CORPORATE BOARDS **USA**

Boardroom Fundamentals 201
Module 3: Disclosure Controls and Internal Control over Financial Reporting

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DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

After collapse of Enron, Congress enacted the Sarbanes-Oxley Act of 2002 (SOX)

Cornerstone of SOX is a requirement that the CEO and CFO certify the financial statements

To enable this certification and to give assurance that financial statements are accurate and complete, SOX requires the implementation of disclosure controls and an annual assessment of the effectiveness of internal control over financial reporting

DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

SEC Definition of Disclosure Controls:

- Controls and other procedures designed to ensure that information required to be disclosed by the issuer in all the reports that it files under the Securities Exchange Act of 1934 is (a) recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms, and (b) accumulated and communicated to the issuer's management, as appropriate to allow timely decisions regarding required disclosures

DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Examples of Disclosure Controls:

- A Disclosure Committee consisting of senior management from across business lines to elevate and discuss matters that may require disclosure in SEC filings
- Documented controls for identifying, collecting and updating information
- A formal reporting process that ensures that significant information bubbles up to senior management for disclosure purposes
- A sub-certification process for mid-level personnel to certify disclosures pertaining to their area of responsibility
- Reporting results of Disclosure Committee deliberations and sub-certification process to the Board Audit Committee

DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

SEC Definition of Internal Control Over Financial Reporting:

- A process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external consumption in accordance with GAAP

DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting includes policies and procedures for addressing:

- The maintenance of records that accurately, fairly and in reasonable detail reflect transactions involving, and dispositions of, company assets
- Reasonable assurance that transactions are recorded as needed to permit preparation of financial statements in accordance with GAAP and that receipts and expenditures are made only in accordance with management authorization and
- Reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of company assets

DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Companies and their independent public accountants will test controls as part of the financial statement audit to determine whether any deficiencies exist:

- Control deficiency—design or operation of a control does not allow management to prevent or detect misstatements on a timely basis
- Significant deficiency—less severe than a material weakness yet important enough to warrant oversight and attention
- Material Weakness—reasonable possibility that a material misstatement of the company's financial statements will not be prevented or detected on a timely basis

Material weaknesses must be publicly disclosed

Questions?

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End of Module 3

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