SOX Audit Environment

Summary
This article gives an overview of the independent audit board, auditors and also their relationship with the management. The objectives of audit are also listed as well as a sample questionnaire for the auditors and a sample representation of management to the auditors.

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Table of Contents

SOX Audit ........................................................................................................................................ 2
The Independent Audit Board ...................................................................................................... 2
Objectives of an Audit .................................................................................................................. 2
Auditors ........................................................................................................................................ 2
Relationship between Audit Firms/Committee and Executive Management ......................... 2
Focus and Sample Questionnaire for the Auditors: ................................................................. 3
Management Representation to Auditors: ............................................................................... 3
PCAOB ............................................................................................................................................ 4
Related Content ...............................................................................................................................4
Disclaimer and Liability Notice......................................................................................................... 5

SOX Audit

The Independent Audit Board
One of the most significant reforms introduced by SOX is the advent of the independent audit board. SOX require corporations to have audit committees made up solely of independent directors. The audit committee is responsible for obtaining information from management relevant to the audit and otherwise assisting in the audit process. It’s viewed as an important part of a company’s internal control because it provides a company presence entirely independent from management and interfaces with the independent auditors (external)

Objectives of an Audit
Primary audit objectives are to:

• Raise the risk and control assessment and design skills of all staff
• Provide accurate and complete information to the Officers, the Board and external stakeholders on the state of risk and control management systems
• Assist staff at all levels to design and maintain better, more optimal risk and control management frameworks.

Auditors
Auditors are measured on, and accountable for, achievement of the primary objectives noted above. Auditors are the traditional inspectors of information within a company. They’re responsible for testing the accounting data gathered from management and from rank-and-file employees. Auditors should be skilled and knowledgeable risk and control design analysts. These skills should extend to customer service, product quality, environmental compliance, fraud prevention and detection, and safety, as well as traditional financial reporting objectives.

Auditors may be either internal employees of a company or independent auditors working for an outside firm. Both internal and independent auditors adhere to Generally Accepted Accounting Principles (GAAP).

Relationship between Audit Firms/Committee and Executive Management
There should be no conflicts of interests arising from close relationships between audit firms and the companies they audit; SOX prohibits auditors from performing certain non audit services to clients they audit. Ensuring auditor’s independence is critical aspect of SOX.

The Sarbanes-Oxley Act has placed a spotlight on the audit committee as Guardians of Corporate Governance and Investor Interest In turn the relationship between the audit committee and the Executive
Management has changed as both group assume increase responsibility for oversight of the financial reporting process, the assurance of accuracy and transparency of financial statements and risk management.

In order to provide effective oversight the audit committee should expect management particularly the CFO to provide the information needed to help members expand their knowledge and awareness of the company’s financial reporting process, including identifying risk and understanding control surrounding these risks.

**Focus and Sample Questionnaire for the Auditors:**

Firms dealing with SOX routinely cite three principal areas of focus by public accounting and auditing firms: strategic, tactical, and operational. The area cited as the most difficult by most firms is operational, because this is where non-compliance with SOX is most often found by auditors. Involving interviews that are focused on controls, tests, and documentation are conducted.

Full management support can result in a more effective and focused audit committee and lead to identification of process efficiencies, more effective risk management and compliance cost reduction.

To attain such a level of effectiveness the CFO should provide audit committee members with the necessary information to appropriately answer the following questions. Once beyond the initial walkthrough, audit firms are routinely embedding lessons learned about the environment into automated electronic (and non-electronic) operational tests for subsequent use by the audit firm.

"Parson Consulting, Confidence Newsletter Qtr 1 2006, Providing Effective Oversight" list some Questions like:

- What is the company’s Risk Management strategy? How long has it been since you revived it?
- Does your company segregate non-financial risk (Operational, brand name, goodwill, market)? What is the strategy for such risks?
- How do you identify and measure the risks/threats that could impact on the achievement of your Business objective?
- What are the major risks of your company? What are its short term and long term implications?
- Does your risk management process integrate with SOX compliance?
- What is the Risk tolerance of your company and how it is determine?
- How risk mitigation is done in your company? Are the risks insured?
- How effective is your control framework and what is the cost you pay for it?
- Can you eliminate some control so as to reduce the overall cost but keeping the residual risk constant?
- How effective is your risk management plan maximize the Shareholders value?

Many more questions can be asked considering the responses to the initial questions.

The motive is to extract substantial information so as to gain proper insight of the company’s financial reporting.

Generally Interviews are designed to determine the following:

- The performance results of their firm
- The business pressures and strategic actions their company was taking
- The process maturities at their firm
- The enabling technologies being employed

Internal and external auditors should not ignore breakthroughs in quality management and risk management.

**Management Representation to Auditors:**

“Tim J. Leech’s Sarbanes-Oxley Sections 302 & 404.A White Paper Proposing Practical, Cost Effective Compliance Strategies” (April 2003, CARDdecisions.com ) has given a number of sample representations. Attachment 9 gives Sample Management Representation to Auditors as follows:
We, the undersigned, acknowledge to the Audit Committee that we have:

(1) Responsibility for developing and maintaining internal controls and disclosure controls that provide reasonable assurance that ABC’s financial statements and supplemental SEC disclosures present fairly the results of operation and the financial position of ABC Inc. in accordance with generally accepted accounting principles and other applicable SEC regulation.

(2) Responsibility for overseeing that the organization has cost effective risk and control management systems that provide reasonable assurance ABC’s external disclosure objectives will be achieved.

(3) Reviewed the significant control and risk issues identified by work units and management through the company's risk and control self-assessment process, and the significant issues identified by our Internal Audit department and our External Auditor that have been brought to our attention. We have initiated steps to adjust controls in areas where the error rates and/or residual risks identified related to the non-achievement of ABC’s disclosure objectives were considered to be excessive and/or unacceptable.

(4) Reviewed our process to manage risk and control and this year’s report on our risk management process prepared by our Internal Audit for the Audit Committee. We are satisfied that our risk and control assessment framework process provides you, our Audit Committee, and our External Auditors with a reliable and materially complete report on the status of risk and controls related to our external disclosure objectives as required by sections 302 and 404 of the Sarbanes-Oxley Act of 2002.

CEO __________________  CFO __________________

**PCAOB**

SOX establishes a five-member Public Company Accounting Oversight Board (PCAOB) that lets auditors know what they’re supposed to be evaluating and sets rules about the relationships and ties auditors can have with the companies they audit.

The PCAOB has the following responsibilities:

- To oversee the audit of public companies
- To establish audit report standards and rules
- To register audit firms

The SEC oversees the PCAOB

**Inspections of audit firms**

Auditors must submit to continuing inspections by the PCAOB. Firms that provide audit reports for more than 100 public companies get inspected once a year. Firms that audit fewer than 100 companies get reviewed every three years. Title I of SOX also empowers the PCAOB to impose disciplinary or remedial sanctions upon audit firms.

**Related Content**

- [Confidence Newsletter Qtr1 2006](#)
- [The SOX Saga](#)
- [Sarbanes-Oxley Sections 302 &404 A white paper proposing practical cost effective compliance strategies](#)
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