Thinking outside the SOX box
Transforming your compliance function for competitive advantage
What if?

What if you could:

- Reduce your SOX compliance costs?
- Be capable of quicker, more on-point decision-making across your entire enterprise?
- Free up existing resources for strategic initiatives?

You can ... by making a bold move and changing how you think about and execute your SOX function.
Table of contents

Page 1  Executive summary: Significant opportunity exists to transform your SOX function
Our survey reveals four actions companies can take now to empower their SOX functions to create fundamental advantages in their sectors.

Page 2  1. Automating your controls
Replacing manual detect controls with embedded automated controls will make a significant difference in the hours burned on SOX each year, resulting in an immediate impact on your cost-containment efforts.

Page 4  2. Offshoring for lower-cost resources
The SOX function procedures are now well codified — it's time to realize cost efficiencies from globalizing your resources.

Page 6  3. Leveraging your IT investment
The benefits of going beyond simple automation and more comprehensively leveraging all of your IT resources also applies to your SOX function.

Page 8  4. Innovating strategically
Strategic innovation around SOX execution can enhance your competitive advantage.

Page 13 Conclusion: Thinking differently about your SOX function
SOX compliance is an opportunity to bring innovative approaches to help you drive more value into your operations.

Page 14 Appendices:
- Methodology
- Industry breakdown
Executive summary

Significant opportunity exists to transform your SOX function

In April 2011, Ernst & Young conducted a face-to-face survey with 225 global executives about their SOX compliance functions. For the most part, we found organizations are still treating SOX compliance the same way most of them originally looked at it: as a compliance exercise.

A small proportion of the interviewees, however, have evolved their thinking. Their companies have come to look at SOX the way they look at many of their operations: as an opportunity to innovate, to automate and to gain competitive advantage. These are companies that have seen the correlation between certain SOX compliance practices and the ability of the SOX function to add value to the business – which 56% of the executives considered a key challenge for their SOX function.

Thinking outside the SOX box reveals four actions companies can take now to empower their SOX functions to create fundamental advantages in their sectors:

1. Automate controls
2. Offshore for lower-cost resources
3. Leverage IT investment
4. Innovate strategically

The Who’s Who of this report

The executives who took part in the survey were all in positions that gave them a close-up view of SOX activities at their companies – and they told us that the SOX function is definitely on the C-suite radar: 78% of the survey participants report to the CFO, CAE or the Controller.

We aimed for broad-based representation across industries, with 21 sectors involved, ranging from aerospace and defense to telecommunications. The greatest number of respondents were in banking and capital markets and insurance, with 11% each of the total participants, followed by technology (9%), and power and utilities and consumer products (8%). See Appendices for full industry breakdown.

While we talked with executives at companies ranging in size from less than US$1 billion in annual revenues to more than US$50 billion, the bulk of the participants (65%) were in the middle of the range, companies between US$1 billion and US$25 billion in size.

“Adding value to the business” identified as a key challenge of SOX functions

What are the key challenges faced by your SOX function?

The majority of respondents consider adding value to their business a key challenge of the SOX function.

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost/Level of effort and innovation in control testing strategies</td>
<td>58%</td>
</tr>
<tr>
<td>Adding value to the business</td>
<td>56%</td>
</tr>
<tr>
<td>Integration with other risk and compliance functions</td>
<td>44%</td>
</tr>
<tr>
<td>Providing learning and career opportunities for SOX personnel</td>
<td>37%</td>
</tr>
<tr>
<td>Technology-related challenges</td>
<td>32%</td>
</tr>
<tr>
<td>Controls monitoring</td>
<td>32%</td>
</tr>
<tr>
<td>Effectiveness of resources</td>
<td>25%</td>
</tr>
<tr>
<td>Dealing with mergers or acquisitions of private or non-SOX-compliant entities</td>
<td>16%</td>
</tr>
<tr>
<td>Other</td>
<td>15%</td>
</tr>
<tr>
<td>None of the above</td>
<td>1%</td>
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</tbody>
</table>

Multiple responses allowed
1. Automating your controls

When we asked the survey executives about the number of controls tested by their SOX function, we got a good picture of just how massive an undertaking SOX compliance is:

- 35% of our participants indicate that they have more than 1,000 controls, more than 60% of which are key controls.

Then factor in that, for 62% of the companies, the testing of key controls alone took at least five hours per control. Add test of design, walk-through and all the controls that aren't designated as key – which could be 20%–40% of the total number of controls – and the time in the field to actually perform all the manual controls. In short, SOX is a tremendous drain on resources that could be deployed on other, more value-added tasks.

It’s a diverse drain on resources, as well: survey participants revealed they were experiencing SOX deficiencies in more than 10 different areas of SOX testing, from derivatives to inventory, with 51% saying that IT general controls were giving them the most problems (financial statement close process was the second-highest area of deficiencies at 9%).

Companies that reduce their total number of controls tend to focus on key controls

What is your company’s total number of SOX-related controls?

**Total number of SOX-related controls**

The majority of respondents have fewer than 1,000 controls.

<table>
<thead>
<tr>
<th>Controls</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 250</td>
<td>19%</td>
</tr>
<tr>
<td>250-499</td>
<td>24%</td>
</tr>
<tr>
<td>500-999</td>
<td>22%</td>
</tr>
<tr>
<td>Between 1,000-2,499</td>
<td>22%</td>
</tr>
<tr>
<td>2,500 or more</td>
<td>13%</td>
</tr>
</tbody>
</table>

What percentage of your controls are key controls?

**Key controls as a percentage of total controls**

Average key control percentages are provided for the corresponding categories on left. The fewer total controls, the higher the percentage of focus on key controls. Companies that reduce their total number of controls tend to focus on key controls.

- Most respondents spend less than five hours on design and walk-through of each control.
- By comparison, the majority of respondents spend 5 hours or more on testing per control.

Testing is the most time-consuming of the three key SOX activities

On average, how many hours do you spend on each key control?

**Design and walk-throughs versus testing controls**

- Percentages may not total 100 due to rounding.
There is widespread recognition that automation frees up resources to be put to better use elsewhere. By increasing your use of preventative automated controls and “turning on” key switches in IT systems, you can drive down the number of manual touch points and labor-intensive detect controls. Similarly, using automated tools in the SOX controls-testing process will have an immediate impact on SOX costs.

Increasing use of automated controls can reduce your costs in other ways too. We saw 55% of survey participants indicate that their external auditors relied on 51% or more of the walk-throughs and testing work performed in-house. So, if you automate controls and do SOX right, you may also be able to increase reliance by your auditor. This may help reduce the time spent by your SOX-function employees handling the inquiries and testing by the external auditors.
2. Offshoring for lower-cost resources

Cosourcing is already being used extensively in the SOX arena: 50% of survey participants said that they used outside service providers for some part of their SOX-compliance work, with 66% using outside resources for testing. And yet:

- 81% of our survey executives said that Internal Audit was involved with their SOX program.
- 40% indicated that their Internal Audit department devoted at least a quarter of its budget or more to SOX activities.

The majority of respondents use outside providers – most often for testing

Do you use an outside service provider for SOX activities?

Outside service provider used for SOX activities

Just over half the respondents have an outside provider for one or more SOX activities.

If yes, how do you use them?

Outside service provider usage

Testing is the key activity performed by outside service providers.

Multiple responses allowed.
Most IA departments are involved in the SOX program

Is Internal Audit involved in the SOX program?

**Internal Audit involvement in SOX program**

For the majority of respondents, the Internal Audit department is involved with the SOX program.

![Pie chart showing 81% Yes and 19% No](chart)

SOX work performance breakdown

What percentage of SOX work is performed by the following:

<table>
<thead>
<tr>
<th>Total</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resources at corporate headquarters</td>
<td>60%</td>
</tr>
<tr>
<td>Regional resources at other company locations</td>
<td>26%</td>
</tr>
<tr>
<td>Domestic third-party resources</td>
<td>9%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
</tr>
<tr>
<td>Offshore third-party resources</td>
<td>2%</td>
</tr>
<tr>
<td>Offshore resources not at company locations</td>
<td>1%</td>
</tr>
</tbody>
</table>

If IA is used in the SOX program, what percent of IA budget/capacity is spent on SOX testing?

**Internal Audit resources on SOX testing**

Most respondents whose Internal Audit department is involved in the SOX program say that less than 25% of its budget and capacity is spent on SOX testing.

![Bar chart showing distribution of SOX budget/capacity](chart)

The outsourcing of activities that aren't fundamental to meeting strategic business objectives has been a leading business practice for many years now. There is no question that it reduces costs and allows in-house resources to be applied to more strategic, core-business matters. The off-shoring of such less-strategic operations not only helps companies reduce costs, but it also allows them to practice “follow the sun” operations, which provide another means for increasing the productivity of in-house and (or) domestically located resources. Yet only 3% of our survey participants were using offshore resources for their SOX function.

The basic procedures involved in the SOX function have been in practice for several years and are fairly well codified. Now is the time to realize the cost efficiencies that can be derived from globalizing your resources.
3. Leveraging your IT investment

Let’s be clear: leveraging your IT investment goes far beyond turning on various automated controls in the systems and automating testing. There is a real opportunity to use technology more strategically. Yet, we found only small percentages using more innovative technology-based techniques:

- Only 21% employ data analytics regularly.
- 88% never use predictive modeling.
- 65% do not use continuous controls monitoring.

We found that 90% of survey participants still use Excel® for their scoping exercise, when there are other third-party tools that can slice and dice risks and controls in order to optimize scoping.

Testing process: data analytics or predictive modeling?

How often do you use the following as part of your testing process?

Tools used in the testing process

Most respondents either never or sometimes use advanced analytical techniques as part of their control testing process.

Among those who use them often or always, data analytics is the most popular technique.

Ernst & Young Controls Review Tool

Ernst & Young’s proprietary Controls Review Tool (CRT) enables our teams to quickly assess their clients’ current controls strategy and assist in the identification of potential opportunities for improving the strategy for testing controls and improving controls-related documentation.

The CRT presents internal controls data in a user-friendly format, including a summary of control statistics, a detailed breakdown of controls by processes and related applications, and different views of the relationships between controls and risks. The CRT can also help provide visibility into opportunities for rationalizing or optimizing controls, including better leveraging of automated controls.
Continuous controls monitoring not widely used

For what percent of SOX controls do you perform continuous controls monitoring (e.g., leveraging Blackline to monitor account reconciliations)?

Continuous controls monitoring

- Almost all respondents say that they either do not perform continuous controls monitoring at all, or do so for less than 25% of all SOX controls.

<table>
<thead>
<tr>
<th>Percent of SOX Controls Monitoring</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do not perform continuous controls monitoring</td>
<td>65%</td>
</tr>
<tr>
<td>Less than 25%</td>
<td>28%</td>
</tr>
<tr>
<td>26%-50%</td>
<td>3%</td>
</tr>
<tr>
<td>51%-75%</td>
<td>1%</td>
</tr>
<tr>
<td>More than 75%</td>
<td>2%</td>
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</tbody>
</table>

Excel® favored for scoping exercises

What tools/software do you use as part of your scoping exercise?

- Excel®: 90%
- Third-party vendor/software: 19%
- In-house - developed tool/software: 14%
- None: 4%

Multiple responses allowed.

Percentages may not total 100 due to rounding.

Takeaway

Strategic use of your IT investment is a critical driver of competitive advantage. Our survey results suggest that this holds true for applying it to your SOX functions as well.
4. Innovating strategically

Our survey explored the opportunities for applying innovative practices to the SOX function and found this to be a relatively untapped option.

For instance, when asked when the last time a controls rationalization/optimization or other innovative exercise had been conducted – only 52% of respondents said it had been during the current fiscal year.

Incorporating the SOX function into Enterprise Risk Management

Is SOX incorporated into your Enterprise Risk Management (ERM) program?

Relationship between SOX and ERM

Almost half of respondents do not incorporate SOX into their ERM programs.

Few key controls are entity-level controls

What is the percentage of entity-level controls that make up your total key controls?

Entity-level controls as percentage of total key controls

The use of entity-level controls is a particularly under-utilized opportunity. Since one really effective entity-level monitoring control may eliminate the need to do many transaction-level controls, companies can significantly reduce the testing workload by properly designing robust and effective entity level controls.

Specific innovative practices we asked about included:

- Use of control self-assessment (58% do not use at all)
- Peer reviews (63% do not use at all)
- Incorporating the SOX function into ERM program (48% do not)
- Creating more entity-level controls (94% had fewer than a quarter of their key controls as entity-level controls)
Rationalization/optimization exercises have been performed

When was the last time a rationalization/optimization or some other innovative exercise was conducted?

Innovative exercises
Only 52% performed rationalization/optimization or other innovative exercises this fiscal year.

If a rationalization/optimization or other innovative exercise was conducted, what techniques were used?

Key techniques
Most respondents utilized rationalization of in-scope controls.

Percentages may not total 100 due to rounding.

Multiple responses allowed.
Control self-assessment not widely used

For what percent of controls does the company use control self-assessment (CSA)?

**CSA**
- The majority of respondents do not use CSA.

Peer reviews not widely used

For what percent of controls does the company use peer reviews?

**Peer reviews**
- The majority of respondents do not use peer reviews.

Percentages may not total 100 due to rounding.

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**CSA**

- **Do not use control self-assessment**: 58%
- **Less than 25%**: 17%
- **26%-50%**: 5%
- **51%-75%**: 3%
- **More than 75%**: 16%

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**Peer reviews**

- **Do not use peer reviews**: 63%
- **Less than 25%**: 16%
- **26%-50%**: 4%
- **51%-75%**: 4%
- **More than 75%**: 12%
There appears to be good reason to explore such innovative practices: they help deliver additional value for the business. For instance, of those survey participants who had incorporated their SOX function into their ERM program, 79% were satisfied or extremely satisfied with the ability of their SOX function to add value, while only 54% of those who hadn’t folded SOX into ERM programs were similarly satisfied. Similar results were noted when we asked about continuous controls monitoring.

SOX incorporated into ERM program and satisfaction with value

Is SOX incorporated into your ERM program?

How satisfied are you with the ability of your SOX function to add value?

The leveraging of SOX information and testing with other departments that could put it to valuable use was also fairly minimal:

- Only 9% of participants indicate they “significantly” leverage their SOX testing results with their regulatory and compliance functions.
- Only 3% of participants do the same with their legal department.

Leveraging SOX information and testing across other functions/departments within a company will decrease the burden felt by the business units. Another point here is that there are opportunities to get a leg up on the competition by building the SOX function into the regular ebb and flow of business operations – by using self assessments or peer reviews. Once you change the mindset at the business-unit level, the SOX function can move beyond compliance and into helping manage and monitor the business on a continuous basis.

Internal Audit most often leverages SOX testing results

How much do you leverage your SOX testing results with other departments in the company or other compliance/reporting functions?

Leveraging SOX testing results

Respondents leverage SOX testing results most with the Internal Audit department.

There are also opportunities to get ahead of the competition by exploring and developing innovative ways to generate more usable SOX information and (or) put SOX testing/data to more diversified use. When we asked about the frequency of controls testing, we found only 4% test continuously through the year. This is roughly the same percentage that has fully automated most controls (which is probably required to make it economically feasible to do continuous testing).
Frequency of testing and roll-forward approach

What is the frequency of your testing and your roll-forward approach?

Key techniques

Frequency results for testing and rollforward are fairly evenly distributed over the year among the respondents.

Percentage may not total 100 due to rounding.

Does this lack of innovation matter? Our survey participants seem to think so. The participants whose companies refrain from using the most progressive testing and scoping practices are less satisfied with the ability of their SOX function to add value.

Use of continuous controls monitoring, CSA and peer reviews coincides with fewer respondents being less than satisfied with value of SOX function

A greater percentage of respondents who were “less than satisfied” with the ability of their SOX function to add value do not use the most progressive or innovative practices:

Takeaway

In the global economy of the 21st century, innovation often plays a vital role in differentiating a company and bringing it to a position of industry leadership. Strategic innovation around SOX execution can lead to better strategic use of your existing resources.
Thinking differently about your SOX function

Thinking outside the SOX box shows that SOX compliance is an opportunity to bring innovative approaches to a subject area that has become somewhat stale and routine. Innovative practices and approaches improve the chances that a company will build more value into its operations, including:

- Reductions in spend from a substantial line-item cost
- More strategic allocations of financial-control resources
- Greater consistency and efficiency of controls across locations through automation
- Reduced stress and burden on in-house resources through a powerful combination of automation, outsourcing, and leveraging SOX work across the company
- Using automated techniques (e.g., data analytics) – Expanded and more comprehensive risk coverage without increasing the budget

When this shift in perspective occurs, there is ample opportunity to bring strategic innovation to the seemingly mundane SOX issues of scoping processes and testing strategies and execution. There are sophisticated tools to explore. Different approaches to acquiring and analyzing data can make the data more valuable, not only for compliance tasks, but for other previously unexplored purposes.
Appendices:

Methodology

Company revenues

Annual revenue:

Annual revenue categories and responses
The majority of the respondents fall into the category of US$1 billion to US$25 billion in terms of their annual revenues.

![Bar chart showing distribution of annual revenues](chart)

 Percentages may not total 100 due to rounding.

Internal Audit department and Internal Control department both own the SOX administration and testing

Who owns administration and testing components of the SOX compliance function?

Ownership of the SOX compliance function
The Internal Audit department and the Internal Controls department are the main divisions controlling the administration and testing components of SOX compliance for the current respondents.

![Bar chart showing ownership of SOX compliance function](chart)

Multiple responses allowed.
SOX compliance function reports most often to the CFO

To whom does the SOX compliance function report?

Reporting relationship of the SOX compliance function

Most respondents report to either the CFO, CAE or the Controller.

Industry breakdown

Response by industry

Industry categories

The two industries with the maximum number of completed surveys were Banking and Capital Markets and Insurance.

 percentage may not total 100 due to rounding.
Contacts

Is your SOX function geared for this transformation? Ernst & Young can help you explore this opportunity.

Robert F. Cullen III  
*Partner, Advisory Services*  
+1 612 343 1000  
robert.cullen@ey.com

Sapna Ahuja  
*Senior Manager, Advisory Services*  
+1 212 773 5928  
sapna.ahuja@ey.com

For a copy of the complete SOX survey, please contact the above or your Ernst & Young engagement team.

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