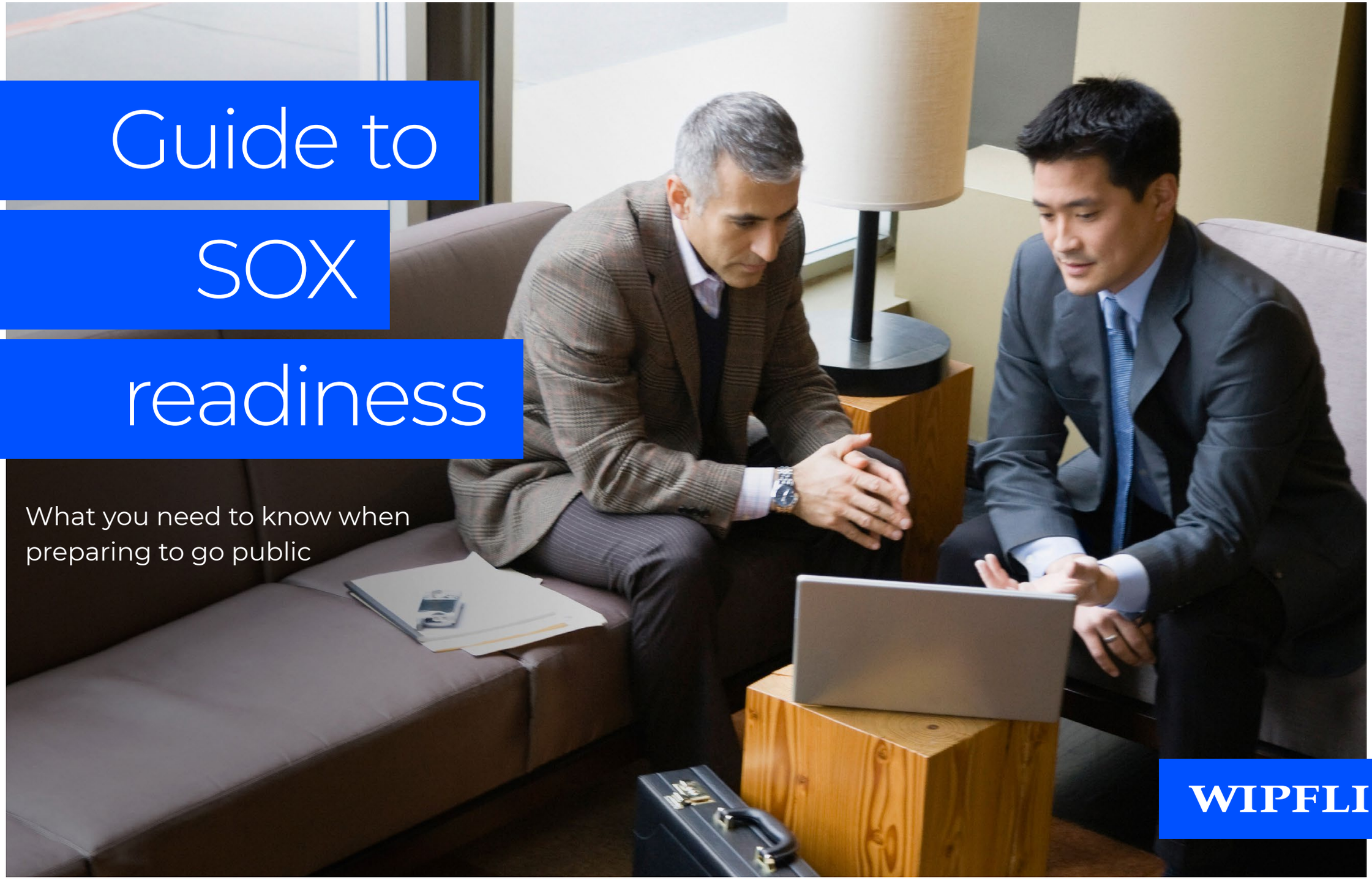
Guide to SOX readiness

What you need to know when preparing to go public



WIPFLI

Getting ready to go public is a big milestone. But amid all the planning and decision-making, compliance issues can be overlooked.

Some organizations underestimate the work involved. Others, immersed in an intense stage of growth, are caught off-guard by the requirements. Either way, the rush to compliance can be grueling and costly. Without proper preparation, the organization risks poor audit performance, with potential fines and administrative action.

Meeting the Sarbanes-Oxley Act (SOX) Section 404 compliance requirements is no small undertaking. As you near the IPO stage, make sure your organization is adequately prepared for the next step.

Most organizations should expect at least a **one-year readiness plan**. However, if you're not confident your internal controls are compliance-ready, additional time might be needed. **Possibly up to 24 months.**

And your first decision is whether you will:

- Conduct with in-house resources only
- Adopt a co-sourcing approach (joint effort with consultant)
- Enact a fully outsourced process

SOX 404 compliance is not something that can be turned on like a switch. The sooner you start building compliance activities into your forecasts and strategic plans, the easier it will be on your team.

To help, we'll first give you all the basic info you need to understand SOX. Then we will walk you through assessing your internal controls over financial reporting — the toughest part of SOX 404 readiness and where most companies end up in a compliance jam.

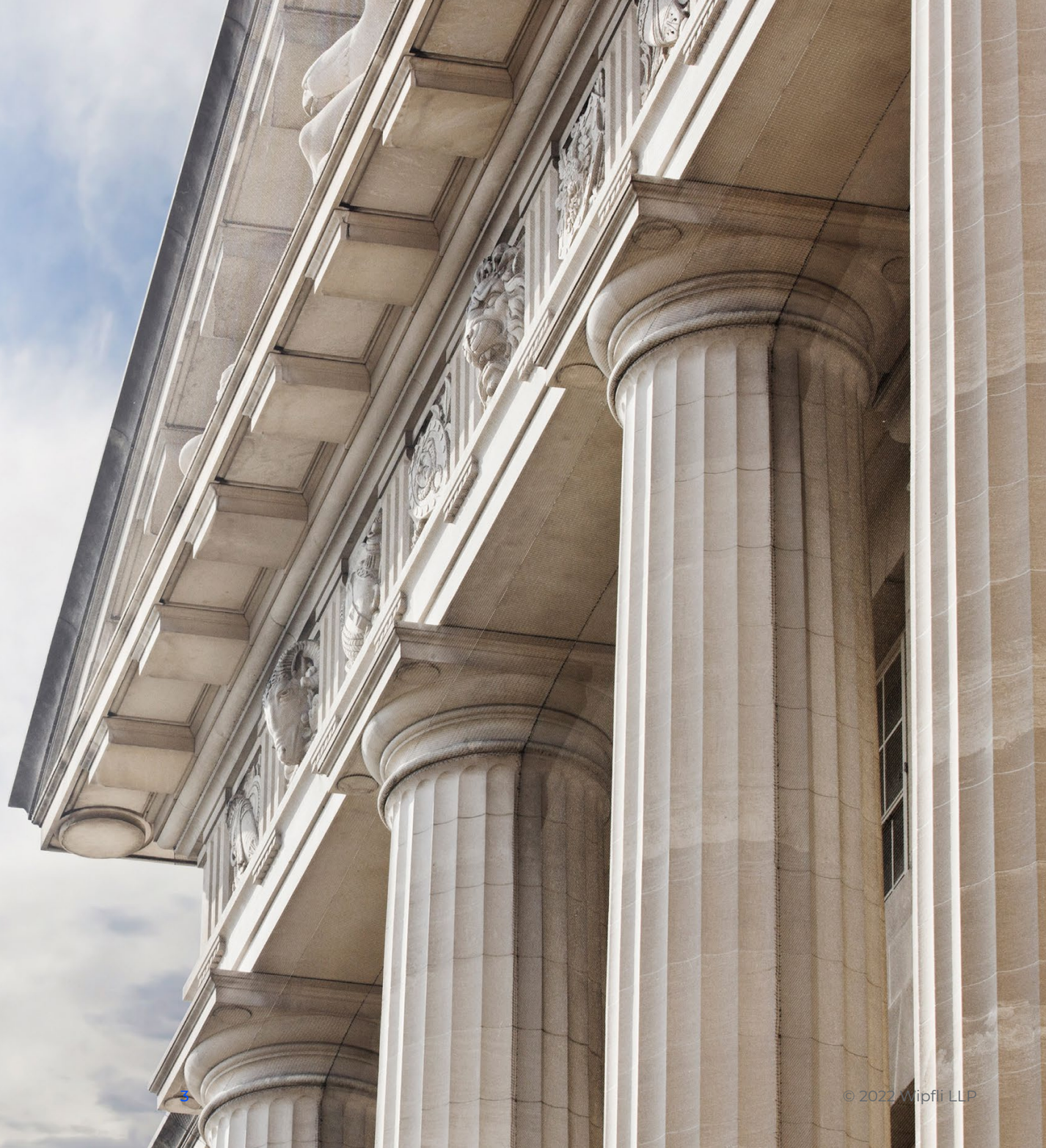
SOX 101

What it is

The Sarbanes-Oxley Act of 2002 was passed to address several high-profile financial and accounting scandals in the early 2000s. It created strict new rules for accountants, auditors and corporate officers. SOX demands strong recordkeeping and includes criminal penalties for violating securities laws.

- Section 404 of the SOX Act mandates that all publicly-traded companies establish internal controls and procedures for financial reporting and must document, test and maintain those controls and procedures to ensure their effectiveness.
- Section 302 of the SOX Act mandates that senior corporate officers personally certify in writing that the company's financial statements "comply with SEC disclosure requirements and fairly present in all material aspects the operations and financial condition of the issuer."

  Officers who sign financial statements known to be inaccurate are subject to criminal penalties. This can include prison time.



Top 4 SOX compliance requirements at a glance

Management statement of responsibility
CEOs and CFOs are responsible for the accuracy, documentation, and submission of financial report and internal control reports to the SEC.

Internal controls
Management acknowledges responsibility for maintaining sufficient internal controls over financial reporting.

Data security
Companies must have formal data security policies that are communicated and enforced.

Ongoing compliance
Companies must provide documented evidence of SOX compliance, with ongoing monitoring and continuous improvement.

Required reports

Quarterly SEC financial certifications

Annual financial statement audit that includes attestation to the effectiveness of internal controls

The segregation of duties

Management

Responsible for filing the annual report as well as designing, implementing and maintaining a solid internal control structure and procedures for the reporting process.

- Can be outsourced, with management oversight
- Identify key controls over financial reporting
- Determine controls are operating effectively
- Make final management assertion

Internal audit

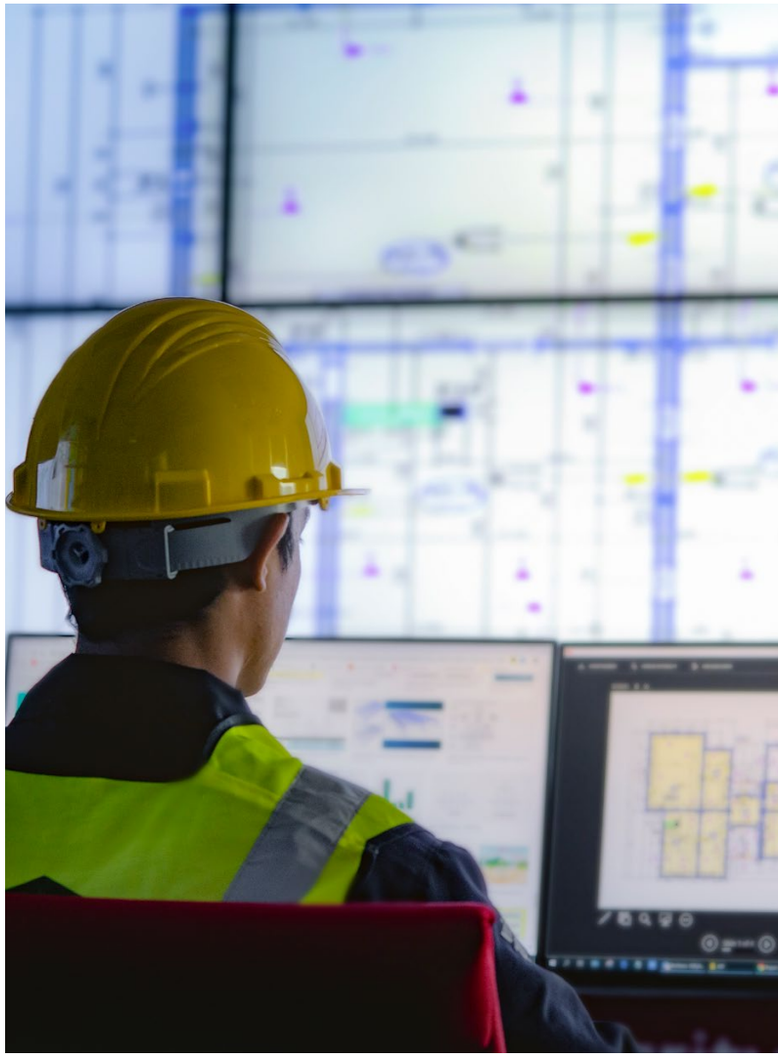
Complete a risk assessment and then develop an audit plan and program for each key control. Internal audit should coordinate or perform all testing and report findings to management, the board and the audit committee.

- Can be outsourced, with management oversight
- Align SOX testing, IT testing and internal audit for efficiency
- Not all internal audit controls are financial reporting key controls, however most key controls are tested within the internal audit function

Board and audit committee

The organization's board and audit committee should exercise their own judgment in evaluating management's SOX competence.

- Engage an external firm (independent auditor) to express an opinion on the entity's internal controls over financial reporting.



Assessing Internal controls over financial reporting (ICFR)

Under Section 404 of the Sarbanes-Oxley Act (SOX), most public companies must assess their internal controls over financial reporting (ICFR) and report on their effectiveness. Under SOX, public companies must also use an external independent auditor to attest to, and report on management's assessment of its internal controls.

You probably have already been managing these controls, at least to some extent, but now your processes need to stand up to an independent audit.

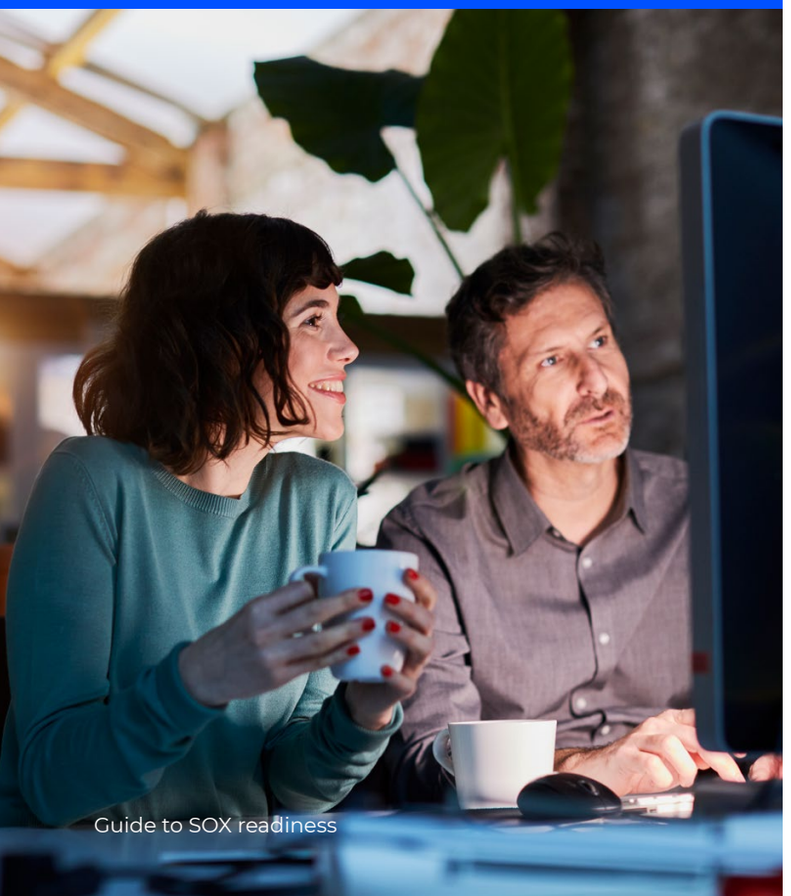
There are six steps critical to a good ICFR:

1. Create a SOX team
2. Assess your risk
3. Document your understanding of key business processes
4. Walkthrough key controls
5. Test key control evidence
6. Remediate key control deficiencies

Here is a breakdown of how to work through each step.

Step 1

Create a SOX team

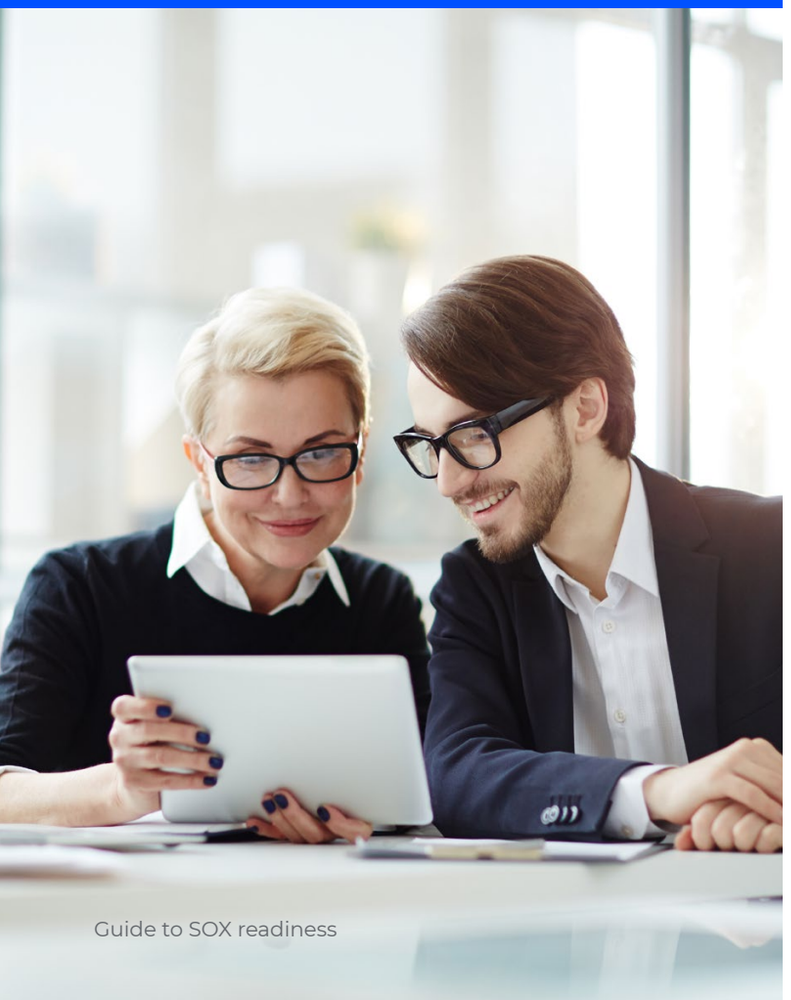


Your implementation team needs a leader or consultant with SOX-compliance experience to drive the process forward. Other essential stakeholders include key process owners, executive leadership, your audit committee, internal audit and your external auditor.

- **Educate:** Set the tone at the top. Your CEO and CFO should provide leadership to build buy-in. Educate control owners on SOX requirements and their role in compliance.
- **Coordinate with auditor:** Start communicating early to ensure your plans meet external audit expectations. Align internal audit and external audit under the same control framework.

Step 2

Assess your risk



Conduct a risk assessment to identify significant business processes and associated risks.

Once the ICFR rating is captured for each control statement, management then considers the impact of risk on the timing, nature, and extent of risk testing to associate ICFR risk with the in-scope controls identified during the SOX risk assessment.

- **Update:** As you grow, you may be implementing new technology or taking on additional third-party vendors. Reevaluate your risk assessment throughout the year to adjust for these, and other core business changes.
- **Coordinate with auditor:** Share your risk assessment with your auditor to ensure buy-in for the significant business processes.

Step 3

Document your understanding of each significant business process

Document your understanding of each significant business process. This may be in a narrative memo or flowchart format.

Look for critical steps that ensure financial information is recorded accurately and use that to document your understanding of the business process and build your key control inventory.

- **Coordinate with auditor:** Share your controls with your auditor to ensure buy-in.
- **Create control documentation:** Set defined standards and build consistent documentation so you can leave a clear audit trail as you move through to testing.

Step 4

Walkthrough controls

Walk through each key control within each significant business process.

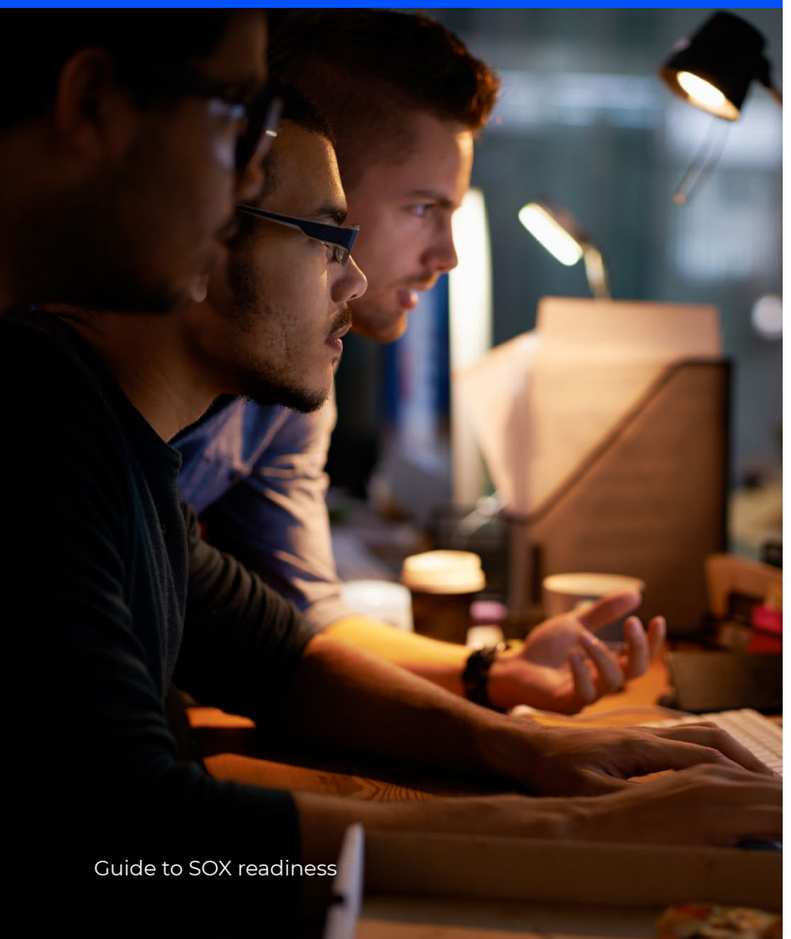
The walkthrough should trace the process or transaction to your information system to the point when it is reflected in the financial reports.

Walkthroughs enable the auditor to:

- Gain a better understanding of the key controls
- Effectively identify risks
- Identify control weaknesses and improvement opportunities

Step 4

Test key control evidence



Your SOX team will test your controls based on frequency and risk to ensure they are operational and effective.

Testing should start early so you have an adequate runway to remediate issues before you are required to be SOX compliant. If you wait too long, and a deficiency is found, you may no longer have enough evidence to test after remediation.

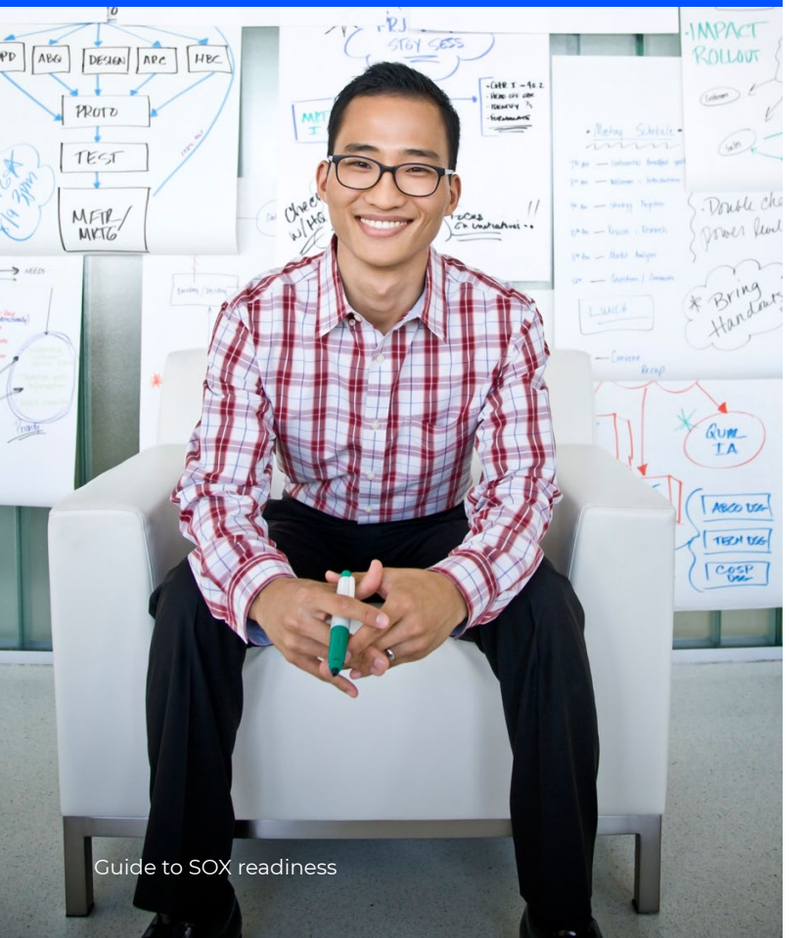
All control deficiencies are then reported to the audit committee. Management and the external financial statement auditors will be required to conduct an analysis to determine the severity of any control deficiency and its impact on the internal controls over financial reporting.

After you have successfully implemented SOX 404 controls, documentation and testing, remember that SOX compliance requires ongoing monitoring and continuous improvement.

- **Coordinate with auditor:** Understand your financial statement auditor's expectations for testing procedures, timing, and sample sizes before you start.
- **Communicate:** Keep leadership and your audit committee informed of testing results and remediation activity throughout the year.

Step 6

Assess, remediate deficiencies



The final step, after evaluating all your key controls, is to correct the deficiencies you found during the readiness assessment.

It's normal to find gaps in your controls — and it's better to identify them during the year of SOX readiness than waiting until your first year of SOX compliance.

Once you do identify deficiencies, you need to correct them. That may mean redesigning your controls, documenting any new controls and testing again. Your team should expect to repeat this cycle until all deficiencies are found and corrected.

Get SOX-ready with Wipfli

Implementing an audit-ready SOX compliance program is a complex job. For most organizations launching an IPO, these requirements will be outside management's routine experience. Our specialists can guide your company through this critical transition.

Benefits of using Wipfli's SOX readiness services:

- Substantive, independent viewpoint on your existing controls
- Process clarity and project management
- Speed to readiness with an established control framework and documentation
- Experienced, right-size approach avoids over- or under-testing
- Enhanced confidence and buy-in from senior leadership and board
- Effective coordination with your external auditor

A readiness program is critical to successful SOX compliance, but the learning curve is steep. We can do the heavy lifting in the run-up to compliance. Once your team gains more experience and has been through an audit cycle, you can more confidently bring processes in house, where practical.

For more information and support, see wipfli.com/SOX.

Perspective changes everything.

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