

# SARBANES-OXLEY COMPLIANCE

The legal need for an audit trail in payroll in the US is working its way into the payroll systems of Australian and New Zealand companies. **David Mason-Jones** explores this latest trend

**D**espite having no legal force whatsoever in Australia and New Zealand, a piece of legislation of the US Congress – the *Sarbanes-Oxley Act 2002* – is becoming a factor in the way that HR directors make decisions about the payroll software and technology they use in their companies.

## Ripple effect of Enron

The route by which this unlikely scenario is taking place has its origins in the collapse of some larger US companies – notably the Enron debacle – within the past decade. It is well known that the US inquiry that followed Enron revealed alarming levels of incompetence, mismanagement and fraud among senior managers.

What is not so well known is that the audit systems which should have ensured accountability and detected fraud had not kept up with the times. Loopholes in the technology had meant that the transparent audit trail necessary to detect fraud was just not available.

The software was also deficient because individual authorisations and sign-offs could not be traced. Large expenditures, movements of money in slush funds and payroll fraud such as the oldest one in the book – the list of ghost employees – could be made anonymously by anyone with access to the system. In short, no one was

accountable and this lack of accountability tainted any financial advice that went up the chain of command.

With poor financial advice, senior managers made poor financial decisions. They were dependent upon their direct reports for all their information about what was going on in the company. At their trials, Enron executives tried to claim ignorance of what was happening in the company. This was not accepted as a defence.

This now creates a precedent that places all HR directors under an obligation to really understand what their payroll software does and how it works. They can no longer rely on a nod from the software people to say that everything about the payroll system is in order.

## Sarbanes-Oxley impact

The result, under Sarbanes-Oxley, is that all US companies must now establish clear audit trails, including clear and unambiguous responsibility for sign-off of any financial decisions within the company.

The critical thing about Sarbanes-Oxley – and this is the feature whereby it impacts on management standards in foreign countries – is that not only must a US company comply

with the Act, but the companies it deals with must also comply. This means contractors, sub-contractors and suppliers must have transparent audit trails and clear personal accountability. This provision applies whether the contractor, sub-contractor or supplier is a US resident company or a foreign entity.

With the vast global reach of so many US multinationals, the stage has been set whereby companies in Europe and Asia-Pacific need to know the implications of Sarbanes-Oxley and incorporate these into payroll software and technology systems.

## Payroll a major audit area

In many companies payroll is the largest single item of annual expenditure and, as such, it attracts the immediate attention of those wanting to see if their contractors are Sarbanes-Oxley compliant.

Therefore, the mechanism by which Australian and New Zealand companies need to become Sarbanes-Oxley compliant is through the bidding process for business with US companies. As US companies become fully compliant they will turn their attention to ensuring compliance by new suppliers in new contracts.

**As US companies become fully compliant they will turn their attention to ensuring compliance by new suppliers in new contracts, and then to existing suppliers**

# SOON

## HR directors need to focus on the Sarbanes-Oxley compliance of their payroll software and technology – whether it is conducted in-house or outsourced

Payroll compliance will be a part of this and will apply whether payroll is handled in-house – as is still the case of many companies – or if payroll is outsourced, as is increasingly becoming the trend.

Ari Kopoulos, national sales and marketing manager for Employee Connect, says: “The initial reaction to Sarbanes-Oxley in the US and, to some extent where compliance was also required in Australia and New Zealand, was almost a knee-jerk reaction to the audit need. In some cases the knee-jerk almost had the effect that some senior executives were regressing back to the stage where they required paper-based sign-offs.

“Now, changes in payroll software mean that this knee-jerk reaction can be relaxed and senior executives can rely on superior software to ensure an audit trail and to bring home individual responsibility,” he says.

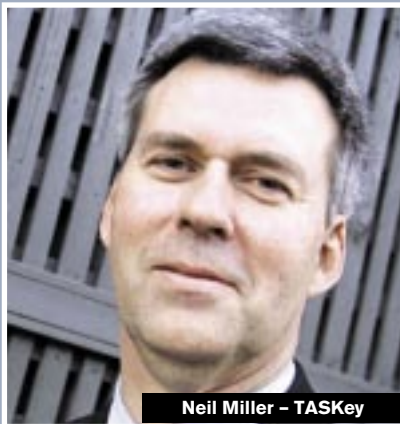
HR directors need to focus, therefore, on the Sarbanes-Oxley compliance of their payroll software and technology whether it be conducted in-house or outsourced. In fact, the effect of Sarbanes-Oxley may be another reason to consider outsourcing payroll to a major outsourcing provider that is Sarbanes-Oxley compliant.

### A factor in the outsourcing decision

A US-based multinational may not necessarily want to take the time during the



Christoph Jenkinson – Watson Wyatt



Neil Miller – TASKey



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contract process to check if all the features of a smaller company's in-house systems are compliant with their needs. It may be easier for them to rely on 'big names' in the outsourcing business which they already know to be compliant.

Terri Hosking, ADP's director of marketing Asia-Pacific, says: "Our systems are compliant and this is most important for Australian and New Zealand companies operating regionally where they come in regular contact with US companies."

The imperative upon HR directors, however, when choosing Sarbanes-Oxley compliant payroll software is not just to outsource it to a large outsourcer and be done with it. The need to ensure compliance means that the HR director must be able to look across the interface between their company and the outsourcing company.

Employee Connect's Kopoulos says: "The mere fact of selecting a 'big name' for your payroll should not automatically give you comfort. It's still quite possible that even a 'big name' may have an outdated legacy system."

#### Software to prevent common sign-ons

Each sign-on into the system must be traceable to an individual and the actions the individual took must also be traceable.

Chrisoph Jenkinson, a payroll expert at Watson Wyatt, says: "This means that companies cannot have common sign-ons or shared sign-ons any longer if they wish to comply with Sarbanes-Oxley."

Apart from tracking accountability, payroll software must be

## THE SARBANES-OXLEY ACT

**T**he Sarbanes-Oxley Act, a law of the US Congress, was passed into law on 30 July 2002, and introduced highly significant legislative changes to financial practice and corporate governance regulation. It introduced stringent new rules with the stated objective: "To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws."

The Sarbanes-Oxley Act is considered to be one of the most significant changes to federal securities laws in the US. It was sponsored by US senator Paul Sarbanes and US representative Michael Oxley. Sarbanes-Oxley law passed in response to a number of major corporate and accounting scandals involving prominent companies in the US. These scandals resulted in a loss of public trust in accounting and reporting practices. Sarbanes-Oxley legislation is wide ranging and establishes new or enhanced standards for all US public company boards, management and public accounting firms.

The Sarbanes-Oxley Act itself is organised into 11 titles, although sections 302, 404, 401, 409, 802 and 906 are the most significant with respect to compliance and internal control (Sarbanes-Oxley section 404 causes the most concern for companies). In addition, the Act also created a public company accounting board.

able to provide real time reporting. Kopoulos says: "Managers and auditors need to be able to go into the system and apply some target information – such as a date range – and be able to pull the information out of the system immediately. There must be no time lag to enable cover up.

"The pressure for payroll software is for the system to allow visibility of every step. If HR directors have legacy systems that don't allow this, or if they are dealing with outsourcers whose software doesn't allow this, then they had better start thinking about making some changes quickly," he adds.

One way of achieving compliance to processes is a system of payroll templates that contain mandatory fields for completion. The mandatory fields enable the system to check the information entered and cross-reference it to confirmed information before proceeding.

With a system of template screens such as this the operator cannot go to the next screen until the first screen is completed with valid and cross-referenced information. This forces compliance to a process and leaves a definite trail. No steps can be skipped.

Kopoulos says: "At Employee Connect our system certainly provides the tools to comply with Sarbanes-Oxley."

#### Stripping away the spin doctors

The task of senior management is often made more difficult because, as information is fed up the chain, intervening managers may reinterpret this information to place themselves in the best light or to minimise blame. Dr Neil Miller, managing director of TASKey, the company that promotes the TEAM software, says: "At every level of an organisation there are spin doctors."

Under Sarbanes-Oxley, the need goes further than just the ability to create transparency and accountability at one level of the organisation. It must strip away the spin doctors and this applies to the payroll function as much as it does to other functions such as project management, inventory, HR management, invoicing or accounts receivable.



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## Managers and auditors need to be able to go into the system and apply some target information – such as a date range – and be able to pull the information out of the system immediately

Senior managers now need to be able to look down into the organisation to actually find out what is going on. This does not mean to say that they have to micro-manage the business – it means they must have information about what is going on.

Miller says: “Our TEAM software allows senior managers to see through possible spin doctoring and look at what is actually being done at lower levels of management.

“One of the benefits of this arrangement is that, rather than leading to the problem of micro-management by senior executives, it encourages lower level managers to make decisions and carry out actions at the lowest level of management possible,” he says.

The critical thing is that all steps can be monitored by management in real time.

### Software to spot fraud

The best that current payroll software can do to actually detect fraud is to enforce compliance by an operator to a process and to cross-check the entries to certain standard benchmarks. Payroll software to definitely detect fraud is not yet available and may never become available.

Jenkinson says: “In most cases the responsibility to spot fraud still relies on a control process rather than on technology and software.”

The type of software used to help identify fraud relies on patterns to spot trends and exceptions to the rule.

However, for this type of software to be effective and work efficiently, the numbers in the pool must be significant – companies

need to have tens-of-thousands of employees. In cases where this software can be utilised, it gives HR directors some intelligence on where to start looking for compliance problems. “From there on in it is likely to still be a process which identifies the fraud,” Jenkinson says.

While compliance with Sarbanes-Oxley is not a legal requirement in Australian or New Zealand law, the fact is that the US accounting standards are spreading globally because of the global operations of US companies and because of the US operations of Australian and New Zealand companies. Compliance by their payroll software is a feature that HR directors need to ensure if they wish to transact significant business with US companies. **HC**



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