

Talk current as of June 2007. Given around the country in conjunction with KPMG and Approva breakfast series for corporate managers in finance, IT and internal audit.

Text of the talk starts on the next slide.

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Key Points of SEC & PCAOB Guidance



- SEC rules now give companies guidance about implementing 404.
- “Safe harbor” – follow these rules, the company is protected
- PCAOB to replace “Auditing Standard 2”; proposes “Auditing Standard 5”
- Auditors no longer give an opinion on management’s opinion – **DELINKING** company work to rules that govern auditors

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LET’S START WITH THE BIG PICTURE. REALLY 3 THINGS HAVE HAPPENED THAT WARRANT CONSIDERATION FOR THE FUTURE OF YOUR SOX 404 ATTESTATION. FIRST, THE SEC HAS PROPOSED A DEFINITIVE SET OF RULES FOR CORPORATIONS PROVIDING A SAFE HARBOR APPROACH TO THE PROCESS OF GIVING INVESTORS THE CERTIFICATION OF INTERNAL CONTROLS AROUND FINANCIAL REPORTING.

SECOND, THE PCAOB HAS PROPOSED TO THROW OUT THE SET OF RULES THAT TODAY GOVERNS THE AUDITOR’S PROCESS OF GIVING **THEIR** OPINION OF A CLIENT’S FINANCIAL REPORTING CONTROL SYSTEM. IN PLACE OF THE OLD 180 PAGE STANDARD AS2, THE PCAOB HAS PROPOSED A STREAMLINED 100 PAGE STANDARD WITH CLEARER GUIDELINES AND LESS MICROMANAGEMENT INTENDED TO ALLOW THE AUDITORS TO IMPLEMENT A MORE JUDGEMENT-BASED BUT CLIENT CUSTOMIZED APPROACH TO THEIR WORK. LASTY, THE SEC & THE PCAOB AGREED, AND MUTUALLY PROPOSED, THAT THE AUDITOR’S OPINION OF **MANAGEMENT’S** 404 PROCESS IS A REDUNDANT THIRD OPINON, AND, THEREFORE, SHOULD BE ELIMINATED. GOING FORWARD, THERE WILL BE ONLY TWO SEPARATE OPINONS GIVEN, ONE BY THE COMPANY AND ONE BY THE AUDITOR, EACH EXPRESSING AN INDEPENDENT OPINON ON **INTERNAL CONTROL OVER FINANCIAL REPORTING**.

BEFORE WE MOVE INTO THE DETAILS OF THE PORPOSALS I WANT TO HIGHLIGHT ONE POINT. SOX 404 IS A REQUIREMENT FOCUSED ON THE INTERNAL CONTROL AROUND **FINANCIAL REPORTING**. IT’S WELL INTENTIONED AND A NEEDED PROVISION. BUT THE INITIAL IMPLEMENTATION WAS TOO BROAD AND EXTENDED TO MANY PARTS OF THE INTERNAL CONTROL SYSTEM THAT WHILE IMPORTANT TO THE BUSINESS, HAD VERY LITTLE TO DO WITH FINANCIAL REPORTING. THE NEW PROPOSALS ARE THE **SECOND** ATTEMPT TO FIX 404. TAKE THIS AS AN EMPOWERING OPPORTUNITY TO REVISIT YOUR 404 TESTING PROCESS AND MAKE IT MORE EFFICIENT.

Key Points of SEC & PCAOB Guidance



- Companies' & auditors' effort focused on controls impacting financial reporting misstatements
- Concept of "coverage" removed for determination of multi-location testing
- All of this is an attack on the cost of "over-zealous" implementation
- Regulators expect substantial behavioral change

If the cost is not greatly reduced by this effort, the political pressure to repeal 404 will be significant.

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EFFECIENCY IS A WORD THAT CROPS UP REPEATEDLY IN BOTH THE SEC AND PCAOB PROPOSED RULES. EFFECIENCY IS ENCOURAGED BY FOCUSING THE COMPANY'S WORK AND THE AUDITOR'S WORK ON THE CONTROLS MOST LIKELY TO PREVENT FINANCIAL REPORTING MISSTATEMENT. EFFECIENCY IS ALSO ENCOURAGED BY IMPLORING COMPANIES TO USE AUTOMATED CONTROLS WHEREVER PRACTICAL, AS THEY ARE EASIER TO TEST AND MORE RELIABLY MAINTAINED. EFFECIENCY IS ENCOURAGED BY ELIMINATING THE CONCEPT OF CONVERAGE FOR DETERMINING THE EXTENT OF MULTI-LOCATION TESTING. RISK IS THE TARGET, NOT COVERAGE.

MOST IMPORTANTLY, AND I CAN'T SAY THIS ENOUGH, EFFECIENCY IS ENCOURAGED BY EMPOWERING "**PROFESSIONAL JUDGEMENT AND LEADERSHIP**" BY THOSE ON THE FRONT LINES OF DOING THIS IMPORTANT WORK.

MANAGERS AND AUDITORS THAT APPROPRIATELY ASSESS AND DOCUMENT REAL FINANCIAL REPORTING MISSTATEMENT RISK AND CREATE A PLAN TO TEST THE CONTROLS AROUND THOSE RISKS ARE REWARDED WITH LOWER COSTS AND A REGULATORY SAFE HARBOR UNDER THE NEW RULES.

Concepts that Require Assertiveness

“Top down” and “Risk Based” means...

1

Find **entity level** controls that give you reasonable assurance that the financials are not misstated.

2

Rely on those entity level controls and do not test the underlying detailed controls.

Take a position driven by the new framework.

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TWO KEY PHRASES ARE CENTRAL TO THE NEW RULES, YOU’RE HEARD THEM REPEATEDLY FOR THE PAST FEW MONTHS. BOTH THE SEC AND PCAOB PROPOSALS REQUIRE THAT ICFR AUDITS BE **“TOP DOWN” AND “RISK BASED.”** THIS MEANS LOOK FIRST FROM THE LEVEL OF YOUR CONSOLIDATED EXTERNAL FINANCIAL STATEMENTS AND USE YOUR INTIMATE AND EXPERIENCED KNOWLEDGE OF THE BUSINESS, THE INDUSTRY, YOUR SALES AND MARKETING STAFF THAT ARE OUT THERE EVERY DAY DOING DEALS, AND WITH THAT COMPREHENSIVE VIEW IN MIND, LAY OUT THE REAL RISK OF FIN REPORTING MISSTATEMENT.

THEN IDENTIFY ENTITY LEVEL CONTROLS THAT ADDRESS THOSE RISKS. SUFFICIENT ENTITY-LEVEL CONTROLS AND A TESTING PLAN FOR THEM, MEANS YOU CAN STOP THERE FOR A PARTICULAR RISK. IF THE RISK ISN’T ADDRESSED BY AN ENTITY-LEVEL CONTROL, THEN YOU MUST LOOK TO A LOWER-LEVEL CONTROL AND TEST PLAN.

THE NEW AS5 STANDARD GIVES SOME EXAMPLES OF ENTITY-LEVEL CONTROLS SUCH AS:

- Controls over management override;
- Centralized processing and controls, including shared service environments;
- Controls to monitor the results of operations;
- Controls to monitor other controls, including activities of the internal audit function, the audit committee, and self-assessment programs;
- Controls over the period-end financial reporting process; and

Identifying Financial Reporting Risks and Controls

- Management should **identify key risks** by considering the source and potential likelihood of misstatements based on internal and external factors. Methods and procedures for identifying financial reporting risks will vary.
- Management should **identify preventative and detective controls** that adequately address these financial reporting risks, but **need not identify every control** that exists.
- Management should **consider entity-level controls**, but must keep in mind that the more indirect the relationship of the control to a financial reporting element, the less effective it may be to prevent or detect of misstatement. As such, it is **unlikely that management will identify only entity-level type controls** as adequately addressing a financial reporting risk for a financial reporting element.
- In conducting its assessment, management need only evaluate those **general IT controls** that are necessary to adequately address financial reporting risks.
- Management must **maintain reasonable support** for its assessment. The form and extent of required documentation to support the assessment **will vary based on the size**, nature and complexity of the company.

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IDENTIFYING THE RISKS AND RELEVANT CONTROLS IS OBVIOUSLY THE KEY. WHAT ARE YOUR FINANCIAL REPORTING RISKS? IS IT ---

IMPROPER REVENUE RECOGNITION AS WITH COMPUTER ASSOCIATES

DIVERSION OF ASSETS BY MANAGEMENT AS WITH ENRON

IMPROPER CAPITALIZATION OF EXPENSES AS WITH WORLDCOM

OR COULD IT SIMPLY BE INNOCENT BUT UNACCEPTABLE MISAPPLICATION OF FAS133, ACCOUNTING FOR DERIVATIVES, AS HAS HAPPENED AT TOO MANY COMPANIES TO NAME.

WHATEVER IT IS, YOU KNOW THE HIGH RISK AREAS IN YOUR BUSINESS.

FINALLY, THE LAST POINT ON THIS SLIDE MAY BE THE MOST IMPORTANT. IN IDENTIFYING YOUR KEY CONTROLS YOU'RE OFFERED A NEW STANDARD OF **"REASONABLENESS"**. THAT IS, THERE MUST BE A REASONABLE RISK THAT THE FAILURE OF A PARTICULAR CONTROL WOULD LEAD TO A **FINANCIAL REPORTING FAILURE**. YOU DON'T HAVE TO PURSUE BIZARRE "WHAT IF" INSTANCES, OR PREVENT THE COMBINED FAILURE OF MULTIPLE CONTROLS. IF IT ISN'T REALLY LIKELY TO CAUSE A MATERIAL ERROR AT THE ENTITY LEVEL, DON'T TEST IT AS PART OF THE 404 PROCESS. DON'T DROP THE CONTROL. DON'T REDUCE YOUR INTERNAL CONTROL EFFORT OVERALL, JUST DON'T INCUR THE EXTRA COSTS OF TESTING AND DOCUMENTING IT FOR THE 404 PROCESS.

Evaluating Evidence of Operating Effectiveness

- The **higher the risks** of material misstatement and control failure, the **more evidence is needed** of effectiveness of the control. The existence of effective entity-level controls may influence the amount of evidence needed.
- Evidence may be obtained both from **direct testing and ongoing monitoring activities**. For smaller companies "**management's daily interaction with its controls may provide it with sufficient knowledge about their operation to evaluate the operation of ICFR**" -- but this would not ordinarily be sufficient when ICFR risk is assessed as high or for companies with multiple management reporting layers or operating segments. Daily interaction includes information obtained by those responsible for evaluating the effectiveness of ICFR through their ongoing **direct knowledge and direct supervision** of control operation.
- Management's **assessment must be supported by evidential matter** that provides reasonable support for its assessment. The nature of evidence to support management's assessment can **vary based on risk** and the complexity of the control, and include memos, emails and other internal communications, as well as evidence within the companies books and records.

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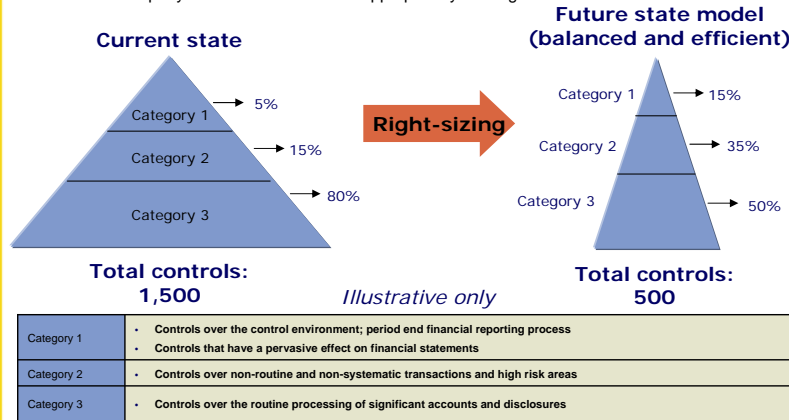
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THE REASONABLENESS THEME CARRIES THROUGH TO THE **EVIDENCE** COLLECTION AND EVALUATION PROCESS. THE SEC'S PROPOSED RULES PROVIDE THAT A COMPANY'S EVIDENCE COLLECTION SHOULD VARY WITH THE LEVEL OF RISK ASSOCIATED WITH THE UNDERLYING CONTROL.

THE SEC PROVIDES A MAJOR OPENING ON THIS FRONT FOR SMALLER COMPANIES. THEY ALLOW MANAGEMENT'S DAILY INTERACTION AND ROUTINE ACTIONS TO BE EVIDENCE OF CONTROL EFFECTIVENESS. E MAILS AND STANDARD REPORTS CAN BE GATHERED AND USED AS ONGOING EVIDENCE. YOUR OWN PROFESSIONAL JUDGEMENT AS TO THE MOST RELEVANT AND **EASILY GATHERED** EVIDENCE IS CRITICAL.

Applying a risk-based approach to rationalize controls

- Observations
 - Many companies did not adopt a risk-based or “top-down” approach
 - Too many controls were documented and tested
 - Disproportionate amount of time spent testing controls that addressed low-risk areas
 - Company-level controls were not appropriately leveraged



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ALL THIS SHOULD LEAD TO A MORE STREAMLINED AND **FOCUSED** EFFORT FOR YOUR 404 CERTIFICATION. HOPEFULLY, COMPANIES THAT PREVIOUSLY TRACKED AND TESTED 1,500 CONTROLS WILL FOCUS ON 500 CONTROLS THAT HAVE HIGH RISK OF CONTRIBUTING TO A FINANCIAL REPORTING FAILURE. WHEREAS 80% OF THE CONTROLS PREVIOUSLY TESTED WERE ABOUT ROUTINE TRANSACTION PROCESSING, ONLY 50% MIGHT BE GOING FORWARD. NARROWING THIS PYRAMID (WITH FEWER CONTROLS) AND MAKING IT MORE TOP HEAVY (WITH MORE FOCUS ON THE ENTITY LEVEL) IS THE IMAGE I WANT TO LEAVE YOU WITH.

PCAOB New Auditing Standard No. 5

PCAOB has stated that Rule 5 is designed to be more principles based & achieve the following objectives:

- 1 **Focus** the audit on the matters most important to internal control
- 2 **Eliminate** unnecessary procedures
- 3 **Scale** the audit for smaller companies
- 4 **Simplify** the requirements

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I WANT TO BRIEFLY TOUCH ON THE NEW RULES FOR AUDITORS TOO. THE MESSAGE FROM THE PCAOB IS SIMILAR AND COORDINATED WITH THE SEC RULES. THE NEW AS5 STRIVES TO

1) FOCUS THE AUDIT OF INTERNAL CONTROL ON THE MOST IMPORTANT CONTROLS;

2) ELIMINATE UNNECESSARY PROCEDURES;

3) SCALE THE AUDIT FOR SMALLER COMPANIES AND

4) SIMPLIFY THE ACTUAL RULES AND THEREFORE THE EXECUTION IN THE FIELD.

Changes for Auditors

- **New standard requires a “top down” approach:**

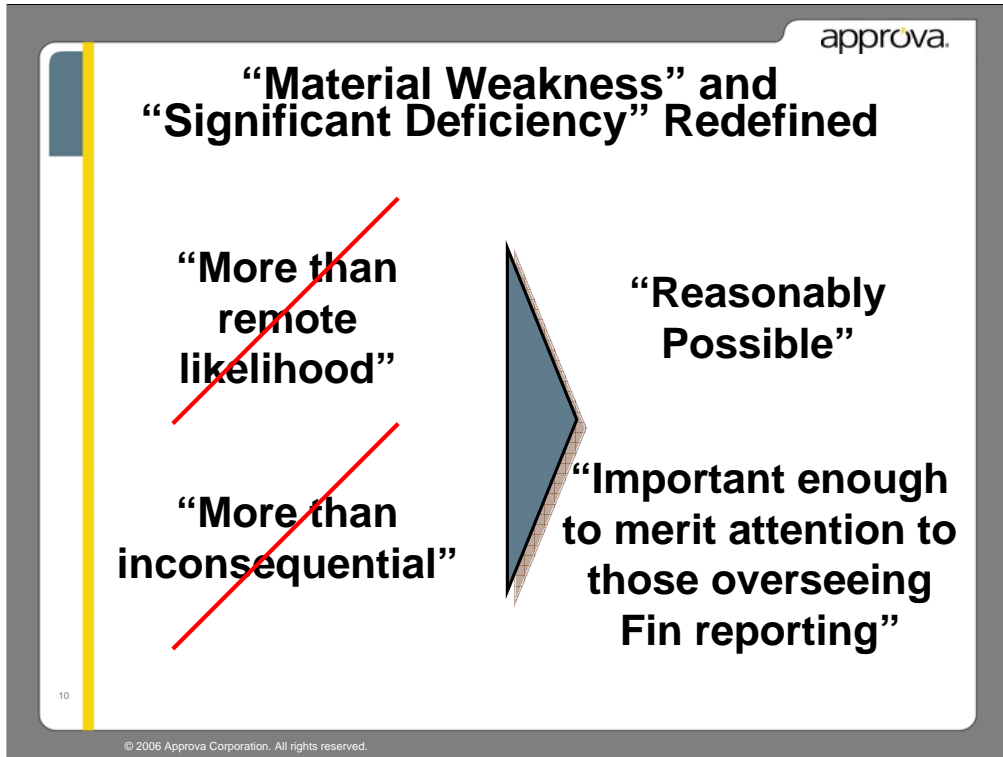
- Start with assessment of company-level controls
- Link financial statement elements to significant accounts, key assertions and significant processes

- **New definitions for material weaknesses and significant deficiencies**

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THE AUDITORS WILL BE **REQUIRED** TO TAKE A TOP DOWN APPROACH. FURTHER, THEY WILL BE REQUIRED TO ASSESS ENTITY LEVEL CONTROLS FIRST AND THEN WORK FROM THERE, AS OPPOSED TO A BOTTOM UP ATTACK.



THE AUDITORS OBJECTIVE IS MADE EXPLICITLY CLEAR. DESIGN THE AUDIT OF INTERNAL CONTROL WITH THE OBJECTIVE OF DETECTING MATERIAL WEAKNESSES. THEIR WORK NEED ONLY BE DESIGNED TO FIND SUCH MAJOR FAILINGS, NOT EVERY PROBLEM IN THE INTERNAL CONTROL SYSTEM OR THOSE UNRELATED TO FINANCIAL REPORTING. IMPORTANTLY, THE **DEFINITION OF A MATERIAL WEAKNESS IS FORMALLY CHANGED TO USE THE TERM “REASONABLY POSSIBLE” OF LEADING TO A MISSTATEMENT RATHER THAN THE FORMER NARROW WORDING “MORE THAN A REMOTE LIKELIHOOD.”** A SIMILAR CHANGE HAS BEEN PROPOSED FOR SIGNIFICANT DEFICIENCIES.

“Material Weakness” and “Significant Deficiency” Redefined

- Material Weakness
 - “A deficiency, or a combination of deficiencies, in ICFR such that there is a **reasonable possibility** that a material misstatement of the registrant’s annual or interim financial statements will not be prevented or detected on a timely basis.”
- Significant Deficiency
 - “A deficiency, or a combination of deficiencies, in ICFR that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of a registrant’s financial reporting.”

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HERE’S THE PRECISE DEFINITION OF A MATERIAL WEAKNESS AND SIGNIFICANT DEFECIENCY AS IT IS INCLUDED IN BOTH THE SEC AND PCAOB LITERATURE. I THINK IT’S INTERESTING THAT THE SIGNIFICANT DEFECIENCY DEFINTION ESSENTIALLY SAYS ITS SOMETHING LESS THAN A MATERIAL WEAKNESS, BUT IMPORTANT ENOUGH TO “MERIT ATTENTION” BY THOSE RESPONSIBLE FOR FINANCIAL REPORTING. THAT’S A PRETTY HIGH LEVEL PROBLEM.

Objective of Internal Control Audit Clarified

- The audit should be designed to identify **material weaknesses that threaten misstatement risk**
- ICFR audit **MATERIALITY** based on the **annual** financials not interim

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MATERIALITY FOR THE PURPOSES OF INTERNAL CONTROL AUDITS IS CLARIFIED AS WELL. MATERIALITY IS TO BE BASED ON THE ANNUAL FINANCIALS, NOT THE QUARTERLY STATEMENTS. IF A MATERIAL WEAKNESS IS FOUND BASED ON THAT ANNUAL LEVEL OF MATERIALITY, THEN THE IMPLICATIONS FOR INTERIM REPORTING ARE TO BE CONSIDERED.

Changes for Auditors

Eliminating Unnecessary Procedures...

- Auditor no longer required to evaluate the process that management uses
- Auditor encouraged to use work in previous audits, to assist in the risk assessment process
- Coverage no longer important, key is risk
- Work of others including internal audit encouraged, but may still be limited due to AICPA professional standards
- No requirement for the auditors own work to provide the principal evidence for the auditors opinion. Replaced “sufficient competent evidence” requirement.

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FINALLY, SOME OF THE SMALLER POINTS AS TO THE CHANGES FOR AUDITORS. THE AUDITOR IS ENCOURAGED TO USE THE WORK OF PREVIOUS YEARS AUDITS AND TO CONSIDER THE WORK ALREADY DONE BY INTERNAL AUDIT AND OTHER CORPORATE STAFF. A CONTROVERSIAL PROVISION OF THE NEW RULES ELIMINATES THE REQUIREMENT FOR AUDITORS TO GATHER THEIR OWN **PRIMARY**, OR FIRST HAND, EVIDENCE.

Increased Auditor Emphasis on Anti-Fraud Controls

- Auditor to consider their fraud and management override risk assessment when identifying controls to test
 - Significant, unusual transactions, particularly late or **unusual journal entries**
 - **Top-level entries** made in reporting process
 - Controls over **related party transactions**
 - Controls over significant **management estimates**
 - Controls that mitigate the pressure on management to manage results

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IN THE VEIN OF BEING MORE PRACTICAL AND TRYING TO FOCUS ON THE ENRON-LIKE PROBLEMS THAT LED TO THE SOX ACT, THERE IS ADDED EMPHASIS ON ANTI-FRAUD CONTROLS. LOOKING FOR MANAGEMENT OVERRIDE OF CONTROLS AND IDENTIFYING CONTROLS THAT TEST UNUSUAL TRANSACTIONS AND LATE JOURNAL ENTRIES ARE ACTUALLY STRENGTHS OF APPROVA'S PRODUCTS. RELATED PARTY TRANSACTIONS AND COOKIE JAR ACCRUALS MANAGEMENT HAVE BEEN A SOURCE OF PROBLEMS SINCE DOUBLE ENTRY BOOK KEEPING WAS INVENTED.

PCAOB Auditing Standard No. 5

- Clarifies the role of materiality, including interim materiality, in the audit
- Removes the requirement to evaluate management's process
- Permits consideration of knowledge obtained during previous audits; eliminates the phrase that each audit must stand on its own
- Directs the auditor to tailor the audit to reflect the attributes of smaller and less complex companies
- Refocuses the multi-location testing requirements on risk rather than coverage (e.g. removal of large portion test)
- Recalibrates the walkthrough requirement
 - Walkthroughs required only for each significant process and not for each major class of transaction within each significant process
 - Direct assistance of others permitted in performing required walkthroughs

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AS I SAID AT THE START, THE REQUIREMENT FOR THE AUDITOR TO EVALUATE MANAGEMENT'S PROCESS HAS BEEN ELIMINATED. ALSO THE CONCEPT OF COVERAGE HAS BEEN REMOVED FOR THE PURPOSES OF DETERMINING MULTI-LOCATION TESTING. THE AUDITOR IS ALSO EXPECTED TO TAILOR THEIR AUDIT FOR SMALLER, LESS COMPLEX COMPANIES.

Some More Good News

- Automated controls are strongly supported.
- SEC clearly states that if companies have manual controls and automated controls they can choose to rely and test the automated controls and not test the manual controls.
- The PCAOB new rules have a dedicated section to “Benchmarking Automated Controls”

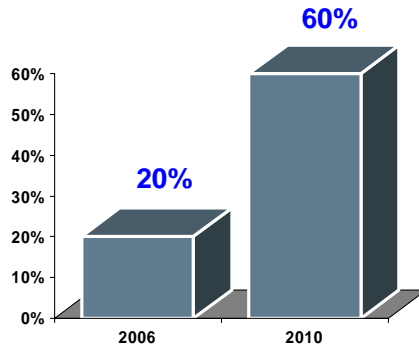
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AUTOMATED CONTROLS ARE STRONGLY SUPPORTED IN THE NEW RULES AND EVEN SPECIFICALLY ADDRESSED IN THE ACTUAL TEXT. THEY ENCOURAGE COMPANIES TO RELY AND TEST AUTOMATED CONTROLS WHEN POSSIBLE. THE PCAOB RULES GO FURTHER AND TALK ABOUT A FRAMEWORK FOR BENCHMARKING AUTOMATED CONTROLS ONE TIME THEN RECONFIRMING THEIR IMPLEMENTATION, RATHER THAN RETESTING THEM EVERY YEAR.

Automation Still at the Early Adopter Stage

% of Firms Using Automated Approach for Monitoring & Testing Controls



“By 2010, auditors will expect regulated organizations to detect fraud by performing transaction monitoring on a continuous basis.”

Source: Gartner Research “MarketScope for Segregation of Duties Controls Within ERP, 2007” by Paul E. Proctor, Jay Heiser and Neil MacDonald. February 9, 2007.

OVERALL AUTOMATION OF CONTROLS IS STILL IN ITS INFANCY. A RECENT GARTNER REPORT PROJECTS THAT 60% OF REGULATED COMPANIES WILL USE AUTOMAION TO MONITOR ALL TRANSACTIONS FOR FRAUD.

Turning Controls From a Cost to an Asset



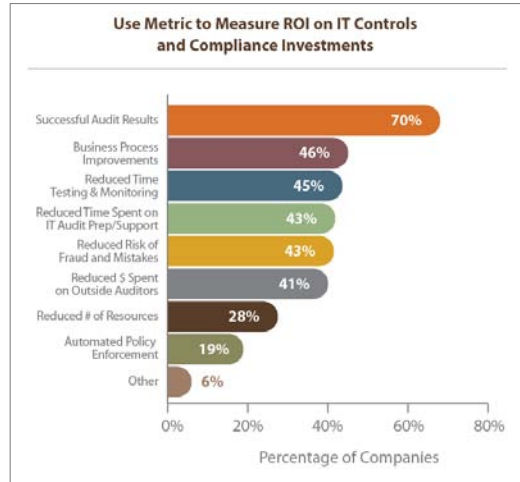
Source: Approva Corporation 2006 Compliance Survey (www.approva.net/survey).
 Note: Numbers may not add to 100% due to rounding.

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AN APPROVA SURVEY INDICATED THAT 70% OF RESPONDENTS EXPECT THAT INVESTMENT IN CONTROLS AUTOMATION WILL PROVIDE VALUE BEYOND SOX COMPLIANCE

Turning Controls From a Cost to an Asset



Source: Approva Corporation 2006 Compliance Survey (www.approva.net/survey).
 Note: Numbers may not add to 100% due to rounding.

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THE LEADING PERCEIVED BENEFITS OF INVESTMENT IN IT CONTROLS AUTOMATION INCLUDE 1)SUCCESSFUL AUDIT RESULTS 2) BUSINESS PROCESS IMPROVEMENT 3) REDUCED MANUAL TIMME TESTING AND MONITORING, AND 4) REDUCED PREPARATION TIME AND STAFF TIME ON IT AUDIT ACTIVITY. AN ADDED BENEFIT WE HEAR A LOT ABOUT IS THE EMPOWERMENT OF THE AUDITORS WHEN RELYING ON THE AUTOMATED TOOLS, THEREBY REDUCING THEIR TIME WITH COMPANY STAFF

Five Recommendations in Conclusion

- 1 Have the CFO, Controller and Audit Partner discuss key financial reporting risk areas.
- 2 Automate controls and automate monitoring
- 3 Make monitoring of controls more routine and built into the process.
- 4 Reduce the number of key controls you track and test
- 5 Prepare information for your auditors about your work that they can rely upon. They no longer will test your work, but they may rely upon some of it.

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ONE FINAL POINT MIGHT BE ON YOUR MIND. “WHAT ABOUT ALL THE GOOD 404 WORK I’VE DONE OVER THE LAST FEW YEARS?” THE SEC ACKNOWLEDGES THE SIGNIFICANT INVESTMENT IN PAST 404 PROCESSES. THEY POINT OUT THAT IF YOU’RE COMFORTABLE WITH WHERE YOU ARE, YOU DON’T NEED TO CHANGE ANYTHING, THE GUIDANCE IS OFFERED AS A CLARIFYING OPTION TO REDUCE YOUR COST AND SCOPE AND TO PROVIDE A SAFE HARBOR. MANY COMPANIES ARE REACTING WITH ONLY SMALL CHANGES TO TAKE ADVANTAGE OF THE SAFE HARBOR. OTHERS ARE BEING MORE AGGRESSIVE AND REDESIGNING THEIR APPROACH.

IN CLOSING I’D GIVE YOU MY FIVE TOP RECOMMENDATIONS FOR TAKING ADVANTAGE OF THIS CHANGE OPPORTUNITY:

1. GET THE CFO, CONTROLLER AND AUDIT PARTNER TOGETHER IN ONE ROOM TO DISCUSS THE REAL RISKS TO FINANCIAL REPORTING MISTATEMENT. MAKE SURE THAT GETS COMMUNICATED TO THE FULL TEAM.
2. AUTOMATE CONTROLS WHEREVER POSSIBLE. AUTOMATE THE MONITORING OF CONTROLS ESPECIALLY.
3. MAKE **ONGOING** MONITORING OF CONTROLS MORE ROUTINE AND BUILT INTO THE PROCESS. USE THAT ONGOING MONITORING AS YOUR PRIMARY MEANS OF GATHERING YOUR 404 EVIDENCE.
4. CONSCIENCIOUSLY REDUCE THE NUMBER OF KEY CONTROLS YOU TRACK AND TEST IN THE 404 PROCESS. REMEMBER THE NARROWED PYRAMID
5. AS OPPOSED TO PREPARING TO HAVE THE AUDITOR TEST YOUR WORK, PREPARE PACKAGES THAT LAY OUT FOR THEM THE MOST IMPORTANT WORK THAT THEY CAN RELY ON AND THEREFORE REDUCE THEIR WORK.

THOSE ARE MY TOP 5 RECOMMENDATIONS. HOPE YOU GOT SOME NUGGET USABLE IN YOUR DAILY WORK.

THANKS FOR YOUR ATTENTION AND GOOD LUCK WITH THE PROCESS.

Appendix – Text of Key Sections

PCAOB New Guidance Specifically addresses automated controls

Benchmarking of Automated Controls

- B28. Entirely automated application controls are generally not subject to breakdowns due to human failure. This feature allows the auditor to use a "benchmarking" strategy.
- B29. If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor verifies that the automated application control has not changed since the auditor established a baseline (i.e., last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor should obtain to verify that the control has not changed may vary depending on the circumstances, including depending on the strength of the company's program change controls.
- B30. The consistent and effective functioning of the automated application controls may be dependent upon the related files, tables, data, and parameters. For example, an automated application for calculating interest income might be dependent on the continued integrity of a rate table used by the automated calculation.
- B31. To determine whether to use a benchmarking strategy, the auditor should assess the following risk factors. As these factors indicate lower risk, the control being evaluated might be well-suited for benchmarking. As these factors indicate increased risk, the control being evaluated is less suited for benchmarking. These factors are –
 - The extent to which the application control can be matched to a defined program within an application.
 - The extent to which the application is stable (i.e., there are few changes from period to period).
 - The availability and reliability of a report of the compilation dates of the programs placed in production. (This information may be used as evidence that controls within the program have not changed.)
- B32. Benchmarking automated application controls can be especially effective for companies using purchased software when the possibility of program changes is remote – e.g., when the vendor does not allow access or modification to the source code.
- B33. After a period of time, the length of which depends upon the circumstances, the baseline of the operation of an automated application control should be reestablished.
- To determine when to reestablish a baseline, the auditor should evaluate the following factors –
 - The effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls and computer operations.
 - The auditor's understanding of the nature of changes, if any, on the specific programs that contain the controls.
 - The nature and timing of other related tests.
 - The consequences of errors associated with the application control that was benchmarked.
- Whether the control is sensitive to other business factors that may have changed. For example, an automated control may have been designed with the assumption that only positive amounts will exist in a file. Such a control would no longer be effective if negative amounts (credits) begin to be posted to the account.

Categories of certification tools

In-scope layers of a significant account

	Automated approaches – categories of tools			
Business environment (Where the tools fit)	Transaction monitoring	Continuous control monitoring	Segregation of duties	IT controls management
Business processes & transactions (purchases/payables)	✓	✓		
Business applications (ERPs)		✓	✓	
IT/application infrastructure (database, network, operating sys)		✓	✓	✓

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Certification tools - what they do

Various technologies can be leveraged to enhance or implement automated controls and continuous monitoring

Activity	Functionality
Transaction monitoring	Testing transactional controls through analyzing transactions for anomalies outside the parameters of controls, monitoring for completeness and accuracy of transactions, and other unusual transactions outside tolerance levels.
Continuous control monitoring	Testing configured/automated controls through monitoring changes in the parameters in control configuration tables
Segregation of duties	Testing segregation of duties through the ability to test who has access to various transactions and/or modules; an access matrix for defining incompatible transactions/functions; monitoring access tables for potential access conflicts; monitoring who has accessed transactions, modules and content.
IT controls management	Testing general computer controls to identify, define, manage and monitor introduction of new or changed configuration items; promote software and hardware into production; manage and monitor system infrastructure.
Internal controls documentation and assessment	Documenting the relevant processes and the associated risks and controls; documenting related policies, procedures and system documentation; risk and control assessments; documenting results of control testing; dashboards, and reporting.

Links to the Proposals

- PCAOB Rules
 - http://www.pcaob.org/Rules/Docket_021/2007-05-24_Release_No_2007-005.pdf
- SEC Rules
 - <http://www.sec.gov/rules/proposed/2006/33-8762.pdf>