

THE FINANCIAL, CONTROLLING AND IT ASPECTS OF THE SARBANES-OXLEY ACT

Zoltán Zörög

Károly Róbert College
3200 Gyöngyös, Mátrai út 36. Hungary
E-mail: zzorog@karolyrobert.hu

Kornélia Nagymihály Ficzeré

Károly Róbert College
3200 Gyöngyös, Mátrai út 36. Hungary
E-mail: kficzere@karolyrobert.hu

Eszter Bakos-Tóth

Károly Róbert College
3200 Gyöngyös, Mátrai út 36. Hungary
E-mail: teszter@karolyrobert.hu

—ABSTRACT —

There is a constant need for controlling the efficiency and reliability of a function as well as financial statements. Establishing an IT support serves the interests of investors and employees, as well. As an answer to the new challenges several countries created legal guidance concerning the internal checking systems: an example of these is the Sarbanes-Oxley Act in the USA in 2002.

We studied the 302nd and the 404th section of the Sarbanes-Oxley Act. The findings show that purchasing an integrated programme especially by developed small enterprises will be unavoidable. The 2010 survey of Protiviti assesses that firms successfully accomplish the prescriptions of the Sarbanes-Oxley Act and make positive statements regarding the effects of the law.

Key Words: *risk prevention, internal controlling, finance, IT supportability*

JEL Classification: M15

1. INTRODUCTION

An effective, efficient and successful operation is of vital importance in the operation of enterprises nowadays. Prevention is the best way of reducing risks that derive from the running of these enterprises.

One of the most important functions of the Internet that supports internal corporate processes are the increase and standardisation of the efficiency of the internal communication network as well as the more effective allocation of the internal corporate resources and assisting the higher-level use of synergies [Taralik, 2008].

Miklós Pakurár has similar thoughts according to which: „IT systems are used for data recording in financial, accounting and logistic processes....By analysing these data a substantially deeper control of the processes is possible by means of which such reserves can be exploited that were not even considered previously [Pakurár, 2003]. In reaching the corporate targets, a properly established and run internal audit system is essential.

Modern corporate and internal audit has to prevent the risks deriving from corporate operations.

Taking the points of view of business administration into consideration it is important that enterprises harmonise their strategic and operational objectives. [Hágen – Kondorosiné, 2009]. As a reaction to the new challenges, several countries have created their own guidance on internal audit systems.

The most important ones of them:

COSO Internal Control–Integrated Framework, USA, 1992, (Treadway Committee),

CICA Guidance on Control, Criteria of Control, Canada 1995,

FRC Combined Code on Corporate Governance, as well as The Revised Guidance for Directors on the Combined Code/ Turnbull Guidance 2005, GB,

Sarbanes-Oxley (in short: Sbox) Act 2002, USA.

The objective of the Sbox law is to re-establish the trust of the investors that were shaken by the corporate scandals and financial frauds in the USA in 2001 and 2002 (Enron, WorldCom and Tyco).

The regulations above emphasise the existence and efficient operation of controls. The key controls, regardless which level they are, can be automated or manually operated ones. However, internal audit cannot operate effectively without the efficient operation of internal audit.

In our paper we examine compliance with the regulations of Sections 302 and 404 in the Sarbanes-Oxley Act on the regulation of the internal audit of enterprises.

Concerning the criticism of the Sbox Act it is advisable to place a great emphasis on the following:

- if the enterprises were able to finance the creation and operation of the new internal audit system,
- what impacts the costs had on the revenue of the companies,
- what solutions could be found by the companies that were unable to comply with the rules.

2. MATERIALS AND METHODS

The Sarbanes-Oxley Act accepted in 2002 and serving as the topic of our paper can be considered a relatively new regulation.

The professional articles, legal interpretations published in English on the Internet as well as our knowledge on the establishment and documentation of the internal audit system applied by enterprises served as **the theoretical review of the regulation**.

Our experience gained in teaching and research was primarily used for **the practical interpretation of the prescriptions of the Act**.

The results of the surveys carried out by Financial Executives International (FEI) between 2004 and 2006 and by Protiviti business consulting and internal audit company in 2010 were processed in **studying the international evaluation related to the Act**.

Due to our commitments to secrecy, companies cannot be named here. However, our experience gained must be published because of their significance in practice.

3. RESULTS AND DISCUSSION

3.1. The Sarbanes-Oxley Act

The Sarbanes-Oxley Act is one of the most thorough and strictest regulations of the American legislation regarding the control over the corporations listed on the American Stock Exchange. Its effect extends to all corporations defined as issuers by the Stock Market Act of 1934 and registered by the United States Securities and Exchange Commission (SEC). The Sbox Act made radical changes in the regulation of corporate management and leadership.

Its most important dispositions in a summary:

- It established the Public Company Accounting Oversight Board (PCAOB) that is subordinated to SEC. It controls and manages the operation and activities of accounting companies.

- It introduces new regulation regarding the operation of the senior management and the board as well as the audit committee, sets new standards of liabilities and in case they are not observed, it disposes of strict sanctions.
- It makes the documentation of the internal audit of the company compulsory, which includes the description of controlling processes as well as the examination and assessment of their operation.
- It stipulates that the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of the company should make a declaration that the quarterly and annual financial statements contain reliable and realistic data and that the internal controls operate effectively and efficiently .
- It introduces strict rules on the independency of the external audit companies **Hata! Başvuru kaynağı bulunamadı.**

3.2. The internal audit system based on Sections 302 and 304 of the Sarbanes-Oxley Act

The stipulations of the Sarbanes-Oxley Act aim at creating a totally new internal audit system. However, the new regulation does not only dispose of the new regulations about the creation of the system but also about its operation and testing. Moreover, it concretely designates the persons responsible for internal audit based on their positions occupied at the company.

Committee of Sponsoring Organisations of the Treadway Commission (COSO)

Figure 1: The construction of the COSO framework system



Sour: own compilation (KPM Study on COSO framework 2004) 45 p.

A great part of the companies under the effect of the Sarbanes-Oxley Act created their own internal audit system on the basis of COSO controlling system. The assessment of control activities usually takes place simultaneously on the organisation and activities level.

Figure 1 illustrates the structure of the COSO framework system due to which control processes intertwine the organisation as a whole resulting in a proper operation, reliable financial reporting and compliance with the law in all phases of work by affecting the tasks of all the employees.

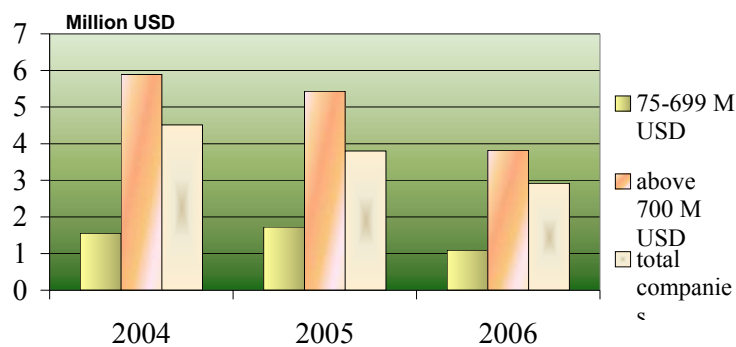
3.3. The impacts of the Sarbanes-Oxley Act on companies

The Sbox Act thoroughly regulates and changes the management and the direction of the company.

The effects of the compliance with the Sbox prescriptions on corporate expenses

Most of the criticism of the Sbox Act came regarding the significant expenses of the companies. Compliance with Section 404 of the Act was estimated to have cost an average of 91.000 dollars (according to SEC own calculations). The formation of expenses is presented by Figure 2 on the basis of the research results of Financial Executives International, („FEI”) in 2007 represented by the responses of the Chief Financial Officers of 200 companies.

Figure 2: The Sarbanes-Oxley expenses of compliance with Section 404 of the Act between 2004 and 2006 based on FEI annual research of 2007 in proportion to the revenue



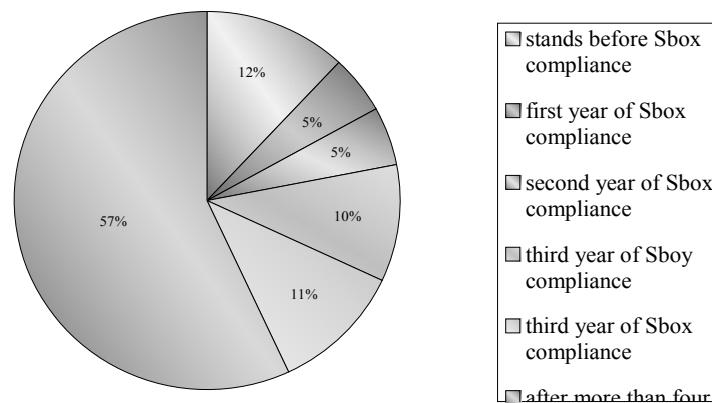
Source: own compilation (based on FEI research in 2007)

The expenses illustrated by Figure 2 include the fees of internal and external audit as well as those of auditors. Relative to years 2004-2006, the expenses of compliance with the Act were decreasing annually. In the first year it accounts for 4.5 million USD for the responding 200 companies. In 2006 the average level of expenses of 2.7 million USD incurred was as much as 35 per cent lower than in 2004. Most respondents assessed the impacts of the Sbox Act positively although to the question whether the benefits from compliance with Section 404 exceed the costs incurred, only 21.9 per cent gave an affirmative answer.

3.4. The assessment of the Sarbanes-Oxley Act nowadays

As a result of the survey conducted by Protiviti business consulting and internal audit company it can be stated that the companies could reduce their expenses deriving from their compliance with the Act and according to 70 per cent of the respondents the benefits from the strict control have by far surpassed the expenses nowadays [Protiviti, 2010].

Figure 3: The Sarbanes-Oxley compliance as reflected in the number of years passed

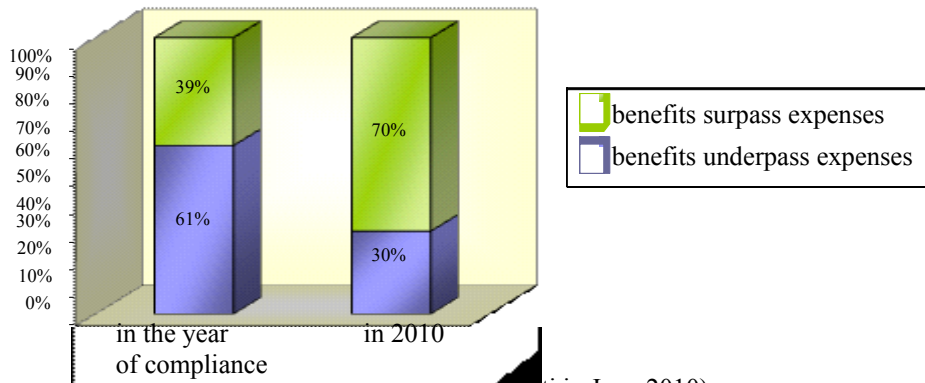


Source: own compilation (based on the survey of Protiviti in June 2010)

Fifty seven per cent of the respondents operate their internal audit system in compliance with the Sbox regulations for more than four years, a further eleven per cent at least for four years (Figure 3). This way the results of the survey are quite authentic in reflecting the longer-term impacts of the Sbox Act on companies.

The results illustrated by Figure 4 also support the experience gained at the examined companies according to which they were able to increase the proportion of the benefits from using the new system prescribed by the Sbox Act over their expenses.

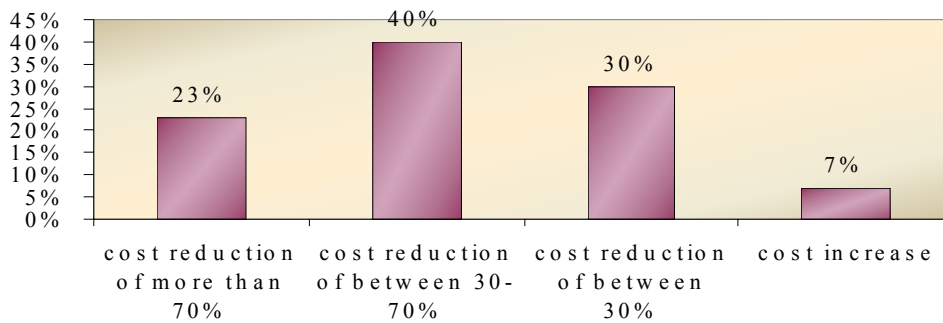
Figure 4: The proportion of benefits gained in compliance with the Sarbanes-Oxley Act and the expenses



Source: own compilation (based on the survey of Protiviti in June 2010)

According to approximately 70 per cent of the respondents the introduction of the Sbox Act proves to be useful in the long term so it can be stated that the original objectives of the American legislation seem to be met, that is to make the operation of the companies much safer and thus regain the trust of the investors.

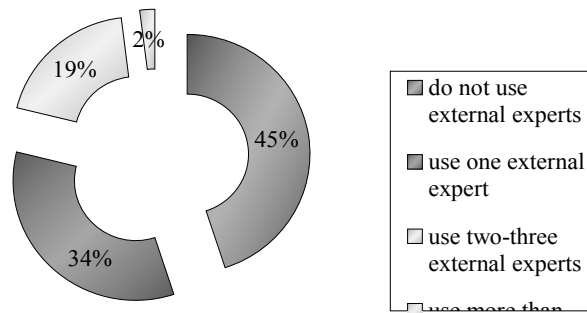
Figure 5: The proportion of the expenses of compliance with the Sarbanes-Oxley Act in the first year and in 2010



Source: own compilation (based on the survey of Protiviti in June 2010)

As illustrated by Figure 5, 23 per cent of the respondents were able to reduce the expenses of compliance with the Act by more than 70 per cent and 40 per cent reached a decrease of 30-70 per cent. All in all, 93 per cent of the companies managed to reduce expenses in relation to the first year and the actual one. Compliance with the Act had significant burdens on companies in the first year as significant time and money were spent on the thorough transparency of their operation, working out a new efficient system and its support by means of proper IT and technical background.

Figure 6: The proportion of the external experts hired for the tasks of controlling and testing



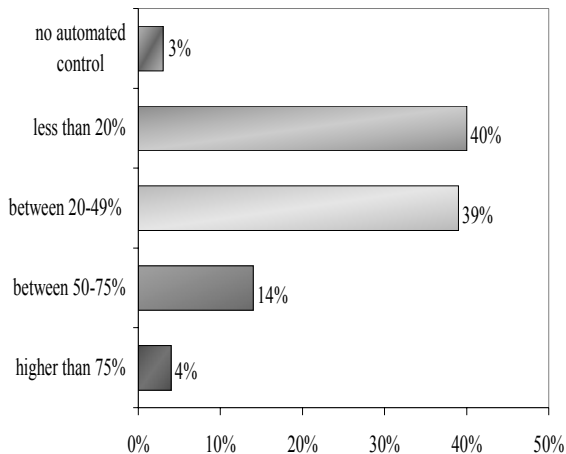
Source: own compilation (based on the survey of Protiviti in June 2010)

On Figure 6 it can properly be seen that 45 per cent of the companies do not use the services of an external expert due to the practical experience, the financial situation of the company as well as the good professional and technological backgrounds available. The examined company as being a small-scale one was forced to hire external experts to create and operate IT controls as well as their testing because they were not able to pay such employees who had the necessary expertise.

On Figure 7 it can be seen well that the proportion of the automated controls over the total number is less than 50 per cent at nearly 80 per cent of the companies as for their establishment they need a properly integrated administrative system and infrastructure, which requires a big but only one investment from the company. The survey of the financial situation of the company comes to the foreground at this point. Our own experience at the examined company also proves the above-mentioned facts as in June 2010

an internal audit was conducted. The examination found everything in order but it recommended that the implementation of an integrated programme developed for small-scale enterprises should be purchased to make the control processes perfect. Implementation is hindered by the fact that exclusively the programme entitled Dynamic developed by Microsoft could be purchased but now they do not have the resources for that.

Figure-7: The proportion of the automated controls to all the controls of the companies participating in the survey



Source: own compilation (based on the survey of Protiviti in June 2010)

3. CONCLUSION

As a result of the examination we came to the following conclusions:

- For a well-organised company that possesses a professional, excellent internal audit system of high standard, it is out of the question to have a controlling system created as a result of the Sbox Act regardless what its ownership structure like or which part of the world it operates in.
- A great part of the companies belonging under the scope of the Sbox Act create their own internal audit system based on the principles of the COSO control.
- Due to the experience of the companies gained throughout the years the expenses of compliance with the Act have been reduced. The decrease in the number of controls, the increase of the number of automated controls for which a properly integrated administrative system and infrastructure, which requires a big but only one investment from the company also contributed to it.

- Summarising the findings of the Protiviti survey we can state that despite the initial hardships the companies were successful in complying to the prescription of the Sbox Act in 2010 and acknowledged its beneficial impacts.
- In case of the examined company, the purchase of an integrated programme developed for small-scale enterprises should be necessary to make the control processes perfect but it cannot be accomplished due to financial constraints.
- The compliance with the Act and testing could be made much easier if data record and control were made more transparent in case of agglomerations consisting of several companies by introducing a unified integrated system. By this way the risks deriving from the use of the accounting software could be reduced and the number of automated controls could be increased resulting in a significant decrease in expenses on the level of the group.

BIBLIOGRAPHY

Ahmed, A.: Sarbanes-Oxley Act and Its Effect to Corporate World
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1587376

De Vay, D.: The Effectiveness of Sarbanes-Oxley Act of 2002 in Preventing and Detecting Fraud in Financial Statements
<http://books.google.hu/books?id=rmg0CAMs4oAC&pg=PP3&lpg=PP1&dq=related:ISBN0471483060&lr=#v=onepage&q&f=false>

Ficzerné Nagymihály, Kornélia: Ellenőrzési ismeretek, 2009 135.p

Hágen, I. Zs. – Kondorosi, F- né: Üzleti tervezés , Controll 2003 KFT Debrecen 2009
ISBN 978-963-88630-0-3 p. 17 – 110.

Merétey-Vida, Zs.: Belső kontrollrendszer különböző felfogások tükrében 2007. 9.
http://elib.kkf.hu/okt/publ/szf_22_10.pdf

Pakurár, M.: A növénytermesztés munkaszervezésének fejlesztési lehetőségei informatikai rendszerekkel 2003. AVA Nemzetközi Konferencia, Debrecen. 9 (CD 1-9)

Protiviti: 2010 Sarbanes-Oxley Compliance Survey: Where U.S. Listed Companies Stand: Reviewing Cost, Time, Effort and Processes 2010, 37 p.
<http://www.protiviticonsulting.nl/enUS/Insights/Surveys/Pages/2010-Sarbanes-Oxley-Compliance-Survey.aspx>

Taralik, K.: E-business szerepe a turizmusban (2008) XI. Nemzetközi Tudományos Napok Március 27-28. Gyöngyös pp. 139-146

The Institute of Internal Auditors: Sarbanes-Oxley Section 404., A Guide for Management by Internal Controls Practitioners 78 p.

www.theia.org/download.cfm?file=31866download.microsoft.com/.../Unexpected%20Benefits%20of%20Sarbanes-Oxley.pdf