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## Sarbanes-Oxley Act

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## Sarbanes - Oxley Compliance



The Public Company Accounting Reform and Inventory Protection Act of 2002 (commonly referred to as the Sarbanes-Oxley Act or SARBOX) was enacted primarily in response to major accounting scandals involving several prominent U.S. companies which resulted in a loss of public trust in corporate accounting and reporting practices. The Act required public companies to develop new practices involving corporate governance and financial reporting with the objective of restoring the public trust in the capital markets (AICPA, 2005).

One of the most significant aspects of the Act's requirements involves a company's responsibilities for internal controls. Under Section 404 of the Act, public companies must now annually assess and report on the effectiveness of the company's internal controls over financial reporting. In addition, the company's outside auditor must issue an opinion as to whether the company has:

- an appropriate basis by which to make their report on the internal controls and;
- controls that are appropriately designed and operating effectively

Final rules issued pertaining to Section 404 indicate that it is a company's responsibility to document internal controls and that developing and maintaining such documentation is inherent to effective internal control. In addition, Section 404 requires that management base its

assessment on the effectiveness of its internal controls on a suitable, recognized control framework. The COSO (Committee of Sponsoring Organizations) framework which contains five significant components is the most widely applied model in the United States. Management must demonstrate that each of these components has been documented, tested and evaluated. Within this context, it is key for management to perform four steps in documenting its internal controls.

1. Document the manner and means by which management determined which accounts and disclosures are to be evaluated and which locations should be included in the internal control documentation.
2. Document the flow of transactions for significant accounts and disclosures to determine where material misstatements could occur. During this process, identify and document the related control activities.
3. Document the assessment of the design of controls.
4. Document the testing of those controls and the assessment of the controls' operational effectiveness.

Compliance with the various provisions of the Sarbanes-Oxley Act requires a substantial investment of time and people. Complex record keeping, detailed tracing of responsibilities, and the documentation of the fulfillment of those responsibilities necessitate the utilization of software that accomplishes these tasks with a minimum of extra effort.

The methodology used in establishing a structure for the documentation of existing controls, the assignment of responsibility for the maintenance of those controls, and the testing and evaluation of existing controls becomes paramount in order to accomplish the tasks required by Sarbanes-Oxley. The follow up as to continuing to maintain the documentation that controls are functioning also becomes a significant part of the compliance process and really is the ongoing portion of Sarbanes-Oxley Section 404 as to internal controls.

Some of the major issues confronting SARBOX initiatives are work in progress valuations for companies that are projected, establishing a

responsibility assignment matrix across all projects, and proper supporting documentation controls pertaining to authorized changes. A sound Enterprise Project Management (EPM) discipline can help organizations accomplish various aspects of appropriate controls to assist management's compliance to SARBOX Section 404. The Dekker TRAKKER® management suite provides a disciplined EPM framework that will help a business unit understand its valuation cost drivers, and record, monitor and control operational business activities that contribute to the bottom line; business rules can be pre-established and automatically report compliance issues as they are sensed. Some of the salient benefits pertaining to Dekker TRAKKER® EPM solution are:

- Define responsibility levels at all locations
- Create critical documentation for management's assessment of needed controls at each location
- Document and structure the flow of significant transactions for the analysis of areas requiring control activities
- Provide structure for the design of the control environment
- Schedule testing of controls by any type of criteria
- Fix responsibility for testing
- Compare scheduled vs. actual progress for all testing
- Prepare responsibility matrices for continuing control activities, testing of those activities, and related documentation
- Manage all resources used to maintain SARBOX controls by location and for multiple locations

The essence of the Dekker TRAKKER® EPM system is that it provides a complete framework for establishing and documenting the entire control environment as well as the documentation required for testing and continuous evaluation.

Sarbanes-Oxley also requires Chief Executive Officers and Chief Financial Officers, as well as upper level managers, to "certify [that] the financial statements are fairly presented and the reports contain no untrue statements or omission of material facts." This requirement places additional responsibility, primarily on the

CEO and CFO, of organizations covered by the Act. Penalties for failure to comply with the Act are substantial including criminal prosecution. There are NO exceptions to the application of the Act. With this in mind, much more is being done within organizations to ensure that their financial statements are correct and include no "material" misstatements or omissions. External audits by CPAs will not provide CEO's and CFO's with total assurance that their financial data is correct, rather, they must be capable of evaluating their financial/accounting data to properly certify as to the accuracy of their organization's financial statements.

This added responsibility requires change to the way in which organizations report operating results. These changes affect both the revenue and expense side of the ledger. Companies who recognize revenue annually from long term construction contracts that span more than one year, or have any type of revenue from activities that either encompass multiple operating periods or have revenue streams that comprise many steps or processes are now faced with looking at those revenue streams and evaluating complex data in order to properly determine income. Likewise, organizations that are involved with the expenditure of funds for long term contracts, complex research and development programs, long time frames for new product testing and introduction, and other similar areas, also must be able to measure the funds expended against the work completed. They must be able to evaluate the potential for cost overruns as to future work in order to properly state their costs and expenses for financial statement purposes.

The best method for accurately calculating long term recognition of revenue and expense is to have a complete project management system to be utilized for both the management of work and the recognition of income and expense as to those long term projects and complex revenue/expenditure functions. The Dekker TRAKKER® EPM product line provides project management software which is totally compatible with the requirements of Sarbanes-Oxley as to the recognition of revenue and expenses from long term or extremely complex functions. Dekker TRAKKER® EPM software provides the ideal framework for analysis, management and control, and properly

portraying financial results. The system provides the capability to calculate the current status of any long term project or any series of complex multiple functions on either the revenue or expense side. The ability to calculate current results as well as to predict the outcome of any project as to future excess or shortfall of revenue or cost overruns is an integral part of the Dekker TRAKKER® EPM system.

Executives/managers required to certify income or expenditures related to long term functions

and/or multiple complex income/expense streams cannot possibly accomplish the requirements of Sarbanes-Oxley without software designed to provide current project status as well as the capability of projecting outcomes based upon current activities. The Dekker TRAKKER® EPM product is designed specifically to assist management in ascertaining that their financial data, and thusly their financial statements, are correct in accord with Sarbanes-Oxley requirements.



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## References

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[http://www.aicpa.org/info/sarbanes\\_oxley\\_summary.htm](http://www.aicpa.org/info/sarbanes_oxley_summary.htm)