Human Resources Information Systems Role in Sarbanes-Oxley (SOX) Compliance

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INTRODUCTION

Compliance with the Sarbanes-Oxley Act (SOX) has become a new indispensable standard operating procedure for public companies competing in the business world of the 21st century. The SOX compliance is crucial for capital market stakeholders that want to ensure transparent insights into the companies' business operations and financials following the revelation of significant fraud in financial reporting by Enron, HealthSouth, WorldCom, and Global Crossing. From the onset the demands of SOX compliance have resulted in increased responsibilities from companies' finance and accounting departments. For more effective compliance and monitoring, the human resource (HR) and information technology (IT) departments need to be more strategically involved (Deloitte & Touche, 2003). One tool that may ease the companies' burden of SOX compliance is the human resource information system (HRIS), provided its role is expanded beyond the traditional scope of ensuring Equal Employment Opportunity (EEO) compliance and supporting payroll systems (Fletcher, 2005).

BACKGROUND ON THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act was enacted in 2002 as a legislative response to a string of major corporate scandals. The SOX legislation was structured to restore the post-Enron public trust in corporate accountability and independence of auditing (Dailey & Brookmire, 2005). In particular, SOX was passed to raise standards for financial reporting by public companies, increase accountability of boards of directors as a mechanism of corporate governance, insure external audit independence, and prescribe penalties to corporations for SOX violations and criminal penalties to CEO's or CFO's for noncompliance (Dailey et al., 2005). See Table 1 for a brief overview of SOX provisions.

The main part of SOX is Section 404 (management assessment of internal controls) that is designed to ensure that internal control processes are in place so that the company can effectively control its processes and outcomes. The SOX Section 404 is relevant to the HR function of a company because the line item, for which most employers spend nearly half of their budgets, includes people-related costs, such as salaries, benefits, incentives, and training. Control processes are needed in the HR department to prevent any occurrence of financial problems that might later require corrections by restatement of earnings, or problems that could surprisingly surface during an audit. Also, compliance with Section 404 requires that HR personnel evaluate whether (a) worker's compensation claims are reasonable; (b) stock options to employees are calculated accurately and all pertinent information about them is disclosed to the employees; (c) the companies, to which the HR function is outsourced, are operating in compliance with SOX and have internal controls meeting proper standards; (d) timekeeping for hourly employees is accurate; and (e) all necessary documentation for employee disciplinary and termination procedures are in place, as well as candidates are screened adequately before hiring; and employee information is only accessible to those who absolutely need it (Grossman, 2005b).

The process of establishing and maintaining internal controls in the HR department can be implemented

Table 1. Brief overview of Sarbanes-Oxley Act (Source: AICPA, 2007; Weiss, 2006; U.S Congress, 2002)

- Establishes an independent public company accounting board to oversee audits of public companies.
- Requires one member of the audit committee to be an expert in finance.
- Requires full disclosure to stockholders of complex financial transactions.
- Requires CEOs and CFOs to certify in writing the validity of their companies' financial statements. If they knowingly certify false statements, prison sentences of 20 years and fines of $5 million are possible.
- Prohibits accounting firms from offering other services, like consulting, while also performing audits, which constitute a conflict of interest.
- Requires ethics codes, registered with the Securities and Exchange Commission (SEC), for financial officers.
- Provides a 10-year penalty for wire and mail fraud.
- Provides whistle-blower protection for individuals who report wrongful activities to authorities.
- Requires attorneys of companies to disclose wrongdoing to senior officers and to the board of directors, if necessary.
- Mandates a felony for knowingly destroying or creating documents to impede, obstruct or influence any existing or contemplated federal investigation.
- Makes it a crime for tampering with a record or otherwise impeding any official proceeding.
- Makes it a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding.

effectively through process analysis (Schwarzkopf & Miller, 2005). Process analysis involves the development of the steps through which a decision must pass before its approval. A major challenge for HR in this process is to determine the path of decisions that must go outside the HR department. Typically, these decisions are related to compensation and benefits because their paths often involve both payroll and IT departments (Grossman, 2005b).

Other Sections of SOX, besides Section 404, also impact the HR function because they may affect HR practices of the company. In particular, Section 402 (enhanced conflict of interest provisions) stipulates the way in which the company's executives and board members can or cannot be compensated. This provision focuses on consumer credit companies making home improvement and consumer credit loans or issuing credit cards to directors and executive officers in the ordinary course of business with the same terms and conditions as to the general public (AICPA, 2007). Based on this Section, a "fire wall" needs to be erected between these executives' business and home expenses so that members of the corporate top management team are strongly discouraged from using their company credit cards for anything that is not directly related to the company business. In addition, Section 306 (insider trades during pension fund blackout periods) of SOX is intended to insure that a "blackout period," during which employees cannot exercise their stock options, applies to both executives and non-executives alike. Employees have the right to receive 30 days' advance notice, explaining the reasons and expected dates for the blackout, as well as the need for beneficiaries to evaluate their current investment decisions because they will not be able to change investments during the blackout. According to Section 406 (code of ethics for senior financial officers) of SOX, a code of ethics must be supplanted with "suitable training" so that employees no longer have the excuse of ignorance. The responsibility of HR management is to ensure all of these requirements are properly implemented and evidenced (Grossman, 2005a).

Another section of SOX, Section 301 (public company audit committees), deals with the grievance system that must be open to current and former employees, customers, and public interest groups so that they may anonymously provide information about compliance issues. The SOX-related complaints should be treated with discretion and without fear of retaliation. This protection against retaliation is covered in Title VIII (corporate and criminal fraud accountability), Section 806—and applies even if whistleblowers are wrong (Grossman, 2005a). Human resource personnel would be well-advised to retain all documentation pertaining to any SOX-related claims, according to Section 802 (Criminal penalties for altering documents) of the Act, because Section 802 prohibits any destruction of relevant documentation (McLean & Elkind, 2005).

SIGNIFICANCE OF HRIS FOR SOX COMPLIANCE

One effective means that HR personnel can use to comply with the requirements of the SOX is a well developed HRIS. An HRIS is a software application