SOX Certifications

10 Tips for Good Housekeeping

By Cynthia Krus and Amelia Toy Rudolph

SOX certifications continue to become more rather than less important to companies and the executives who sign them. If a material weakness must be disclosed, the company may be required to engage in budget-busting corrective measures. Executives and the companies they serve face potential financial, regulatory and litigation exposure resulting from "signing on the dotted line." Finally, SOX certification procedures and controls have become a critical part of standard due diligence measures. For example, companies are commonly asked to represent and warrant satisfaction of SOX requirements in a securities offering, lending arrangement or a business combination.

How then does a company ensure that its SOX certification procedures are fresh, well documented and consistently followed? Here are 10 tips to facilitate a vigorous and effective SOX certification process. These considerations should be tailored to a company's particular facts and circumstances; there is no "one size fits all" process for SOX certifications.

1. Don't rush the process.

Taking enough time for meaningful engagement, oversight and input from the certifying executives is critical. The certifying executives are personally responsible for the certified reports, and they should be afforded enough time to read the reports, understand what they are certifying, and be comfortable with the process. Among other things, they should

- Receive regular reports from those within the company most closely involved in preparing the report;
- Have a meaningful opportunity to ask questions of those individuals;
- Consult legal counsel, external auditors and other professionals; and
- Make revisions to the report as appropriate.

Legal or other personnel can assist the certifying executives in these efforts by arranging for disclosure committee meetings with the certifying executives to outline the process, to review any issues that may have arisen during the process, and, at the end, to conclude and evaluate the process.

2. Build on current best practices.

It is not necessary to reinvent the wheel. The SOX certification process, however, has been in place for over five years. Companies need to avoid complacency and thoroughly review their process to ensure that it still reflects the company's business. If lines of business have been acquired or disposed of, or if planned expansions or product areas have been successful, the review process may need to be adjusted. Ideally, a review of existing processes will enable companies to decide whether particular practices have worked or not.

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Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 (SOX) require certain executives—at a minimum, the CEO and CFO—to certify that the annual or quarterly report has been reviewed by the executive, is accurate in all material respects, and that the financial information is fairly presented, among other things. The topics covered by these certifications include:

- The certifying executives' review of the report;
- Material accuracy of the report;
- Fair presentation of the financial information contained in the report;
- Effective disclosure controls and procedures; and
- Significant deficiencies or changes in internal controls over accounting and financial reporting.

The format of and language to be included in these certifications must comply with SEC rules and regulations and may not be varied.

In addition, the review process may be enhanced by taking note of industry developments. Companies can use such a review to augment existing, effective procedures or to integrate existing procedures into a new process.

3. Stick to a schedule.

In establishing a schedule, it is helpful to work backwards from the filing date to determine which actions will need to be taken, by when and by whom. Once the schedule has been established, stick to it. Companies should build in time for potential follow-up work and internal and external quality control, which should include review and input by outside professionals. To enhance a meaningful process, allow enough time for real input. In this regard, the coordinator for the process should have the authority to manage the process and to ensure compliance with the process and timeline.

4. Engage and involve the certifying executives.

Provide for a regular flow of information to the certifying executives, including regular meetings with lower level officers to engage the certifying executives in the report preparation process and to educate the certifying executives with respect to the key judgments being made.

5. Engage the audit committee and board of directors.

The board of directors and audit committee should be informed about the main decisions involving the report being certified, should be given an opportunity to review the contents of the report, and should have oversight of the effectiveness of the company's internal controls and confirm their adequacy. The audit committee also should be given an opportunity to decide how to have information presented in the certified reports, including the form of the information (such as graphs or tables) and the amount of detail included. Companies should ensure that the audit committee receives reports throughout the course of the year on issues that arise and how the issues were resolved. In addition, time should be set aside at each audit committee meeting to discuss the review of internal controls. As a result, to the extent that issues arise, the audit committee already should be up to speed, which is essential to a swift resolution of the issues.

6. Review disclosure committee process.

The U.S. Securities and Exchange Commission (SEC) expects companies to develop a process for reviewing and evaluating their disclosure controls and procedures according to their particular business and internal management and supervisory practices. A disclosure committee is now a standard component of this process. Such a committee may be formal or informal, but its purpose should be to consider disclosure obligations and evaluate the materiality of potential disclosures on a timely basis. At least once per quarter, the disclosure committee should report to senior management, including the certifying executives. In this regard, the disclosure committee and disclosure coordinator can serve as "air traffic controller" for the process. If issues arise, the committee or coordinator can help drive the process and solutions in a timely manner. Without an "air traffic controller," the process may go off kilter.

7. Consider supplemental or subcertifications.

Many companies have implemented a subcertification process, calling upon lower level employees providing information for the reports to certify up the chain of command that they have assessed the disclosure controls and/or internal controls within their area of responsibility and that those controls for which they are responsible are operating effectively. In turn, the certifying executives rely upon these subcertifications as part of their own certification process. Subcertifications, if used, should be carefully crafted—not merely cookie-cutter reproductions of the ultimate SOX certifications.

To be meaningful, subcertifications should be narrow in scope and tailored to the lower level employee's area of personal knowledge and accountability. It may also be prudent to educate the employees being asked to sign these subcertifications how they fit into the company's public reporting obligations, how they will be relied upon, what repercussions could follow from a false subcertification signed in bad faith, and the importance of speaking up promptly if the employee believes that a disclosure or internal control is not operating effectively. If the employee does not understand the process or his or her specific function within the process, the employee may overreach and assume a greater role in the subcertifications than is appropriate for his or her specific area of responsibility, possibly disrupting the certification process rather than streamlining it.

8. Document the process.

A careful and thorough process, once established and followed, should be documented for the record. In the unfortunate event that a misstatement or omission is identified in a report for which SOX certifications have been provided, the existence of a solid certification process can prove very beneficial. To the extent that issues arise in the process, there should be a documented process for addressing the issues, including a process for reporting issues to senior executives and the audit committee and a process for resolving issues.

9. Review the certification process at least annually.

A process may work well on paper but fail in practice. Changing circumstances may also call for adjustments to the process. Companies should evaluate their certification processes regularly to ensure that they continue to be effective, identify areas for possible improvement and provide a solid foundation for the certifications. The certification process must remain fluid to match the changing business and operations of the company and market environment.

10. If there is a problem, elevate it quickly.

If a problem is discovered during the preparation of the periodic report, it should be elevated quickly to the certifying executives and, depending upon the facts and circumstances, to the audit committee, legal counsel and/or external auditors. The most significant issues should be elevated to the board of directors. The resolution of the problem should also be documented.

A careful, thorough and diligent certification process, if followed consistently for each periodic report, can play an important role in establishing the necessary "tone at the top" for a corporate culture of transparency and accurate public reporting.

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