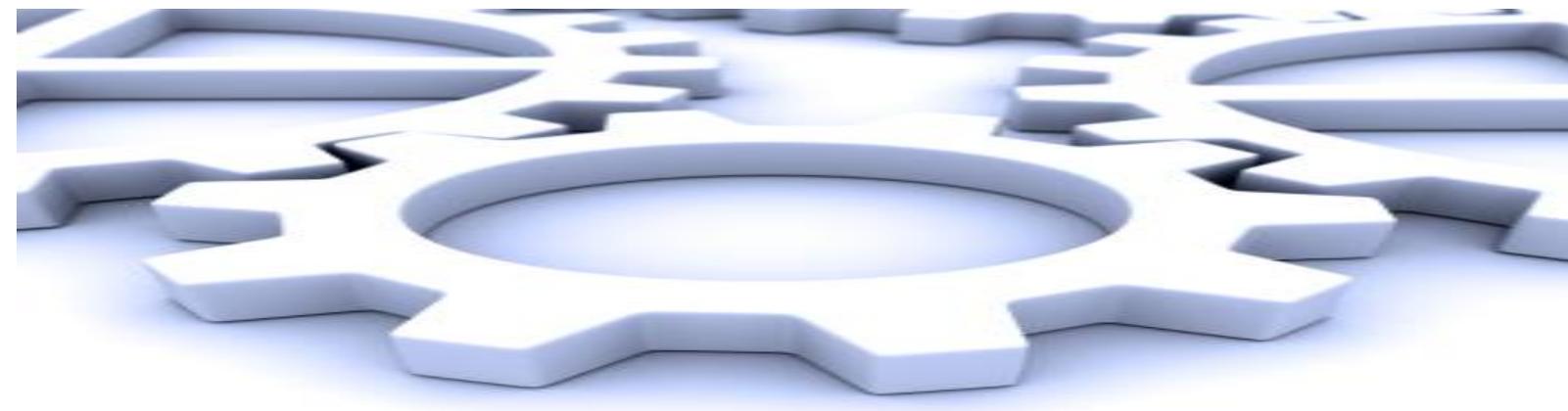


# Sarbanes-Oxley 404(a)

Efficient, Effective Consulting Solutions



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## **Standardized Solution to Sarbanes-Oxley Compliance**

We have developed a standard Sarbanes-Oxley solution for use by public companies and private companies looking to evaluate and strengthen their internal control structure. The tools used in this solution have been implemented by more than 20 companies of all sizes and vetted by multiple audit firms.

Our customizable, scalable solution involves a full-scale implementation sufficient to allow management to meet the requirements of the Sarbanes-Oxley Act under Section 404(a). See Appendix A for a synopsis of those rules and the process.

### **SOX in a Box?**

While every business is different, the concepts of internal control can be applied similarly across many industries. Our process involves understanding your business and then leveraging our existing database of controls to properly document your existing controls and offer you effective solutions for where you have gaps. We also can provide an extensive array of documents and templates you can use to round out your controls. It isn't a one-size-fits-all, off-the-shelf solution, but we avoid having to recreate documentation that would otherwise waste time and money.

### **The Value Proposition**

We are able to utilize our vast experience and our proprietary tools, templates, knowledge repositories and databases to deliver a comprehensive solution. We stick to firm deadlines and fixed fee quotes. Our motto is "we provide quality work, on time and on budget" and only the rarest of circumstances result in a deviation from this pledge.

### **About Us**

Founded in 2004, we are a CPA firm whose exclusive focus is to provide project-oriented accounting consulting services. Our goal is to serve as an extension of our clients' accounting departments by making the talents of a world-class finance and accounting team accessible to clients of all sizes. SOX 404 consulting and SEC compliance outsourcing are core competencies of our firm, comprising approximately 30 percent of firm revenues.

### **Why Use Us?**

#### ***Experienced Personnel***

We utilize full-time, dedicated consultants, many of whom have a minimum of 10 years of experience in public accounting, industry and consulting. We hand pick our people from our extensive connections within the Phoenix finance and accounting communities.

Your engagement will be overseen by the founders of the firm who are director/executive level individuals that take a hands-on approach to management. Planning, documentation and testing will be performed by one or more of our experienced consultants as needed. The combination of experienced individuals and effective oversight leads to a high quality engagement.

### ***Leverage Existing Work***

We have a repository of research memos, sample processes, existing databases, and methodologies that we have developed over years of work. As they say, why reinvent the wheel? Because many internal controls are common across organizations of all industries, we bring a multitude of pre-formatted documentation and tools to reduce the time spent identifying, documenting or implementing controls. These documents are then custom-tailored to your organization to create a comprehensive SOX solution.

### ***Continuity***

Our consultants are available to our clients as needs arise throughout the year. There are significant efficiencies to be gained by using a team that is familiar with your business. We have served our clients on average for more than 5 years.

### ***Track Record of Success***

We have experienced 10 straight years of continuous growth, primarily driven by referrals from happy clients and their auditors. Our singular focus of providing outsourced accounting solutions allows us to provide excellent service at reasonable rates.

## **Sarbanes-Oxley Consulting Experience**

We have SOX 404 experience with companies of all sizes. Our practice director led the first-time global engagement for a \$2 billion semiconductor company with 45 legal entities. Since that time, we have participated in internal control evaluations of companies of all sizes, ranging from start-ups to multi-billion dollar organization. SOX 404 engagements for large companies differ significantly from those for smaller public companies. As such, we have spent a considerable amount of time developing SOX 404 solutions for smaller public companies that can be implemented at a reasonable cost. Our engagement team members have strong backgrounds in internal controls and SEC compliance. In addition, they have strong project management skills to provide a structure for success. We frequently update key stakeholders through timely reports concerning existing status, project plan, remediation activities, etc.

## **Fixed Fee Engagements**

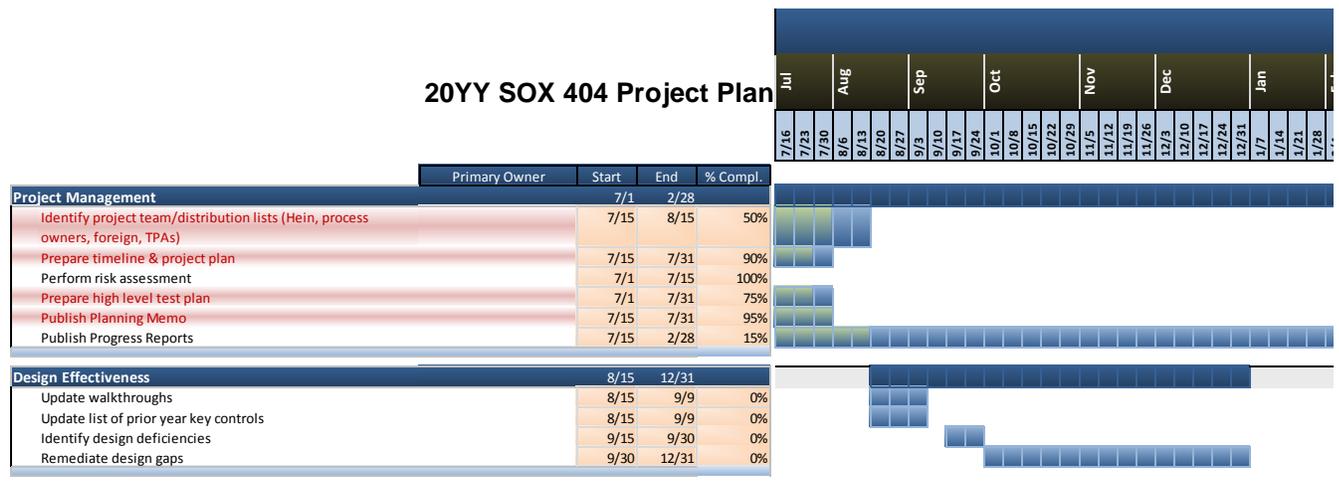
Many SOX engagements are open-ended with the theory being that the amount of work that is to be done is not known. We disagree. Based on our experience, top-flight individuals and our knowledge repository, we can accurately predict the amount of time it will take to complete the engagement from the completion of a short questionnaire and a brief interview.

## Our Key SOX 404 Deliverables

Listed below are descriptions and samples of our key deliverables.

### Project Plan / Gantt Chart

We begin with the end in mind. We determine our deadlines and work backwards from there. Time permitting, we schedule multiple rounds of testing to allow us to identify control weaknesses, implement remediation activities, and retest prior to the reporting deadline, in order to reduce the risk of any reportable control deficiencies.



### Planning Memo and Risk Assessment

Comprehensive planning of the SOX 404 engagement is important to ensuring that all COSO and SEC requirements are adequately addressed. The objectives of our planning process are to:

1. calculate materiality levels;
2. identify business developments impacting the organization;
3. identify all financial reporting processes and systems;
4. identify significant processes and locations;
5. evaluate the status of previously identified control deficiencies (if applicable);
6. address the impacts of any third party service providers (if any);
7. specify the deliverables to be provided during the engagement; and
8. establish the project timeline.

The risk identification and analysis process considers both quantitative and qualitative factors which are used to focus the scope of the SOX 404 assessment effort and determine the evidence required. This includes analyzing the impact of each account on the financial statements, the volume of activity, centralization of controls, susceptibility to fraud, subjectivity and complexity of account, etc. A thorough risk assessment process includes:

1. identifying significant financial reporting elements (accounts or disclosures)
2. identifying material financial statement risks within these accounts or disclosures
3. determining which entity-level controls would address these risks with sufficient precision
4. determining which transaction-level controls would address these risks in the absence of precise entity-level controls
5. determining the nature, extent, and timing of evidence gathered to complete the assessment of in-scope controls.

Samples of risk assessment planning tools are as follows

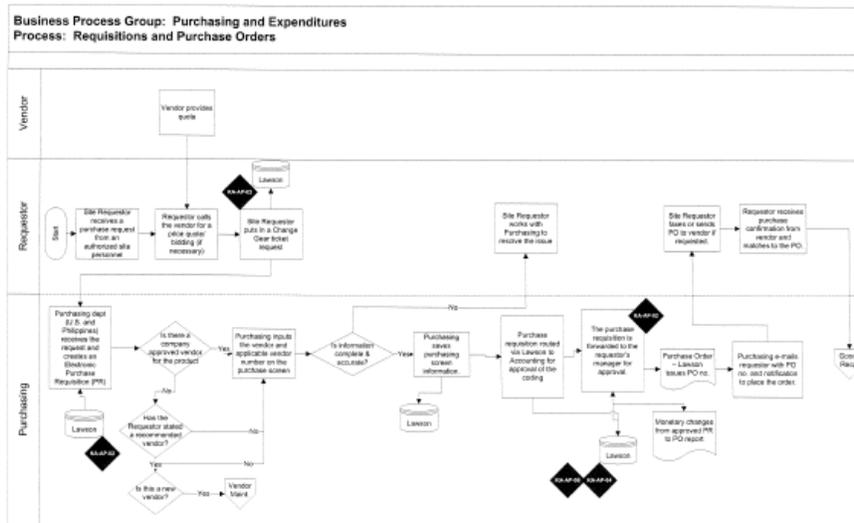
Cycle	Impact on Financial Statements	Complexity of Process / Disclosures	Subjectivity / Use of Estimates	Volume of Activity	Degree of Change
Weight	200%	200%	200%	100%	100%
<b>Revenue &amp; Receivables cycle</b>					
Customer set up	Med	Med	Low	High	Med
Pricing	Low	Med	Med	Low	Low
Customer database management	High	High	Low	High	High
Billing	High	High	High	High	High
Cash receipts	High	Med	Low	Med	Med
Returns and cancellations	Med	Med	High	High	High

Financial Statement Account	Treasury	Revenue & receivables	Purchasing & payables	Fixed Assets	Payroll	Taxes	Equity	Financial Reporting	Entity	General Computer Controls
Cash and cash equivalents	X	X	X	X	X			X	X	X
Restricted cash	X							X	X	X
Short term investments	X							X	X	X
Accounts receivable, net	X	X						X	X	X
Credit card processor holdbacks	X	X						X	X	X
Inventory		X	X					X	X	X
Prepaid expenses & other current assets			X					X	X	X
Property and equipment, net			X					X	X	X
Intangibles, net								X	X	X
Goodwill								X	X	X
Accounts payable			X					X	X	X
Accrued liabilities			X					X	X	X
Warrant liability							X	X	X	X
Deferred revenue		X						X	X	X
Promissory notes								X	X	X
Deferred tax liabilities						X		X	X	X
Preferred stock							X	X	X	X
Common stock					X		X	X	X	X
Revenues	X	X					X	X	X	X
Cost of Sales			X		X			X	X	X
Operating expenses			X	X	X			X	X	X
Other income	X							X	X	X
Income tax provision						X		X	X	X

## Flowcharts and Walkthroughs

Process flow diagrams are a useful tool to depict: the process to initiate, authorize, process, record, and report transactions; the points within the process at which misstatements could occur; and control activities that are designed to prevent or detect such misstatements. These diagrams provide greater transparency to segregation of duties, highlight the systems involved, and identify outputs produced by the entity.

We perform walkthroughs to (1) confirm that our understanding of the significant classes of transactions or significant disclosure process is accurate, (2) confirm the points where data is captured, transferred or modified as these are the points where misstatements are most likely to occur, (3) verify that we have identified potential deviations that can give rise to deficiencies within the process.



## Key Control Matrix

We have developed a database of over 225 controls that serve as a starting point for the control identification and documentation process. Each control is assigned various attributes which serves to (1) assist in the evaluation of design effectiveness, (2) facilitate test plan development, and (3) address external audit requirements.

A sample of this documentation is set forth below:

### Business Process

Fixed Assets

### Sub-Process

Acquisitions and disposals

### COSO Control Objective

Capital expenditure requests are approved. Acquisitions are made by authorized personnel.

### Risk

Capital expenditure requests are not approved in accordance with management's directive.

### COSO Component

Control activity

### Control Description

The Controller must approve any capex over \$2,000, the CFO must approve any capex over \$5,000 and the BOD must approve any capex over \$20,000 prior to purchase. These approval limits are defined in the Accounting Policies & Procedures Manual which has been approved by the BOD.

### Control Categories

Manual, Preventative

### Financial Statement Assertion

Valuation

## Evaluation of Design Effectiveness

SOX 404 requires that controls be evaluated for "design effectiveness." A well designed set of controls will address the potential errors that can cause an account balance to be misstated. This involves evaluating whether the Company's controls:

1. adequately cover the 20 COSO principles for smaller reporting companies (if applicable);

2. adequately cover the 5 COSO control components (control activity, risk assessment, control environment, information & communications, monitoring);
3. adequately cover the 5 financial statement assertions (existence or occurrence, completeness, valuation & allocation, rights & obligations, presentation & disclosure);
4. contain an appropriate mix of automated versus manual controls;
5. contain an appropriate mix of preventative versus detective controls;

Any deficiencies will be aggregated and evaluated as described below.

### *Evaluation of Control Environment*

An important aspect of performing an audit of internal control is the process of identifying and evaluating entity-level controls. In broad terms entity level controls includes the company's control environment and period-end financial reporting process. The control environment component is the foundation upon which all other components of internal control are based, and sets the tone of an organization.

Due to their pervasive effect on the organization, entity-level controls also impact the conclusion about whether the company has effective internal control over financial reporting. The PCAOB has defined entity-level controls as:

- Controls related to the control environment;
- Controls over management override;
- The company's risk assessment process;
- Centralized processing and controls, including shared service environments;
- Controls to monitor results of operations;
- Controls to monitor other controls, including activities of the audit committee and self-assessment programs;
- Controls over the period-end financial reporting process; and
- Policies that address significant business control and risk management practices.

### *Evaluation of Operating Effectiveness*

Operating effectiveness involves evaluating whether a control was consistently performed by a person who had the necessary authority and qualifications. Sampling and re-performance control tests are employed most often in the evaluation. The number of samples selected for testing is positively correlated to the frequency of the control being performed. Due to the importance and frequency of billing, cash receipts and cash disbursement activities, tests surrounding these areas are more extensive. Review of software configurations are employed to validate certain system-based controls such as password requirements, back-up settings, error messages, etc.

## Control Deficiency Log

After the results of testing are completed, we review the identified deficiencies in terms of significance and potential impact on the financial statements and assess whether such deficiencies, either individually or in the aggregate, rise to the level of a reportable condition.

Ref	Process Cycle	Control #	Description of Deficiency	Issue Created By	Deficiency Owner	Issue Type	Year Issue Identified	Recurring	Deficiency Classification	Status
6	Fixed Assets	43	None of the 10 capex greater than \$5,000 tested showed evidence of Executive Committee approval. For 2 of the 15 capex tested there was no evidence of the GM's approval on one of the several invoices comprising the total expenditure. For 3 of the 15 capex tested there was no evidence of approval.	Rivers & Moorehead	Mike Smith	Operating Effectiveness	FY2011	No	Inconsequential	Remediated by year end
7	Fixed Assets	44	The Fixed Asset Rollforward and the FA Disposals Reconciliations do not have evidence of management's review.	Rivers & Moorehead	Mike Smith	Documentation	FY2008	No	Inconsequential	Remediated by year end

## Final Conclusion Report

The objective of this memo is to summarize our assessment of the effectiveness of the internal controls over financial reporting. We summarize each step of the SOX 404 process and ultimately address and analyze each deficiency or group of deficiencies identified through the process. We review a draft with management and the audit committee prior to issuing a final report to ensure that we have a consistent understanding of the overall conclusions.

The following is an excerpt of the evaluation of a control deficiency included in a final conclusion report.

Case 1	
Processing cycle	Entity Level Controls
Control objective	To ensure that the proper control environment exists to establish a foundation for effective internal controls.
Description of control	Various controls relating to the following principles: <ul style="list-style-type: none"> <li>Integrity and ethical values</li> <li>Board of directors</li> <li>Management's philosophy and operating style</li> <li>Organizational structure</li> <li>Financial reporting competencies</li> <li>Authority and responsibility</li> <li>Human resources</li> </ul>
Entities affected	All
Type of deficiency	Design
Description of deficiency	Several deficiencies were noted as follows: <ul style="list-style-type: none"> <li>No approved code of conduct</li> <li>No approved employee handbook</li> <li>No approved accounting policies</li> <li>No independent directors or financial expert on board of directors</li> <li>No remediation efforts on many of last year's deficiencies</li> <li>No documented financial review process performed by board of directors</li> <li>No documented oversight of auditors by board of directors</li> </ul>
Deficiency identified by	SOX consultant (first identified in 2007)
FS line item	All
FS assertion addressed by control	All
Does deficiency relate to an actual misstatement	No
Compensating controls	None
Mitigating factors/controls	None
Conclusion	Material weakness

## Other Optional Services

### *Internal Audit Services*

Because of the duplication of efforts that would be required, it is uncommon to have internal audit work performed by personnel that are independent of the SOX 404 evaluation process. The understanding of the business, process flows and other information obtained through the SOX 404 engagement is needed to conduct internal audit activities. Additionally, testwork performed on internal audit activities can be relied upon during the SOX 404 engagement. If you are interested in implementing internal audit services, we suggest you utilize our firm.

While efforts may vary in this regard, we would recommend that audits to be performed in the first year focus primarily on fraud prevention. These audits include:

- Vendor review
- Compliance with travel and entertainment policies
- Access terminations
- Debit/credit card reviews
- System access and segregation of duties
- Review of anti-fraud program

Not all audits require the same level of effort – for example, the vendor review is much more time intensive than the system access and segregation of duties. Internal audit activities would be scheduled at times that are not SOX 404 intensive to avoid overloading the accounting staff.

### *Accounting Policies and Procedures*

To the extent that you have limited documented policies and procedures, we can furnish an updated, written accounting policies and procedures manual (typically 30 pages in length), covering key functional areas such as revenue, procurement, fixed assets, etc.

### *Segregation of Duties*

In typical smaller or mid-sized companies, there are inherent issues with segregation of duties given the limited size of the accounting staff. While we may suggest changes to limit such concerns, there does not need to be an absolute segregation of duties in order to avoid a reportable condition, provided that there are sufficient mitigating controls. Our approach takes these factors into consideration.

## Engagement Oversight

At all times, your engagement will be overseen by Steve Rivers or Tammy Rivers, who are both managing partners at our firm. They will be responsible for the quality of the engagement and the interactions with management and the Board of Directors. Engagement fieldwork will be conducted and managed by one or more of our director-level consultants with the assistance of other accountants as needed. The assignment of the engagement team is established at the onset of the engagement.

## **Conclusion**

At Rivers & Moorehead, we provide a combination of highly-skilled consultants and existing tools, templates and methodologies to address our client's SOX 404 needs. Accordingly, we can deliver a comprehensive approach at affordable rates.

## Appendix A: Overview of Management’s Assessment of Internal Controls

There are two components to the internal control evaluation process under Section 404 of the Sarbanes-Oxley Act of 2002 (“SOX 404”), correlating to Sections 404(a) and 404(b) of the Act. Under 404(a), management must make its own assessment of internal controls, often through the use of consultants such as Rivers & Moorehead. Under 404(b), the auditors must render an opinion on the sufficiency of internal controls. For smaller public companies (<\$75 million of public float), only 404(a) is required. Similarly, except for the largest of companies, entities that go public under the JOBS Act only have to comply with 404(a) for the first five years of being a public company. Unless separately stated, our discussions herein are related to assisting management in performing its assessment of internal controls under 404(a).

While there are many subjective decisions along the way, the process for performing such an assessment is very regimented. All companies must undergo a methodical process to evaluate their internal controls against a framework developed by COSO, a consortium of financial and accounting professional associations (“COSO Framework”). This process is outlined as follows:

