



The Sarbanes-Oxley Act of 2002

*Assessing the Unique Challenges
for Payroll,
Human Resource Information Systems
and Benefit Administration
Under the Microscope of Sarbanes-Oxley Scrutiny*

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ABOUT ADP

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Note: Nothing in this white paper is intended to be, nor should it be construed as, legal or accounting advice. If you need legal or accounting advice on any of the topics discussed herein, then you should consult your legal or accounting advisor.

Dear Business Executive:

Thank you for requesting a copy of the ADP white paper: ***Assessing the Unique Challenges for Payroll, Human Resource Information Systems and Benefit Administration Under the Microscope of Sarbanes-Oxley Scrutiny.***

Choose an effective path to Sarbanes-Oxley compliance

Sarbanes-Oxley compliance is a complex and expensive requirement for U.S. public companies. The matter of how best to comply presents your company with a challenge: you and your public accountant must document, test and certify that all “in-scope” Sarbanes-Oxley processes have sufficient internal controls – and do it as cost-effectively as possible.

The good news is there are resources that can help to alleviate some of the burden. For instance, companies that have selectively outsourced certain applications that may be considered “in-scope” – such as *Payroll, HRIS* and *Benefit Administration* – are realizing an unforeseen advantage in their Sarbanes-Oxley compliance efforts: third-party assistance.

***Payroll, HRIS and Benefit Administration* are all almost certain to be “in-scope” processes under Section 404**

Help from a third-party can make a significant contribution to your Sarbanes-Oxley compliance strategy. When you outsource, your service provider engages outside auditors to test and document product offerings, including *Payroll, HRIS* and *Benefit Administration*. In fact, most of the tasks for Section 404 testing and documentation of internal controls are performed by the service provider and its third-party audit firm – not by you. In turn, substantiation of internal controls testing is delivered to you annually, in the form of a complimentary SAS 70 Type II Report.

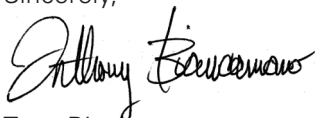
As the market leader in outsourced *Payroll, HRIS* and *Benefit Administration* solutions, ADP is already helping clients to form an effective foundation for Sarbanes-Oxley compliance with comprehensive SAS 70 Type II Reports for most of our products.

Shape a strategy that makes the most sense for your organization

I am confident that the comparisons and assessments presented in this white paper will provide important information to help you and your team shape your approach to Sarbanes-Oxley compliance. We thank you for expressing interest in this white paper – and in ADP.

If you have any questions, please feel free to call us at 1.800.865.0397.

Sincerely,



Tony Biancamano
Vice President of Compliance
ADP Employer Services

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I. EXECUTIVE SUMMARY

The Sarbanes-Oxley Act of 2002 is one of the most far-reaching laws to affect the landscape of Corporate America since the securities reform laws of the New Deal. Like most landmark legislation that seeks to right wrongs, it is a double-edged sword. On the one hand, it promulgates a number of important regulations around corporate governance, ethical behavior, the role of audit committees, and fairness in financial reporting and disclosures. On the other hand, it imposes a new compliance burden on *all* publicly registered companies that come within the orbit of oversight of the Securities and Exchange Commission (SEC).

This white paper purposely limits its discussion to three business processes: *Payroll, Human Resource Information Systems and Benefit Administration.*

Compliance presents its own unique challenges for *payroll, HRIS and benefit administration* because each has unique complexities. For starters, system requirements, processes

and methods can vary substantially from company to company, adding a degree of difficulty to any compliance activities. In your Sarbanes-Oxley preparations, it would be prudent not to let the seemingly mundane nature of these three administrative processes prompt a decision to put them on the back burner, because they are likely to be identified by your public accountants as material to your internal controls over financial reporting. In fact, since these processes typically generate a large number of transactions and cumulatively involve large dollar amounts on a company's financial statements, the administration of *payroll, HRIS and benefits* is almost certain to be part of your "in-scope" processes for review, documentation and testing under Section 404 of Sarbanes-Oxley.

Regulatory compliance already costs your company money and Sarbanes-Oxley compliance is going to add to that burden. The only question is – *how much?* Several factors make it difficult to accurately answer that question.

For one thing, the newness of the law has created an environment of uncertainty where there are no established expense guidelines or benchmarks. Since no company has yet completed a full reporting cycle under Section 404 of the Act, the cost of compliance is still being expressed in widely varying "estimates." An additional and perhaps more potent variable is the simple reality that Sarbanes-Oxley compliance is going to be a perpetual proposition, requiring companies to satisfy rules that are bound to evolve and requirements that are likely to change.

Since public companies for the most part run their finance and administration functions in-house, and internal systems by definition project an aura of finite control over the processes, methods and operating environment, ostensibly that might be a valid reason for corporate managers to breathe a collective sigh of relief. On the surface, the annual Sarbanes-Oxley requirement for company management and the company's public accountants to

document, test and certify that all “in-scope” processes have effective controls should be a proverbial “slam-dunk.”

However, several factors regarding in-house systems might be cause for concern. First, no internal systems have been specifically built to comply with so far-reaching a law that was so recently enacted. Secondly, a major study of internal *payroll*, *HRIS* and *benefit administration* systems has indicated internal systems contain certain “hidden” operating expenses that system owners never realized they were incurring, making ownership far more expensive than ever imagined. Thirdly, there is the risk that hidden operating costs could also be the harbinger to system anomalies and other inconspicuous factors, which could produce an expensive surprise during a Sarbanes-Oxley internal control review.

While Sarbanes-Oxley compliance activities present a significant challenge, there are resources that can help to alleviate some of the burden. For instance, some companies that have chosen to outsource their *payroll*, *HRIS* and *benefit*

administration are in fact realizing an auxiliary advantage from third-party assistance.

Auditors, engaged at the expense of many outsourcing service providers, are testing and documenting service provider product offerings, such as *payroll*, *HRIS* and *benefit administration*. In these cases, the majority of management’s tasks related to Section 404 documentation and testing of internal controls are performed by the service provider and its third-party audit firm – not by you. Substantiation of internal controls testing is delivered to service users annually in the form of a SAS 70 Type II Report. This service auditor’s report is acknowledged by the public accounting community to provide documentation and testing of the internal controls over these outsourced processes in a format designed to minimize the work you must perform under Section 404.

The significant amount of attention that is required to address a relatively small portion of Sarbanes-Oxley compliance activities – *payroll*, *HRIS* and *benefit administration* – reveals the sheer enormity of the total

compliance effort. It should become painfully clear to any observer that companies faced with Sarbanes-Oxley compliance are looking at a very large undertaking. It demands the creation of a long-term compliance strategy that will serve them well over the long haul, because this historically prominent law has changed the compliance landscape in such a lasting way. Clearly, the common corporate wavelength should be tuned-in to one anthem: that achieving compliance requires a perpetual solution, because Sarbanes-Oxley will always be with us as one of the true superstars in the world of regulatory compliance.

II. INTRODUCTION

A Watershed Event for Corporate America

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) is one of the most high-profile interventions by the federal government of the United States into the accounting and governance practices of public companies.

Triggered in large part by a persistent rash of corporate bankruptcies that caused

employee pension funds to evaporate and shareholder equity to vanish, this far-reaching law touches every publicly registered corporate entity that comes under the jurisdiction of the Securities and Exchange Commission (SEC).

Sarbanes-Oxley (approved by a 423-3 vote in the House of Representatives and a 99-0 vote in the Senate) is a complex law with lofty and beneficial goals.¹ It aims to

increase investor confidence by improving corporate governance rules, defining a more prominent role for corporate audit committees, establishing a minimum-acceptable threshold for corporate ethics standards, and introducing a whole new level of accountability for senior corporate executives by holding them personally responsible for their company’s financial statements.

1 “The Sarbanes-Oxley Act of 2002 – Status,” The Web Site of the New York State Society of CPAs, www.NYSSCPA.org.

III. OVERVIEW

As the body of knowledge concerning The Sarbanes-Oxley Act of 2002 and its related rules and regulations continues to grow, there is certainly no shortage of opinions regarding the impact of this landmark legislation and what publicly registered companies should do next.

The purpose of this white paper is not to suggest or propose a broad, “silver bullet” solution that would provide easy answers to all the many complexities of Sarbanes-Oxley compliance. It is difficult to imagine any single document that could successfully achieve that objective. Instead, this paper embraces a much more defined scope and focuses on three universal business applications that have important Sarbanes-Oxley implications: *payroll*, *HRIS* and *benefit administration*.

Why such a precisely defined examination of so broad a topic?

For one thing, compliance presents its own set of unique and interesting challenges for these three administrative processes. System requirements, processes and methods vary significantly, company-to-company, and because these administrative functions represent a relatively small part of the overall compliance mosaic, there is an inherent danger of putting them on the back burner.

This, we believe, would not be a prudent approach. In fact, we anticipate that long-term Sarbanes-Oxley compliance – specifically the provisions of Section 404 – will demand an increasingly deeper examination of specific, highly transaction-driven yet seemingly mundane business functions, including payroll and other employer-related

processes. *Payroll*, *HRIS* and *benefit administration* not only generate a large number of transactions, but also cumulatively involve large dollar amounts on a company’s financial statements. These are good reasons why they are likely to be identified by your public accountants as material to your company’s internal controls over financial reporting and, thus, among the “in-scope” processes for review, documentation and testing under Section 404 of Sarbanes-Oxley.

We are not alone in this long-term view.

One published poll of corporate executives suggests that up to 80% of companies “consider that compliance mandates must include finance, operations, and *IT processes*.”²

David M. Katz in [CFO.com](#) cautions, “Indeed, if you thought the provisions of

2 “Sarbanes-Oxley Compliance Spending Will Exceed \$5B in 2004,” John Hagerty and Heather Keltz, AMR Research, December 8, 2003.

Sarbanes-Oxley only concerned corporate finance, independent auditing, and equity research, you've missed the fine print. Sarbox also covers such disparate corporate functions as information technology, human resources, compensation, and environmental compliance."³

To understand this line of reasoning, one need only peruse the provisions of Section 404.

Why focus on Section 404?

Even though Sarbanes-Oxley Section 302 (Corporate Responsibility For Financial Reports) has captured most of the tabloid-sized headlines – because it requires each respective chief executive officer and chief financial officer (under the constraint of personal liability) to prepare and attest to the accuracy of their company's financial statements and disclosures – a significant portion of a company's movement toward Sarbanes-Oxley compliance actually flows from Section 404 (Management Assessment Of Internal Controls).

In fact, compliance with the letter and spirit of Section 404 can help to provide senior executives with the measurable substance that it takes to comply with Section 302. The rationale is sound and difficult to dispute.

Section 404 puts the spotlight on transaction-rich processes (like *payroll*, *HRIS* and *benefit administration*) that "feed" a company's financial reporting. Under Section 404, a company is required to provide an annual evaluation of its internal financial controls over financial reporting. This involves formal documentation and testing of existing controls, and a report that addresses any gaps, systemic problems and deficiencies.

Prior to issuing its internal control report, the company provides its internal control report to its public accounting auditor and asks the firm to "attest to, and report on, the assessment made by the management of the issuer."⁴ In order to make an accurate assessment of management's report, the auditor (which, incidentally,

must be registered with the Public Company Accounting Oversight Board – PCAOB) needs to substantiate the testing and evaluation process that its client did and perform its own test, in order to attest to the assertions of company management. Established by Sarbanes-Oxley legislation, the PCAOB is an independent, non-profit entity that adopts rules to help registered public accounting firms conduct effective audits.

By any reasonable measurement, Sarbanes-Oxley is not a quarterly or annual excursion for the accounting department, but a perpetual journey that involves the active participation of the entire management team. It is also an expensive and complicated new compliance burden for publicly registered companies.

So how burdensome is the road to compliance and how much will the trip cost?

3 "What You Don't Know About Sarbanes-Oxley," David M. Katz, CFO.com, April 22, 2003.

4 The obligations of Sarbanes-Oxley apply to public companies. References throughout this white paper to a "company" are intended to mean a public company "issuer" for purposes of the Act.

IV. THE PROCESS AND COSTS OF COMPLIANCE

Regulatory compliance is a big and growing burden

There is a longstanding tenet of American corporate enterprise: Regulatory compliance costs money. The only question is – *how much?*

Current expense estimates are staggering.

It is estimated that federally mandated regulatory compliance activities alone now cost U.S. companies nearly \$750 billion annually.⁵ A recent report disclosed that 61 federal agencies employed nearly 130,000 workers and spent almost \$20 billion just to regulate activities in the workplace.⁶ In 1960, similar expenditures were under \$2 billion. State, local and regional regulations only add more layers of cost to the overall compliance burden.

While some industries, such as healthcare, banking and utilities, operate in more highly regulated

environments than others, regulatory compliance in some shape or form affects every business in every industry to some extent. Two contemporary factors which add to the complexity of compliance include:

- 1)** the sheer number of government bodies that wield regulatory power (for example, there are about 1,000 separate jurisdictions that just collect employment-related taxes in the U.S.) and
- 2)** the propensity for most government rules and regulations to be proverbial “moving targets” – subject to a continuous and repetitive cycle of interpretation and change.

Uncertainty adds to the overall cost of compliance

Independent of rule and regulation changes that are promulgated

and evolve over time, new laws have a tendency to cause special compliance expenses due to uncertainty, because of a lag in time between promulgation and the establishment of bedrock operating rules. As one attorney for a leading Washington law firm puts it, “There’s a massive compliance cost associated with just figuring out what to do.”⁷

The Sarbanes-Oxley Act of 2002 is an excellent case study to support counsel’s apt observation.

With Sarbanes-Oxley barely a year old, everyone involved in compliance activities – from company/issuer to overseer – is still sailing in uncharted waters:

- 1)** The PCAOB is busy adopting rules for the conduct of effective audits (one new standard that has been proposed specifically requires auditors to follow PCAOB standards in auditing public companies)⁸,

5 “The Cost of Compliance...” Risk & Insurance, Lori Widmer, November 2001.
 6 “Federal Regulatory Costs, Staffing At Record Highs,” Nation’s Business, James Worsham, January 1999.
 7 Widmer, “The Cost of Compliance...”
 8 “Board to Consider Two Auditing Standards...” PCAOB, November 7, 2003, www.pcaobbus.org.

2) Audit firms are responding to rule adoption by committing resources to ensure they meet the PCAOB's compliance standards as registered public accounting firms,

3) The SEC, which has oversight and enforcement authority over the PCAOB, is busy adding staff "to provide enhanced oversight of auditors and audit services..." (The Act also increased the SEC's budget to \$776 million in fiscal 2003 to support a more robust enforcement program.)⁹

4) Many of the 7,000 or so publicly registered companies that must comply with the Act are actively budgeting people and other resources primarily to stay ahead of the compliance curve and avoid the "hot third rail" consequences of noncompliance.

Compliance cost estimates still vary significantly

Understandably, many people are attempting to put a price tag on Sarbanes-Oxley compliance

efforts. However, the newness of the law (no company has yet completed its initial compliance cycle) is contributing to a wide range of estimates:

- One survey indicates that "large-cap companies are spending an average of \$480,000 on software and IT consulting" just to meet the compliance requirements of Section 404 of the Act.¹⁰
- Another report that polled members of The Business Roundtable shows that prestigious membership is divided over the extent of compliance expenses, citing that half of the group's 150 members "said it would range from \$1 million to \$5 million."¹¹

If the size of company revenue proves to be an accurate yardstick for gauging how corporate managers are estimating the financial impact of compliance on their organizations, companies in the mid-to-large segment share a common concern.

About 6 out of 10 firms with revenues of \$1 billion or less, according to a recent survey by

a top accounting firm, expect Sarbanes-Oxley compliance to be costly. Agreeing with them are nearly 4 of 10 firms in the \$1 billion or more bracket.¹²

Although these projected estimates are disparate, there is one prevailing opinion that unites most observers – the cost of Sarbanes-Oxley compliance will surely involve a significant ongoing expense.

9 "Summary of Sarbanes-Oxley Act of 2002," AICPA, see Section 601: SEC Resources and Authority.

10 "Sarboxing," John Goff, CFO.com, June 26, 2003.

11 "Sarbanes-Oxley: Dragon or white knight," Del Jones, USA TODAY, 2003.

12 "Sarbox Costly? Yes It Is, No It Isn't," David M. Katz, CFO.com, February 20, 2004.

V. AREAS WHERE THERE MIGHT BE CAUSE FOR CONCERN

The responsibility for ensuring effective financial controls always resides with the publicly registered company that is required by Sarbanes-Oxley to report, document and attest to the accuracy of their financial details and procedures, and the effectiveness of their internal controls over financial reporting.¹³

Since public companies for the most part run the lion’s share of their finance and administration functions in-house, and internal systems by definition project an aura of finite control over the processes, methods and operating environment, ostensibly that might be a valid reason for corporate managers to breathe a collective sigh of relief. On the surface, the annual Sarbanes-Oxley requirement for company management and the company’s public accountants to document, test and certify that all “in-scope” processes have effective controls should be a proverbial “slam-dunk.”

However, several factors regarding in-house systems might be cause for concern.

First, no internal systems have been specifically built to comply with so far-reaching a law that was so recently enacted.

Secondly, a major study of internal payroll, HRIS and benefit administration systems has indicated internal systems contain certain “hidden” operating expenses that system owners never realized they were incurring, making ownership far more expensive than ever imagined. Thirdly, there is the inherent risk that hidden operating costs could also be the harbinger to system anomalies and other inconspicuous factors, which could produce an expensive surprise during a Sarbanes-Oxley internal control review.

Self-contained in-house systems must be documented to keep pace with change

The greatest benefit of managing administrative applications in a totally self-contained sys-

tems environment is internal control. However, with this ultimate convenience, flexibility and control comes some inherent challenges, not all of which are controllable.

From the moment a company assumes the complete burden of “owning” the system, processes, methods and operating environment in which payroll, HRIS and benefit solutions are created it must remain vigilant to deal with change. That’s because ownership includes the responsibility for making your system comply with regulatory requirements and associated costs that are either emerging on the horizon or have yet to hit the radar screen.

As a matter of fact, a close examination of the adjustments you may need to make to your system and internal processes to meet Sarbanes-Oxley requirements are likely to introduce you to system operating expenses you may never have realized you’ve been incurring,

13 “Myths and Realities of Sarbanes-Oxley,” Steve Wagner, FEI (Financial Executives International), www.fei.org/mag/Exclusives/12-03.cfm.

making system ownership far more expensive than you ever imagined.

An accurate snapshot of what in-house operations involve and cost concerning payroll and HRIS expenses, presented in a recent study, revealed that in-house systems are saddled by “hidden costs” that add to the actual cost of system output, such as processing paychecks.¹⁴ Some of the unaccounted for expenses include:

- Recurring system upgrades
- Labor costs incurred to process payroll
- Non-labor processing costs (facilities, third-party fees, etc.)
- Labor costs to maintain systems
- Non-labor processing costs to maintain systems (facilities, maintenance contracts, etc.)

The study concluded that the average cost of a paycheck produced in-house is \$16 – about 30% more than the cost per check produced by an outside service provider.

In addition, the study found that much of the functionality of in-house HRIS modules was not implemented. So, in effect, the unused software becomes expensive “shelf ware” that still incurs upgrade costs and maintenance fees. As with payroll, the cost of HRIS output is also higher because of costs that are not accounted for.

What does all this have to do with a Sarbanes-Oxley compliance discussion? Companies that choose to “build and maintain” their own *payroll, HRIS or benefit* applications incur far more than the expense of the investment in hardware, software, installation costs, people, physical space, maintenance, system upgrades and daily operating costs. Hidden costs could also be the precursor to system anomalies and other factors that could derail a favorable Sarbanes-Oxley internal control review.

The incremental burden on in-house overhead that Sarbanes-Oxley testing imposes is another consideration:

- 1) The company must document, maintain and test the effectiveness of their internal controls for these and other pertinent applications, and
- 2) The company’s external public accountants must then review and test the work by conducting a controls review. This dual process is required by the law, so the auditor can “attest” to management’s assertion that internal controls are in place and working as stated.

All of this activity comes with layers of cost: the known costs of system purchase, implementation, maintenance and upgrading; the “hidden costs” contained in those systems; the incremental expense of addressing anomalies and other factors associated with Sarbanes-Oxley testing and documentation.

The incremental factor of third-party assistance

Many companies run most of their finance and administration

Continued on the next page.

14 “The Total Cost of Ownership: Warning Signs of In-House Systems Costs,” PricewaterhouseCoopers, September 2003.

functions in-house, however what if a company outsources its *payroll*, *HRIS* or *benefit administration* to a service provider? Who then tests the internal controls for these processes – the company, the company’s auditor, the service provider or the service provider’s auditor?

While Sarbanes-Oxley compliance presents companies with challenges, there are resources that can help to alleviate some of the pain caused by compliance activities. For instance, some companies that have selectively outsourced certain applications to service vendors may in fact realize an auxiliary advantage in their compliance efforts from third-party assistance.

This unforeseen benefit is one that is accrued from a company’s earlier strategic decision – probably unrelated to Sarbanes-Oxley considerations – to simply not spend any more money than they have to in support of business functions that by definition do not contribute to the building of revenue or profitability. Instead of these firms making a major capital investment in a *payroll*, *HRIS* or *benefit* support system,

it is far more beneficial to let a qualified service provider assume the risks and costs associated with changing technology, ongoing maintenance and system upgrades.

Public companies that go to outside service providers for applications processing expect to leverage incremental value out of those relationships. Since outsourcing firms routinely work at improving their products, services, and processes and employ leading technology as a means of retaining and gaining clients, accordingly all of the benefits of outsourcing are not set in stone at the beginning of the business relationship.

Others are subsequently added. One of these involves valuable third-party assistance concerning Sarbanes-Oxley compliance.

Service auditors, engaged at the expense of many outsourcing service providers, test and document service provider product offerings, such as *payroll*, *HRIS* and *benefit administration*. In these instances, the majority of company management’s tasks related to Section 404 documentation and testing of internal controls are performed not by you, the client, but by the service

provider and its third-party audit firm. Substantiation of internal controls testing is delivered to service users annually in the form of a SAS 70 Type II Report. This document is acknowledged by the public accounting community to provide documentation and testing of the internal controls over outsourced processes in a format designed to minimize the work you must perform under Section 404.

The key fact to keep in mind about SAS 70 Service Auditor Reports is that not all SAS 70’s are equal.

There are basically two kinds of SAS 70 Reports – Type I and Type II

The Type I Service Auditor’s Report:

- 1) Describes the overall business and control environment,
- 2) Enumerates the control objectives,
- 3) Describes control techniques that are in place to achieve the control objectives.

A Type I Report includes an opinion that the description of

controls is presented fairly *on a specific date*, and that the described controls would be sufficient to achieve the control objectives (if all described controls were functioning).

The public accounting community has determined that a SAS 70 Type I Report WOULD NOT be sufficient to meet Sarbanes-Oxley's substantiation requirements.

The Type II Service Auditor's Report includes everything that is covered in the Type I review, plus:

- 1)** Tests the operating effectiveness of the control techniques,
- 2)** Reports upon every control exception,
- 3)** Increases the emphasis on the remediation process.

A Type II Report includes a third-party opinion as to whether the control techniques actually operated with sufficient effectiveness *during a stated period of time* to achieve the control objectives.

Companies that secure a SAS 70 Type II Report from their

service provider for each tested application would deliver those reports to their own external auditor during a Section 404 internal control review. That documentation potentially reduces or eliminates the need for the external auditor to conduct a test of the applications, which already have been scrutinized by a service auditor. The availability of SAS 70 Type II Reports (which pertain to *selective* business applications) from the service auditor of an outsourcing service provider will certainly aid a company's compliance efforts for specific applications, but by definition will not address all Section 404 compliance requirements. However, alleviating even a portion of the cumbersome and costly annual burden of substantiating internal controls for "in-scope" applications can measurably lighten the overall load on internal staff and budgets.

Quantifying the savings that most companies would accrue from reliance upon SAS 70 Type II Reports from their service providers is difficult, primarily because circumstances are likely to vary from company to company. The bulk

of the money saved by public companies that obtain SAS 70 Type II Reports from a service provider may not come from huge audit expense savings alone, but rather a reduction in their audit expense, as well as a much more pronounced saving from not engaging an in-house solution for certain applications (such as *payroll*, *HRIS* and *benefit processing*) in the first place. Notwithstanding the savings realized from lower monthly operating costs, remember that most decisions to outsource *payroll*, *HRIS* and *benefit administration* also involve another important dollar-related reason: the desire to mitigate risk through timely, accurate and substantiated compliance activities. SAS 70 Type II Reports are tangible instruments that can help companies realize that important goal and clear the high bar of Sarbanes-Oxley expectations.

VI. THE AUXILIARY BENEFITS OF COMPLIANCE ACTIVITIES

Meeting new regulatory requirements usually sends prudent, risk-conscious organizations into “battle stations” mode, encouraging an examination and re-evaluation of how things are done with an eye toward how to best ease the pain and expense of compliance.

This process of examination and re-evaluation is important to an organization for two significant reasons:

- 1) It helps the organization to focus on the immediate challenge, and
- 2) The search for the right solution can produce unintentional yet highly beneficial collateral effects –
 - Modernization of outdated, inefficient processes – Until recently, far too many corporate administrative processes were *paper-based, prime environments for fraud*. One example is the preparation, routing and approval of

employee expense reports. (Relevant facts: 45% of all companies are impacted by fraud and nearly a quarter of all fraud schemes are linked in some way to expense reimbursements.)¹⁵

Sarbanes-Oxley requires companies to do a better job of controlling fraud. As a result, cost-efficient *automated control and reimbursement systems are gaining a foothold*. The dual result is an aid to regulatory compliance and a systemic way to curb fraud, which one source establishes as \$60,000 per average incident this year.¹⁶

- Investing in new technology to enhance competitiveness – Organizations went through extensive evaluations of their internal systems and processes in response to perceived and real damage and risk from Y2K “computer bugs.” However, one of the biggest strategic side benefits of this massive upgrading effort with

a hard deadline was the implementation of *new systems and procedures* that increased organizational efficiency, and the ability to compete more effectively *going forward*.

- Establishing new rules concerning how to use corporate resources – For example, should a new compliance solution that generates no revenues or profits warrant a capital investment in new or expanded systems and staff?

Or should capital investments be limited to sustaining and expanding core business activities?

Sarbanes-Oxley compliance will undoubtedly give rise to its own share of ancillary benefits. Likely areas include accelerated evaluation of new technology solutions, especially those that are hosted by third-party providers.

¹⁵ “The Consequences of Non-Compliance,” Compliance Solutions (Sarbanes-Oxley), Concur Technologies, www.concur.com/solutions/compliance/default.htm.

¹⁶ Concur Technologies, Compliance Solutions (Sarbanes-Oxley).

VII. END NOTES

Some key thoughts to retain from this white paper:

- 1) Compliance is a perpetual process – a never-ending journey that needs to be taken.
- 2) Most companies should expect Sarbanes-Oxley compliance to appreciably add to their compliance burden.
- 3) The most important point about Sarbanes-Oxley compliance is to adopt a compliance strategy that makes the most sense for your organization. To aid your compliance efforts and take some of the burden off

your internal resources, take advantage of third-party assistance from providers of outsourcing services for administrative applications likely to be “in-scope” for Sarbanes-Oxley scrutiny.

Finally, avoid the temptation to get lost in all the details. Focus on the big picture. Sarbanes-Oxley isn’t about raising the level of pain and expense for public companies affected by the law. It’s about raising the high water mark of corporate integrity for all the boats in the harbor.

Deloitte partner Steve Wagner explains with brevity and candor why public companies

should actively adopt a positive attitude with respect to this landmark law: “If you do just enough to get by...you may find yourself in a quagmire of bloated controls, burgeoning expenses and enduring headaches,” he writes. “But if you embrace the spirit of the law – strong ethics, good governance, reliable reporting – you’ll get a re-energized company and reassured investors.”¹⁷

An important postscript: Don’t waste any time looking to shape an “end-game” strategy for Sarbanes-Oxley compliance. There is none. You just keep on playing.

17 Wagner, “Myths and Realities of Sarbanes-Oxley.”

**For more information about this white paper,
or to speak with an ADP representative,
please call 1.800.865.0397
or visit www.adp.com/compliance.**

VIII. APPENDIX

Selected Glossary of Pertinent Sarbanes-Oxley Terms

Public Company Accounting Oversight Board (PCAOB) – a non-profit entity, established by Sarbanes-Oxley legislation, that oversees the audits of public companies and adopts rules to help registered public accounting firms conduct effective audits.

Securities and Exchange Commission (SEC) – has “oversight and enforcement authority” over the Public Company Accounting Oversight Board.

Registered Public Accounting Firm – a public accounting firm that is registered with the Public Company Accounting Oversight Board, which has authorized the firm to conduct Sarbanes-Oxley-related audits of publicly registered companies.

Section 302 of the Sarbanes-Oxley Act of 2002 – compels company CEOs and CFOs to substantiate in each annual and quarterly report filed with the SEC that they: 1) have reviewed the report, 2) certified that, to their knowledge, it contains no misleading or untrue statements or omissions, 3) presented the company’s financial condition and results accurately and fairly, 4) attested that they are responsible for maintaining internal controls and have evaluated the effectiveness of those controls 90 days prior to each report, and 5) presented their conclusions on the effectiveness of those controls (including the disclosure of major deficiencies).

Section 404 of the Sarbanes-Oxley Act of 2002 – requires that companies in their Annual Report (Form 10-K): 1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and 2) contain an assessment of the effectiveness of internal controls over financial reporting.

Company/Issuer – a publicly registered company that, among other things, is required to issue an annual report on internal controls over financial reporting to the SEC under the provisions of the Sarbanes-Oxley Act.

Internal Control – a process designed to provide “reasonable assurance” that a company has reliable financial reporting, effective control over its operational procedures and is complying with pertinent government laws, rules and regulations.

Service Organization – a provider of certain services which have a bearing on a client’s financial reporting and internal controls.

Service Auditor – an auditor engaged by a service provider that reports on a service organization’s internal controls that could be relevant to a service organization’s product offerings to its clients.

Service Auditor’s (SAS 70) Report – a report by a service auditor concerning the description of a service organization’s internal controls, which can have a direct bearing on a user organization’s internal controls.

Type I (SAS 70) Auditor’s Report – includes an opinion that the description of controls is presented fairly *on a specific date* and that the described controls would be sufficient to achieve the control objectives (if all described controls were functioning).

Type II (SAS 70) Auditor’s Report - includes an opinion as to whether the control techniques actually operated with sufficient effectiveness *during a stated period of time* to achieve the control objectives.

SOURCES

The following sources were examined and utilized in the course of preparing this document:

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- * "The Cost of Compliance..." Lori Widmer, Risk & Insurance, November 2001.
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- * "Sarboxing," John Goff, CFO.com, June 26, 2003.
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- * "The Total Cost of Ownership: Warning Signs of In-House Systems Costs," Pricewaterhouse Coopers, September 2003.
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NOTES





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