention
- Fines
- Forfeitures
- Restitution
- ┌ Barred from serving as officer or director of a public company.

Consequences of Poor Behaviors

- CFO Magazine reported that *“even the hint of a scandal can tarnish a reputation built over decades...Having your name linked to fraud can be the death knell for a CFO’s career.”*
- It was guilt by association, even when they weren’t directly part of the misbehavior.
- Settlements were often perceived to be admissions of guilt.

Consequences of Poor Behaviors

- Shame, embarrassment, humiliation, disgrace
- Marital tension, separation, divorce
- Dramatic decline in family finances
- Strained and destroyed relationships with friends and in the community
- Bullying, taunting in school and public places
- Family reclusiveness or relocation
- Wounds and scars that last a lifetime and for multiple generations

As We Begin the New Year...

- We need to make a strong personal commitment to maintain trust, to apply strong ethics and integrity in our positions...
- ...to lead other executives by example...
- ...and urge them to also “count the cost” and stay on the High Ground.
- For our own sakes and for the greater purpose of economic development, we need to stand strong and flourish on the foundation of Trust

Advice about Trust from a Convicted Felon

"The main pillar of our capitalist free market economic system, which is a cornerstone of our democracy, is the integrity of financial information. Without reliable financial information, capitalism cannot survive. The integrity of financial information can only be achieved through building blocks such as sound internal controls and independently verifiable financial information."

~ **Sam E. Antar**, convicted felon, former CPA, and CFO of Crazy Eddie's (one of the largest U.S. stock market securities frauds of the 1980s)

Rules-Based vs. Principles-Based Application of Ethical Values...

Presenter

Michael Mooradian, CISA is Vice President, Operations & IT Compliance at Lord & Benoit, LLC, and a seasoned professional with over twenty years of senior management experience in the information technology field. Prior to joining Lord & Benoit, Michael directed IT organizations supporting multi-national locations for Digital Equipment Corporation, Brooks Automation and The Thomson Corporation. He has provided consulting services to clients such as AT&T, the Securities and Exchange Commission (SEC), Dun & Bradstreet, IBES, Business Wire, Ziff-Davis Publishing and Pfizer.



Importance of Corporate Values

- Research has repeatedly shown that visionary companies that succeed for decades are guided by a set of core values
- Corporate values are not situational, relative, or provisional. They reflect the foundational ideologies of the company and cannot be altered in an economic downturn
- Values provide a common language for aligning a company's leadership and its people

Putting Values Into Action

- Senior management must embrace and model corporate values
- Values do not drive the business; they drive *the people* within the business.
- Employees who succeed in business by violating organizational values must not be permitted to prosper

Putting Values Into Action

- Mapping company values to measurable behaviors emphasizes both their importance and long term commitment and can now be measured and tracked within a performance review
- Behaviors help define performance expectations for employees by focusing on the importance of not only achieving results but how those results were accomplished.

Putting Values Into Action

Putting Values into Action

- People are rewarded (compensation increase, promotion etc.) based on performance and values

The Values Framework

- Establishing company values
- Mapping behaviors to those values
- Creating job-specific behavior expectations (e.g. within a job description)
- Incorporating behaviors into performance goals
- Focusing performance evaluations on both behaviors and results
- Developing compensation programs that reward total performance

How SOX Helps Build Trust

- Integrity and Ethical values are a priority in COSO Framework, not only for management, but Board of Directors/Audit Committee. And all employees through Human Resources
- Fraud prevention helps the bottom line, prevents problems, ensures systems are consistent with company objectives.

How SOX Helps Build Trust

- Long term personal benefits of trust and integrity, and risks of poor ethical behavior
- Successful companies communicate core values, which help drive consistent employee behaviors, create measurable results, and establish appropriate systems for rewards.
- With employees following company values, we see controlled growth, sales and profitability

Continuing Professional Education

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- You will be asked to complete an Evaluation Form

We will send you:

- Certificate of Completion form
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Please note: State Boards of Accountancy have final authority on the acceptance of individual courses for CPE credit.

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What's Next?

Lord & Benoit

Shining Light on Section 404 Compliance

Virtual SOX™ Technologies
Reaching the World with Automation
March 23, 2010, 2PM ET