



EMPLOYEEASE



Strategic Human Resources and **Sarbanes-Oxley**

A White Paper On Industry Trends

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Is there a link between strategic Human Resources (HR) and Sarbanes-Oxley (Sarbox)? Recent findings suggest a strong correlation between companies who succeed with their Sarbox audits, and companies who employ a strategic approach to HR. The opportunities available to HR, when taking a strategic approach, might be more significant than at first glance.

A Strategic Approach to Human Resources

For years there has been an industry-wide discussion on the need for Human Resource (HR) professionals to take a more strategic role within their organizations. This discussion has raised many questions, such as:

- *What exactly is strategic HR? Why is it so important?*
- *Are there barriers to achieving strategic HR?*
- *How do I overcome those barriers?*
- *Is there a road map to transforming from transactional to strategic?*

When Sarbanes-Oxley was enacted in 2002, many HR professionals added new questions to the discussion such as:

- *What is HR's strategic role in managing Sarbanes-Oxley compliance?*
- *What tools and controls should we have in place to facilitate compliance?*

The purpose of this paper is to share how a strategic HR approach might play a key role in simplifying the process of Sarbanes-Oxley (Sarbox) compliance regulations.

A Closer Look At Sarbox

The extent to which an organization is prepared for Sarbox is driven by its commitment to create a culture of compliance, while establishing controls and audits that make sure compliance is managed on an ongoing basis. Learning more about Sarbox in relation to your organization can help with addressing this.

What is Sarbanes-Oxley?

The Sarbanes-Oxley Act (Sarbox) was created to protect investors—and restore public trust—by improving the accuracy and reliability of corporate disclosures.

A key element is that Sarbox makes unauthorized disclosure of nonpublic data, *i.e.*, not widely disseminated to the general public, a violation of federal securities laws. Not only should nonpublic information be

protected, but it also should be monitored to ensure it isn't disclosed inappropriately.

Since reporting on financial controls began, 750 companies out of 2,500 have admitted failing. HR issues were the second most common cause for failing. (Source: *HR Magazine*, Oct. 2005) Failing audits generally translated into a negative impact on the organization's stock price.

Section 404 of Sarbox

This section of the audit requires management to report on the adequacy of internal controls around the safeguarding of assets that could have a material effect on financial statements. An organization must demonstrate that it has the capabilities to monitor, detect and record electronic information disclosures.

What is "Material?"

Since every organization is different in its trade and composition, what is regarded as "material" varies from company to company. As an example, a consulting firm's employees are its key assets. The payroll, benefits and stock options would be vital to the organization's success, and therefore considered as material in an audit. Generally speaking, what is material is financially related—the transactions, assets and information that are regarded as critical to the company's vitality.

For a company to pass a Sarbox audit, auditors must certify that quarterly and annual filings are true, and that they do not omit material facts. The only way to minimize Sarbox-related risk is to define, and implement, practices and policies that are repeatable and auditable.

HR's Role in Sarbox Compliance

Human Capital represents most companies' largest single investment—as much as 40-60% of annual expenditures. Plus, HR controls, or directly influences, many of the key processes that have financial impact on the organization (benefits, salary, stock, etc.)

HR Magazine's October 2005 issue listed the top areas that HR professionals should emphasize in managing Sarbox. Those areas include:

- Create and enforce an ethical culture
- Prioritize areas to control
- Establish controls
- Conduct a risk assessment
- Provide information and communication
- Monitor your processes

According to *HR Magazine*, "Understanding, managing and monitoring approvals, authorizations, verifications, reconciliations, and vendor relationships is a major strategic undertaking for HR professionals. Reviewing performance, security and segregation of duties adds even greater complexity to the equation."

Organizations who understand their processes and build controls for monitoring them are best equipped to pass their Sarbox audit.

Successful Sarbox Audits

The amount of preparation a company does before an audit can make a difference. A Sarbox audit can feel like a fire drill or a root canal if the proper time isn't invested on the front end of the process. The more and sooner HR becomes involved in the process the easier the Sarbox audit becomes.

More than one experienced HR professional offers the opinion that a well-prepared HR department can set the organization up to pass an audit. Similarly, an ill-prepared HR department can cause the company to fail an audit.

Here are four examples where HR departments took a strategic role with regard to Sarbox and helped to "win" their audits.

- **Consulting firm**—with 900 employees hires three people into their treasury department specifically to address Sarbox. The HR department manages all employee data in a centralized system that feeds information to payroll vendors, an outsourced 401K supplier and all benefits suppliers. In preparing for the audit, HR is able to quickly respond to information requests and document all processes related to material information. Were the HR department not more prepared, the company estimates that it would have had to hire at least four individuals to handle the audit preparations and ongoing management.
- **Manufacturing firm**—with several thousand employees. attempts an extensive pre-audit and discovered HR has the only credible database in the organization. HR is able to help identify problems in the organization's information security and accuracy. Years previously, corporate HR consolidated multiple systems across various divisions so that it could roll up information. The initial result was to reduce cost and better manage the organization but it rapidly becomes clear that the company would have failed their upcoming Sarbox audit, were it not for the HR's strategic approach.
- **International organization**—rapidly growing, finds segments of its employee data are raising red flags with auditors. An aggressive merger & acquisition strategy has resulted in discrepancies between employee start dates and seniority, casting doubt on stock options and other financial transactions. Fortunately, the organization utilizes an HRIS system with widely flexible reporting capabilities. The initial intent in selecting the system was to have something that could scale easily with the M&A strategy. In this case, it helped HR quickly—and convincingly—respond to auditors' concerns and keep the audit on track.
- **Technology company**—with many geographically-dispersed divisions finds in a pre-audit exercise potential security concerns around IT having access to critical information on security clearances. Their web-based HR system allows them to add an additional layer of security—thereby resolving the issue in time to pass their audit—by easily creating a few additional electronic connections between HR and IT.

These companies have several things in common:

1. They were able to execute on necessary actions relatively easily because of the strategic approach their HR departments took in advance of the audit;
2. They utilize systems that allow them to react quickly;
3. The systems they use allow them to easily control the environment for information exchange and the ability to monitor easily for discrepancies.

The Sarbox Audit Process

The unknown can instill fear. Regardless of how many organizations have successfully undergone and completed the audit process, every audit is different. Not every organization expects that HR processes will be considered material to their audit, but when it does happen, this can give the organization cause for fear if the HR department is not prepared.

The audit process may appear to be a daunting and strenuous one. However, organizations that prepared well in advance by investing in process and monitoring controls reported that the audit helped them get even more organized.

As noted with the examples, it can even provide an opportunity for HR to showcase its potential and its ability to support critical corporate objectives.

"[The Sarbox audit process is] an excellent opportunity to review your processes and controls while making sure that the way you think everything is happening is really happening."

— Pat Edwards, Human Resources VP, EOG Resources

Documenting Processes

The first step is *identifying* what areas are important to your organization for establishing, documenting and monitoring internal controls. Internal controls are defined as activities or practices designed to reduce the risk of error, misreporting transactions, fraud or improperly authorized transactions.

The next step is actually *documenting* those processes. With process analysis and mapping, you can chart out the steps that a decision must pass through before it is approved. The mapping process forces HR to question and test internal controls to make sure that the opportunities for errors and fraud are eliminated and that duties are segregated properly.

HR should then *establish* and *monitor* these controls. *PAYTECH Magazine's* July issue suggested that HR should avoid relying on information managed in spreadsheets to maintain control over information. With a quality table-driven HR database application, the magazine suggests "it is easier than ever to comply with a practice or policy."

Ask yourself:

- Can our HR and benefits systems or outsourcer produce real-time, repeatable, and auditable transactions?

- Do our workforce systems provide the ability to track approvals back to the originator?

According to the publication, if you answered, "No" or "I don't know" to either of those questions, your organization is in danger of failing to meet the demands of the Sarbanes-Oxley Act.

Working with a Third Party Administrator

Sarbox requires that organizations outsourcing business processes such as benefits administration must prove that their service provider also has effective internal controls.

The Statement on Auditing Standards (SAS) No. 70 audit is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA). A SAS 70 audit or service auditor's examination is widely recognized, because it represents that a service organization has been through an in-depth audit of their control activities, which generally include controls over information technology and related processes. Service organizations or service providers must demonstrate that they have adequate controls and safeguards when they host or process data belonging to their customers. (Source: SAS70.com)

The intent of the SAS 70 audit is to provide information and assurances regarding the financial controls of a service provider. This auditor-to-auditor report provides validity and substance to an organization's declaration of security and management's focus on continuous security improvements.

An HR department working with a vendor who is already deemed to be SAS 70 compliant makes portions of the Sarbox audit much easier. In fact, many companies report that had their processes been in-house or IT systems on their own servers, passing the audit would have been far more exhaustive.

Auditors Appreciate Defined Workflows

Sarbox auditors appreciate well-defined processes that are integrated, structured, repeatable and auditable.

Ask yourself:

- Can we easily report on our processes to show workflow and approval?
- Do our systems track reporting relationships between employees?
- Do our HR and benefits systems provide structure to enforce workflows?
- Are we integrated electronically with our third party service providers to avoid redundant data entry and opportunities for errors?
- Are all integration points with external service providers secure?
- Does our system facilitate segregation of duties?
- Can remote locations access only their appropriate information?

If you answered, “No” or “I don’t know” to any of these questions, your organization might be at risk of failing. Well-defined and defensible processes are available through Employeease, a SAS 70-compliant resource.

Long-Term Sarbox Compliance

Over the long term, the biggest driver to Sarbox compliance is creating a culture of ethics and making sure that the organization is constantly focused on the importance of compliance. These responsibilities typically fall onto HR, creating an opportunity for a more strategic approach.

Barriers to Strategic HR

In Employeease-sponsored research conducted by TwentyTen Research, it was discovered that the biggest barriers to focusing on strategic issues—like Sarbox compliance—are:

1. Not having time,
2. Lack of involvement with corporate issue setting, and
3. Insufficient budget to address both administrative and strategic issues.

Overcoming The Barriers

The same Twenty/Ten study reports that by investing in and utilizing tools such as:

- Employee and manager self-service,
- Enrollment services,
- Hosted web-based HRIS, and
- Connectivity,

these companies are dramatically more likely to have the time and budget approval to invest in strategic activities.

Steps Toward A Strategic HR

What steps can one take to achieve strategic HR? Since every organization, and HR professional within is unique, there is no one path to take. However, based on the initial findings of the research discussed in this paper, there are some broad-based recommendations.

Look for opportunities for change—Recognize opportunities, like Sarbox, as potential catalysts for change, and take advantage of those opportunities to make recommendations that will initiate the evolution of the HR department structure.

Make changes that initiate structural migration—Define how the new HR structure should look and move toward it. Make sure employee information is in a format that is easily updated and accessed regardless of location. HR processes should be well defined and an integral part of the new system. The new system should be capable of easily generating reports from varying perspectives, at a moments notice.

Think proactive, not reactive—Demonstrate the ability to be strategic. Work *with* the data, not *on* the data. Look for common errors now visible in the new system, and address them.

It's an ongoing process—Stay on top of being one-step-ahead. Keep looking at new information and trends to find new opportunities for reducing cycles.

If you're doing these things, you're on the path to a more strategic, successful HR.

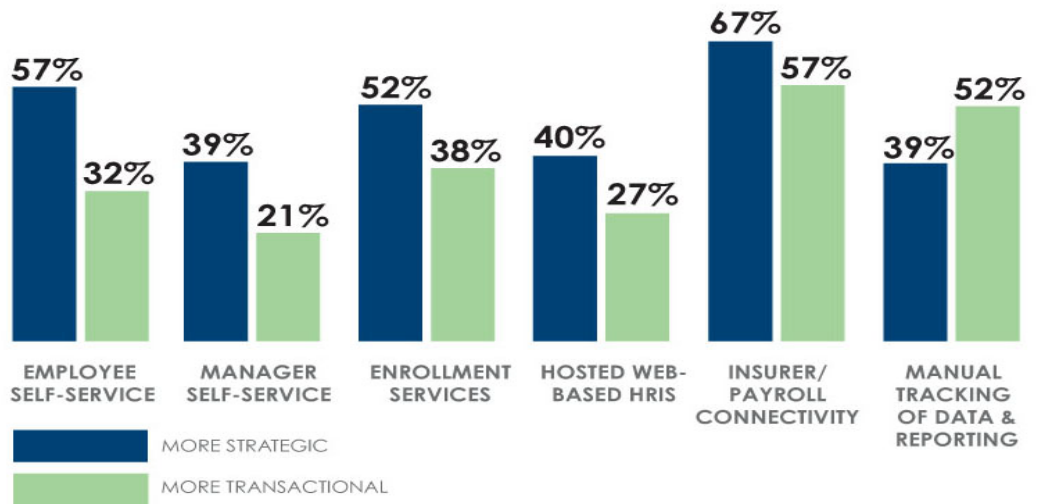
Conclusion

The silver lining in Sarbox may be that it presents an opportunity for HR to proactively demonstrate strategic contribution and support of corporate directives—while addressing the transactional and administrative issues that plague it.

[Call out box]—should go next to sections “**Barriers to Strategic HR**” and “**Overcoming The Barriers**” above

Independent research firm Twenty/Ten recently conducted a study titled *Why HR/Benefits Should be Any Company's Top Priority*. The study focused on the HR community in mid-sized companies with 1,000 – 10,000 employees. The intention of the study was to discover the routes that strategic HR professionals follow.

RESOURCES USED BY HR TO EXECUTE ITS DUTIES



Appendix

For more information on the research presented in this paper, or on strategic HR, please refer to:

- www.hr-research.com is a website developed and maintained by Employease specific to the research touched upon in this paper.
- www.employease.com for information on webcasts, customer success stories and additional HR resources.

Employease provides an innovative and proven mix of web-based solutions and outsourcing options giving HR executives the power to choose how best to manage HR and benefits processes.

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