## COSO Based Approach

### Phase 1 - Project Foundation (Scoping)

#### Organize Project

1. Identify Internal Control Definition
2. Identify Project Sponsor
3. Identify Team Members
4. Identify Roles, Responsibilities, and Resources
5. Identify Tool/Software Requirements and Needs (Excel? Or Other Program(s))
6. Identify Training Requirements and Needs

#### Develop Project Plan

7. Define Plan Objectives
8. Establish Critical Components and Paths for Timely and Successful Completion of Project
9. Define Key Performance Indicators
10. Define Milestones and Checkpoints
11. Identify External Advisors, if any.
12. Validate Approach with External Auditors

#### Risk Assessment

13. Determine Materiality (Overall and Planning)
14. Determine Significant Accounts and Disclosures
15. Assess Significant Accounts as High, Medium, or Low Risk
16. Identify Significant Processes and Business Units / Locations
17. Assess Significant Processes and Business Units / Locations as High, Medium, or Low Risk

#### Finalize

18. Identify Final Scope and Work Plan
19. Execute Pilot Program

### Phase 2 - Identify & Document Controls (Documentation)

#### Document Controls

20. Evaluate Internal Controls at the Entity-level (Entity-level Questionnaires, Surveys, etc.)
22. Determine Documentation and Testing Strategies
23. Inventory Existing Documentation (P&P Manuals, Job Descriptions, Process Owner Documentation, Internal Audit workpapers and reports, External Auditor workpapers, Spreadsheets used for Financial Reporting and Operational Processes)
24. Perform Walk-Throughs
25. Develop Narratives, Flowcharts, and Risk Control Matrices (RCM) for Significant Processes
26. Identify Key Controls Surrounding Processes (including Spreadsheet Controls)

### Phase 3 - Evaluation of Controls (Testing)

#### Perform Tests of Controls

28. Test Control Design Effectiveness
29. Test Control Operating Effectiveness
30. Test Key Controls
31. Test Spreadsheet Controls (i.e. Calculations, Sorting, Proper Re-Calculation, etc.)

#### Remediate Issues

32. Preliminary Evaluation of Controls
33. Agree on Action Plan to Remediate Issues
34. Formalize Timing for Remediation
35. Track and Report Progress on Remediation

#### Re-Tests and Update Documentation

36. Re-test Failed Controls
37. Report on Control Effectiveness
38. Update Documentation
39. Develop Year-End Requirements

### Phase 4 - Document Results

40. Perform Year-End Update
41. Document Significant Changes to the Control Environment, Re-test if necessary
42. Establish Monitoring Systems
43. Management's Report on Internal Financial Control
44. Independent Auditor's Report on Management's Evaluation

---

(1) Refer to PwC July 2004 Whitepaper titled 'The Use of Spreadsheets: Considerations for Section 404 of the Sarbanes-Oxley Act'
J. Closing Thoughts on Efficiency

Most will agree that the Section 404 requirement has improved the quality of internal control systems through increased attention by both management and the external auditor. However, there is less than universal agreement that the improvement has been justified relative to the enormous cost.

The following checklist may help management teams ensure their Section 404 program is efficient.

1. Has operating management taken ownership of their processes and documentation, rather than leaving it to the Section 404 team or the internal auditing function?

2. Does operating management update all process and control documentation promptly throughout the year and not just when testing starts? Is there an effective change management process in place, including the timely assessment of process changes for their potential impact on key controls?

3. Is operating management committed to assess and remediate all control deficiencies promptly? In situations where remediation is not justified based on management’s assessment of risk and cost, is management committed to communicating that decision promptly so the effect on management’s overall assessment of controls can be identified and discussed with senior management?

4. Has a top-down, risk-based approach been used to identify the key controls? Is management confident that all identified key controls are truly key? Has the design of the related processes been reviewed to determine if changes can result in fewer and more effective controls, relying more on automated controls or on higher-level controls (e.g., detailed reconciliations and flux analyses)? The fewer the controls to test, the lower the cost.

5. Is management of the Section 404 program at a sufficiently high level within the organization to:
   - Influence operating management relative to completion of their responsibilities?
   - Communicate effectively with executive management the program’s progress and potential issues?
   - Negotiate as needed with the external auditor (e.g., to increase reliance on management testing, agree on key controls early, and address concerns as they arise?)
6. Is the use of internal resources optimized, including the use of internal auditors to perform testing or to validate testing performed by management staff?

7. Has overall staffing been optimized, reducing reliance on more expensive external consultants and testers?

8. Has reliance by the external auditor on management testing been optimized?

9. Does the external auditor follow a top-down, risk-based approach as required by AS 5?

10. Is there a detailed project plan:
   a. That includes a walk-through of all significant processes early in the year, preferably in the first quarter?
   b. With testing scheduled in such a way that all key controls are tested by mid-year, with additional testing to update the results scheduled closer to year-end? This enables the external auditor to start their walkthroughs and testing early, providing time for management to address and remediate any deficiencies identified in either management or external auditor testing.
   c. That includes all key activities required to complete the program, such as fraud risk assessment, consideration of any end-user computing issues, assessment of SAS 70 reports from service providers, etc.?
   d. Detailing all required resources, including specialists (e.g., for IT or tax processes and controls), so they can be scheduled early?
   e. With regular reporting to senior management that focuses on key metrics and issues, such as:
      - Progress against timetables, highlighting steps that are or may be behind schedule?
      - Percentage of key controls tested compared to their scheduled completion level?
      - Number and percentage of key controls that are failing?
      - Number of failed controls that are potentially significant to the Section 404 assessment?
      - The number of failed controls where remediation will not be completed within 30 days, so senior management can focus on a timely completion?
      - The number of key controls where remediation and retesting may not be completed with sufficient time for the external auditor to retest (these are likely to be open deficiencies at year-end)?
      - Costs to date and projected through the end of the year?
      - Potential resource issues?
      - Other issues, such as coordination and concerns raised by the external auditor?
11. Has there been communication and coordination with all service providers to ensure that a SAS 70 type II report will be available at the appropriate time, and that early warning is provided of potential deficiencies being identified during the SAS 70 audit?

12. Finally, is the Section 404 program itself assessed for effectiveness on a continuing basis, to ensure it is improved as the organization learns from experience and benefits from changes in regulations or their interpretation?