

"Financial Executives Forum"

A Discussion On Sarbanes-Oxley

Friday, May 13, 2005

8 - 8:30 a.m. Continental breakfast
9 - 11:30 a.m. Forum discussion
11:30 a.m. - 12:30 a.m. Lunch

Location:

Microsoft
7000 SR-161 (President George Bush Turnpike)
Irving, Texas 75039

ABOUT THE PROGRAM

The Financial Executives Forum is a joint program sponsored by the Metroplex Technology Council, Financial Executives International, and the School of Management at the University of Texas at Dallas. The forum brings together senior financial executives from across the Metroplex and provides not only an opportunity for sharing best practices and benchmarking but serves as a collective voice to regulators and oversight boards.

The May 13 forum will focus on Sarbanes-Oxley compliance, in particular Section 404. Participating members have completed their first year of compliance and will share their opinion on a range of topics including: effectiveness of the regulation, efforts required and value gained from compliance, lessons learned, suggestions for continued compliance, opportunities for improvements, and the changing role of financial executives and the impact of regulation on the careers of financial executives. Comments and opinions will be summarized and submitted to the appropriate regulatory and oversight bodies as well as made available to the members of sponsoring organizations.

Other participating sponsors include: Avnet, BizNet Software Inc., CTAP, LLC, and Fujitsu Transactions Solutions Inc.

PANELISTS FOR THE FORUM

Bob Rifkin, financial reporting manager, Texas Instruments
John Sparks, VP internal audit, Dean Foods
Jeff Plowman, partner, Deloitte
Greg Samuals, partner, Haynes & Boone
Greg Furr, controls and compliance manager, JC Penney
Sal Saggese, VP & chief accountant, JC Penney
Angela Stephans, SVP & chief accounting officer, Club Corp
Mike Zillis, VP & controller, Avnet
Bob Weede, assistant corporate controller, Microsoft
B.J. Rone, executive vice president & CFO, Alliance Systems
Carolyn Pitman, VP & controller, Northrup Gruman
Moderator Constantine Konstans, Ph. D., professor of accounting, UTD
Moderator Dennis McCuistion, consultant KERA "The McCuistion Program"

SOX Roundtable
May 13, 2005
Transcript

[Note: Ellipses (...) indicate inaudible words. Some proper names may be misspelled. Some speaker identifications may be incorrect.]

CD #1

Dennis: I want to introduce the panel, starting on my left, and they are in roughly alphabetical order. Bob Riftkin down here, he's been with Texas Instruments for 29 years, holding a series of financial management positions. Currently he is the company's Director of Financial Reporting and also the leader of the team responsible for Sarbanes-Oxley, Section 404 compliance at TI.

Sitting next to Bob from Dallas is Scott Graham. He's Managing Director of Protivity. They're a risk consulting firm. Scott heads up the SOX compliance, the internal audit and the corporate governance in the Dallas area and he's a former AA partner.

Greg Furr – he's Controls and Compliance Manager at JC Penney and he manages the SOX 404 implementation team for the company. He's been with them for 26 years in various capacities.

Dennis: Jeff is an audit partner in the Dallas office of Deloitte and Touche, 19 years in public accounting. He serves clients in the manufacturing, consumer and banking industries. He currently serves as the lead audit partner on five accelerated filers and as a concurring reviewer on two others.

And Carolyn Pitman, Vice President and Comptroller of Northrop-Grumman Integrated Systems. They're a \$5 billion operating unit. She's the Site General Manager for the Shared Service Center. She's a former E&Y CPA and was the SOX leader for Integrated Systems, so glad to have you, Carolyn.

BJ Rone, Executive Vice President and CFO of Alliance Systems, has over 25 years of senior executive management experience in organizations basically relating all the way from startups to those in excess of \$475 million. He's been featured on the front cover of CFO Magazine. He's been in Business Week and Texas Monthly, a Tatum Partner for two years and his corporate career has included CEO, board member and CFO of several public and private companies, including several years with TI and United Technologies.

And sitting next to him is John Sparks. John is Vice President and Chief Audit Executive for Dean Foods Company. He also was responsible for the architecture and implementation of Dean's first 404 certification project, is a \$10 billion revenue company. Their total experience has been groomed from a combination of Fortune 100 and Big Four CPA environments, but most importantly, he serves as Executive Director and Treasurer of the Board of Directors for Head Start of Greater Dallas.

Jan Shery is the partner in the Corporate section of Haynes and Boone. She serves in the law firm's board. She was named to the Best Lawyers in Dallas by D Magazine and the Texas Super Lawyers by Texas Monthly.

Angela Stephens is Senior Vice President, Comptroller and Chief Accounting Officer at ClubCorp. Her responsibilities include overseeing field and corporate accounting operations as well as internal and external reporting. Prior to Club Corp she was with Broadband Now Inc., Southwest Securities and KPMG.

Jim Shrand you've heard from and about. He and Mike and some of the other folks were very instrumental in putting this together, but he has a real job, too. He's Vice President, Financial Operations at Avnet. They're an \$11 billion, about to be \$13 billion distributor of semiconductors, other electronic parts all over

the world. He manages the Shared Service Center in Richardson. He's the former comptroller of JC Penney International Development.

Mike Reardon is the luckiest man in the room as of April 30th. He just retired as Divisional Vice President and Assistant Comptroller at JC Penney as of April 30th. When I say just did, it was 13 days ago. He was there for 39 – his career was 39 years at least. During that time he was involved in all major financial installations.

Dennis: And last and certainly not least, Bob Weede.

Dennis: Bob Weede is responsible for the corporate accounting and financial reporting process including Microsoft SEC filings and for much of the company's policy and internal controls efforts to meet the new requirements under Sorb-Ox. Prior to being named Assistant Corporate Controller in May of 2003 – Bob was responsible for the accounting, financial reporting and internal controls for their treasury activities including treasury performance measurement and risk compliance. Prior to joining Microsoft he had a real job as a CFO and comptroller of two investment management firms, each in the startup stage in San Francisco. So, Bob, glad to have you here, too. Please give a great welcome to this panel. [Applause]

Okay, I'd just like to start now. You have the objectives are up here, the overall objectives from this idea of thought leadership, but we're going to talk about it in really three or four segments. The most definitive will be the first two, shared problems and complaints.

I'm going to start with this idea of complaint and that sort of thing and I'll start with a provocative quote from a guy named Alan Reynolds who wrote this for the Cato Institute. See if any of you can identify with this. He says, "To summarize, the Sarbanes-Oxley Act was a largely irrelevant and potentially troublesome response to several misdiagnosed problems. The law was unnecessary, damaging, insufficient and a major distraction from several formal irrelevant issues that remain neglected." He didn't have a strong opinion about it but there's where he was. Jeff, what's your idea about the problems, complaints? Where are we?

Jeff: I guess it's important to understand the perspective. That's a quote. I didn't read that article but the perspective is, you kind of go back and Enron happened, no one really understood Enron. The people who ran the front page about Enron, all they understood was that a lot of people that worked there lost jobs, lost money, that there was some kind of fraud that happened, but understanding Enron is very difficult. But not long after that WorldCom happened. WorldCom was a lot simpler to understand. It was very simple accounting entries that were made that were absolutely fraudulent. When WorldCom happened our government responded and passed a law where congressmen who typically vote against everything even got on board and voted. So this law was put into place very quickly, and whenever you do something like that that's kind of a knee-jerk reaction there's going to be some unintended consequences.

You know, my perspective is a lot different than that quote. My perspective, having lived through this, is that a lot of good things have come out of this – a lot of things that make corporate America better, that make investor confidence better. Are there some unintended consequences? Absolutely.

Dennis: Okay, great. I appreciate that. Problems, complaints.

Jan: I think one thing that bothers me is that the collaborative spirit that we once had as we approached our public reporting has changed considerably, and so when we're dealing with people we're always pushing our clients in a direction that they may not want to go. We have to be a little bit more aggressive with our clients, and at the same time our relationship with the outside auditors both in terms of how they relate to the company and how they relate to us as lawyers has changed completely. And I think it has been more adversarial and I think it has not necessarily resulted in the right kind of approach to handling these issues.

Panelist: I'd agree with that and add that not only do we have no significant help from our auditors, we have to hire other audit firms to help us talk to our audit firm because our audit firm can't tell us anything or

they aren't going to be independent. That just causes friction instead of trying to get to the solution that you need to get to. I don't think the overall premise is bad but I think that the mechanics are awful, and so, you know, any help you can give would be good.

Dennis: Good point. Yes ...

Panelist: I think the premise is good but because there has been a lack of interpretation and examples to follow it's been extremely difficult being on the front end of this to really understand how to pull it together. And I agree with your points about the different firms that we're having to look at for different things and then trying to reconcile the different viewpoints together into one solution.

Panelist: Yeah. I read an article comparing the Sarbanes Act to 9/11. 9/11 has been called a wakeup call for America security wise and a lot of things have been done to try to fix that, and Sarbanes is sort of a wakeup call. And to really say what is good or bad, it looks to me like you've got to look at it in different buckets. One is the public accounting firms. A lot of the public accounting firms were trying to earn big fees doing consulting work and doing the selling of tax shelters and everything else that probably was not the best thing in the public interest for them to be doing. Andersen was a good example. If you look at another bucket, and that is what's going on inside the company, most of what Sarbanes is doing should have been there already. The internal controls should have been in place. The ethics should be there, and having worked in several companies like most of y'all in the panel, I know that they're not. I know that there's a lot of cooking the books and creative accounting. Those terms arise to the surface because they are really out there and that's really going on. So on that side Sarbanes has done what it should do and it's given a jolt to a lot of people.

The real difficulty in most companies has been getting the resources, allocating the resources – both time, people, financial – to address all this is the main issue in most companies that I see today. I've worked on the Sarbanes as a Tatum Partner. About the time I was a Tatum Partner is when it hit. We got a lot of consulting work out of it, of course, and a lot of advisory work, and getting management's attention that these are real issues and they're not going to go away and we need long-term fixes. The real cost of Sarbanes though is not all of the audit fees, the increase and all that, it's if you go in and fix all the IT problems and the infrastructure problems and the internal control problems, that's a lot of people and a lot of money to spend, and that's where the real cost is and it needs doing.

Panelist: The gentleman that wrote the article from the Cato Institute belongs in that class of individuals that likes to connect dots, and what they say, okay, here is Sarbanes-Oxley. One of the impacts, one of the significant impacts of the act was that it short-circuited creativity, it short-circuited entrepreneurial behavior. It also channeled, as was just pointed out, a number of resources into areas that are not productive, of revenues and so forth. This then affected the employment, and even though there was confidence renewed in the market as a result of Sarbanes-Oxley, that was more than offset by the fact that we had this slowdown in employment. That's one of the arguments that they would use. I don't necessarily agree with that, but.

Dennis: It is the argument. Now, I have to tell you that Paul Peterson is sitting right here. He and I had lunch in the first week in December of 2001. Earlier that year in March of 2001, I interviewed Jeff Skilling who was in town to speak for SMU. But he spoke there that day and he said that Enron is doing so well. That was March of '01. He resigned in August of '01. Paul and I were having lunch in December of '01, less than 30 days after they took bankruptcy

Paul: Well, my reaction was, once the federal government decided to take on someone in any area, particularly accounting firms, it was probably over for them.

Dennis: Yeah, and he predicted to me that day that Arthur Andersen would not make it as a firm, and I've got to tell you, I was blown away. Maybe some of the rest of you thought that as early as December of '01, but I've got to tell you, he's the only person I know of who was saying that that's what was going to happen. So, getting back to the problems that you guys have had, let me just say from a director of two New York

Stock Exchange companies and being on the Audit Committee, I mean, it has taken our eye off the ball. Does anybody have that problem in their own particular company, where the focus is this? Now, Mike, you've retired. You're out of here. You can tell the truth. [Laughter]

Mike: Well, I have some of the same feelings that have been mentioned here. I think that, as far as I can tell, these people broke laws that were already in place. It was against the law to do what they did at the time, so it's not like Sarbanes came in and created a law to fix it. There are still bad guys out there doing bad things and it just seems like we've painted everybody with the same brush. You feel guilty until proven innocent and I just think that's kind of wrong. It's a tremendous distraction. I can only speak for JC Penney but internally, operating management is involved in stuff that, frankly, they shouldn't have to be that involved in it.

I was in Salt Lake City and gave a presentation not long ago. I had the 1985 ethics statement that I signed – 1985, way ahead of Sarbanes-Oxley – and it had all of the stuff in there. If you just follow the ethics that we all agreed to when we signed our name to, we were in good shape. So I think that you can't argue against controls – they're important, you've got to do it – but at the end of the day you really focus companies on stuff different than where really their business head should be, so I think it's not that good. I think Congress ought to get together and fix it.

Dennis: Well, as I recall, Enron had a 64-page ethics statement, if I'm not mistaken, 64 pages on their Website.

Mike: I just wanted to ask the question because, you know, kind of along the lines of what you were talking about. I've seen articles that have said, "Do we really need Sarbanes-Oxley?" That if you take a look at the things that were done wrong in Enron and WorldCom, none of those executives were prosecuted under Sarbanes-Oxley. They were already prosecuted under existing laws for fraud. Why do we need this? Why do we need a law that says you have to have controls? Because when I've talked to other comptrollers they've said, "You know, at the end of the day, it isn't the fact that someone has signed off on a receivable or the processes are somehow now documented differently." I mean, a comptroller is going to check his or her numbers and look for their validity not by looking at what people have signed off on but rather through the analytics of do these numbers sniff. Has that changed anybody's – I mean, do we need a law to do that? That's kind of my question.

Dennis: Greg, do you want to address that?

Greg: Well, I agree. One thing we found coming about in some of our testing was, people had signed things, but as you dug into what they'd signed about, they maybe hadn't done what they said they had done. The test is, are people doing what they're supposed to do? Are they executing their jobs? Are they aware of what their control points are? Are they looking at those analytics and getting a sense of whether things are right? And probably one of the things that Sarbanes-Oxley steered off course on was, it became this thing where we're looking at everything and not focusing enough on the high-risk areas, and that was really where I think a lot of the cost and a lot of the distraction came from.

Dennis: Everything was a control that was important. Scott, you're nodding your head there, shaking your head.

Scott: When you asked the very first question to kick us off, that was the first thing that came to my mind is that it became everything is important. There was a lack of risk-based analysis when you looked at controls. Right or wrong, gun shy or whatever you want to call it, people say we don't want to miss the boat here so we're just going to cover everything. That's one of the biggest lessons we've learned as a firm helping 300 or 400 companies now is that there was too much documented, there was too many controls identified that really weren't significant, and that's going to be a – we're here in year one again to say we need to do it better and we need to reduce those controls down to what's very, very vital and that add value and then the rest is not that important and probably shouldn't be focused on.

Dennis: So if we knew then what we know now we wouldn't make every control significant and try to check everything. That's one lesson, Angela, from your standpoint. Jan.

Jan: I think, you know, as a lawyer, from a lawyer's perspective, and having drafted lots of 10-Ks, 10-Qs, worked on proxy statements, I've had a lot of situations where management has not spent the time with the documents that they needed to. And so, as you look at – let's put aside internal controls and go to certification process and the process of reviewing documents is so much better now in companies. I find that companies are spending the time asking the right questions, pulling together committees and doing the kind of work that they should have been doing all those years to make sure that their public filings are right. At the same time, what I've seen is board members being much more actively involved in what's going on in a company, and to have board activism and board involvement in what's going on is a huge plus. It's a huge plus, and the point is it wouldn't have happened without Sarbanes-Oxley, I don't think. It wouldn't have happened. And I think the internal controls is another issue, but there's so many things about Sarbanes-Oxley that have in my mind made companies operate more like they should have been operating all along.

Dennis: Let me just say about Sarbanes, or the question is, would boards have acted differently? I can assure you, boards act differently. That I know. Would they have acted differently because of Enron, WorldCom, Tyco, etc., or are they acting differently because of Sarbanes-Oxley? That's the question, because once you get to Bernie Ebbers being convicted.

Jan: Or where directors having to pay money out of their pockets.

Dennis: Well, you get to the Disney deal as an example right now and a couple of others that have had directors paying out of pocket, then you're going to get directors' attention. Let me just – I want to finish this and then I'll go to you. This is our lawyers at one of the firms I'm on the board of came and gave us an update at our board meetings last week and here is a quote – a quote – from Hal Degenhardt. Does anybody know Hal Degenhardt, head of the SEC Enforcement Staff in Fort Worth, has publicly remarked that regional enforcement offices of the SEC – are you ready for this – are, quote, "in a race to be the first office to bring a successful enforcement action against an audit committee member."

Now, when you have the SEC and their regional offices in a race to be the first one to indict a member of a public company audit committee, you have people in my estimation, folks, that are out of control, and they have gotten their sense of sniffing something up there called Sarb-Ox and now they're out of control on that. Jeff?

Jeff: The SEC is now in a position where they feel like they're competing with Eliot Spitzer to get the headlines, to splash something out there. There has been enforcement actions for years that are dealt with by the SEC, you don't hear about them. Those bad companies or those bad people making bad decisions in companies are dealt with and removed, okay. The difference is now in the environment we're in with everything that's happened, the SEC wants to compete with Eliot Spitzer and throw it all out there. My question is, is that helping investor confidence?

Dennis: As you know, one of the reasons why the law was passed was to help investor confidence, okay.

Wayne: Hi. My name is Wayne Avolanit and I've worked for probably a handful of Fortune 500 companies in the last 15 years, and I wanted to make an observation which was basically I've seen a global commoditization of things like semiconductors, oilfield equipment – the type of companies I worked in where everything got cheaper. So companies got bigger and it became more competitive in the worldwide market for people to make a profit and to keep that earnings growth chunking along on this regular quarterly earnings growth. I think – I guess I'd state it as an observation – that by 2001 or 2002 that the earnings management was wholesale and I think Congress knew that. Let me ask, should there be a firewall between the operational performance of a company and the financial reporting? A firewall – something where the controls are so rigid that they do not allow earnings management.

Dennis: Interesting. Go over here; Paul, he'll be next. But who'd like to take on that? Bob, do you have any

thoughts about that?

Bob: Yeah. It's just hard to see how that's realistic. Again, getting back to the ethics statements and the history, if you do things the right way, those things don't become an issue. And I think with the kind of bubble mentality and the way the stock market was going in '99 and 2000, things really got out of control when that was happening to some degree probably a lot of places. But I think the crash of the market and the Enrons and all I think really has brought people back to reality. And I think putting in those walls, I think there's too many negatives associated with taking away the business partnership and the value that the financial people can add as far as cost reduction and a lot of things. So, I'd be afraid that would be an overreaction.

Dennis: You talk about an antagonistic issue between your outside auditor and your firm, this has really created one internally.

Panelist: I would agree with that, but that comment is indicative of a tone that's set at the top. It is sick and that's where we all should start when we start talking about this whole issue that the act was trying to address is that the tone in many organizations was just diseased. It had that mentality and had been for 20 years and gaining a lot of speed toward the end of the '90s. I think now there's a second thought like maybe we can't do that now.

Dennis: I think CPAs ought to stay close to their client. However, and I'm going to put this to you, John, if I may. I'm sitting here as a CEO and you're sitting here as my CFO, okay? We're sitting here and we've got these analysts who are calling us and we've got these analysts who expect to give them earnings guidance at least every 90 days or in between the whatever the situation may be. And we know one thing, if we know nothing else, that if say we're going to make \$3.00 and we make \$2.98, they will hit our stock for 10 or 15 or 20 percent because of two cents on a quarterly call. Now, I ask you, what are you going to do? What are you going to do? You're just going to say, "Well, we're going to miss it this time. We'll make it up next time." What are you going to do, John?

John: I think that the smart ones are going to sit and look at the realities today and go, "We're going to have to miss a few." That's the ultimate tone at the top, and I think a few are doing that. You're not going to be on track every time.

Dennis: I don't know why we can't do that. Bob from Microsoft.

Bob: Yeah. I think that included within your control structure in your environment has to be those management override controls. So it's not just about control activities, about documenting and testing payroll in Japan and all the things that many of us think probably have gone too far, but it's about that tone from the top and then the management override controls that prevent somebody in a senior financial leadership position from sponsoring or suggesting or approving an entry that would not be appropriate. And so you've got to build in those controls as well, and if you do that then you should prevent that situation.

Dennis: Okay, Bob, let me pose this question to you. I'm listening to what Jeff Skilling says and then the year after that I'm talking to a guy named Steve Cooper, who many of you may have met. Steve Cooper came in and took over Enron, a turnaround specialist. He said, "Let me tell you who I feel sorry for." He said, "I feel sorry for the Enron board." And we were all going how can you feel sorry for them? He said, "I may not be the most sophisticated financial analyst in the world," I've got to tell you, I couldn't understand Enron's financials. I could not. I don't believe there is a person on the planet in any accounting firm who could have understood – any person individually – who could have understood Enron's financials."

Dennis: My point is, Microsoft is a multinational company as obviously you guys are, and you're dealing with issues and it's not just black and white like this stuff is about whether we recognize revenue this way or not or whether we recognize it in this quarter or not. I mean, how do you deal with those issues on a day-in, day-out basis under the purview of Sarbanes-Oxley?

Bob: So it really started back with 302 and 906, so it goes back to an earlier comment about the certification review and challenging of assumptions and disclosures within our own Q and K filings. It goes back to a process that was really honed and got stronger with 302. And so, there's a quarterly process for reviewing financials, for challenging assumptions, for reviewing all significant estimates and so forth that occurs within management and then gets discussed with the board or with the audit committee. And then together with D&T, our outside auditors, we discuss the top five or six judgments that are made, we talk about the significant changes in estimates that impacted our numbers, and so all that's given light of day, and that's what has to happen.

Dennis: Here's a situation. I've got to deal with Microsoft and it's a little complex. We think the accounting part ought to be this way. We think it ought to be this way, and we go to D&T, and we say, "D&T, here's the way we think this ought to be. Give us your thinking about it." What do you say to them?

Jeff: What I say to them is I need to see the documentation. I need to read through the contract, whatever is involved, to gain an understanding. Ninety-five percent of the time I come up with an answer going through that process. Five percent of the time I need to talk to other partners within my firm. If it's something that there's not sort of chapter and verse in the accounting literature and it's not clear and it's judgment, whatever, then there's a consultative network within my firm that I have to go to.

Dennis: So you call Washington, you call New York, you call the home office, and you say, "What's going on here?" Then they all huddle someplace and say what?

Jeff: We go through the discussions about what the best application of the accounting principles is, come up with our recommendation, go back to the client and say that we agree or disagree.

Dennis: Speaking of tone at the top, what's your tone at the top?

Jeff: My tone at the top is that there is no client more important than our integrity, than our reputation, and that we will do the right thing, and that comes right from the very top. We are also serving our clients, and so we want to do that within a framework that best serves our clients. Hopefully that I have a relationship with my clients so that this doesn't come up as a question the day before they're supposed to file, that maybe there's discussion before they ever even enter into the transaction. Let's all understand what the accounting is on both sides before the transaction is ever entered into.

Bob: There has to be some collaboration. We have to draw our own conclusions first. We have to have our own position about it. And then after giving a thoughtful internal vetting to what we think the appropriate treatment is we'll go to D&T and we'll have a discussion with them about it. And we have a process to ensure that as issues come up and we go into our quarter-end process, that well before that that we sit down and review those issues and talk about the list of things that we're working on.

Dennis: Is it different now than it was pre-Sarbanes-Oxley?

Bob: It's much different. I think one of the things that is kind of a hangover to it that we're all going to have to resolve on every filer and their auditor is how you deal with, in the financial reporting process and the audit process, the discovery of issues. So as they're going through their audit process and they're finding potential adjustments, are those big enough to cause a problem, because if they are then you have potentially an automatic material weakness, right, as we furnish them with financial statements, being clear about what our level of review and so forth is. So there's a lot more procedure and protocol that we've got to give care to as we work with our auditors to get that done throughout the quarter.

Panelist: I can't let a statement go by that you quoted just a moment ago. I don't feel sorry for the Enron directors because of the complexity of the accounting system of Enron. It was incumbent upon those Enron directors to put forth whatever effort – they are very smart people – to put forth whatever effort was necessary to understand what was going on. And I cannot believe, even though they were being misled in some cases, that they should be off the hook on that basis. I just wanted to make that statement.

Paul: Something that struck me about our discussions here, BJ's comments about a lot of what was required in Sarbanes is fundamental to good business management and good business control. And I just want to remind everybody that we're in an era now more than ever – I call it the Court of Public Opinion – and I sense that, well, it's the accountants pointing fingers at the client and the lawyers and everybody involved in this. But if you kind of elevate this to a higher level, I think the whole question of our whole free enterprise system is kind of at risk, and I think we really need to think of this Sarbanes-Oxley as something that's probably a little higher level than a government procedural process. You've got to remember, there was no Securities Exchange Commission before 1933, and it was created by our government in this country, our representatives, because of the abuses that had gone on in business – not by all businesses but by a few. This is kind of like a replay, and I guess I just question today more than ever, people on the street that aren't involved in business have fundamental questions about the management and control of business.

Dennis: I think that's a good point, and later when we get to this idea of recommendations, Paul has rightly pointed out the SEC Act of 1933, but they also went back in 1934 and made a bunch of adjustments to it because they realized they had screwed up in their haste to get to where it was. Let me get some comment about what Paul said. Jim, how about you?

Jim: I agree with what Paul said a hundred percent. I think that from our view, going back to some of the original questions, the biggest complaint in this whole process and certainly from our view is the sheer time. You know, we've spent – over 10,000 people days trying to get this thing completed, but I think it's done two things. One is, certainly, I agree with BJ, it's the wakeup call, the 9/11 type scenario, you know, senior executives saying they don't look good in stripes, those kind of things, but it's also empowering people. And being in the operational side of the finance area, it's empowering the operational people and others to speak up and ask questions that maybe in the past they wouldn't have otherwise felt comfortable doing or whatever. Even with code of conducts and other things going on, I think it's heightened the awareness of the players and the whole process whether they be in the operation or in the finance area, and it's given them the empowerment to challenge things a little bit and challenge the status quo of what things are ...

Dennis: So it's not all bad.

Jim: No, exactly. There's a cost implication.

Attendee: You know, the way I looked at it was that at most it was an expensive, onerous process, but all the way through the mid-'80s and then to the '90s there was a lot of focus on driving cost out of the finance and accounting operations. All that, I mean, it probably surpassed what it cost us the last 18 months what was driven out.

Dennis: Are you saying that Sarbanes-Oxley as we know, is doing exactly what it's supposed to?

Mike: My question really was, getting back, why is it five times more expensive than we planned it to be? Is that because we do have conflicting interest or is it because the standard that the accountants are held to, the auditors are held to, is not clear or conflicts with the standards that the company is held to? And at the end of the day, are the lawyers – I'm not sure if my question is clear – but it seems to me that I've heard complaints saying that I've talked to my auditors and they want – they're not sure what they have to do so they're just being absolute about everything and it's just killing me. I can't – who breaks the tie and do those problems exist? Have you experienced those? That's my question.

Dennis: These are the FEI numbers, aren't they? They were in the NACD publication. But I think these are the FEI numbers, the year-one cost of Sarbanes-Oxley of whichever companies the FEI surveyed. The estimates in January 2004, a million-nine; March 2005, this is 14 months later, 4.3 million. Now, I don't know if you folks have sat with outside auditors as I have in the last two weeks and heard them explain why their original estimate – their low, medium and high estimate – that the way it's coming in is significantly,

about 50 percent higher than the high, and we've had those kind of questions with them, which is what's going on, what's the deal here? So Mike poses a great question, what is the deal here? Greg.

Greg: And a lot of it was that as the act was being implemented, pronouncements were being made, decisions were being made. People had a deadline to go up against, and our company, we were making our decisions, this is how we're going to do it, only to find out a month later some standard was issued and well, that wasn't exactly what they wanted us to do, we've got to start over now. A lot of that starting and stopping I think drove the cost up.

Dennis: So the beginning startup with the standards being written by the SEC and, of course, the actual birthing of the PCA over here – created some of these issues as well. What else caused the problem here in the beginning in terms of the cost overruns and all that, Bob?

Bob: Well, it was just the first time around for everybody and, again, as far as regulations as part of it, we didn't know how to be organized, so every step of the day, I mean, there was no long-range planning horizon to get through the process. It was what do we have to do today or have to do this week? There were just tremendous inefficiencies and I think the starting point, I mean, there's just a lot of low-hanging fruit that we can be much more efficient the second, third time around. But ultimately we're going to need some sanity in the regulations that will allow flexibility and common sense to take over.

Dennis: A lot of you have either now or in your past have been involved in budgeting for your organization, and so if you're budgeting for next year and you have a 20-year history it's not, shall we say, as difficult as it is for a new thing coming along. And somebody says, "Well, here's a number. He's what it ought to cost," and then all of a sudden it costs a multiple of that. Carolyn, how about you, your experience with that?

Carolyn: Well, we had a false start in the beginning because our internal audit group wanted to – thought that needed to maintain complete independence from the whole Sarbanes-Oxley effort. So we were going down a path of we don't have resources, where do we turn for resources, and there wasn't a good understanding within the company of what those resources might cost and so we struggled a lot. Finally at the corporate level in our project management team there was a coordinated effort to go out, and we worked with Ernst & Young to provide a team to us. But even in that first early stage of that process we still didn't realize the magnitude of what that really meant. Luckily, a few months later, internal audit, their course changed and they did become involved in the project and they were a key driver in us completing the project, but still our external resource costs were substantially higher than we thought.

Dennis: BJ, you've had the experience at privately-held companies. Give this group some sense of this issue as it looks through your lens.

BJ: Well, first of all, on the thing we're talking just about here, I think one thing has happened, too, from a cost standpoint is, I think the demise of Andersen probably did as much by itself to get the attention of the public accounting firms as did the SOX Act itself. They changed a lot of procedures and they had to look at their whole marketing program, a lot of things they were doing to earn significant income like an investment banker and consulting and so forth they are now prohibited from doing, and the hiring practices and all this. So there's a lot of changes and it was hard for them to forecast what this was going to cost to their bottom line.

Dennis: So it wasn't that they just low-balled us with some fee. They didn't know either.

BJ: There was tremendous change they were going through and it was just very difficult – impossible, as it turns out – to project and forecast what this is going to cost them in the end, and difficult to project what they were going to really have to get out there and do in the field that they were not doing before and really holding some feet to the fire, you know.

BJ [Cont'd]: Looking at the risk assessment saying you're single sourcing from this one company. They've got one manufacturing location. We're going to have to start spreading our business out elsewhere, and

then they're also coming in wanting to see what kind of compliance things we're doing. We say, yeah, but we're private and there's no public debt. It doesn't matter. We want to be sure that you're complying with these. So we've started seeing these assessment forms. They're almost like audit schedules. Before they'll buy any product from us they want us to fill out these forms and they're quite onerous, you know, at the private company level.

John: The whole issue of cost, and if you step back from my perspective, the whole reason we're dealing with all these costs from the detail is the guidance, lack of guidance. All the guidance is directed towards the firms. The guidance is not directed towards issuers. The second term that keeps coming up here is the term I use, "emotional fortitude." You're an issuer. We're looking at the same guidance as the Big Four are. Look what they're saying. These are human-nature issues here – fear, caution. They're in a position to naturally respond that way. They're going to be slow to give guidance on the front end. That was our realities. You have to have the emotional fortitude as a company to take the same guidance beyond the front end of it and reverse-engineer it, if you will, and go, yes. Is it a knee-jerk reaction and is it poorly written? Yes. Do we have responsibility? Yes. Do we also – are we a business here from a profit? Yes. Somebody's taken the energy on the very front end and designing it, recognizing all this and having the emotional fortitude to sit with your partners, the outside partners, every step of the way and pull them into a discussion of, well, I know it's going to be months before we get guidance but we have to act now and get them to buy in. That's key to the cost.

Dennis: Jan, here's the deal. I'm a CEO of a Fortune 100 company and I'm just thinking about telling Sarbanes-Oxley and my auditors to take a hike. I'll just pay the fine or whatever I need to do because this is bogging down all the people. All I'm doing is hiring bean counters out there and lawyers and things like that. I'm sick of internal audit. I'm sick of hiring contractors and all that stuff. What do you think? Give me your legal advice.

Jan: You're probably going to have to resign. I think the one thing that we have seen is that CEOs are leaving. They are being replaced by their boards. If they're not willing to step up and do what they need to do they're going to be replaced, and that's going to happen.

I want to say one other thing. The small-cap companies – that's the kind of attitude you're going to get at a small-cap company rather than a Fortune 100 company. I mean, they recognize that market perception is so important, but these small-cap companies are getting killed and a lot of them are thinking about going private. I think, what's the number, 20 percent have been thinking about or have considered in the last year going private, and so that's a huge drain, I think, on investment in the United States. And so it's something that we really, when the SEC adopted all of this, that they really did not look at or distinguish between what needed to be done at the Fortune 100 level versus what needed to be done at the small-cap level, and so that's a huge change that needs to come.

Dennis: Okay, Jan, look. One of my clients is BJ and BJ and I are in your office and we're saying, we've got this \$120 million company and it's private right now but, frankly, the owners and BJ, as you can tell, are getting old. [Laughter] And the fact of the matter is that we need an exit strategy. We don't have any kids to follow us along and all that stuff, and so we think going public is one of those things we need to consider. What's your advice to me today?

Jan: Well, probably your advice, if you're a smaller company, okay, is really to think about selling rather than going public. Going public is just a huge burden and the potential liability is great, and so you're going to have to balance all these costs of being a public company – which have obviously escalated dramatically – against what kind of return you can get from selling your company. So you're seeing a lot of people move to the sales side.

The other thing I want to say, you know, we were talking about Arthur Andersen. Keep in mind that the reason Arthur Andersen went down was really the destruction of documents. It was really a criminal act that they undertook, and so, you know, and it was a few partners at Arthur Andersen; it wasn't all of them. So it wasn't so much how awful Enron was. They may have weathered that. Keep in mind Vincent & Elkins may,

you know, has weathered this. Other accounting firms have weathered other accounting problems, but it was a conspiracy to destroy documents and it was a definite criminal act.

Dennis: I'm talking about the tone at the top before. Before the Enron thing even came up, AA was involved with things out in Phoenix. You had all kinds of other issues going on. I'm asking you to tell us the truth right here on tape about the tone at the top of Arthur Andersen. Was it in fact we're the smartest guys in the room like Enron, yes or no?

Scott: I don't believe so.

Dennis: Anybody else?

Kathy: I work for a life and health company and we are a low-cost provider. We sell insurance to middle America, and so as a result of that, you can imagine, we try to keep our costs down to a minimum. Also, we're an insurance company so we're heavily regulated. For us this was an incredible extra burden, and the reaction – it's not a question; it's a statement here – I got two reactions from internally. Well, a whole bunch of others I can't say on record, [laughter] but was that why did we lose control over how we decide how to spend our money internally on what we think is important, and so now we have to spend our money on documenting stuff and having controls in place that we say really we just don't want to have them. And then the other comment people said to me was, "Whatever happened to the Paperwork Reduction Act?"

Dennis: I appreciate that, Kathy. Angela, you're in the middle of all this stuff. How does this resonate to you so far what you've heard?

Angela: The cost resonates to me. The concern about paperwork resonates to me. One thing I guess I disagreed with a little bit was when they were talking about dealing with the – well, we did agree that it was different dealing with public accounting firms than it used to be, and I think it's much – the difference is now I don't have the experience that 5 percent of my issues go up to national. I have the experience that 50 percent of my issues go to national. And some of the issues could be things that you had agreed with your accounting firm when they started ten years ago, this is the right way to account for something, and a couple weeks before we're ready to file our K, all of a sudden they want to rethink that because they don't want to take any risk. Or someone else looks at it and says, "Hey, I don't know about this," and I may have a new partner that doesn't have the 15 years of history with the company that the one before did. So I have had a lot more I think burden that way. I think that the overall, Sarbanes has caused more accountability. I think that that's great. I think that the specifics of it are going to kill me, and you know, we're spending a lot of money on something that I'm not going to get that much benefit for.

Dennis: Okay, well, let me give you an example. I'm in – what's today, Friday? Friday the 13th, yeah, okay. Minneapolis on Tuesday, so Minneapolis on Tuesday and I'm in front of a board of directors, \$70 million company, public company but sort of public. They had some challenges in the past, okay, so I'm not going to go into all that, so they have had some challenges. But one of the issues that I'm dealing with this board on is this: How do I deal with my external auditor because the relationship, as you guys have alluded to here, is this. We don't trust each other, the audit partner hates us, or at least that's the feeling that they have, so how do I deal with that?

Jeff: My very first comment was around unintended consequences. I believe that the relationship of management with their external auditors and the board and audit committee often stepping in and almost being the referee between the two is an unintended consequence. If you step back and you say, "What's the best way to serve the investor in terms of getting companies to come up with the right accounting on transactions," this relationship that has happened because of Sarbanes-Oxley is not helping us get to better investor confidence and better answers and serving the investor public. I think that in terms of the tweaking that needs to be done, that's the number one issue in my mind.

I was in a CFO conference, actually put on a conference for our CFOs in Dallas two weeks ago with our

head of risk and our CEO of our firm, and this was addressed and both of them said that that is not the way we want it to be. They both are taking this back to the SEC, back to the PCOB to say, "We need to fix this." Asking our clients not to come talk to us is not the right answer, right, and that's what has happened is that companies are paranoid because if they do come ask early and maybe they have the wrong answer, then the audit firm says, "Oh, that's not only an adjustment but it's a material weakness." That whole thing – and frankly, the best accounting knowledge resides in the firms, so cutting off the filer from the best knowledge of accounting early on in the discussion, it does not serve the investor public, and that to me is the number one issue that needs to be dealt with going forward.

Dennis: Okay, and we're going to change this discussion to what we need to do going forward because, in the interest of time, we're about half-way through our time, and I want to kind of change that focus but I want to give anybody else a chance, if they haven't had a shot.

Let me say, for the record, Enron did not fail because of their accounting problems. Enron failed because of poor decisions, poor business decisions, and they tried to cover it up with accounting problems. That's a whole different issue there that somehow gets lost in Washington, DC. Let's try to wrap up this idea of problems and complaints. Who had something here that they'd like to share that they haven't had a chance to get off their chest yet? Angela.

Angela: One thing that has been a surprise to me is the amount of time from an IT perspective that it's taking to comply, and I think that was something that was later in the game and I'm fortunate that I have a little bit more time to do it. But I guess it's just frustrating to me because IT people definitely in general – I'm generalizing – are not wired to talk about internal controls and documentation, and yet they're the people that you need and the knowledge that you need to comply on those things. So I'm interested in seeing if that was an issue with other people or how they dealt with it.

Panelist: You've heard the term you cannot legislate judgment? A good analogy here. I'm going to go on record. I certainly am very critical of our circumstance and realities of the guidance we've all had. I'm somewhat of a paradox though in that I believe that history is going to show that Sarbanes-Oxley was a catalyst and I think it's going to show that those who already were thinking and had the core elements – the tone at the top and the right people around – were already looking at process issues in how to make the company stronger. And I think the opportunity that most will miss is using Sarbanes as a lens to strategically look at process improvement focused within the company on tone-at-the-top issues and the higher level of risk – things that matter. They've mattered before Sarbanes, they will matter post-Sarbanes, even if it comes out in an equivalent 1934 SEC revision.

That's my view and I kind of come across as straddling the fence, if you will, but we've been given a situation and we could all criticize it. The reality is how do we change it going forward and look long term, and I think the long-term answer is strategic focus.

Dennis: You are positively ambivalent about it and thank you very much. [Laughter] Yes.

Attendee: I'd like to just point out. I think in many publications it's been pointed out that the cost for remediation or Sarbanes implementation is about a million per billion of revenues. Quite frankly, I think a lot of firms have looked at that as pretty hellacious, but I think several of the Big Four firms have also looked at the repercussions of failure to establish good corporate governance. And in those cases, if you look at what's the market capitalization of these companies a week after, a month after and 90 days after, you're starting to look at a trend that's kind of normalizing. We've got enough data points and you're typically seeing maybe 20 or 30 percent of market cap evaporated. In some cases the companies will never survive but even in the case where the company survives there's been a hellacious cost and a long-term recovery path because they've kind of taken some shortcuts.

I've had the pleasure of being the general auditor of two Fortune 500 companies with operations in over 140 countries in the world, and in addition to that I was a corporate governance practitioner at PW and then also at E&Y. And frankly, I've seen issues with audit committee members falling asleep. Quite frankly, I've

seen comptrollers not knowing how many accounts payable centers they have. And I think it's too popular to condemn Sarbanes and I think there's an opportunity to look at the glass of being half full, because there are some significant reengineering process opportunities. We now have – good or bad – we've got a road map of what we've got and where it is, what's working and what isn't, and we can streamline organizations, we can apply risk management to the costs and risks and benefits of getting more efficient control structures involved, and I think that's what I was really hoping to understand is the wave of the future.

Dennis: Okay, and that's what we're going to talk about for most of the rest of the time. We're going to try to come to a consensus on what we should do. A consensus, by the way, is to find, is the process of abandoning all beliefs, principles, values and policies in search of something in which no one believes but to which no one objects. Tell us more about that.

Panelist: He heads that practice.

Dennis: Just give us the facts about what you're seeing out there that really works well if we do this right.

Panelist: What works well or what will work well?

Dennis: Either way.

Panelist: Two comments. First of all, I would say the single most important thing I saw in my clients was that the chief financial officer was involved in the process from the very, very, very beginning. If he or she was involved toward the end of the project there was a more likely chance that there was failure, there was rework, there was what are we doing here, I don't understand. If that executive is involved very early, he can help drive the cost. I mean, it's a cost equation for him, too. If he's involved he can help steer that thing.

Dennis: Okay. And in your experience has that been the norm, the exception, a little of this, a little of that?

Panelist: I think it's probably 50-50, maybe even the exception, leaning toward more the exception. I think it will change in the future because some attention was gotten at the end of the year and many executives realized originally they delegated and relegated it down in the organization too far.

Dennis: Great point.

Panelist: But as far as what will work in the future, I think that the cry for cost reduction will continue. It's continuing now and it's going to drive smart actions. The only way I think that – one of the only real ways that we can as corporate America drives this tone all the way through the organization and drive costs down involving just internal people is to have a very good assessment process that's driven by the process owners themselves. So you have to teach those process owners the self-assessment process, if you want to call it that. That will leverage the organization, keep the costs down, and it is the embodiment of the tone from the top. And that is driven through the organizational system – the 404, 302 – all the other representative statements and certifications that the senior management has to make, so I think that's a best practice that we see evolving. To do it with project teams and outside consultants and internal audit groups and it will be just too expensive and it will hurt too long and pretty soon some people will say, give the tools to the people who are the operational people to help them assist themselves because right now they don't know how.

Dennis: But then you've got to be able for the external auditors to buy off on some of the things you're doing in order to get the costs back in line, don't you?

Panelist: True.

Dennis: And that may be the issue. Now, I wrote up here the number. Does anybody know who came up with the number of 35 billion in terms of the cost of Sarbanes-Oxley? Does anybody know who came up with that? Somewhere in my stuff I've got it – you've seen it – but then if you assume a 15 multiple on 35

billion, I want you to look at the market-cap cost that this wonderful little regulation that's supposed to help us happen.

David: My name is David Springate. My point is, simply, 35 times 15, that's 525. So you say, okay, maybe I've got a loss of capitalized value of 525 billion, but if that 35 billion cost represented, say, 3 percent of earnings, working the numbers back to 100 percent of earnings, if you gained a multiple of – say it went from 13 to 15 because people are more sure – you'd have a gain that is not a loss of 2,500, so that ratio is 5:1. So it might be that this really pays. I mean, it's arguable at least that a lot more value has come back into the stock market.

Dennis: Well, I think that's an excellent point, and I think the point that every company would like to do is to make sure that we do get some return on investment because, as I recall the numbers – I don't know if it's an FEI number or NACD numbers – 94 percent of financial people say that the cost exceeded the benefit in the first year of Sarb-Ox, 94 percent, and that's just not acceptable.

Greg: I just wanted to mention also that our company, while I would certainly say the benefits did not exceed the cost in year one, we certainly hope that now we have a process in place going forward that will enable us to look for business process improvement. And as we go through this I think we're developing a culture now where we realize business process improvement and compliance have to go hand in hand. You can't – you can no longer do one without the other. And I would also say that I think we're coming to a realization that as you go through and document all these controls, there's a huge cost to the companies to execute these controls. And there's a realization coming on people that, you know, we spend a lot of money making sure that controls work the way they're supposed to, that just to make sure that the controls are there, that people are doing what they're supposed to be doing, companies will begin to say, "How can we automate these things? How can we make them preventive instead of a detective where you've got to go back and clean up messes?" But make them preventive so they don't happen in the first place.

Dennis: Okay, yeah. I want you to focus on that for just a second because I think that is an excellent point, the difference between something that is corrective after you find it versus something that's preventative before it gets there. Talk to us a little bit more about that.

Greg: Well, most companies – at least our company traditionally – has not wanted to spend a lot of money. You spend as little as you can on, say, a system for a control process. You want to do what you need to do to make sure it's controlled but you don't want to throw a lot of money into that because it's perceived as non-value-add. But what happens ultimately then is you have to build a further downstream process that's manual. Whereas if the money had been invested up front to say don't ever let that happen to start with, then you don't have to have people focusing on those controls downstream, doing it manually, cleaning up messes. It's just that it's hard to get your hands around that at the time that you're building the system or the process.

Dennis: Did anybody – sitting up here – did anybody in your company find something let's just say in a controlled area and then they found a little fraud or something going on.

Jeff: I can tell you a story of a company that had their Sarbanes team at a small subsidiary – small, less than 10 percent of revenue – working through the control documentation very early in the process, and one of the employees pulled aside the internal auditor and said, "You know, there's two or three boxes over there you guys need to look at." In those boxes were documentation of a company that the president of this subsidiary owned. He was funneling expenses over into this other company in order to keep his margins and get his bonus and a whole bunch of other financial things that he was doing. This is a very decentralized company. They relied very much on their president and comptroller at the subsidiary as their control. Come to find out the CFO of the subsidiary knew all about it. He was being paid by this other company, and it turned into massive fraud. SEC is investigating now. And it was because the team was there doing this work.

Dennis: Okay. This has been about five years ago, the Pinkerton Group, the security company, did a study and here's what they found, in over 20 years study of Americans. Thirty percent of Americans will steal and will look for ways, actively look for ways to do so, 30 percent. 40 percent will steal if they have an opportunity, if they have an opportunity, and don't think they'll get caught. And then the other 30 percent, you can just leave them alone with a keys in the vault and they won't do it.

Now, we know, and we have a lot of these people in our company, and I think we know – at least we do the best we can, don't we? – to make sure that we have as few as possible of the top 30. But my point is, and I think I point to that internal controls and internal audit as simply this. If we don't do our job here, if we don't have the controls in place, then we take the chance of effectively increasing the number at the top. And I think that's one of the real efforts here that we need to make to do that, and I think all of you know that in what we're trying to do here, so. Okay, Greg.

Greg: On your cost/benefit I just – the cost is real easy to measure. The benefit is not so easy to measure. It's long term. It's the – I see companies that remediated 500 controls, you know. You closed a whole lot of doors here getting ready that you might not ever know what the benefit is of having those doors closed, so that's kind of the point I want to make is be careful when you're doing a cost/benefit analysis.

Panelist: It's not a quarter-to-quarter analysis either. We made an investment that's going to take years.

Dennis: I think that's an excellent point. Like most investments they take time to pay off, but in most investments we have some sort of internal rate of return that we can compute and here it's hard to think we may get to that. Connie.

Connie: Yeah. I just want to interject something here. Greg, would you mind just giving kind of what I consider a best practices approach that JC Penney is using in going after 404 which ties into what we're talking about now. You in effect have created a new profession.

Greg: Well, I don't know that we've created a new profession. What we're really trying to do at Penney's is – last year it was a project, this year it's a process and we want to move it into – we were in a conference a couple weeks ago where they said, "How will you know when this thing is really set into the culture?" One answer that was given was, "When we stop calling it Sarbanes-Oxley." It's just what we do, and I thought that was a great answer. And at Penney's we – it was a project last year, and we hear our share of bellyaching about having to do it again this year, but we want to move beyond that because we really do feel like there is a cost savings out there to be obtained through changing what we do. As someone said earlier, we now have a road map of what our controls are. We know what our processes are. We ought to be digging into that and seeing how we can improve those now.

Jeff: I was just going to add onto that. I do know of a client of ours that is a Fortune 500 company and as a result of all of this they have taken a day out of their closing process. Now, the CFO sees that as gigantic, that having his finance people with an extra day every day every month analyzing the business as opposed to closing the books.

Joe: We just went through an interesting fraud experience ourselves at Adam's Golf. I'm the CFO. We let our credit manager go in November and discovered a month later that he had been stealing from the company for three and a half years to the tune of almost a million dollars. We're a \$60 million revenue company so that's fairly significant. And through the course of trying to discover what he did, how he pulled it off, you know, pulling it off over three and a half years he was on the watch of myself and two other CFOs, two CEOs, two external audit firms, three comptrollers. We had five specific detective or preventative controls that were supposed to keep this thing from happening. We, in the process of determining what actually happened, needed one other control, obviously. He had spent a lot of time figuring out exactly what the controls were and how to get around them, and just wrapping up with our current external auditor how could we have prevented this and going – if we had gone through all the Sarbanes process would it have prevented this. And we had both come to the pretty tough conclusion that the Sarbanes process would not

have stopped exactly what this gentleman wanted to pull off. I mean, he was so smart and so determined to steal money that ultimately there's a huge people part of this process that will never be remediated by the Sarbanes process. If you have a person wanting to steal they're going to figure out ways to steal, and it's a tough conclusion to come to but it's probably pretty revealing in that you can try and try but you may never catch everything.

Dennis: Now here's what The Wall Street Journal says April 19th: "Detecting fraud, good luck. The Association of Certified Fraud Examiners published a 2004 report noting that 43% of detected business frauds of \$1 million or more came from tips. External or internal audits caught 41% of the cases. Internal controls, only 8%, and 18% were detected by accident."

Bob: Yes. So I guess three things. One, we've really standardized our financial close processes across the company, so we've got standard close checklist for our subsidiaries, we've got standard close checklist for our operations centers, for our corporate center, for our consolidation and so forth, so there's a much more dependable, repeatable process that we know that we can count on. So aside from being more efficient, I think there's a benefit because now people as they move from one part of the company to another will have something that they know that they've been doing before and they're doing it the same way in another location. I guess the other thing is that we've standardized our SDLC process across the company or across the IT organization that supports our line of business, and so SDLC meaning software development lifecycle.

Bob: And so, all of those controls, all of those general computer controls, are now on a standardized process across the company rather than having kind of multiple different methods and controls by which different units deliver and maintain software. So again, just a more efficient process. And then I think the third area is just in the process by which we report our numbers on our Qs and our K, and what we've done there, frankly, is taken several days out of that process. We've managed two quarters ago and continue to report our numbers on the same day that we file our Q, and so that we don't have to deal with the issue of potential subsequent events and so forth. We're not having two processes where we have one process to review, certify, document numbers around our earnings release and then a second one around our financial filings. So efficiencies like that are really something that's been brought about as a result of our internal controls assessment.

Dennis: I like to hear that. Now, Mike, there are things that obviously you've seen and you've seen going forward that we've talked a little bit about JC Penney over here, but tell us what we can do and what we should be doing and how we can benefit from this.

Mike: Well, certainly at Penney's and working with Greg and his team, we've tried to figure out ways to take advantage of the situation. We took five days out of our close process so that's been very helpful to Penney's. We do get numbers to operating management a lot quicker; fewer estimates, more actual stuff happening quicker in the process. That's been very good. People feel good about that. I think that we're working our way through those issues of it being an onerous activity. It's now what they do as part of the job. That was a big negative last year. Everybody thought this was something we just dumped on everybody. Finance was just dumping this on the rest of the people. So I think that's been a big plus inside the corporation. I agree that our CFO is much more involved in some projects than he was at an earlier phase. He now sees the critical nature of this.

One of the things that I am concerned about though is there is a lack of entrepreneurship in developing new systems because of a fear of all the things you have to go through, all the hoops you have to go through. I mean, we've been told not to install systems in the last quarter of the year because of all this, so that takes a big chunk of time to do stuff, and there's a lot of things that need to be done to get this detective work in place. We're a little concerned about that.

Dennis: Okay, good. Jim, give us something positive here. Give us something we can take away, some best practice, some recommendation here.

Jim: Well, definitely we're in 68 countries, so from a global perspective the communication – we've got regional CFOs – has improved, so the cross-border, if you will, conversations regarding best practices in all different areas, whether it be the close or payables or anything else. Probably the biggest – I think one of the biggest advantages, and I think it's been touched on, is the conversations occurring on a monthly basis in, say, a CFO staff meeting. We talk about it every month, or excuse me, when we have our monthly staff meetings in addition to just regular conversations with the core team that's involved in the implementation and the testing and the compliance and everything else.

But probably the biggest benefit so far, and we're not quite done – we're a mid-year company – but the biggest thing is challenging existing controls. Instead of going overboard with a boilerplate of here's hundreds of controls, because we identified roughly 90 key processes, and with eight to ten on average controls and numbers of risks, obviously, in each process, it's daunting, okay? We use Protivity – great tool – it's worked out real well in the global implementation of SOX. So having that document repository has been real helpful and allows everybody to communicate on the same page.

Dennis: Okay, so a couple of things to take away. First of all, material is a big issue, I guess, to all of us, isn't these things? I mean, if we had it to do over again we wouldn't identify all these controls of everything because some of them simply are just not material or there are mitigating controls. But one of the things that I found from my perspective is that a lot of the stuff we were doing we didn't have it documented. Is that an issue that you guys have had, this documentation issue?

Panelist: We definitely had, I'm going to say, months and months in '03 cleanup of documentation, okay. Get it up to date, clean it up, eliminate it, improve it. But more importantly what we found – and this is still an ongoing process – is ensuring that the controls are embedded in the documentation. But again, as my former Penney friends know, and I've spent five years writing documentation, you can go overboard. You can go overboard with documentation so we try to keep it fairly simple and not have too much out there.

Paul: I had a question. Thinking of this as a system of controls rather than compliance, I wondered if anybody had any experience where they'd actually approached this as a capital investment the same way if they were putting in environmental control equipment or a new fab plant or something, if they've actually capitalized this and amortized it over a period of time and actually taken advantage of tax credits on it.

Dennis: Okay, let's talk about process. Have you guys been involved in process improvement pre-Sarbanes?

Dennis: Okay, and what – is there a difference between pre-Sarbanes and post-Sarbanes in terms of what process improvement looks like in your company?

Panelist: In my view, take Sarbanes out of the picture. I look at it as a convergence of all the financial knowledge, accounting, auditing. If you're a student of quality and process improvement or reengineering, whatever the buzzwords, pull all that together and start looking at all process from the blank sheet of paper up, and you were talking about preventive and automated. Just this last week we went through and I told an audit committee that in '04 the world saw me as the skiddas [phonetic] compliant, that my audience as well as an audit committee and board needs to see I have enough energy in '05 to tear it all down and challenge it and take it to another level. And that means we've got all this information. We've inventoried and cataloged everything. We were in the verge of having all these stats of how manual are we, how automated are we, why do we need X number of processes, why do we need the additional cost, it's an exercise of bureaucracy, it's a matter of effectiveness. And you can start looking at everything you're doing from how engaged is an audit committee, how can you increase that engagement, how engaged has your CFO been, how can you increase that, do people talk to one another.

Our biggest success story was in IT. Pre-Sarbanes, two silos. You had an IT group and then you had the accountants and neither talked to one another. And although it was not an expressed goal, what came out of this is today they're integrated, they do talk, and when you're dealing with them on a daily basis you can see visibly how they think differently and the silos are coming down. The silos should have been looked at

long before Sarbanes. It's back to this whole issue of how many issues do you raise. You said 500 issues I heard. We raised close to a thousand issues. Does that mean you audited too much or does that mean you came in culturally to where it had eroded down and you're at a baseline to take it somewhere else? It depends on your philosophy.

Dennis: Yeah, it does. Angela.

Angela: The other thing, other than the financial best practices, is that when you're dealing with the field and you're talking to them about how they do a process or whatever, if they don't have an audit background there's not a lot of difference or variation between a financial type control versus an operational type control. And from an audit standpoint you can do that and you can pick out the ones and say, okay, fine, but what's more important I think even to the business is the operational control issues they bring up. And while I'm not having to document and remediate that right now, that's the things I'm keeping a list of because – or having people keep lists of – because those are some areas where, one, there's some concerns that they're all of a sudden feeling like they can bring up, and two, you can really add even more value to the business.

Dennis: I was going to say that may be where your real value is anyway, right? If you've already done a pretty good job on the financial side, those things in terms of process improvement, that's where the improvement comes from.

Panelist: Monday I'm going to have a room of 200 comptrollers in front of me and we did something really no different than everybody else. We defined everything in six buckets to find the risk and controls. Our generic controls as a company were 168 in '04. Last week – and I got Deloitte's accountants, I got them to agree – we took it down 35 percent. I've taken the documentation, I've created yardsticks, if you will, to show every comptroller he's every key control now defined and here's why it's key. It's key financial reporting wise and/or fraud wise and/or operational wise. And of those, here's ones we're going to track for SOX purposes, but more importantly, if you're sitting with your own processes and you're going to particularly contemplate a change from a 302 perspective, be aware that you've got an opportunity: Do I keep it manual, do I make it automated? Is it detective or preventive?

Dennis: Good point.

Carolyn: Yeah. One key thing that we've been doing and we got a large initiative going across our whole corporation to consolidate systems, and in doing that to consolidate into shared service centers, and particularly what I'm involved with is our financial service center. So now with Sarbanes-Oxley there's a great opportunity to save cost and produce efficiencies and improve our controls in that area just by doing that.

So what we've done is, we have seven major operating sectors within our company and each one has their whole set of Sarbanes-Oxley documentation, and what we've done is we've pulled sets of those process documentations in each specific area and we have review teams looking at those for best practices and trying to reduce the number of key controls and really hone in on what is key, and that is the basis for what we're using in terms of continuing refine our shared service center so that we're capable of becoming more efficient and taking on these other operating units. It's been very effective for us.

Dennis: What has that done to the communication across particular business lines and everything else in your company?

Carolyn: It's really created some synergy there. That's something that our CEO of the company has really been emphasizing over the past two years. There have been a lot of councils and forums, but this is one where you can really sink your teeth into it, and you've got people at the operational level talking to each other about some pretty basic things, and it's really helped us.

In terms of number of controls, controls documented across our company were 25,000; number considered key was 10,000 controls. So we've got a huge opportunity this year to get that reduced.

Our goal is to be in the 5,000 range at least this year.

Dennis: That's an amazing number. BJ, how would you like to deal with that, huh?

BJ: In the companies that I've worked in, the public companies and private companies, I have seen process improvements and I have seen a lot more attention given to upgrading IT software and so forth. But my belief is if you have a poorly run company, that the implementation of SOX is probably going to accelerate the demise of that company as opposed to save it. Because if the widgets of that poorly run company are already costing too much, adding the cost of SOX on top of it, unless you do some management changes, is not going to save the company.

When I'm in a company and they're just beginning to look at SOX, rather than having Finance dumping all this work on the operating departments, what I try to do is some education. And I've looked at a lot of publications and I found one where I can go in and I can tell the IT VP, "Here's an area you ought to read and you ought to understand the background of what's happening in SOX that affects your area," and if it's the VP of Marketing and Sales a different section. I brought a copy of this as an extra copy.

BJ: This is the second issue of this thing. This just came out, the second update on it, but I highlight certain areas in here and I give assignments to the different key people in the company to read it so that we're all in this together interaction and so everybody can understand the interaction of the different departments, because if IT is not doing what they've got to do then nothing is going to work because they serve everybody.

BJ: One last thing on the private companies. It has helped private companies in one positive way, and that is to recruit new board members, because a lot of people are resigning from public boards.

Dennis: Jan, give us from your perspective all the way down the road. You work with a lot of different clients in this thing. What are the keys to really doing something good with this thing and what do you see the successful people doing?

Jan: Well, I think I've said it before in terms of the disclosure controls and the procedures and putting those in place to make sure that you have good information that's being circulated both to the public markets and within the company. I think the good companies are having strong, effective boards that are asking really good questions, that are sitting down and really taking their job very seriously and recognize that it's not a five hour a month job. It's a huge job to go on a public board and requires a huge commitment of time and a huge commitment of effort. I like the lead director idea. I like the executive sessions without the CEO being in there. I think that's a huge plus for companies. You know, we talk about code of ethics. It's a great thing to have. I mean, most companies probably had it but they're stepping back from it a little bit, evaluating it again and looking at it from a fresh perspective. Obviously, you know, the whistleblower hotlines are great things to have. Lots of companies did not have them before and they have them now. Charters – having each committee have a charter of things that they're supposed to do and required to do, and holding onto those charters and embracing those charters has been great from a corporate governance standpoint. So I see lots of good things.

Going back to the 404 problems and the internal controls where I see companies getting into trouble there is really when they have foreign operations that they don't have control over. They have some guy running a foreign office over there and not paying attention to what he needs to be paying attention to. They don't have enough audit function in those foreign operations and are consolidating those operations or a subsidiary that is kind of in a different marketplace but doesn't have the right person there to really interface with the home office in terms of making sure that things are going well.

I also think, you know, as you talk about all of these processes and all these internal controls that you're doing, you never – what I find is people don't bring in the lawyer early enough. Because the disclosure issues are so phenomenally difficult that when you find a material weakness or you find a significant deficiency or something that needs to happen, the lawyers need to be – the inside lawyer or the outside lawyer – needs to be brought in early so you can start thinking through the issue and thinking through what the disclosures are going to need to look like in your 10-K.

Dennis: Jan, let me tag onto that and ask it to you this way. Especially from my perspective, we always hear the word "tone at the top" and you guys have mentioned that phrase several times here as well. How critical is it for these folks – all of you folks – to do your job if the tone at the top is not totally committed to the spirit of this thing, even if it's committed to try to lesson the cost, but at least committed to the spirit of what we're trying to do here?

Jan: I think it's very difficult to do your job if the tone at the top is not right, and I think that you're going to see, as I said, you're going to see changes in CEO. You are. Boards are going to require it. When your personal money is now on the line, okay, you have an obligation as a board member to make sure that that guy at the top is doing what he needs to do and doing it right. And if not you need to remove him, and we've seen – I've worked on four deals recently where the CEO has been replaced, sometimes representing the CEO, sometimes representing the company. It's a new role. It's a new role and it's got to be reporting to the board and answering to the board. You know, you can't run your own little shop anymore.

Wayne: Thanks. On that note, you mentioned there's this undercurrent here that I sense we're all kind of on the defense that we need to somehow minimize the cost of this thing. Well, you know, all through the '90s and the reengineering and what have you we somehow, as I think as a nation if you will, came to believe that accounting was not a value-added activity, okay. Well, you know, I disagree with that. I think it's very much a value-added activity. If I was a CFO I don't think I'd call my VP of Internal Auditing or what have you and say, "Hey, man, this is costing me a lot of money." "How much is it going to cost to do this thing right?"

Dennis: I don't know if you guys are still working on this idea of trying to figure out what the cost/benefit thing is for good governance, but if you are I'd like for you to talk about that for just a second, too.

Dennis: Okay, here's what I'd like to do in the ten minutes or six minutes that we have left. If you have a recommendation as to how we could positively improve Sarbanes-Oxley from a legislative or regulatory standpoint, I'd like to hear that. And then I'd like you to have as your closing comment sort of your thoughts about the future and where you think we're going. Bob, I'd like to start with you. What can we do and what's the future going to look like here?

Bob: So before I do that let me just add one thing to what you said about tone from the top because you asked a question about how important it is. I would say without the right tone from the top it's impossible. It's part of the control environment. If you don't have it, it's not there. With it, it's completely possible.

So, that said, in terms of what might be done in the future, I think the PCAOB needs to establish the same kind of process that the FASB did with the derivatives implementation, where there's a very frequent process of implementation guidance that's given in the form of kind of FAQ, just frequent guidance granted, provided until this all kind of shakes out.

And then I guess I'd say in terms of just recommendations as people are going through this would be, IT controls was mentioned. That's been a problem for us as well. We continue to wrestle with it. We're coming up on our certification and we're still having questions about the right scope around some of our IT controls and systems. So focus on it early and often.

The other thing I would say is to some of these earlier comments, don't be afraid to work with your auditors. Just establish a proactive relationship with them. Make sure you're in agreement. You have discussions

about what they're communicating to the audit committee, how it compares to how management thinks about it.

Dennis: Good. I appreciate that. Mike?

Mike: Well, I think the thing that I feel like needs to happen is just to readdress that the 1934 edition I think has to happen at a high level. I think that this guilt by association or this guilt until proven innocent is just too wearing on the companies and the stockholders, so I'd like to see the Congress take a look at it, whatever groups need to take a look and get it a little less onerous and a little more honest. And I agree with whoever said down there that the wedge between the accountants. As you say, the intent is for there not to be a wedge but I think we've eliminated some silos and created some others and that needs to be addressed because that's just not right. When you're holding back information from the people that have the answer for fear they're going to use it to hurt you is just like, "My God, what were we thinking?"

Dennis: That's the structural impediment that's in the way right now. Angela.

Angela: I'd agree with that. I put down ... recommendation, just build a little more judgment into it, which I think is kind of what they're saying. And in terms of the future, how I see the future, I think one of the biggest things that I see is ethical discussions, ethical tone at the top. It's not that it wasn't there but it's more commonplace now to talk about it, you know, and it's a very valid response to come back and say, "That is just not the right thing to do," and I don't think I heard that as much previously. Whether or not people thought it, I think it's just more at the forefront now.

Dennis: It's certainly at the tip of our tongue these days, isn't it. Thanks very much. Jan.

Jan: Well, I think what you're going to see and I think the commission has said that you're going to see is this 1934 Act kind of revision, and I want them to focus a lot on the small-cap issuers. I want them to give them some way to make this work within the context of what they deal with as compared to what a Fortune 100 company deals with.

And then in terms of the future, keep in mind what happened with Blockbuster this week. I mean, the Carl Icahns, the ISS is out there and they are taking a very big watchdog role in terms of corporate governance issues and in terms of all of these issues. And everybody's got to get their ducks in a row because they are going to come out there and they are going to come out swinging. If you're paying your CEO way too much money, if you're coming up with lots of material weaknesses, if you're not paying attention to what your board structure is, you're a target and they're going to come in and they're going to try and take control of your board or do something in order to put you on the market and get you out of there, so you've got to do it.

Dennis: Thanks. John.

John: I think key in the next wave of guidance is something to direct the issuers, some input from the issuers that deals not only with practicality but the size of your company. I think from a going-forward point of the issuers, the successful ones who are ones that will focus on strategy and design, not on compliance alone. And I love the term – I'm going to use it in my conference Monday – the moment we quit using Sarbanes as a daily term and we start getting back to design and strategy issues, that's when the cultural, the new culture will be evidenced.

BJ: I sent an e-mail with nine suggestions of what I think to Mike Shea about SOX does not touch ... to do with selection of board members and the qualification of board members and the establishment of the various required committees and the fact that every committee should have a written charter, the fact that public companies should on their Website be required to explain their policy toward corporate governance, and also I gave some comments on the private companies. And then the 40 questions that all the panelists gathered, I wrote some answers to some of those and gave them to you so you can use that material.

Dennis: Yeah, I think most of this stuff, certainly on the companies I'm on the board of, it's all been addressed through SOX or otherwise, let's put it that way. But you're right, those things need to happen. Do you agree with the situation on the smaller companies, that there needs to be a different sort of standard or a different way of handling it?

BJ: I think that some relief to the smaller companies from a sheer cost standpoint because of the fees and so forth should be done, just like Congress offers relief to startup companies on tax abatement and so forth, but the internal controls and so forth should be the same, I think. The tightness and the reporting accuracy and so forth should be there.

Dennis: Carolyn.

Carolyn: I agree with the point on more implementation guidance from management and companies out there. I think that there also should be more of an effort to address materiality concepts in certain areas. And I think our goal should be to integrate SOX fully into our processes, and the point down here really resonated with me, too, is when we stop calling it Sarbanes-Oxley we'll know that it's fully integrated.

Dennis: Jeff.

Jeff: I guess a couple of things. One is this thing about guidance, you know. When you step back and look, there has not been any guidance for companies at all. The guidance has been to the audit firms and the guidance, and then the companies read the audit firm guidance to try to figure out what that means they're supposed to do. So why the SEC PCOB isn't communicating directly to the companies, I'm not sure about what they do internally, maybe because that's something they've never done before. They've only communicated with the companies about what they have to do externally sort of in how they report. But I think that there needs to be specific guidance to the companies. The only kind of rule there's been is the firms have this, "We expect companies to do more," okay.

The SEC and PCOB – the SEC sponsored a roundtable about a month ago in Washington, had a lot of users of financial statements issuers there. I think that's the start of something that could be very helpful in this process of whatever this '34 Act or tweaking or different guidance or implementation should be, so should continue with that process.

Dennis: Good. I appreciate that and we'll see what happens on Monday when PCOB comes out with something else, we'll see. Greg.

Greg: I don't have anything really a lot different than what I've heard. I would like to see more guidance that would enable companies to work more closely with their external auditors without impairing perceived independence. Did it for years and years I think 98 percent of the time very successfully with the independence as we worked, as they were certifying on financial results. I don't know why Sarbanes-Oxley and internal controls had to change that so radically, and we had a very good relationship with our external auditor, but still there was something of an always having to be careful about what you say or how you ask questions and things like that. And then the risk-based scoping I think is very important as well.

I would also just make a note, something I thought about since we completed our work a couple of months ago. I've had numerous requests from within our company saying, "You know, you guys have all this documentation now about what our processes are. We could really use it for this or this or this," and suddenly it's like, oh, we've got something in one place that we've never had before. It looks like that's turned out to be a benefit that no one was quite –

Dennis: Yeah, use it as a resource, exactly. Scott?

Scott: I think as far as further guidance from the SEC or PCA would be to really clarify the standard of reasonable assurance. That's the standard, and people sometimes think it's an absolute standard but it's

not. So we believe as a firm – and I believe it, too – is that that’s probably one of the top things that needs to be addressed in further guidance is what does reasonable assurance mean, and very soon.

As far as the future, I think that we ought to not delude ourselves into thinking that we’re done with investing. It’s going to cost more, and you need to continue to invest for us to sustain the effort you’ve begun and to not be shortsighted in investing for the future, building stability. And reinforcing – the second point about the future I’d like to bring up – is reinforcing the tone at the top through a very vigorous and robust self-assessment process where you engage the process owners, give them the tools, teach them how to assess themselves, each other, whatever, so it’s really ingrained down in the roots of the organization. It’s not a finance activity; it’s not an audit activity. Give them the tools and a process that reinforces it clear from the top, drives it all the way down.

Dennis: You expect that as part of their performance and you inspect it and then there it is.

Scott: That’s right.

Dennis: Bob.

Bob: Back into the table probably mostly echo what’s been said. I think in round two we really need to get to where we are able to management trivial many. It just doesn’t make sense for us to go through many more times mindlessly. And then also important to relationship with the auditors, allow us to be in an environment where they can make decisions and get back to the 5 percent of issues rather than the high percentage.

Dennis: Fifty percent, right.

Bob: It may not be far off. Again, going to the future I think one of the good things is we’re past the reengineering, get .. cost out accountants being a nasty word. Even though folks are a nuisance and we go through, I think there is an understanding of the criticality of the function and more respect and I think we’ve turned the corner there a little bit.

Dennis: I appreciate that. Connie, we’re out of time, unfortunately, but why don’t you make your last comment and then – or if you have any quick, it had to be quick.

Panelist: Well, I think a lot of the conversation has gone to where Sarbanes becomes a process in lieu of a project and some of the controls that we have talked about, finance people already were aware of it. This is not nothing new, but I think it has given us the clout or the finance professional the clout to make it pervasive in the organization. So could there be a case be made that Sarbanes now for a couple of years will be redundant and unless some of the principles in the legislation be embedded in the existing SEC regulations where you won’t have another legislation to comply with.

Dennis: You can make some of those controls voluntary, by the way.

Connie: Dennis, I’m wondering if you want to do any summarize because I want to follow up.

Dennis: I do. Then I’ll come to you. First place, before I summarize what I want to say, would you give these folks a great round of applause for all the great work they’ve done here? [Applause]

And let me just say from my standpoint, I get the opportunity to do this kind of thing for companies all over the place and obviously on television every week for the last 15 years, but I am ultimately a business person. That is who I am. I am a laissez-faire capitalist, greedy capitalist pig [laughter] and I don’t make any bones of it. And the stuff that’s gone on with some of these companies embarrasses me worse than it embarrasses you, by the way. But I believe we have a lot of work to do, and I don’t think there’s any way to overemphasize tone at the top, the ethics issues, doing what’s right and all that stuff. We have to do that, not just for ourselves, not just for our shareholders, but ultimately for the future of this country because it is

the businesses who drive this future. It ain't the people in Washington, DC. I got out of there yesterday and I got home and took a shower when I left, [laughter] that's how I feel about it.

So anyway, I'll leave you with one last cartoon. I don't know who you're hiring these days or whatever but here is one. "Matthew, how wedded are you to generally accepted accounting practices?" And then maybe that's the standard you'll use in the future, [laughter] who knows. Thank you very much. I appreciate it.
[Applause]

Connie: Folks, Dennis, I just want to thank you so much. He's obviously a professional moderator and he exudes the kind of a spirit that brings out the very best in people, and the forum, the panel was just outstanding. You as usual were outstanding. And to the audience, I must say, you did a great job. Good questions, and thank you for being here. I want to again reiterate our thanks to our sponsors, Microsoft, to Avnet, BizNet and to Converge Technology Application Partners for their monetary and resource contributions. Now, my understanding is that at this time we will be getting a box lunch.

Panelist: Connie, before we do that we've got a couple of give-aways.

Connie: Okay, why don't you come up and do the give-aways.

[END]