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The Sarbanes-Oxley (SOX) initiative at our company involved a corporation with approximately $15 billion in assets with primary operations consisting of two banks. The project was scoped into 13 major business lines. The SOX project also addressed FDICIA.

SOX Resources

During 1st quarter 2004, a decision was made to have Internal Audit document and test controls for SOX with oversight performed by a SOX Steering Committee comprised of key personnel from Accounting, Finance and other key business lines. The Internal Audit team had been responsible for documenting and testing controls for FDICIA purposes. The 2003 FDICIA work was greatly enhanced in anticipation of the SOX effort. The completion of the 2003 FDICIA documentation involved 1,165 internal audit hours. The FDICIA project was completed late February 2004. Internal Audit had prepared an annual audit plan for 2004 with about the same number of hours anticipated for SOX. Therefore, one employee was assigned to the project. A decision was made to engage a separate division of the company's external audit firm to perform a gap analysis. The objective of the gap analysis was to help ensure that the correct types of controls were tested and that the documentation was satisfactory. A decision was also made to purchase SOX documentation software from the external audit firm. The project was delayed for approximately six weeks due to the software implementation. After the initial scoping, the number of estimated hours was revised to about 2,000 hours and resources were redirected from completing the internal audit plan to SOX. Adjustments were formally made to the internal audit plan. The initial documentation and testing was expected to be last approximately 18 weeks with a completion target date of end of August.

The actual number of hours devoted by Internal Audit to document and test internal controls during 2004 was 7,403 hours. The total number of hours devoted by Internal Audit during 2005 to complete 2004 SOX was 1,741 hours for a total of 9,144 hours. However, overtime was not tracked. The formal internal audit plan was not completed as, eventually, all internal audit resources were assigned to SOX. All documentation and testing was performed by Internal Audit and there was no outsourcing.

The fees paid to the external audit firm included $50,000 for the automated system and $152,028 for the gap analysis. Additionally, the estimated cost of the SOX attestation by the external audit firm is approximately $670,000. The estimated cost of the Internal Audit function was approximately $350,000 which represents approximately 47% of the total budget.

Perceived Benefits

There were two primary benefits of SOX to our company. The first benefit is that management's focus has been expanded. Management is now placing more emphasis on internal controls as business decisions are made and is considering the impact of their decisions to controls. The second benefit is that SOX encouraged management to begin making independent decisions concerning treatment of complex transactions. This has reduced management's dependence on the external audit firm for these decisions. Other perceived benefits from the project were as follows.

- There seems to be a more serious approach to disclosing information in the SEC filings.
- Internal Audit gained an invaluable, more detailed knowledge of the processes and controls throughout the company. As outsourced personnel were not utilized, this knowledge will continue to enhance the internal audit team's value to the organization.

Perceived Costs / Dissatisfactions – Internal Audit Perspective

Other than the obvious financial costs of increased fees from external auditors, cost of a SOX automated system and cost of internal audit resources, the following represent negative outcomes of the project.

- The amount of resources needed to complete SOX was greatly understated. There was a significant strain on the Internal Audit resources which may have contributed to key employee turnover.
- The audit coverage accomplished through SOX was significant and covered the vast majority of the formal audit plan. However, the regulatory agencies were unwilling to accept the SOX documentation as audit coverage.
- The SOX project team looked for an automated solution prior to having a thorough understanding of the functionalities that would be necessary. As a result, the automated system did not provide an effective means for completing the documentation. Therefore, the use of the system was halted during the project and a substantial amount of time and resources was lost.
- Internal Audit's need and expectation during the gap analysis phase sometimes conflicted with the limitations imposed by the independence requirements. At times, management had no good source to validate the project approach.
- There was a high level of dissatisfaction with the evolving nature of the standards. The project would have much more efficient and effective had the standards been initially clarified.
- The internal audit staff is being increased to accommodate ongoing SOX compliance. There has been difficulty attracting internal audit personnel with appropriate skill sets. The overall demand for these types of resources may greatly outweigh the supply as more companies staff for SOX compliance.

Perceived Costs / Dissatisfactions – Business Unit Perspective

Business lines were certainly not prepared for the increased scrutiny and time that would be required to support the SOX project. The following represent issues encountered by business lines during the SOX project.

- The independent testing required of the external auditors had a significant impact to the productivity of business lines. The documentation and testing performed by Internal Audit had to be re-performed independently by the external auditors in many cases. This caused the business unit to divert twice the amount of time and resources away from business activities.
- Compliance with SOX required increased levels of documentation to be completed and retained. This level of documentation requires resources devoting time to completing documentation rather than focusing on performing the actual control.
- As inquiry alone was not a sufficient test of a control, the project focused more on the documentation that proved a control was performed rather than on the true quality of the control.
- The rules were too hazy and it resulted in too much uncertainty, which led to unproductive approaches.
- Management, internal auditors, external auditors and business units spent far too much time and expense on concerns over meaningless and immaterial information that added no value to a information presented in our 10-K.
- Because of the vagueness of SOX 404, business units took insignificant issues to an extreme, personnel were overworked, and doing so didn't correlate with the goal of more truthful disclosure.

Overall Results

Internal Audit documented a total of 1,317 controls and tested a total of 935 controls (testing percentage 71%). The initial number of significant deficiencies identified by Internal Audit was 48 with one potential material weakness. The initial number of deficiencies identified by Internal Audit was 271. Much effort was required from the business units to remediate the issues. Additionally, Internal Audit resources were also required to test the remediation. The final results from Internal Audit were no material weaknesses, 9 significant deficiencies and 159 deficiencies. The internal audit firm identified the same significant deficiencies as Internal Audit and also identified 2 additional significant deficiencies. The external audit firm also identified other deficiencies that were not identified by Internal Audit primarily due to the testing of different time periods, different controls, etc. There were essentially no differences between Internal Audit and the external audit firm regarding tests of operating effectiveness.

Success Factors

The documentation and testing did not meet the initial target completion dates. However, the project was completed in time to comply with the requirements. The factors that contributed to the success of the project were as follows.

Success Factors, Cont.

- No outsourced personnel were utilized during the project. Therefore, there was much consistency in the documentation and testing as well as a solid base of understanding of processes prior to the project.
- Internal Audit personnel were utilized to document and test the controls. Therefore, there was no training needed as would have been the case if business units had been required to complete their own testing.
- The FDICIA documentation provided a solid base for the SOX compliance project.
- The eventual utilization of simple spreadsheets, flowcharts and narratives allowed the team to focus on the actual controls and tests rather than learning a new system.
- There was a good working relationship between the external audit team and the Internal Audit staff that existed prior to the project. This resulted in an efficient transfer of documentation to external audit and good coordination of testing. Additionally, both teams worked well together to implement integrated audit approach as Internal Audit performed year-end testing for the financial statement audit.
- The external audit team was staffed with a sufficient number of experienced personnel and displayed a very high level of commitment to the success of the project.
- The SOX Steering Committee was comprised of key Accounting and Finance personnel as well as key personnel from various business lines. The committee met frequently and discussed issues.

Overall Opinion

Due to the judgmental nature of scoping, documentation standards, testing methods, classification of findings, etc., the regulations that were implemented could not have achieved consistency, even among industries, in identifying material weaknesses and/or significant deficiencies. There was no clear correlation between the SOX requirements and restoration of investor confidence / enforcement of ethical standards. Other opinions formulated during the SOX implementation are as follows.

- The inefficient nature of increased documentation of controls and the lack of a true cost/benefit approach to implementing controls contradicts the major reasons why companies are able to thrive. Successful companies focus on what is good for their business, they take calculated risks, and they come up with solutions. SOX 404 should have provided for an evaluation of the cost benefit of implementing certain controls.
- The documentation and testing performed by internal Audit for SOX provided a thorough audit of key controls for significant areas of the company. However, this same result could have been achieved with a solid internal audit plan not necessarily dictated by SOX.

Overall Opinion, Cont.

- As companies continue to staff for SOX, many are creating much duplication of effort as separate SOX teams will be documenting and testing the same controls that the Internal Audit staff tests and that the external audit teams will be required to test. Not only will companies be adding staff to the SOX and internal audit teams but external audit fees will increase and business lines will have to add staff to accommodate the repeated documentation and testing of controls. Efforts are needed by the regulatory agencies to decrease the burden of these requirements.