# SOX-5000: A PROCESS FOR SMALL FIRM COMPLIANCE

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## ABSTRACT

Passage of the Sarbanes-Oxley Act in 2002 provided the American investor with assurances that SEC regulated firms are making accurate representations of their financial performance. Sad to say, the sins of a few has caused every domestic and international whose stock is registered with the Securities and Exchange Commission (SEC) to incur significant costs to ensure that they are in compliance with this law. The production/operations function has considerable prior experience dealing with internal control processes. Forty years ago, the American Production and Inventory Control Society (APICS) and its members were able to convince outside auditors that proper cycle counting procedures were capable of providing more accurate inventory reports than the traditional end-of-fiscal period inventory counting exercises. In addition to getting this task done, APICS's cycle counting procedures built two bridges that are proving helpful to resolving the SOX challenge. The first led to increased professional understanding between operations managers and outside auditors. The second created capabilities that led to the process defining ISO 9000 programs. When a firm strives to achieve ISO 9000 status, it must learn how to define how each business process should be done. This requirement applies to all business and product transforming processes involved in the manufacture of a good. This paper reports on an ongoing primary research project. The first part defines the nature of the task that small manufacturing companies face as they strive to satisfy the requirements of the Sarbanes-Oxley Act. The second part will be cases studies reporting on small manufacturing firms' experience in pursuit of this goal.

The scandals that resulted in the collapse of Enron led Congress to enact legislation to protect the investing public from financial shenanigans. The Sarbanes-Oxley Act requires both the chief executive officer and the chief financial officer to certify every financial statement is accurate. Both officers must attest that the information does not include untrue statements or omit necessary information. Both officers are legally responsible for establishing sufficient internal controls to ensure that the financial statements for a accounting period are based on factual information The passage of SOX necessitated regulated firms to redesign its management structure. Increasingly the firm's internal auditors report both to its CEO and CFO. Many firms have created separate chief compliance officers to ensure that internal controls are capable of assuring the firm's top executives that they will not be at risk of the new criminal charges. Many benefit when a public firm is able to project a stable pattern of better than industry average sales and earnings and then make their numbers. While most CEOs are honest, their firms are expending significant resources to satisfy the requirements of Sarbanes-Oxley. For firms that already had the right culture and strong internal controls, satisfying these new reporting requirements is not all that difficult. SOX forces firms to address the managing earnings issue—an ongoing activity throughout most firms. When finance professionals to "define improper earnings management,: they often have difficulty providing a concise answer. The purist will say that an accounting system should provide the most accurate assessment of the firm's performance. Fraud is defined as "Intentional misrepresentation or concealment of information in order to deceive or mislead. This paper provides a taxonomy of shenanigans that may exist within small manufacturing firms, We use this term because most earnings management activities do not necessarily constitute fraud but the vagueness of this term requires firm's to begin to centralize earning's management activities. Part One of this paper concludes with an action plan for achieving these results. Within the operations management profession, we have long known that the first step in an program to automate a business process is a fundamental understanding of current practice – both good and bad.