Sarbanes-Oxley: The Critical Role for Project Leadership

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AVON

Agenda

- Sarbanes-Oxley, Section 404
- Why Project Leadership & Management is Critical to Success of Sarbanes-Oxley
- Avon Product's 404 Project Approach
- Thoughts on Role of Project Leader and Progression of Career

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[handwritten: SAS70 TYPE 2 REPORT certified]

Agenda

- Sarbanes-Oxley, Section 404

[handwritten: (COSO) committee of sponsoring organizations of the Treadway commission]

Background – Sarbanes-Oxley 404

- Enacted on July 31, 2002
- Purpose is to prevent accounting scandals from recurring, and to build public trust in corporate business practices
- Single most important act of legislation affecting corporate governance, financial reporting and accounting practices
- The Act contains 11 titles, ranging from additional responsibilities for management to criminal penalties for white-collar crime

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Background – Sarbanes-Oxley 404

- Section 404: Management Assessment of Internal Controls
- Requires a management assertion and auditor attestation on the effectiveness of internal controls over financial reporting
- Effective for companies filing after November 15, 2004
- Deadline has already been delayed twice as companies struggle to comply
- Impact on corporations is massive – compared to Y2K; except it never goes away!

Background – Sarbanes-Oxley 404

Management is required to:

- Accept responsibility for the effectiveness of the company's internal control over financial reporting
- Evaluate the effectiveness of the company's controls using a suitable control criteria (COSO)
- Support the evaluation with sufficient evidence including documentation
- Present a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year.

[handwritten: AICPA: webtrust systrust]

[handwritten: COCO – canadian version]

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Background – Control Types

- Reconciliations
- Management reviews
- Authorizations
- Segregation of duties
- System configurations & access
- Edit checks, exception reports
- Interface/conversion controls

Background – IT Controls

- Application controls
  - Aligned to business process which feeds financial reports.
  - Controls which support financial assertions of validity, completeness, accuracy, or rights & obligations.
- IT general controls
  - Program development
  - Program changes
  - Computer operations
  - Access to Programs and Data

- For more information go to the IT Governance website at wwww.itgi.org.

Background – COSO Framework

Control Environment - tone of an organization, influencing the control consciousness of its people

Risk Assessment – assessment both at the entity and the activity level

Control Activities – These policies and procedures help ensure management directives are carried out

Information and Communication – Pertinent information must be identified, captured and communicated

Monitoring – internal control systems need to be monitored
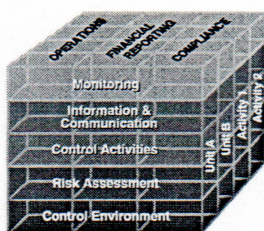
Background – Sarbanes-Oxley 404

External auditor is required to:

- Express an opinion on the financial statements
- Express two opinions on internal control over financial reporting which requires:
  - Evaluating and opining on management's assessment of internal control over financial reporting
  - Evaluating and opining on the effectiveness of internal control over financial reporting

Background – Sarbanes-Oxley 404

The Public Company's Accounting Oversight Board (PCAOB) has set the standard for the work to support 404 and includes

- Management's responsibilities and documentation requirements; auditor's testing of operating effectiveness
- Definition of significant deficiency and material weakness
- Evaluation of multiple business units and locations
- Use of service organizations
- No rotation of testing
- Mandatory auditor walkthroughs
- Quarterly procedures

Agenda

- Sarbanes-Oxley, Section 404
- Why Project Leadership & Management is Critical to Success of Sarbanes-Oxley

Why Project Management?

- Unclear scope – virgin territory!
- Time & resource constrained
- Implementation of new business process
- Global initiative
- Education & training critical
- Coordination of many stakeholders
- Rollout of IT tool
- High impact if not done right!

KPMG's – control assessment tool
Now IBMS

Project Management – Assessment Steps

- Plan & Scope the Evaluation
- Management Self-Assessment
  - Document Controls
  - Test and Assess the Design and Operating Effectiveness
  - Correct Deficiencies
- Internal Audit Independent Testing
- External Audit Independent Testing

Project Management - Managing the Triple Constraint

SCOPE   TIME
QUALITY
COST
RISK

- Scope – what is the deliverable?
- Time – how long will it take?
- Cost – How many resources are needed?
- Quality – To what quality standard?
- Risk – How certain are the conditions surrounding the project?

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Background – Avon Products

- Leading direct seller of beauty and related products
- $6.8 billion in annual revenues
- Market to women in 143 countries
- 46,000 associates
- 4.4 million independent sales representatives

Background – Avon Products (cont.)

- Year end – December 31
- Limited Shared Services
- No ERP
- Limited formal process documentation
- Decentralized approach to operations

Background – the 404 Project

- Project started in January 2003
- Formal project manager assigned
- 1st assessment completed in December 2003 and included management self-assessment, internal audit independent testing, and external audit review of documentation
- Implementation of web-based education program and documentation tool
- Close out initial project and turnover to ongoing organization

Background – Project Statistics

- Involved 97 reporting units/functions
- 10 key processes; 300-400 controls of which 200 are key
- Currently documented 20,000 controls across the enterprise
- 1700 process and control owners involved
- $5 million project cost (internal & external)

Strategy & Approach

- Many decisions to be made to establish approach for scope, timeline, and budget
- Heavy involvement of CFO and Steering Committee
- Spent 6 weeks in up-front planning
- Most critical phase of project

Strategy – Key Decisions

- Project Objective – merely 404 compliance or more
- Company coverage – all reporting units or risk-based
- Control Framework - COSO
- Outside consultant or go it alone
- Role of management, internal audit and external auditor (independence)

Strategy – Key Decisions (cont.)

- "Right" amount of documentation – risk/control templates, narratives, process flow
- Testing Standards – sample sizes, timing, who tests?
- Language issues – English only versus local language
- Self-assessment & certification process
- Review & Remediation Approach – corporate, regional, local
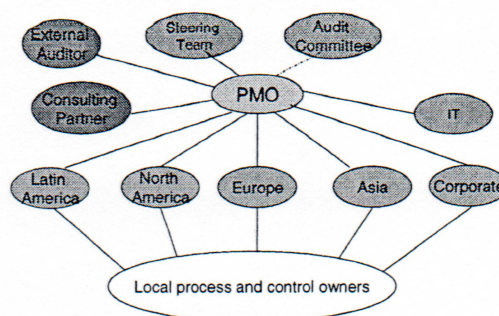
Strategy – Key Decisions (cont.)

- Education & training
- IT tool
- Pilot or "big bang" approach
- Assessment of outsourced processes
- Evaluation of non-control activity components of COSO
- Who pays?

Project Organization – Key Stakeholders

- Business Sponsor – CFO
- Project Manager, dedicated team (PMO)
- Steering Team – Controller, Internal Audit, Legal Counsel
- IT
- External Auditor
- Regional/local business and financial management
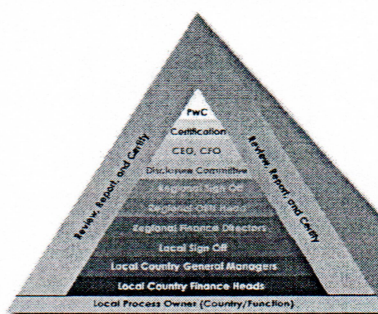- Process and control owners

Project Organization - Structure

External Auditor · Steering Team · Audit Committee · Consulting Partner · PMO · IT · Latin America · North America · Europe · Asia · Corporate · Local process and control owners

Project Organization – Roles & Responsibilities

- Process owners certify as to control design and effectiveness; document controls and assign control owners
- Control owners test and assess control effectiveness; recommend remediation plan
- Local, regional, and corporate business and finance management certify as to design and operating effectiveness

Project Organization – Review & Certification Process

PwC Certification · CEO, CFO · Disclosure Committee · Regional Sign Off · Regional CFO Heads · Regional Financial Directors · Local Sign Off · Local Country General Managers · Local Country Finance Heads · Local Process Owner (Country/Function)

Repeatable, Sustainable Process

- Not a one time event!
- Clarification of Ownership is critical
  - Facilitation of process owned by Controller
  - Implementation of process owned by business and finance management
  - Internal Audit is independent
- Continuous process improvement – rules being finalized and clarified
- Move from compliance focus to business focus

Reaping the Benefits

- Compliance
- Improved control effectiveness – earlier identification of weaknesses before they become significant
- Increased governance structure and practices
- Process information now available and being used for key decision-making
- Foundation for Enterprise Risk Management

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What is a project leader?

Quotes from senior management:
- Has a passion for detail and appreciation for strategy
- Has the competency to identify gaps and the self-confidence to escalate and initiate resolution
- Ability to recognize patterns and variances
- An optimistic spirit, resilient
- Anticipatory, Objective, Persistent, Disciplined
- A teacher

What is a project leader?

My favorite senior management quote:

When we have something which needs to get done we give it to you and we know you will lead us through figuring out what needs to be done and how to do it.

Then you'll push us through getting it done – no matter what the obstacles may be.

*Quote from my boss

What is a project leader?

From the mouths of babes….

Recently a 5 year old boy was asked what he thought a "leader" was. He said that a "leader" is the person who is in the front of the line when you play "follow the leader." You follow them around and try to do the things that they do, until they start acting really stupid. Then you go play something else.

Kathy's Top 10 Tips for Success in Leading a Sarbanes-Oxley Project

#6 Follow the 80/20 rule

#7 Clarify and simplify

#8 Review everything with your external auditor – their opinion matters the most!

#9 Always get a 2nd opinion

#10 Read the PCAOB standard (all 211 pages!)

Kathy's Top 10 Tips for Success in Leading a Sarbanes-Oxley Project

#1 Have fun and enjoy!

#2 Establish and maintain a close relationship with the key people who have to sign – the CFO and CEO

#3 Be persistent and yet be patient

#4 Join share forums

#5 Insist on establishing and meeting deadlines

Final Thoughts on Project Leadership and Career Progression

Thank You!