Practical Issues in Addressing SOx 404 Requirements

Entity Level Controls

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Areas of Focus

- 1. What are entity level controls?
- 2. How can completeness of entity level controls be ensured?
- 3. How can entity level controls be effectively assessed?



Entity Level Controls

- Critical to the overall control environment
- Oversee and maintain a sound system of internal control
- Monitor operations and oversee the control environment and risk assessment process at the overall corporate level
- Have a pervasive impact on the risk of error or fraud at the process, transaction, or application level



Use of COSO Control Framework

- Apply COSO framework at the entity level to ensure completeness of controls
- COSO framework includes the following components:
 - Control environment
 - Risk assessment
 - Information and communication
 - Control activities
 - Monitoring

Source: COSO Internal Controls – Integrated Framework



COSO at the Entity Level

COSO Component

Risk Assessment

Control Environment

Information & Communication

Control Activities

Monitoring

Attributes

- Integrity/Ethical Values
- Commitment to competence
- HR policies and practices
- Board and Audit Committee
- Management philosophy and operating style
- Organizational structure

Points of Focus

- Effectiveness of policies and procedures for hiring, compensating, promoting, etc.
- Communication of employees roles and responsibilities.
- Accountability of employees for results.
- Clearly defined employee retention and promotion criteria
- Response to departures from approved policies
- Code of conduct established and reinforced.
- Employee background checks

Source: COSO Internal Controls - Integrated Framework



Testing Entity Level Controls

- Entity level controls should be tested in the following ways:
 - Assess entity level controls to ensure <u>effective</u> <u>design</u>
 - Validate entity level controls to ensure that effectively designed controls are <u>functioning as</u> <u>intended</u>



Points to Consider

- Entity level controls are critical to the overall control environment
- COSO control framework can be used to determine overall conclusion on control effectiveness:
 - Draw conclusion based on effectiveness of each attribute
 - Draw overall conclusion for each COSO component
 - "Ineffective" conclusion at attribute level does not mean ineffective conclusion at entity level - need to understand compensating controls



Points to Consider - Continued

- Both design effectiveness and appropriate functioning of control must be tested
- Conduct entity level control testing as early as possible:
 - fixes may be difficult/time consuming
 - •strong controls could reduce testing requirements while poor controls may increase reliance on activity controls
 - external auditor may be less reliant on management testing in a weak entity level control environment

