Managing SOX Through Change at CIT Group Inc.

CIT has made SOX pay off.

By the time you read this article, if your company is a large accelerated filer with a calendar year-end, you will have just completed your third year of complying with the Sarbanes-Oxley Act of 2002 (SOX). For CIT, the first year was painful—oh so painful! The second year was better, with this last year better still, despite changes in SOX practices and organizational shifts within CIT. Why? In addition to integrating SOX compliance into daily operations, we standardized our approach across a diverse mix of businesses, and leveraged resources to maximize quality and efficiency.

At CIT we challenged ourselves to make future compliance efforts more efficient and sustainable, as well as a value-added function.

Taking Stock

After a brief recuperative period following the inaugural year of SOX, we at CIT challenged ourselves to make future compliance efforts more efficient and sustainable, as well as a value-added function. Yes, we recognized SOX, in one form or another, was here to stay, even though many large accelerated filers encountered problems, incurred significant costs, and began pushing against the requirements. In light of relatively recent, well-known corporate scandals, few observers argued that the legislation was un-needed, nor could they deny that benefits were already being realized. What many did find troublesome, however, was the onerous practice implementation emanating from PCAOB Audit Standard No. 2.

CIT’s SOX leadership performed a postmortem on Year One, examining what we did well, what we didn’t do so well, and how to improve our program. Do we have a viable and sustainable testing model in place? Do we have the right people with the right training in place? Can we spread the testing more evenly throughout the year to better utilize our resources, rather than concentrating most testing at year-end? After all, we postulated, the state of effective internal control should be perpetual, not just temporal.

Simultaneously, we sharpened our focus on SOX requirements and challenged the intent and practices formulated under PCAOB Audit Standard No. 2. Why was management more reactive than proactive in affecting compliance? Didn’t reporting requirements call for management’s assessment of its system of internal control over financial reporting? Why were the registered independent public accountants running the show and dictating terms? Whatever happened, we asked, to the principal of reasonable assurance? Have the accounting and auditing professions forgotten the adage from Auditing 101 that a system of internal control should not cost more than the benefit provided? Certainly, a large component of Year One costs was documentation efforts, but the near absolute standard applied in the inaugural year was economically costly, impractical and unsustainable.

Reassured by similar sentiment and findings observed in the marketplace, CIT’s SOX leadership decided on several guiding tenets to follow in redesigning an effective SOX program for Year Two:
Management must proactively retake the lead in designing its assessment program on the effectiveness of internal control over financial reporting.

Corporate-level or general controls must be given greater weight in determining testing scope and in overall assessment of effectiveness.

Risk-based scoping was paramount for efficiency and effectiveness.

The number of key controls must be reduced.

A standardized approach across diverse businesses was needed to yield greater efficiency.

Testing throughout the year made greater sense for reasons of work-load and efficiency, as well as to provide comfort on the effectiveness of the system of internal control throughout the year.

Leveraging Internal Audit

In Year One, we instituted a self-testing model, placing Internal Audit in an advisory capacity to provide quality control over self-testing efforts and make recommendations on streamlining the number of key controls. However, our postmortem results, supported by Internal Audit’s observations in its quality control efforts, were critical of our self-testing program. Despite training and good intentions by all, results of self-testing were mixed. In most cases, self-testers were not auditors and documentation of results was often not up to the standards of auditing professionals.

We believe there are many benefits to deploying a self-testing model—the most visible of which is recognition of control ownership by the businesses. However, the SOX Leadership was convinced we could achieve significant efficiencies, as well as improve the quality of testing without losing sight of control ownership, by outsourcing management’s testing to Internal Audit. Who within the organization has better skills to conduct testing than our highly trained professional?

After all, the state of effective internal control should be perpetual, not just temporal.
audit team? CIT determined it was possible to utilize Internal Audit in this fashion and not compromise its independence under the standards of The Institute of Internal Auditors, since management retained ownership of the control environment, identified its key controls, resolved reported deficiencies, and conducted the actual internal control assessment based on Internal Audit’s test results.

Leveraging the existing capabilities of an independent and strong internal audit department to conduct SOX testing made sense in many ways: Internal Audit is independent of management; Internal Audit follows a risk-based approach to its audits; Internal Audit has a base of experienced manpower to handle testing throughout the year; many operational controls subject to audit overlap with key controls identified to the SOX program; and professionally trained auditors are better equipped to document and communicate testing results, including alternative procedures followed. Moreover, as application of PCAOB Auditing Standard No. 2 was developing to allow independent registered accountants more latitude in relying on the work of others, outsourcing management testing to Internal Audit was providing another means of reducing SOX costs. Internal Audit was best positioned to obtain synergies with our registered independent public accountants, and assist in integrating SOX into the financial statement audit.

Transformation from self-testing to Internal Audit testing was not seamless. In order to manage the increased workload and to develop additional subject-matter expertise, Internal Audit had to fill some staffing gaps—i.e., financial reporting, an area not often in an internal audit department’s scope. Year One budget dollars formerly paid to consultants shoring up documentation requirements and conducting self-testing on behalf of management were re-directed to Internal Audit to build necessary staff at significant ongoing savings. Some gaps in staffing remain, but with the exception of general information technology controls, Internal Audit now conducts all of management’s testing.

**Having a standard means of viewing diverse businesses through these seven common processes enabled us to identify where we had duplicative key controls, as well as where we had too few, or even lapses in, key controls.**

**Standardized Key Control Project**

CIT is a complex organization offering a broad suite of products and services, encompassing asset-based loans; vendor finance programs; operating, capital and leveraged leases; import and export financing; mortgage loans; student loans; accounts receivable collection; debt underwriting and syndication; various advisory services; and more. At the inception of SOX, CIT operated in product silos, with separate sales teams, back-end processes, systems and support teams. Although SOX leadership recognized some level of commonality of key controls across its diversified...
product and services offerings, we planned on implementing SOX in a divide and conquer fashion—i.e., according to the product silos in which we managed. Time was a critical factor, and the SOX leadership team decided to plow straight ahead to meet the Year One deadline. Refining our initial approach and identifying commonality of key controls across business units was postponed until Year Two.

Simultaneous to the implementation of SOX, CIT undertook an initiative to structurally transform from a product-centric management focus to a management style more customer and industry-focused. With that change in front-end approach came a huge challenge to reengineer the back-end, streamline operations, and eliminate redundancies, particularly with multiple receivable platforms. The timing in Year Two was right to explore, design and implement a program to identify common key controls, as well as to incorporate developing best practices related to SOX compliance.

Termed the Standardized Key Control Project, Internal Audit was commissioned to conduct this initiative. The Project was designed for two phases, with its identified goals being to:

- Migrate to a common language/terminology across business units
- Promote “likeness” in business processes, rather than “uniqueness”
- Streamline test plans and reduce testing time
- Design a flexible key control template used for business acquisitions and other changes in CIT’s business model
- Provide a means to adapt more quickly to changes in SEC and PCAOB guidance

The first phase of the Project was to identify common business processes or transaction cycles used across our array of business. As a result of taking a decentralized approach to documentation and design in Year One, underlying information differed in form and presentation from business to business. By further analyzing documentation (process flowcharts, narratives, key control identification, and testing programs) for substance,
## EVOLVING SOX MODEL

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<th>Year One</th>
<th>Year Two</th>
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<tr>
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<td>IT Governance, Corporate PMO, BU CFOs</td>
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<td><strong>Documentation</strong></td>
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<td>Reduced self-testing, Majority Internal Audit testing</td>
<td>Limited self-testing, ITGC only</td>
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<td></td>
<td>Internal Audit provides quality control</td>
<td>Increased Internal Audit testing</td>
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<td>Corporate PMO &amp; BU PMOs</td>
<td>Corporate PMO &amp; BU PMOs</td>
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<td><strong>Risk-based Testing Scope</strong></td>
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<td>Internal Audit for medium risk units</td>
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<td>Limited 4th Q self-testing</td>
<td>Limited self-testing and other alternative procedures in 4th Q</td>
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<td>Internal Audit &amp; remaining self-testers</td>
<td>Internal Audit &amp; remaining self-testers</td>
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<td><strong>Management’s Assessment</strong></td>
<td>SOX Leadership</td>
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we identified seven common processes related to most products. Those are:
- Originations
- Funding & Disbursements
- Accounts Receivable Management
- End of Lease Process
- Inventory Management
- Portfolio and Risk Management
- Financial Accounting and Reporting

Having a standard means of viewing diverse businesses through these seven common processes enabled us to identify where we had duplicative key controls, as well as where we had too few, or even lapses in, key controls. The Project delivered a Standardized Key Control Program, essentially a “macro-template” bridging SOX leaderships’ identification of key controls to the underlying documentation and support for each of the company’s businesses.

The second phase of the Project focused on what we term as the “push-down” or corporate-driven control touch points in our various business process flows. Typically, “Push down processes” are centrally guided by a corporate function, and conducted by a decentralized business unit. Execution of controls occurs both downstream with the business unit and upstream with the corporate function. Examples of “push-down” processes include sales and property tax; income tax; provision for loan losses and charge-offs; compliance with controls over key spreadsheets; and preparation of financial statement and footnote disclosure packages. Standardized “push-down” controls were identified, positioned within the Standardized Key Control Program, and linked to the respective key controls within the corporate functions.

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Every successful business must continuously strive for improvement, finding new ways to affect operating efficiency. Managing SOX is no exception.
Clearly, the changes commenced in Year Two have provided economic payback for CIT in the second and third years of compliance, and we expect the benefits to continue in the future.

The Standardized Key Control Program was gradually introduced during Year Two and fully implemented in Year Three of SOX. Besides making our SOX compliance efforts more efficient, we find the Program to be extremely useful in other ways. The Standardized Key Control Program ac-

SOX ADVICE

- Reclaim the lead if you haven’t already done so. First and foremost, SOX requires management’s assessment of management’s system of internal control over financial reporting. Management must be comfortable with the way management designs and operates its system of internal control.
- No two companies are identical, nor are their systems of internal controls. Avoid a “check the box” or “off-the-shelf” approach. Value can be obtained from the analysis and sweat equity that goes into customizing your SOX program and documenting your business processes and controls.
- Take a “top-down” approach to scope your requirements. Don’t start from the bottom and build up.
- Assess your general or corporate controls, especially in the area of corporate governance. Take into consideration the company’s strengths in establishing the scope of your program, and identify elements that can be improved. Benchmarking in this area is fairly easy through peers’ intranet sites and through external services specializing in assessing corporate governance, such as The Corporate Library, Governance Metrics International, ISS Corporate Governance Quotient, and Moody’s Corporate Governance Assessment.
- Allocate your efforts and resources to areas of greatest risk first to get the biggest bang for your buck.
- Incorporate Internal Audit’s talents into your SOX program. Leverage to maximize efficiency and coverage.
- Discuss ways to reduce audit costs with your registered independent public accountants. Greater integration of the financial statement audit with the SOX assessment produces savings, as does having the registered independent accountants place more reliance of the work of others like Internal Audit.
- Spread testing throughout the year rather than bunching in the 4th Quarter, particularly at year-end. Refresh testing conducted early in the year with alternative procedures closer to year-end (e.g., periodic operational reviews, management interviews, interim meetings to discuss findings to date, etc.).
- Keep the forest in sight; don’t get lost in the trees! There is a lot of information to disseminate. Discern between control breakdowns that impact financial reporting and operational issues. Filter your findings according to how each impacts or potentially impacts your financial statements. Not all deficiencies are created equal.
- Don’t discard those operational issues uncovered in your SOX testing. Use them to improve operational processes to produce efficiencies.
Financial Watch

complishes the following:

- Provides Internal Audit with a flexible and informative tool to plan audits and educate its staff, both newcomers and those rotating between assignments, on key controls and business flows.
- Serves as a map to assist our independent registered accountants in conducting walk-throughs.
- Helps manage internal controls in a fast-changing and growth-oriented company.
- Serves as a useful benchmark in developing shared services, streamlining existing back-office process, and integrating business acquisitions into CIT’s operating model.

Looking Forward

Exhausted by implementing a SOX compliance program in Year One, it would have been extremely tempting to continue the status quo in subsequent years. However, every successful business must continuously strive for improvement, finding new ways to affect operating efficiency. Managing SOX is no exception.

Today, we have a more effective and efficient compliance program than two years ago. No, it is not perfect, and we will continue to assess its design and efficacy. Clearly, the changes commenced in Year Two have provided economic payback for CIT in the second and third years of compliance, and we expect the benefits to continue in the future.

The SEC has issued proposed guidance for management to conduct a SOX compliance program, and the PCAOB has proposed Audit Standard No. 5 to replace No.2. Although these initiatives are welcome, the content of each is not new. Both proposals codify and legitimize practices that have developed over the three years in which SOX has been effective. For large accelerated filers, take note of the proposed guidance and evolve your program if you have not already done so. To our colleagues in the process of designing and implementing a SOX compliance program, learn from the growing pains incurred by accelerated filers, utilize the new proposals to maximum efficiency, and continue to think outside the box on achieving compliance in the most expeditious manner.

ELT thanks CIT Senior Vice President - Finance And Accounting Robert O’Neill for this month’s article.