White Paper

New laws, new challenges, new opportunities:

The impact of the Sarbanes-Oxley Act of 2002

Samuel D. Baker
Managing Principal
Xerox Global Services, Inc

Table of Contents

Introduction

In July of 2002, President George W. Bush signed the Sarbanes-Oxley Act (the Act) into law. The Act was, in most part, a reaction by Congress and the President to the accounting scandals, as typified by the Enron and Anderson accounting matters that had plagued American industry during 2001 and 2002.

The Act provides that corporate officers and members of a company's management team at many levels may be held criminally liable for failing to:

- Conduct business according to strict interpretations of the Generally Accepted Accounting Principles (GAAP)
- Make accurate and timely reports as prescribed by the Securities and Exchange Commission (SEC)
- Properly manage and maintain corporate records

The Act also establishes protection for "whistle blowers" that provide information to any investigating agency concerning a company's fraudulent conduct in these areas.

Corporate executive and governance along with the accounting community has, rightfully so, given extremely high priority to the activities needed to bring their companies into compliance with the Act. Most of the focus to date has involved the accountancy and reporting needs brought on by the Act. While these activities are vitally important, the Act also requires companies to be able to provide traceable, auditable proof that corporate records, which contain the supporting documentation for the reported financials, are being managed and maintained accurately.

Document-related requirements and challenges

The Act consists of several mandates that force organizations to gain much better control over internal documents—no matter whether they reside on paper, on media, or online.

For instance, the Act states that organizations must “prepare and maintain for a period of not less than 7 years, audit work paper and other information related to any audit report…” including “maintenance of records that in reasonable detail accurately and fairly reflect the transactions.” (The Act, Title I, Section 103(2).)

This means the auditor for the firm must keep all work papers related to the audit. In practice, those papers become part of the company’s corporate records and must be managed and maintained as any other corporate record.

Like the auditing firms, organizations are responsible for maintaining documents. Regardless of other allowances for records destruction or retention for the subject records, the Act indicates that once it is invoked, no records may be destroyed or criminal penalties may be applied. In essence, this may require a company to keep all records in perpetuity as the matter is investigated and eventually litigated.

Another area of particular significance in the Act is the language contained in Title VIII, Section 802:

“Who so ever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document or tangible object with the intent to impede, obstruct or influence the investigation or proper administration of any matter within the jurisdiction of any department or agent of the United States or any case filed under Title 11 or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more that 20 years or both.”

Although still untested, this provision gives sweeping new authority to prosecute corporate officers and managers for inept corporate record management. The matter does not even have to be formally under investigation or prosecution—it can be just contemplated by any governmental department or agency.

While the prevailing thought today is that the Act may only apply to publicly held companies, all companies, private or public, fall under some form of Federal Regulation. It may be as simple as the Occupational Safety and Health Administration (OSHA) or as complex as the Department of Defense, but the Act encompasses any U.S. agencies and departments and any contemplated action. In short, the potential is that virtually all companies doing business in the U.S. today can be held to the obligations of the Act by any governmental agency.

Corporate Record: paper and beyond

Many corporations have record management policies that account for paper records, but to date, electronic records have been largely ignored or relegated to Information Technology (IT) departments because they are not viewed as part of the corporate records.

It is no longer the case, however, that corporate records consist principally of paper. There is significant case law in the U.S. that expands the definition of corporate records to include e-mail, files on disk, voice mail, hand written notes, and paper or electronic drafts and renditions of documents. The Act further encompasses the working papers of the independent auditor engaged by the corporation in the preparation of reports and submissions. All the records for a company must be subject to one comprehensive management policy. Additionally, the company must be able to demonstrate continual administration and execution of its corporate record retention policy to verify that the SEC Filings are the result of thorough and consistent management of all paper and electronic documentation.

Adverse Inference

A company's corporate records have always been subject to a rule of adverse inference. This rule provides that if a company fails to produce a document that is within its power to produce and which should have been produced, a court may instruct a jury to infer that the document's information is unfavorable and that the failure to produce can be viewed as a willful act of spoliation.[1] With the pervasiveness of e-mail, file transfer, and the ability of a single user to burn either a CD (650 MB) or now a DVD (4.2 GB), organizations are in great danger of vital company records being taken out of the company and used against them, putting them at risk of costly civil action. The Act adds to the rigor required as it holds the management and officers criminally liable for failing to act or for malfeasance in their actions in this regard.

Following the "Knowledge Trail"

Several factors within an organization make the implementation of controls and management that enable accurate auditing a significant undertaking. The audit would include electronic forms of documents including e-mail and files on disk. With respect to paper, a significant amount of time must be spent capturing paper at its source, eliminating true duplicates, preserving iterations, and insuring that the sequence of events surrounding the paper is clear and precise. In effect, the company must establish a "Knowledge Trail" that gives the company the tools and information to reliably track who had a document, when they had it, and what they did with it.

- In the case of paper, it may be following a document's path: where was the paper forwarded? Was it copied, faxed, scanned, or shredded?
- In the case of electronic files, the original file is significant as are derivative works on the same "Knowledge Trail". Digital documentation simplifies the process of revising a previously authored text. But this new document, with new meaning and

[1] Spoliation is the destruction of documents

context, must be included in the audit because such alterations, nefarious or otherwise, may point to root knowledge for corporate action and policy.

Records management to Knowledge Chains

In most organizations, better controls over work product originality must exist if they want to advocate that their record keeping is managed, comprehensive, and verifiable to meet the requirements mandated by the Act.

An example of work product controls may be found in an engineering unit, where numbered journals are issued to engineers. The organization must then be able to track the numbering and re-capture the journal once the project is complete. In this way, notes, thoughts, work product, diagrams, and other salient information are preserved. A similar "chronicled" environment must be established for each user in a company to capture work product in real time for the corporate records.

A strong records retention policy is one building block of an overall solution. Another is implementing company procedures for the management of documents and records. However all systems that rely on human consistency are fatally flawed. The system must therefore enforce policy and procedure through automation at the end user level as well as the central infrastructure level.

To compound this challenge, it is imperative that the corporate record retention initiative is enhanced with an operational plan of execution. This plan must include all forms of information and be in step with the auditing and reporting needs under the Act. The plan must also take into account all employees, transactions, and business in which the company engages, including foreign transactions.

Companies with a comprehensive Electronic Records Management (ERM) activity may have a decided edge in developing an operational plan for enterprise-wide records management. A second advantage can be found in a comprehensive Electronic Document Management Strategy (EDMS). These two activities are not duplicative—they are complementary. The ERM addresses the corporate records, which until recently had a very narrow definition consisting principally of *finished work product*. The EDMS addresses the daily creation, acquisition, management, routing, and distribution of documents that drive a company's business. In as much as the Act now treats all documents as records, the policies implicit in an ERM must be applied to the EDMS activities. The combination of the ERM and EDMS disciplines requires a company to review technology, business process, and authority to take action. When put to use, ERM and EDMS initiatives control all documents, whether they are files on disk, in e-mails, and on paper.

Files on disk and local drives

The files needed to be included in the corporate records are found by aggregating several technological capabilities, starting with an Office Document Management Architecture (ODMA). The ODMA is a desktop function that forces users to save documents to a corporate repository as opposed to saving to local hard drives. This works well for users who are reliably attached to the corporate network infrastructure. However, there is still a significant amount of document creation that occurs in a detached mode. Working offline means there is no opportunity to capture the work in real time. A company must therefore implement technology that "reaches out" to local drives during login, scan the local cache of files, extract that which is new or changed, and create a record of the existence of the file if not a 'copy' of the file itself.

e-mail

A similar function must exist for e-mail systems, which is difficult because there is no interface standard for e-mail.[2] There are centralized mail servers, however, that offer a convenient and reliable aggregation point for identifying and capturing records. A challenge with e-mail is the reconciliation of the Carbon Copy (CC) and Blind Carbon Copy (BCC) chain of any one particular mail. It may require that each mail item be analyzed at each point to identify changes and the authors of the change.

[2] SMTP and POP3 are transmission / transaction protocols as opposed to content protocols. VIM is not widely used. MAPI is proprietary to the vendor.

Paper

Many organizations capture and process paper as a function of a *Line of Business Activity* (e.g. Accounts Payables, Claims Processing, Delivery Receipt, Contracts, and Human Resources) and the cost justification has traditionally been in the retrieval and distribution. With the stringent requirements of the Act, it is probable that many organizations will implement new processes and technologies to manage all the paper in the enterprise. The good news is that these new solutions can create significant cost avoidance (and incarceration avoidance) opportunities.

Leading organizations have begun using centralized scan centers to capture large quantities of aggregated paper, which enable cost per page reductions, consistency of process, and quality of work improvements. Aggregation of paper to a central facility also provides an opportunity to exert management control and enforcement of records policies as the entire subject collection is processed through a single operation.

The most difficult paper to capture will be seemingly “collection-less” paper, often characterized as “other correspondence” or memos. This paper is best captured, indexed, and added to a collection by the principal recipient. Once added and identified to the repository, the document can be managed.

Naturally, users will be more apt to add these documents to the central repository if the process to do so is fast and simple. In most cases, the process currently involves walking up to scanning stations distributed throughout the enterprise, all connected to a centralized processing area. On the back end, knowledge workers review each scanned submission, validate the information the user inputs, add additional information as necessary for records standards, and repose the document.

Another approach to adding paper documents to the central repository is through the fully digital mailroom, where all paper (with the exception of obvious advertisements, catalogs, and “junk” mail) is scanned and routed to the addressee. The addressee can review the documents, add them to a collection, or delete as necessary. While this approach offers a more comprehensive capture activity (reducing a company’s liability) with less manual labor and responsibility for office workers, it may result in scanning items that don't need to be processed, leading to a more "cluttered" central repository.

Of course, there will always be a certain amount of paper that remains un-captured. What is important to note is that 100% is not achievable. What organizations *must* achieve are clearly stated policies and demonstrable adherence.

Benefits of the Act

While the Act certainly adds challenges to corporations, it doesn't necessary follow that the challenges are all negative. In actuality, once the changes that enable adherence to the Act are made within an enterprise, the organization can benefit from faster, simpler access to critical business information, lower document distribution costs, accelerated workflows, and protection of valuable intellectual property. Of course, these benefits are difficult to see around the one glaring obstacle in front of most organizations: changing workflows, technologies, and processes across the enterprise to create an environment that works in accordance with the Act.

New workflow systems

Most workflow systems may be adapted to achieve the management requirements set forth in the Act. To date, workflow has been applied to high volume transactions (usually financial in nature) or authorship and approval. Tracking Knowledge Chains has not been an overt goal of implementing workflow. Given that the path into and out of a record/document repository can be paved with workflow allows a company to begin to answer the *who had/has it and what did they do with it?* questions. Simple in/out logging answers the first part of the question. The second part can be addressed with ad-hoc work routing. If e-mail is the ad-hoc workflow engine, then as e-mails are tracked by the system, the routing is captured as well.

In more formalized and administrative workflow environments, the time on task, successor, and predecessor activities are captured and noted as a function of the work process routing. Keeping this log becomes a function of the records group, which ties the activity back to the routed document.

Creating corporate culture

To date, no governmental agency has been tasked with certifying that a company is in 100% compliance with all of the requirements of the Act. In fact, no authority has even been anointed to rule as to the validity under the Act of a particular records management endeavor in general. The courts have numerous rulings for and against corporate record systems, and do so on a regular basis when needed, with the operative phrase being "when needed". The language in Section 802 of the Act speaks directly to this by putting the onus on the company to have its records management activities in order so it can be obtained at any given moment.

As such, it makes records management an issue of daily activity as opposed to an "end of the line" activity. Each member of the company must practice records management every day. Each decision around each document has a records management and now a compliance with the Act component. Just as companies have responded to the accountancy issues in the Act by instilling good accounting practices in the corporate body, companies must also ingrain records management into the corporate body.

Technology can help, but only to a certain extent. At some point, human endeavor is necessary. It is therefore critical to create a culture where each employee realizes the importance of adhering to policy and has the discipline to treat all documents in accordance with the policy. To create this culture, an organization must disseminate information to gain end-user buy-in, encourage employees to participate, give out rewards and recognition when merited, and penalize when necessary for non-performance.

A large portion of the Act, in essence, is looking to change corporate culture by forcing corporate discipline around execution and management of information contained in paper and electronic documents.

For organizations that already have comprehensive Knowledge Management and Intellectual Asset Management initiatives in place, creating this culture is easy. Much of the work already done to implement the initiatives is applicable to this task. For companies without these initiatives, however, the creation of Communities of Practice, diffusion of knowledge about the Act, record management, and corporate policy is tantamount to a successful program.

First steps

Unfortunately, there is no one single, simple solution to ensuring adherence to the Act. The solution is programmatic—focused on changing company culture, enforcing corporate policies, and providing tools to users to make adherence to the mandates as easy as possible to the point of being transparent. The timeline is endless. Once initiated, in concert with the Act accountancy activity, the program will continue until the company ceases operations.

Assessment of the state of records management is a good first step to determine where a company is in comparison to where it needs to be. Augmentation of the records policies (and the records management staff) should also occur early. A roadmap of the technologies required, their implementation timelines, and the impact to the existing technical infrastructure must be determined. Senior Management must initiate the cultural changes by forming Communities of Practice empowering and enabling the change to occur. Once an action plan is formulated, phase implementation can begin.

There are organizations experienced in implementing document management solutions that enable corporations to digitize, store, archive, search for, and retrieve documents quickly and easily on site or at hosted facilities. With outsourcing help, a company's paper and electronic documents are integrated into a digital workflow, which ensures greater control over documents. And with greater control, an organization has simple, immediate document access not only for governmental agencies who enforce regulatory compliance, but also to the knowledge workers who use the documents to build the company's value.

Xerox Global Services helps companies streamline and digitize their document-intensive business processes—everyday processes like customer communications, billing, training or records management. Our people work closely with clients to identify, quantify, and realize hidden opportunities to save money, find new sources of value and simplify how work gets done.

Xerox Global Services is able to provide expert consultation and implementation of solutions that create a corporate culture around effective document management to meet the requirements of the Sarbanes-Oxley Act of 2002. For more information on how Xerox Global Services can help implement record management technologies and services, call 800-ASK-XEROX ext. XGS or visit *www.xerox.com/contactglobalservices*.