

Federal Corporate Compliance: *Projected Effects on the Optical Storage Market*

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Discussion

- **Recent history of Federal Corporate Compliance**
- **Specifics of the Sarbanes-Oxley Act of 2002**
 - **Business process perspective**
- **SOX Compliance and the OS Marketplace**
- **Knowledge Management and ITOs**

Federal Government & Internal Corporate Controls

Securities Act of 1933; Securities Exchange Act of 1934

- Established Corporate reporting procedures still in place
- Certain sections updated by the Sarbanes-Oxley Act of 2002

Treadway Commission, 1992

- Convened due to corporate failures of 1980s (Union Carbide disaster in Bhopal; Prudential insurance fraud cases, among others)
- Report establishes a recommended internal controls methodology, commonly referred to as COSO

Federal Government & Internal Corporate Controls

Sarbanes-Oxley Act of 2002 (SOX)

- Enron; Tyco; WorldCom; Global Crossing ...
- Treadway is revisited ... the financial controls piece is dusted off and scrutinized
- Public companies AND auditors under a microscope
- Corporate financial reports: CEO, CFO and Auditors must publicly verify info is accurately depicting their business
- Consequences: up to \$5M fine, up to 20 years in prison
- Establishes the *Public Company Accounting Oversight Board*

***Legislative reaction to corporate scandals:
Congress sensed transgressions were at the Board-level in
their dealings with Auditors, and they were correct***

SOX: Details and Implications

Places pressure on Executive / Board level

- Ignorance is NOT bliss: \$1M, 10 years in prison for certifying a financial report that is found to be unrepresentative of a company's financial status

Compliance driven by internal controls processes that are managed at Operational levels

- Internal and external audit agencies required to ensure companies have controls in place that can accurately assess their financial situation

*Hours defining processes; hours testing these processes;
significant documentation requirements*

SOX: Analysis, Identification, Documentation

Effectively addressing SOX compliance

- The heart of SOX is holistic controls, NOT a quick fix ...
- Enterprise-wide analysis and knowledge management

Requires complete analysis of financial reporting processes

- ✓ Identification of the underlying supporting processes AND the inherent risk levels
- ✓ Identification of the key controls that offset those risks
- ✓ Internal testing to validate the effectiveness of those controls
- ✓ External testing by the CPA firms to confirm the results of the internal testing
- ✓ Opinions in the annual financial statements from the CPA

SOX: Documentation

Specific Documentation requirements

- An auditor must retain records for 5 years (Sec 802)
- PCAOB (Fed Govt) must retain records for 7 years (Sec 103)
- GAAP: “life of the document + 7 years”

Companies generally keep critical financial data for 7 years

Magnetic Media is not suitable for these applications!

SOX and OS Markets

Significant market effects for OS technology on multiple fronts:

- **Consulting and Auditing Products: SOX Compliance Modules** from software companies, consulting firms
- **Holistic controls analyses: processes analyzed and re-built**
- **Finances of compliance: Up to 50% of 2004 auditing budget allocated for SOX – up 1.5–2X from 2003 totals**
Companies must reduce costs of audit in 2005

Companies will want to investigate efficient storage/recall of 2003 and 2004's costly documentation.

Holistic KM and ITOs

Imagine a company in which information is culturally managed at the lowest possible level

- ***INFORMATION TECHNOLOGY requirements, assessments and eventual purchases are managed within the line***
 - ***Corporate ITOs are free to manage corporate KM policies, procedures and are relieved of the day-to-day maintenance of the IT plant***
 - ***The downward distribution of IT plant responsibilities reinforces in each line manager that he or she is solely responsible for their BU's information and the decisions made from that information: that BU's corporate knowledge***
- ***This describes an environment in which SOX is complied with in an organizational manner and will enhance that company's ability to compete in any environment.***

Summary

- ✓ **Federal Corporate Compliance in the form of SOX is here to stay and carries heavy penalties for non-compliers – affects public companies and auditors**
- ✓ **SOX: Executive requirements stemming from understanding the financial controls at the operations level**
- ✓ **OS Marketplace positively affected by the solutions being developed and the attention/\$\$ being spent**
- ✓ **The future?: knowledge management at the line level**

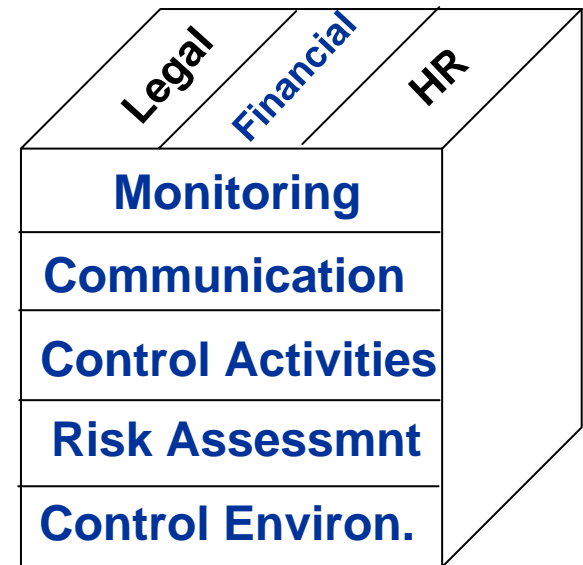
Backup / Details

COSO: Organizational Process Control

An effective system of internal controls requires all 5 COSO components working together –

Control Environment
Risk Assessment
Control Activities
Information & Communication
Monitoring

Everyone in the organization plays an active role



Effective Internal Controls require attention at all business levels

SOX Statistics

PricewaterhouseCoopers Management Barometer survey of 177 top execs (from IM&A):

- Nearly half the respondents (46%) report that expanded corporate reporting resulted in higher IT budgets: 11 % increased their IT budget considerably; 35%, moderately.
- In the next 12 months, **51% are considering adopting new technologies** to improve their companies' current reporting infrastructures. Another 11% are still evaluating options.
- More service businesses (60%) than product sector companies (48%) are considering new technologies.
- Tools companies use for enhancement of data access, control and reliability include enterprise resource planning (40%) and **data warehouses (39%)**.
- [Only] 44% said their companies track and report internally on the **costs** of Sarbanes-Oxley and other compliance programs.
- Nearly all (93%) of the responding executives expect to initiate process improvements to streamline future Sarbanes-Oxley compliance.

The Public Company Accounting Oversight Board (PCAOB) surveyed 500 big companies in mid-2004. 19% haven't even started compliance reviews; 32% have just begun; 15% are about ready to go; 20% are beginning to implement the rules; 8% are almost compliant; and a mere 5% are fully compliant.

FEI in Sept 2004: survey of 248 audit prof's of companies > \$1B revenue: half are <60% compliant and 67% have no annual budget to maintain SOX compliance

A framework to manage evolution and transformation

- **Processes are the lifeblood of an organization ... and are as important as the products and services of an organization**
- **By managing your processes, you can more easily adapt to a faster-than-ever changing marketplace**
- **The Systems Approach**
 - Ensures entire problem set is captured
 - Identifies all interdependencies
 - Agile and flexible
 - Strategy, operations & infrastructure are linked and addressed concurrently

***Enterprise Process Management:
understanding the problem, adapting to any issue***

Strategic thinking has been forever changed with the introduction of new technologies

- **Strategic elements must be analyzed with factors that are more removed from the direct subject**
- **Assumptions must reflect dynamics introduced by elements not previously part of the business**
- **Analysis must be extended to include customer and vendor enterprises**
- **Focusing on core value propositions is important, but non-core elements are also critical to the success of an organization**

Analysis must span the entire enterprise from customer to vendor