

The Shindler Perspective, Inc.

The New Control Environment

By Marty Shindler

Greed, self-dealing, fraud, misrepresentation, inadequate disclosure of essential information to owners and other stake-holders, insider stock trading, significant financial restatements, financial collapse, bankruptcies, investigations by regulatory authorities, management changes, and even jail time. These phrases might form the basis of a Hollywood feature film or two. In fact, films have incorporated many of these characteristics; *Wall Street*, for instance.

These phrases have been much in the news over the past year or so. Think Enron, WorldCom, Global Crossing, Tyco, and Andersen, among others. And while these scandals have been more prevalent in the United States, other countries are facing similar challenges.

Coupled with troubled economies, threats of war, and terrorism, these problems significantly reduced public trust in major corporations and in turn led to the downturn in U.S. stock markets. According to a CNN/USA Today Poll in July, 77% of the public believe that CEO greed and corruption have caused this financial meltdown.

This perception has not been limited to major public corporations but has trickled down to all sorts of organizations, public and private, large and small, for-profit and not-for-profit. It is also not just the dot-coms as some may think. Few organizations have been unaffected. And there may be more corporate misdeeds to be discovered that will play havoc in the marketplace.

To help restore confidence in the markets and to help bolster the faltering economy, Congress passed, and President Bush signed, the Sarbanes Oxley Act of 2002. Mention of this law has become almost as common in the press as the phrases at the start of this article, and for good reason: implementation of the law has already begun as companies with fiscal years that coincide with the calendar year are audited and their year-end financial reports are published.

I recently spoke with a former business associate who is a partner in one of the major CPA firms. From his point of view, the next few months will be extremely busy as publicly traded companies begin to evaluate their procedures and implement the requirements of the Act.

After our phone call it occurred to me that while the requirements of the Act for publicly traded companies were vital, the same principles could benefit all kinds of organizations.

Let's look at two important sections of the Act, as recently published in a PriceWaterhouseCoopers White Paper:

Corporate Responsibility

- “Requires audit committees to be independent and undertake specified oversight responsibilities.
- “Requires CEOs and CFOs to certify quarterly and annual reports to the SEC, including making representations about the effectiveness of specified controls.
- “Requires the SEC to issue rules requiring attorneys in certain roles to report violations of securities laws to a company's CEO or chief legal counsel and, if no action is taken, to the audit committee.”

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Enhanced Financial Disclosures

- “Requires companies to provide enhanced disclosures, including a report on the effectiveness of internal controls and procedures for financial reporting (along with external auditor attestation of that report) and disclosures covering off-balance sheet transactions and *pro forma* financial information.
- “Requires disclosures regarding code of ethics for senior financial officers and reporting of certain waivers.
- “Requires accelerated disclosures by management, directors, and principal stockholders concerning certain transactions involving company securities.”

Other than the specific references regarding SEC rules, reports, and transactions involving company securities, these are business principles that all organizations should strive to observe.

How can anyone argue that CEOs and CFOs should not be ultimately responsible for the financial control environment and the fair, ethical, and appropriate reporting of the results of operations, regardless of the type of organization? In this day and age, CEO excuses about “not being an accountant” are not acceptable. CEOs and CFOs can and should obtain input from division executives, as the control process works in both directions. However, final responsibility must remain at the top, and top management must set the tone that will trickle down through to all organizational levels.

Similarly, shouldn't private and public not-for-profit institutions have an independent audit committee to oversee the financial conduct of the organization? Many institutions have revenues and assets that rival those of publicly traded companies; they just have different reporting and tax requirements.

And how can anyone with fiduciary responsibility not be interested in controls on expenditures, safeguarding of assets, segregation of duties, effectiveness and efficiency of operations, ethics in business, and so forth? Above all, it is imperative that the control environment be documented in the form of policies and procedures, even though the organization must be able to change them as needed in a dynamic business environment. An added advantage of implementing new procedures should be improved coordination of the management team, as input should come from the whole organization.

Of course, the foregoing is not a complete assessment and analysis of the Sarbanes Oxley Act, but merely my thoughts on how it may be applied.

The path to overhaul has been prepared. Organizations that head down the path should emerge stronger and more effective.

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