

Contingent Workforce strategies™

Keeping Your SOX Up

By Bridget Mintz Testa

It probably would not be overstating matters to say that the Sarbanes-Oxley Act has changed corporate finance in the U.S. Contingent work is making it possible for companies to survive that transition.

Following public outrage over the financial debacles of Enron, WorldCom, Tyco and other mismanaged corporations that opened the new millennium, Congress passed the American Competitiveness and Corporate Accountability Act of 2002, colloquially named for its authors the Sarbanes-Oxley Act, quickly shortened to SOX. Applicable to any company listed on a United States stock exchange and enforced by the U.S. Securities and Exchange Commission (SEC), the act requires companies to tighten financial controls and audits. CEOs and CFOs have to sign off, literally, on the accuracy and truth of their financial reports. Intentional mis-statements in these reports can earn corporate executives prison terms of up to 20 years and fines of up to \$5 million.

SOX compliance reports must be filed with the SEC within 75 days of the end of a company's fiscal year. Companies whose fiscal year ended on Nov. 15, 2004, were the first required to file (although some received an extension). Filing deadlines for all other companies will occur throughout 2005 and even into 2006, depending on their fiscal year-end

dates. Foreign businesses must file this year as well.

Meeting these deadlines has both stretched and stressed the resources of many companies, and a substantial number have made the strategic decision to turn to a contingent workforce to make compliance work without impacting other financial operations.

"Lots of spending for SOX is for a contingent workforce," says John Hagerty, vice president of research at Boston-based AMR Research. The company surveyed 200 business and information technology executives last fall and found that, of the total \$5.5 billion spent on SOX compliance in 2004, \$1.8 billion — close to a third — went to pay for contingent employees. This year, \$1.7 billion of the total \$5.8 billion in compliance costs will be spent the same way, AMR projects.

The largest companies likely have the resources to deal with SOX compliance, says Sondra Kiss, vice president of business development for San Francisco-based M² (M Squared), which provides consultants for management, finance, accounting, human resources, IT, operations and marketing projects. But those are relatively few; most companies aren't staffed to handle to increased burden. "The small and medium companies don't have the internal audit staff or expertise," Kiss says. "This is the group that's feeling the most pain and needs the most contingent help."

These placements are occurring in several areas of professional specialization. Here's how some organizations are meeting the challenge.

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Using
contingent
workers is
a smart
solution to
Sarbanes-Oxley
requirements

Accounting and Finance

One that's feeling the SOX pinch is Invitrogen Corp., a global life science technology company headquartered in Carlsbad, Calif. Despite an international finance and accounting staff of 180 people, the company lacked internal expertise in audits and financial controls sufficient to manage SOX compliance. "We brought that [skill set] in," says John Radak, vice president of finance and chief accounting officer at Invitrogen.

Radak brought in two M² finance and accounting experts and two from Resources Connection of Costa Mesa, Calif., to work on SOX compliance in North America. Three of the four stayed for six months, from April through September; the fourth stayed longer. Radak also brought in four additional finance and accounting consultants, again two from M² and two from Resources Connection, to work for one month in Japan, Scotland and New Zealand on SOX compliance. The consultants did the documentation and testing work that the statute requires to prove not only that the numbers add up but also that corporate financial reports adequately reflect the state of the company.

This isn't a trivial job. "The initial effort to comply with SOX is a huge undertaking," Radak says. "Even if I took people internally [to work on SOX], I'd have had to backfill with temporary or permanent employees. I was going to incur the incremental costs no matter what, and I preferred not to use internal personnel."

Three factors contributed to Radak's decision. First, Invitrogen's staff lacked the required audit and control knowledge. Second, the initial compliance effort constituted a one-time personnel requirement, both in the U.S. and globally. "The contingent firms allowed us to easily find those workers locally," Radak says.

Finally, he notes, choosing to shift core staff to SOX compliance and bring in contingent employees for the regular financial work would have forced steep learning curves on both groups. Having each set of workers perform tasks they already knew eliminated this extra training. Radak says, "It was less risky to have the contingent workers do the SOX work than to have them backfill our regular workers."

Because SOX compliance is both specialized and seasonal, it often doesn't make sense to train for it in-house. Many other companies have made the same choice to bring in outside expertise. According to Staffing Industry Analysts, the company that publishes this magazine, accounting and finance staffing firms grew 13.5 percent in 2004, reflecting corporate demand. To meet that need, specialist accounting and finance staffing companies have

developed a pool of experts who are leading SOX projects and performing audits and controls for corporate clients. And where companies choose to pull employees away from other financial duties to work on SOX compliance reporting, finance and accounting staffing firms are reporting demand for personnel to replace them for general accounting tasks.

Only very large companies are likely to have sufficient in-house resources.

Technology

The Sarbanes-Oxley law was enacted because corporate executives lied about financial matters. This historical

fact has generated a widespread assumption that SOX only addresses finance. "Many organizations framed SOX in financial terms only," says Hagerty of AMR, "but it quickly became obvious that IT was involved in [financial] controls."

Kiss, who oversaw M²'s work for Invitrogen, says that after her consultants worked on the financial side there for a few months, it became clear that the company needed to bring in IT experts as well. "This is a typical lag between finance and accounting and IT," she says. "The realization that IT is necessary in SOX is not immediate."

Ultimately, Invitrogen had five M² IT consultants working on SOX-related issues as well. They came in June and stayed through September. Radak says the M² IT personnel took on the documentation and testing of finance-related IT processes and controls, particularly those involving the company's enterprise resource planning (ERP) system. This is probably the most significant SOX area for IT, since ERP is entwined in every activity, from the most mundane purchases of paper clips and notepads to the most sensitive strategic initiatives. Because of that, "IT touches everything," Kiss says.

Legal Counsel

Any new law gives lawyers more work to do, and SOX is no exception. "There is no question but that the requirements of SOX have increased the need for legal advice and therefore the people who are providing it," says Stan Keller, a partner with Boston law firm Palmer & Dodge. There is a question, however, as to whether SOX is driving public companies to use more contingent attorneys.

SOX requires expertise in audits and controls from accountants. From attorneys, it requires wide and deep expertise in compliance law. "Sarbanes-Oxley compliance work requires such a level of dedicated, multidisciplinary work that it would be difficult for a contract lawyer to master the subject

based on general legal knowledge,” Keller says. “Palmer & Dodge has had to dedicate experienced resources on a group basis to develop compliance expertise and maintain it as requirements change.”

In addition, many company details — among them its

business practices, risk profile, personnel and culture — influence the shape of an effective compliance program. That mix of compliance knowledge and intimate familiarity with the specific company isn’t something the average contract lawyer could be expected to master quickly, in Keller’s opinion.

SOX Appeals to the Privately Held

Pivate companies also are saying “yes” to SOX — and they’ll need contingent expertise to help reach compliance.

Because it applies only to companies that trade on stock markets in the United States, the Sarbanes-Oxley Act of 2002 does not require private companies to meet its stringent auditing and financial controls. Yet many private companies appear willing to comply voluntarily with at least portions of SOX.

This trend comes in spite of soaring estimates by public companies of the costs of mandated compliance. In January 2004, Financial Executives International (FEI), a 15,000-member corporate financial advocacy group based in Florham Park, N.J., asked public companies with average yearly revenues of \$2.5 billion about the fees they expected to pay auditors for SOX Section 404 compliance efforts. (Section 404 requires the management of a public company to assess the effectiveness of its internal controls over financial reporting.) At the time, their chief financial officers estimated individual corporate compliance costs at an average of \$1.93 million. By July (the latest information available), that estimate had risen to \$3.14 million, a 62 percent increase.

These numbers don’t appear to scare private businesses. Last September, the FEI teamed with the City University of New York’s Zicklin School of Business to survey 224 CFOs, 144 of whom worked for private companies. **Nearly 60 percent of the private-company CFOs said their companies planned to comply with some portions of SOX.**

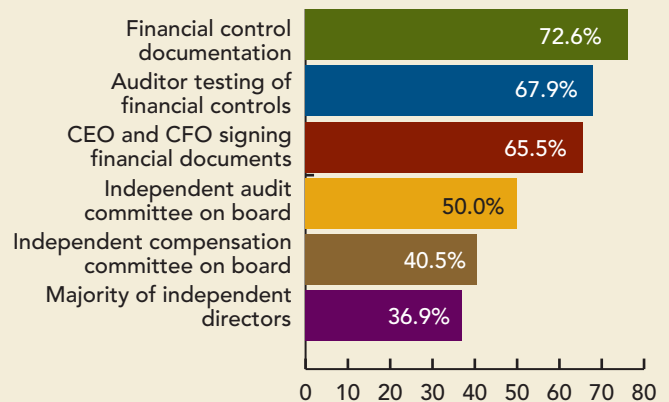
“Many private companies recognize that some of the provisions of Sarbanes-Oxley are simply good governance and management, and they are voluntarily adopting them,” says Colleen Cunningham, FEI’s president and CEO.

Private companies have several additional reasons for voluntary compliance, according to John Hagerty, vice president of AMR Research in Boston. Planning to go public is perhaps the strongest motivator. Hagerty says a company planning an initial public offering would have

to adopt SOX compliance measures first, so doing so early will speed the journey to a timely IPO.

The possibility of being acquired is another reason to embrace SOX. “A buyer may want some assurance that the proper controls are really in place,” Hagerty says. A third motive is that investors, including banks, may want more transparency into a company’s financial operations and results, which SOX provides. Finally, according to Hagerty, SOX compliance may simply become a “best practice” and thus standard by 2008.

Which aspects of the SOX requirements do private companies plan to meet? Based on the CFO responses to the mid-September survey, the FEI and Zicklin School of Business forecast these percentages of private companies that will comply with different SOX requirements:



Just as public companies are turning to contingent help today to meet the demands of SOX, so will private companies. And perhaps more so. Privately held businesses tend to be smaller than many public companies, and so may have in-house less of the expertise necessary to bring them into compliance. Since the pressure of a hard-and-fast deadline won’t be there, the need for contingent workers may not be as dramatic as it currently is for public companies. But it definitely will be there.

This need not rule out all contract legal involvement in SOX, however. “There can be an exception if there is a dedicated effort to develop the expertise and provide it on a consulting basis,” he adds.

At legal staffing company Contract Counsel of Royal Oak, Mich., recent client requests appear to affirm Keller’s view of the challenge SOX poses for contingent attorneys. The staffing supplier is seeing strong demand for compliance specialists, according to Mark Grobbel, business development director, but they aren’t being sought on a contingent basis. “When a client brings in a compliance person, 98 percent of the time it’s direct hire,” he says.

But there may be other work for contingent lawyers related to or derived from SOX. For example, one client brought in Contract Counsel attorneys to review contracts for liabilities that might be incurred by company executives signing off on SOX financial reports. Grobbel also sees cases where companies relieve legal staff of existing responsibilities and put them to work on compliance. “This leaves a hole that the company fills with contract, a combination of contract and direct hire, or direct hire,” he says. “The hole might be filled by someone who needs to prepare and file SEC reports or do general legal work such as reviewing and negotiating contracts or spearheading transactions. It wouldn’t be litigation or employment.” In contrast to finance and IT, then, it’s more common in the legal arena to see contingent workers provide support for those doing the specific SOX work.

SOX Forever

Though many companies undoubtedly wish it were so, SOX compliance is not a one-time event. The law establishes ongoing requirements for quarterly and annual reporting. Any time a company makes major changes in its operations, all those changes must be documented and tested for compliance.

As a result, Invitrogen for one has added a full-time employee dedicated to SOX maintenance. “We can handle it internally unless something major occurs, like implementing a new ERP

system,” Radak says. “That has to be re-documented, re-tested, everything. Or if the company makes a significant acquisition, we have to make the acquired company SOX-compliant.”

If such significant business changes occur, Radak says he’ll bring in consultants. Indeed, that’s his plan any time the company needs additional non-permanent help. “I staff for normal requirements,” he says. “I bring in external resources for the peaks.”

As 2005 proceeds, public companies will keep wrangling with SOX compliance, and Hagerty says that they will likely hire contingent employees. Many private companies have voluntarily chosen to comply with at least portions of SOX, and they will probably bring in contingent help as well. Nonprofit organizations and state and local governments are also potential SOX candidates — and they’ll also likely turn to contingent help.

The next phase of SOX-mediated change in corporate finance is likely to be to develop business processes that have SOX compliance is built in. And of course when core business systems are replaced or migrated, new SOX compliance baselines must be established.

Sarbanes-Oxley compliance thus becomes yet another object example of the strategic value of contingent workers. It is work that must be done, involves core business processes and requires specialized expertise, yet it is episodic. A company certainly could hire traditional employees to do the compliance work, but they would become a fixed cost on the annual budget.

“The challenge for companies,” Kiss says, “is that SOX requires a high level of expertise. They might normally go to a Big Four accounting firm for help, but the Big Four are so much in demand right now that their rates have skyrocketed. Companies must get the expertise, though, and that means hiring contingent experts that don’t have the Big Four rates or overhead.”

When core business systems change, new SOX compliance baselines are needed.



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