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SOX and COVID-19: Navigating compliance in the midst of a global pandemic

By *Dimensions* staff

Nearly 20 years after the passage of the Sarbanes-Oxley Act, SOX compliance continues to put onerous demands on many public companies. Amid the impacts of the COVID-19 pandemic on companies and their employees, manual SOX-compliance processes such as those involving Microsoft Excel have become even more difficult. This exposes the long-overdue need for SOX automation, which is emerging as a remedy in the new pandemic environment.

This was the focus of a Toppan Merrill webinar in October 2020: *SOX and COVID-19: Navigating Year-End Compliance in the Midst of a Global Pandemic*. The event featured insights from a panel of audit and compliance professionals who have been working in the new normal of the SOX-compliance landscape:

- Jeanne Abundis, Partner, KPMG
- Chris Champion, CAO, Occidental Petroleum
- Elizabeth Epler Jones, Partner, AXIA Partners
- Jennifer Pierce, Director of Internal Audit, Penn Virginia
- Mike Schlanger, Vice-President of Solution Sales, Toppan Merrill

“It has been almost 20 years since the SEC required companies to create an internal control process,” Mike Schlanger noted in his introductory remarks. “It’s still a challenge to manage your SOX process. Add in the COVID-19 pandemic and its impact on every business process, and we’ve got some real issues that all of you are dealing with.”

One 2018 survey by Protiviti, a global consulting firm with expertise in internal auditing, found that 63% of the responding companies are still not using technology tools in the testing of their controls to comply with SOX Section 404. The survey also revealed:

- An average of 33.3 internal hours spent per control just for documentation and testing
- 156+ process-level controls at 57% of companies with three or fewer locations
- Over 59% of companies increased hours spent on SOX compliance by more than 10%

- Companies with annual revenue of more than $500 million typically spent at least $1.06 million on internal SOX compliance
- Over half of all SEC filers report increases in external audit fees

"What COVID did," Mr. Schlanger noted, "is exacerbate the already existing challenges and then expose that maybe there are some processes you operate today—that have been in place for 10 years, 20 years, 30 years—that are not meeting your needs in this new reality. And it might be time to review the need to have a more robust automated platform."

What are the top SOX-compliance management challenges that the pandemic has exacerbated? The webinar participants noted a few:

- More time needed to conduct external audits
- Time management (work/life balance for employees)
- Communication and collaboration
- Corporate fatigue at all levels of the organization
- Re-engineering the organization with the new work-at-home reality for most employees
- Cybersecurity: access to records, data, audit support, original evidence
- Rethinking the cost/benefit test of physical site visits
- Visibility to internal management, to the audit committee, and ultimately to shareholders

At the same time, the importance of audit activity is more critical now than ever. The SEC is not offering a temporary free pass on SOX compliance, noting how important it is for companies to be transparent and disclose the impact of COVID on their business in all areas. As Sagar Teotia, the SEC's Chief Accountant, observed in a June 2020 statement: "In these times of rapid change and increased uncertainty, the need for the oversight role that audit committees play is as critical as ever."

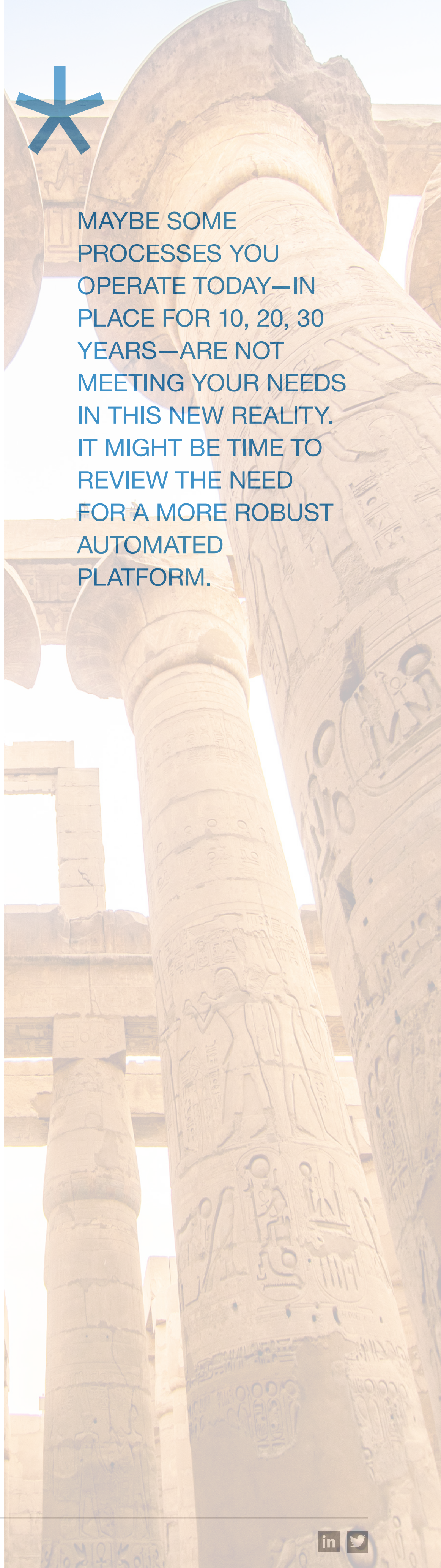
How are companies and auditors trying to maintain SOX compliance in this environment? They may, for example, be reassessing business travel and rethinking long-held beliefs around the necessity and benefits of site visits, leaning instead toward enhanced technology to fill these gaps. As companies adjust to the demands of remote SOX-compliance management, processes seem to take longer. Companies must plan for more time in the adequate documentation and testing of their SOX controls.

SOX compliance in pandemic times: Views on the new normal

The webinar's panel of audit and compliance professionals provided insights from their experiences out in the wild of the new pandemic normal.

Company insights

"What I am starting to see is what I would call corporate fatigue," began Jennifer Pierce of Penn Virginia. "You begin to forget what people look like. You don't have that ability to drop in. You are very tied to your [Microsoft] Outlook schedules. People are working long hours because they are incorporating their work/life balance [at the same time] they are trying to



MAYBE SOME PROCESSES YOU OPERATE TODAY—IN PLACE FOR 10, 20, 30 YEARS—ARE NOT MEETING YOUR NEEDS IN THIS NEW REALITY. IT MIGHT BE TIME TO REVIEW THE NEED FOR A MORE ROBUST AUTOMATED PLATFORM.

add in homeschooling ... Things like that have impacted the SOX organization."

Chris Champion of Occidental Petroleum concurred. "[The challenges are] really around maintaining an engaged employee base ... All of a sudden we had people that were doing their professional job and also homeschooling at the same time. And so it quickly became about being able to be flexible as an employer ... in order to maintain the continuity of what we need to do.... So you try and try to get a process in place where employees know when to turn it off because work and [personal] life were happening at the same time."

He also pointed out the awkwardness of employee management in the pandemic work environment. "How do you onboard people, how do you maintain culture and tone at the top? How do you maintain training and talent development? The critical element of SOX is having people properly trained."

"Go back to the basics," suggested Elizabeth Epler Jones of AXIA Partners. "Get your controls executed and make sure you've got the right amount of documentation. Step back, and let's look at your risk. Let's reevaluate." She warned that, as when your company is going through a retraction, "all of a sudden, everything becomes more material" and things you did not have to worry about in the past "all of a sudden become relevant."

The sudden onslaught of new online communication tools has raised other obstacles, Ms. Pierce indicated. "For my organization, our employee base is a little bit older, and so the technology was very hard to accept." In the beginning of the pandemic, few knew how to work with Zoom, whether downloading or logging in correctly.

How can some of the in-person experience be instilled into the current digital workflow? Leadership can model that in action and attitude. "We went through an enterprise risk-management process, and it was very important to [Ms. Pirerce] that executive management did it via video. ... And it was amazing, because once the executives bought into it and once they began doing video, they began demanding video."

Given that tone at the top, the employee base took to video conferencing as well. "I think it's important that executives take the lead on this technology, and ... once you do that, it does permeate throughout the organization and it makes a lot of processes a lot easier."

Ms. Pierce extolled the benefits of switching from a spreadsheet-based process to an automated SOX compliance process. "Now, when a file is put out and my corporate controller says 'Who gave that information to you?,' I go to a website, I can print a screen, and I can show you exactly who gave it to her. Then she can make a judgment call on whether that was the correct document and she can work within our own department. In addition, it's allowed for some great visibility with my audit committee."

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Auditor insights

For external auditors, the new normal presents novel problems to be solved by auditors and their clients' audit committees. Just as companies' internal SOX processes take longer, the external audit also takes more time. Nonroutine transactions made by a company due to pandemic demands can increase its risk of a control failure. All the while, remote communications have changed the way the external auditor and the company's audit committee function and interact.

Jeanne Abundis of KPMG discussed some of the unexpected challenges that have arisen for external auditors in the switch from in-person to video meetings. "The auditor/client relationship can be naturally an adversarial role," she noted, "and we try our best to make people feel comfortable whenever we have meetings with them. [But] it is more challenging to generate that comfort level with our client."

Moreover, she pointed out, video meetings can deprive external auditors of the body language that they naturally read during in-person meetings. "We gather information from [body language] whenever we are having in-person conversations. You don't really realize the impact that has until it's gone." So the auditors ask clients to turn on their video at the start of the meeting.

Ms. Abundis then took up the theme of the tone at the top, but from the auditor's perspective. "That's a crucial item that we consider whenever we are looking at the company's [control] environment and thinking about those principles." She encourages filers to "think about materiality now" and whether it has altered the company's risk profile. "Now that your company may have had economic impacts from COVID-19, do the controls need to be augmented? Do additional controls need to be put in place as a result?"

The PCAOB, explained Ms. Abundis, "is always interested in any nonroutine transactions and the testing of internal controls around those nonroutine transactions, so I would expect that there would be additional scrutiny and inspections this year on any nonroutine transactions that companies have." The first recommendation is to make sure you have robust control structures around those.

"Engage your external auditor early and often," she concluded. "If you are experiencing some sort of external or nonroutine transaction, get them involved as soon as possible, so you can work out the risk assessment."

Ms. Jones provided similar advice about enhanced harmony between companies and auditors. Remedies that were easy to implement in the past may be more complicated now.

Rethinking SOX compliance management

For many companies, managing SOX on a spreadsheet is now impossible, Toppan Merrill's Mike Schlanger concluded. Specific key concerns include:

- Ensuring documentation (narratives, flowcharts, and RCM) is accurate
- Ensuring changes are carried through to testing
- Staying on top of control execution and document requests
- Effectively managing any deficiencies discovered

NOW THAT YOUR COMPANY MAY HAVE HAD ECONOMIC IMPACTS FROM COVID-19, DO THE CONTROLS NEED TO BE AUGMENTED? DO ADDITIONAL CONTROLS NEED TO BE PUT IN PLACE AS A RESULT?

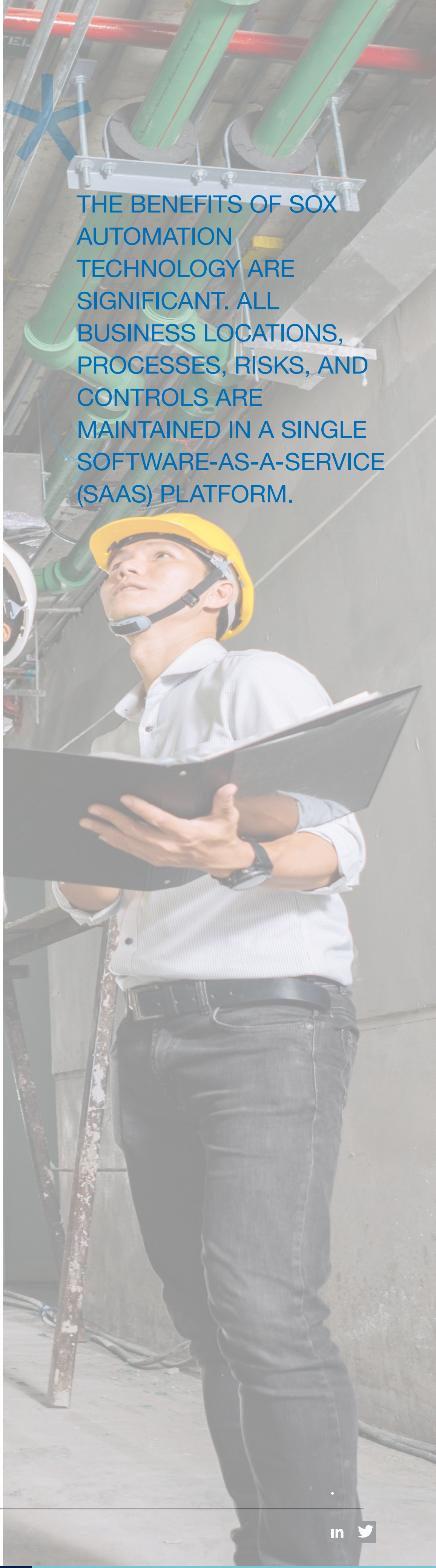
When making the move from a spreadsheet process to an automated SOX solution, companies can realize both tangible and intangible benefits:

- Better overall communication and collaboration
- Time savings and measurable cost savings (overall hours)
- Increased agility
- Increased visibility and focus on true risks to the company
- Workflow management/visibility into the process: knowing what your people are doing
- Reporting: internal management and audit committee

The benefits of SOX automation technology are significant. All business locations, processes, risks, and controls are maintained in a single software-as-a-service (SaaS) platform. Through dashboards and reporting tools, the process is more transparent than ever.

Automation also offers ease of collaboration, wherever employees are working. Compliance professionals can seamlessly capture changes to their control environments. Workflows can be configured, leading to more streamlined processes. Through role-based permissions and access control, managers are provided with visibility and flexibility.

To assist with proper compliance, especially in this COVID-impacted time, Toppan Merrill offers a SOX automation solution, which can mitigate the risks of failure at each SOX program stage gate.



THE BENEFITS OF SOX AUTOMATION TECHNOLOGY ARE SIGNIFICANT. ALL BUSINESS LOCATIONS, PROCESSES, RISKS, AND CONTROLS ARE MAINTAINED IN A SINGLE SOFTWARE-AS-A-SERVICE (SAAS) PLATFORM.

Beware how COVID-19 infects the internal audit process

Abstracted from: *4 Key COVID-19 Audit Risks For 2020 Year Ends*
By: Bob Dohrer and Carl Mayes
Association of International Certified Professional Accountants, Durham, NC
Journal of Accountancy, August 2020

Abstracted from: *The Impact of COVID-19 On Internal Audit*
By: Mark Martinelli, Alfred Friedman, and Joel Lanz
Synchrony Financial, Stamford CT (MM); Sterling National Bank, Montebello NY (AF); Joel Lanz, CPA, PC, Jericho NY (JL)
The CPA Journal, June 2020

COVID-19 is a game changer. Companies have been operating for most of this year in the public-health emergency caused by the coronavirus pandemic, so audits for fiscal years ending in 2020 will challenge outside auditors and in-house accountants in new ways. CPAs Bob Dohrer and Carl Mayes advise auditors to focus on four dangers that make material misstatements in financials more likely than before the pandemic: the risk of employee fraud; the failure of internal controls; the risk of unintentional noncompliance; and the inaccuracy of auditing accounting estimates.

Auditors need to puzzle out employee fraud. Operating in a pandemic increases the risk of fraud, so auditors should be hypervigilant, authors Dohrer and Mayes warn. Employees may be feeling pressure to keep the company viable or to compensate for the lost income of a furloughed or laid-off spouse. Internal-control failures may give them the chance to falsify financials or embezzle in order to relieve those pressures, and they may feel a tendency to justify fraud that benefits their company or family. Another risk is the heightened danger that internal controls on financial reporting—which turned virtual when office work became remote—could fail. The auditor must assess how clients designed and implemented their pre-pandemic controls and, if different, their controls established after the pandemic began. This assessment will impact the remainder of the audit. Auditors discovering substantial flaws and material weaknesses in controls must inform the company managers responsible for governance. A third danger to the financials arises from the numerous small businesses' applications for US economic-stimulus programs. The risk of unintentional noncompliance with program rules is high because the rules are complicated, applications may be prepared hastily, and accounting departments are unprecedentedly working off-site. Finally, auditing accounting estimates of revenue recognition (especially in nonpublic companies), allowances for doubtful accounts, and goodwill or other intangible assets may be inaccurate. Auditors might have to employ valuation experts instead of looking at historical results or other customary benchmarks.

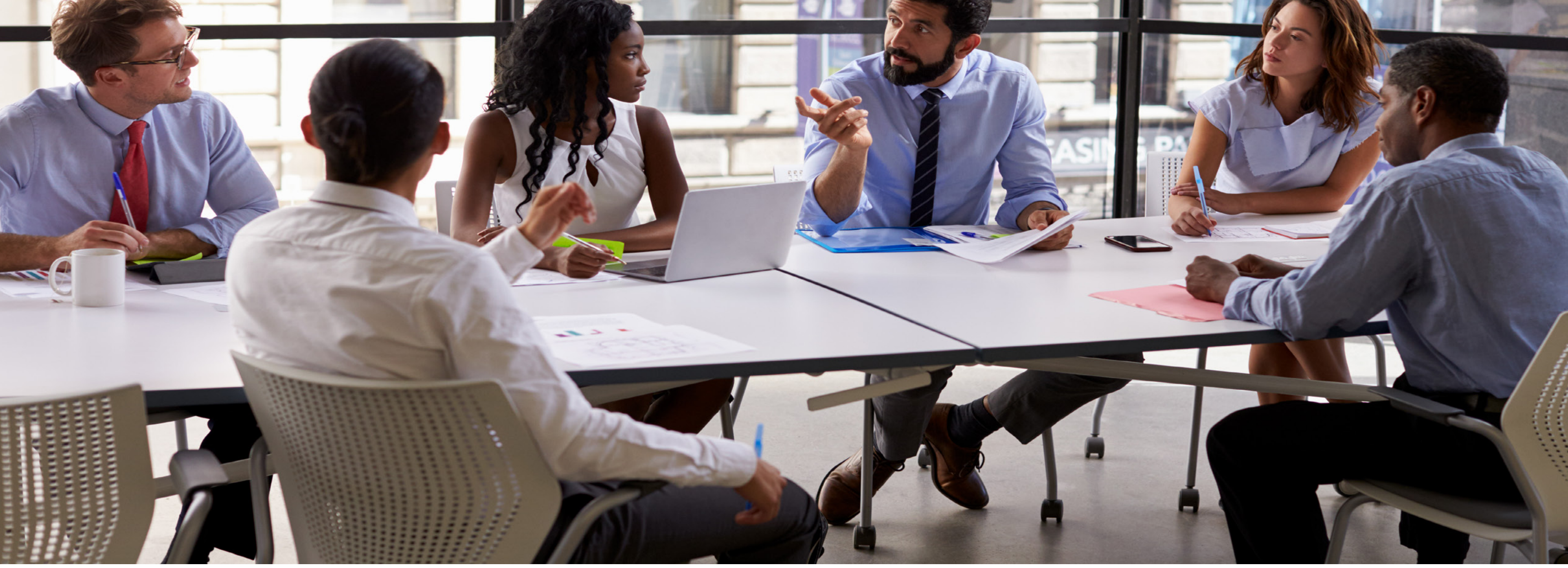
In-house accountants have a lot on the ball. Blessed with an organization-wide vantage point, in-house accountants are uniquely situated to evaluate how well companies cope with the pandemic, observe CPAs Mark Martinelli, Alfred Friedman, and Joel Lanz. They are tasked with advising on not only financial but also business and management concerns, and advising both managers and the board of directors' audit committee. (To promote independence, the chief audit executive ought to be a direct report to the audit committee.) Cybersecurity, a constant and escalating danger even before the pandemic, should be a priority. Both British and American cybersecurity regulators have warned about attacks on companies—pharmaceuticals, healthcare organizations, medical researchers—that are responding to the pandemic. The attackers' goal is to steal personal data in huge quantities, intellectual property, and intelligence. Internal auditors should assess the plans for averting this danger.

Audit committees rely on jacks-of-all-trades. Frequently described as the audit committee's eyes and ears, internal auditors must be credible, dependable, and able to form solid relationships, remind authors Martinelli, Friedman, and Lanz. During the pandemic, audit committees have been relying on the internal auditors to endorse and augment management's status reports on the efficacy of plans for handling risk; on compliance with regulators' demands made more difficult by COVID-19; on identification of temporarily halted control actions and eventual resumption of those actions; and on enhanced supervision of vendors and other outside service providers. Internal auditors are consequently spending more time studying external evaluations and vendors' reports. One finding is that some vendors are struggling to remain resilient enough to withstand the pandemic's strain.

New risks could rattle companies. The internal auditors assess the company's risks and report their findings to the audit committee and other corporate stakeholders at least yearly. At the start of the pandemic, some internal auditors used their proficiency in risk management to assist in solving urgent problems such as delivering services, keeping companies running, and applying for financial relief under the Paycheck Protection Program. Now that companies are turning from addressing crises to revising long-term operational standards, the authors suggest, internal auditors must assess and report the risks peculiar to running a business in the new normal of the pandemic. These vary among industries but could include credit, cyberspace, marketplace, liquidity, governance, and supply-chain risks. Internal auditors are employing all available tools and data—whether generated internally or externally—to look for risk exposure in real time.

Abstracted from ***Journal of Accountancy***, published by Association of International Certified Professional Accountants, 220 Leigh Farm Road, Durham NC 27707. To subscribe, call (888) 777-7077; or visit *www.journalofaccountancy.com*. Article available at *www.journalofaccountancy.com/issues/2020/aug/key-coronavirus-audit-risks-for-2020-year-ends.html.*

Abstracted from ***The CPA Journal***, published by New York State Society of CPAs, 14 Wall Street, 19th Floor, New York NY 10005. To subscribe, call (800) 537-3635; or visit *www.cpajournal.com*. Article available at *www.cpajournal.com/2020/07/29/the-impact-of-covid-19-on-internal-audit*.



RECENT DEVELOPMENTS

Companies urged to take XBRL seriously by former SEC chief accountant

By *Dimensions* staff

The quality of XBRL tagging in financial disclosures is no longer just an SEC compliance issue. It is an integral part of a company's ability to tell its financial story, attract investment, raise capital, protect its reputation, and keep a sharp competitive edge. As investors, analysts, and regulators increasingly use financial data in structured format, companies must get their XBRL right or be left behind.

Wes Bricker, the SEC's Chief Accountant from July 2016 to May 2019, hammered home this theme in a recent article for Financial Executives International: *Why XBRL Should Be On Your Radar*. Mr. Bricker describes himself as "a big proponent of XBRL, having seen its potential first-hand" at the SEC, as well as in his current roles at PwC and on the XBRL International board.

"As with any aspect of digital advancement that is gaining momentum, it's important for companies to understand how it works, its benefits and challenges," he writes. For companies and the capital markets to make the most of the information streamlining offered by XBRL, "it's important to understand the current challenges and how to best overcome them."

XBRL tagging errors, inconsistent tagging, and inappropriate custom tag use for the same information across companies are problematic not only for SEC compliance but also for the company's financial narrative as understood by investors and analysts. Errors in financial reporting or other processes create concern across the market "because of [their] corrosive impact on confidence over time," Mr. Bricker warns, adding that "with XBRL errors, there's also a potential corrosive effect for individual companies, such as potential negative impacts to stock price, credit ratings, and even reputation."

Disclosure mistakes committed through poor quality XBRL can be corrected by amended filings. However, the erroneous filings also tend to live on in the unforgiving digital landscape. "Errors are difficult to scrub from the Internet, even after filings are amended," he points out. "Likewise, if revenue was underreported because of XBRL issues—and was truly higher than what appeared in the interactive data—that, and other similar errors, could pose reputational risks." These problems can multiply if filers unwittingly carry forward these errors from period to period.

More than just investors, analysts, and regulators are watching a company's financial data. Credit-rating agencies and third-party service providers are also looking at XBRL financial data. Use has grown so much that the SEC is now postlng XBRL fileset data on a monthly basis. Mr. Bricker notes: "Erroneous financial data, for example, could bring about errors in the models that rating agencies use to determine a company's credit worthiness. And here's the ultimate risk: if faulty data sparks an unjustified decision (such as a lower credit rating or investment decision), costs go up and market confidence goes down."

Faulty XBRL is not merely a fringe phenomenon. According to the XBRL US Data Quality Committee (DQC), 34% of the Form 10-K and Form 10-Q XBRL filings in September 2020 had errors picked up by the DQC's validation rules. The rules are freely available, and the DQC website allows filers to check their filings with the data quality rules.

Recommended actions

Many remedies exist to improve XBRL reporting. Mr. Bricker observes that "[e]ducation and training of staff in corporate accounting, finance, treasury, and investor relations is crucial," and he suggests that companies redouble their efforts to keep internal controls working properly. That includes attention to the proper XBRL tagging of financial reports. The time and resources that companies put into the preparation of financial statements every quarter "is undermined if stakeholders encounter XBRL tagging errors in those reports."

He recommends that the company maintain good lines of communication with its external auditor. "Auditors are in the business of quality and can be helpful here." In the European Union, for example, the auditors must state whether the company's financial statements comply with the European Single Electronic Format (ESEF) rules, including XBRL tagging.

For its part, PwC is teaming up with the Sustainability Accounting Standards Board (SASB) on translating the SASB's 77 standards into an XBRL taxonomy and on crafting a data-preparer's guide to tagging nonfinancial information and disclosing it through regulatory and non-regulatory channels. Mr. Bricker views this translation as important for both companies and investors. [For more, see an article on this project from *Accounting Today*.] PwC is also launching its own application ("ESG Pulse") for environmental, social, and governance reporting by companies.

About *Dimensions*

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