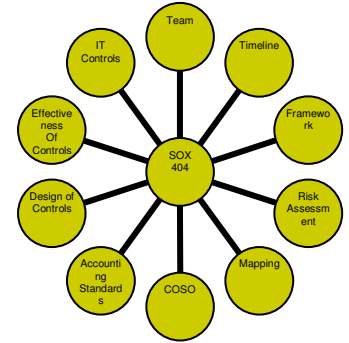


Ten Steps to SOX Compliance for Smaller Public Companies



Executive Summary

The following presentation¹ was designed to:

- Assist with the SEC with its Concept Release for helping Smaller Public Companies comply with the requirements of Sarbanes-Oxley Section 404, and to
- Help smaller public companies (and CPAs) to affordably comply with the provisions of the Act

The following are the ten steps that Lord & Benoit has identified for meeting the requirements of SOX 404:

1. **Line up your team** (*This involves gathering the resumes and qualifications of the SOX team both internally and external resources. Upper management and Audit Committee or Board members should also be actively involved.*)
2. **Establish a timeline** (*This process is for scoping the entire SOX project from both a timeline and task perspective.*)
3. **Choose the appropriate frameworks** (*Companies will need to choose an internal control framework, namely COSO or COSO for Smaller Public Companies. We highly recommend the later although it is not intended to supplant the regular COSO. The IT framework must be chosen as well, such as ITGI Control Initiative for Sarbanes-Oxley, SAS 55 or CoBIT*)
4. **Perform Enterprise and Fraud Risk Assessment** (*SOX project leaders should START with risk assessment, both fraud and enterprise risk. A good risk assessment will allow the team to focus on key controls and possibly reduce scope in non key areas.*)
5. **Map significant accounts**, locations, business units, assertions, processes and subprocesses and IT infrastructure (*Again this should be done as early in the project as possible for the same reasons mentioned in enterprise and fraud risk assessment above.*)
6. **Company Level Controls – COSO** (*This should also be done early in the project for the same reasons mentioned in points 4 and 5 above.*)
7. **Company Level Controls – Accounting and Disclosure** (*For a smaller public company, this area should be addressed early as well. Most control weaknesses in smaller public companies are company control level activities.*)
8. **Assess Design of Controls** (*The design of controls should be assessed and possibly redesigned given the typical lack of segregation of duties in smaller public companies.*)
9. **Test Activity Level Controls** (*Detail testing should be closer to the back of the project than the front due to typical re-design of control issues.*)
10. **Test IT General and Application Controls.** (*This is done concurrently with the test of internal controls throughout the project*)

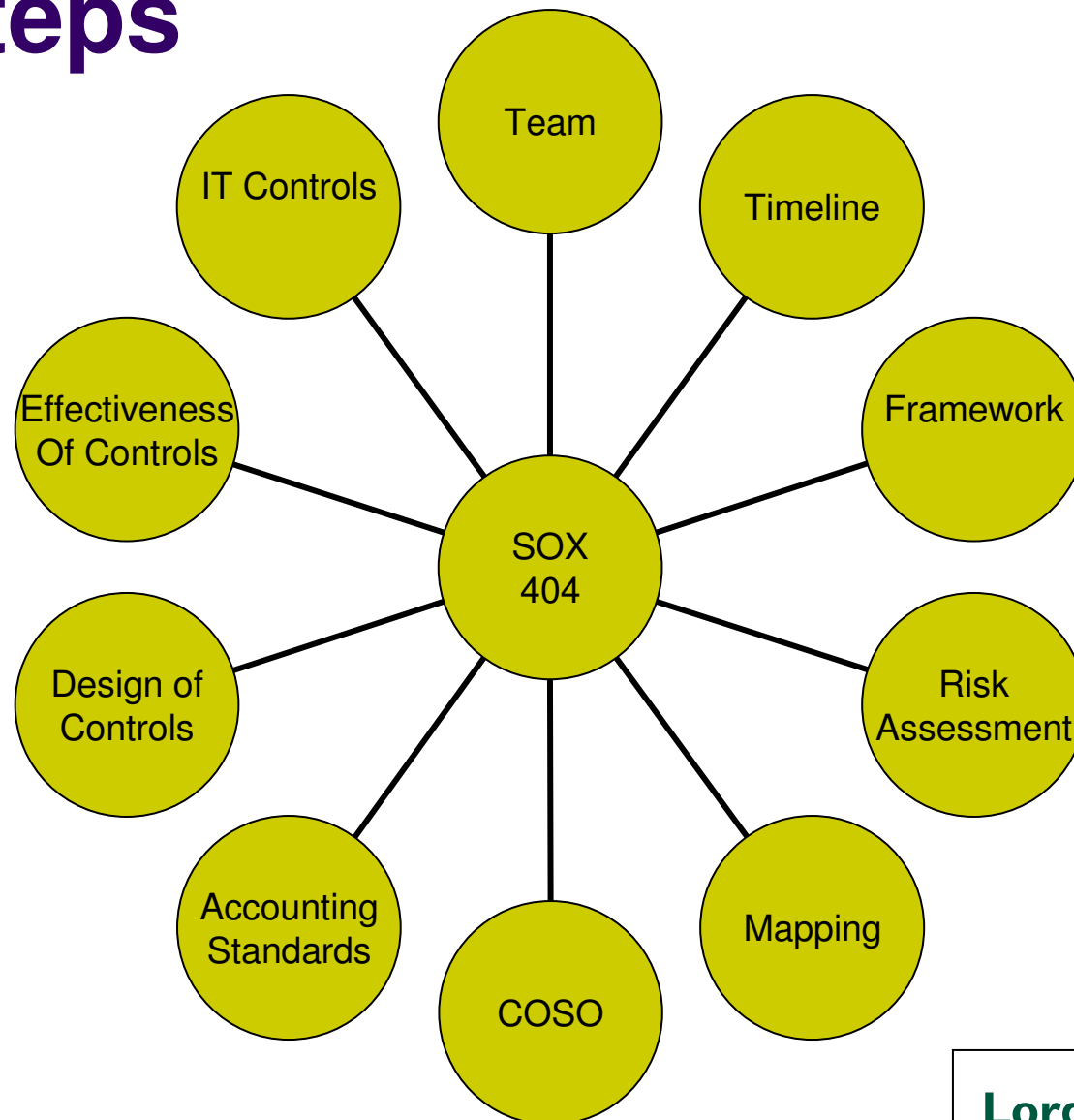
For questions about this research, you may contact Bob Benoit at (508) 853-6404 x204

¹ We believe this framework meets all of the PCOAB of Auditing Standard #2 – Internal Controls over Financial Reporting; however it is prudent for company management to have their outside audit firm approve frameworks in advance.

Ten Steps



The following are ten steps that a smaller public company could follow to implement a complete a SOX 404 project.



Source: Lord & Benoit, LLC www.Section404.org



Step 4

Macro Level Risk Assessment



Although not required by professional standards, we recommend a **Macro Level Risk Assessment**. It summarizes ALL of the adverse Section 404 weaknesses that peer companies reported in their compliance efforts. This is a sample of all of the first year adverse reports of companies in the Biotech, Pharm and Life Science industries. Macro Level Risk Assessment helps us understand the risks in our peer industries with the end goal in mind.

<u>Accounting Material Weaknesses</u>	<u># Co.s</u>	<u>%</u>
Revenue recognition issues	11	45.8%
Inventory, vendor and cost of sales issues	8	33.3%
Tax expense/benefit/deferral/other (FAS 109) issues	8	33.3%
Accounts/loans receivable, investments & cash issues	7	29.2%
PPE, intangible or fixed asset (value/diminution) issues	7	29.2%
Foreign, related party, affiliated and/or subsid issues	5	20.8%
Liabilities, payables, reserves and accrual est failures	4	16.7%
Debt, quasi-debt, warrants & equity (BCF) security issues	3	12.5%
Fin Stmt/ footnote/ US FASB, segment disclosure issues	3	12.5%
Acquisition, merger, disposal or reorganization issues	2	8.3%
Income statemt classification, margin and EPS issues	2	8.3%
Lease, FAS 5, legal, contingency & commit issues	2	8.3%
Deferred, stock-based or executive comp issues	1	4.2%
Depreciation, depletion or amortization issues	1	4.2%
Gain or loss recognition issues	1	4.2%
Intercompany/Investment w/ sub/affil issues	1	4.2%

<u>Internal Control Material Weaknesses:</u>	<u># Co.s</u>	<u>%</u>
Accounting documentation, policy and/or procedures	22	91.7%
Material and/or numerous auditor /YE adjustments	14	58.3%
Accounting personnel resources, competency/training	12	50.0%
Restatement or nonreliance of company filings	12	50.0%
Segregations of duties/ design of controls (personnel)	10	41.7%
Untimely or inadequate account reconciliations	6	25.0%
Information technology, software, security & access issues	4	16.7%
Restatement of previous 404 disclosures	3	12.5%
Senior management competency, tone, reliability issues	3	12.5%
Ethical or compliance issues with personnel	1	4.2%
Ineffective or understaffed audit committee	1	4.2%
Insufficient or non-existent internal audit function	1	4.2%
Scope (disclaimer of opinion) or other limitations	1	4.2%

Source: Lord & Benoit, LLC using AuditAnalytics.com

Another Look of “Mapping”



We provided this template to help you visualize the mapping process for a typical smaller public company...

