

THE SOX 404 CHECKLIST

DO YOU HAVE “INTERNAL CONTROL”
OF YOUR REVENUE?



The **SARBANES-OXLEY 404 CHECKLIST**

– DO YOU HAVE “INTERNAL CONTROL” OF YOUR REVENUE?

The Sarbanes-Oxley Act requires proper internal controls and procedures to ensure correct financial reporting of public companies. To ensure compliance the law specifically requires companies to:

- a) **Establish internal controls and procedures**
- b) **Certify their completeness and quality**
- c) **File an Internal Controls Report**
- d) **Have an external auditor attest to the adequacy of your internal control system**

One of the key reporting elements, and the item which has been the leading cause for public restatements – *REVENUE* – is under more scrutiny than ever before. How are revenue-related processes handled at your company? Can you be sure revenue is managed correctly throughout the entire revenue cycle? What processes or checks and balances do you have in place to ensure proper revenue reporting?

ANSWER THE FOLLOWING QUESTIONS AND SEE WHAT YOU MIGHT BE MISSING:

This Sarbanes-Oxley Section 404 checklist is comprised of 15 questions (listed below) pertaining to your current revenue related business practices. Each answer is weighted by a point system that is used to calculate a final score. The final score will let you gauge where your company falls with regard to Section 404 preparation. You will find a table at the end of this document that outlines three possible categories based on level of preparedness.

▶ **What controls ensure that orders are recorded properly?**

	Points
Orders are keyed into an order entry system in the field by the sales staff.	0
Orders are keyed into an order entry system in the field by the sales staff. Orders are reviewed and recorded by a member of the Finance / Accounting group.	2
Orders entered by a member of the Finance / Accounting group are reviewed by management. A complete audit trail of all activity is maintained in the order entry system.	5

- ▶ **What controls ensure that revenue is properly allocated to the components of the order (license fees, services, hardware, training, maintenance, etc.)?**

	Points
Revenue is allocated by Accounting and entered into a spreadsheet.	1
Spreadsheet entries are manually reviewed by management and compared to pricing based on established revenue recognition rules.	3
Revenue is allocated automatically by an enterprise system based on established revenue recognition rules.	5

- ▶ **What controls ensure that the appropriate pricing is applied to each component of a contract in order to determine how revenue should be allocated?**

	Points
Pricing is determined by Accounting at the time an order is entered into the enterprise system.	1
Pricing is maintained in a spreadsheet. The spreadsheet calculates the amount to allocate to each component based on the pricing.	2
The order entry system provides price books. One price book contains the pricing to be used for revenue allocation. Revenue is reallocated automatically based on the price book.	5

- ▶ **What controls ensure that invoices for non-delivered components of a contract are accounted for appropriately?**

	Points
Invoices are manually generated. Journal entries are entered into the system for the invoices.	1
Invoices are generated by the system. Revenue is adjusted by Accounting based on information stored in a spreadsheet.	3
Revenue is scheduled automatically independent of billing terms by an enterprise system based on established revenue recognition rules.	5

- ▶ **What controls ensure that revenue is not recognized for delivered components of an order (e.g. license fees, hardware) until distribution of CDs or activation keys has occurred?**

	Points
Shipping and Accounting receive a duplicate report of orders to ship. Accounting invoices from this report. Shipping contacts Accounting if an order doesn't ship.	1
Shipping emails Accounting when the items are shipped. Accounting then creates a manual invoice.	3
Shipping is integrated with the order entry and accounting system. Orders are released by the accounting system. Released orders are "ship confirmed" in the system by shipping. System prevents invoice generation until shipment is confirmed.	5

► **What controls ensure that unbilled revenue is being recorded properly?**

	Points
We don't have unbilled revenue.	0
We don't recognize unbilled revenue because there is no way to track it.	1
We keep spreadsheets of unbilled revenue and periodically review, recognize and match against billing activities.	2
We have an enterprise system that separates billing schedules from revenue schedules, which allows us to recognize revenue independently from billing activity.	5

► **What controls ensure that invoices for complex terms (e.g. milestones) are generated based on the stated terms of the contract?**

	Points
Complex billing terms are maintained in a spreadsheet. Invoices are created manually based on this information.	1
Invoices are manually compared to the terms of the original contract for accuracy. Once confirmed, the invoice is re-keyed into the accounting enterprise system.	3
Complex terms are set up in the enterprise system at the time of order entry. Invoices are generated automatically based on these terms. Invoices tied to an event are not released until the completion of the event is confirmed.	5

► **What controls ensure that deferred revenues are recognized based on established revenue recognition guidelines?**

	Points
All deferred revenues are entered into the General Ledger. G/L accounts are amortized in total.	1
Deferred revenues are scheduled in a spreadsheet. The spreadsheet provides the amount to be recognized monthly. The amount to be recognized is manually posted to the G/L.	3
Deferred revenues are scheduled automatically by the accounting enterprise system at the time an order is entered. Schedules are created for each deferred item individually. Revenue is then recognized automatically based on these schedules.	5

► **What controls ensure that revenues recognized under a percent complete method or based on specific milestones are not recognized prematurely?**

	Points
Contracts are manually reviewed and journal entries are posted based on the review.	1
Complex spreadsheets are maintained to help calculate the amount to be recognized monthly. Spreadsheets are manually updated. Journal entries are booked to recognize revenue based on the information in the spreadsheet.	3
Deferred revenues are scheduled automatically by the accounting enterprise system at the	5

time an order is entered. Schedules are created for each deferred item individually. Revenues tied to milestones are placed on hold until the milestone is met. Revenues under a percent complete method are updated and recognized directly in the enterprise system. General ledger entries are generated by the system based on the amounts contained in the revenue schedules.	
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▶ **What controls ensure that payments received are posted to the appropriate invoices?**

	Points
Invoices are re-keyed into a spreadsheet. Paid invoices are removed from the spreadsheet. A separate spreadsheet is maintained for paid invoices.	1
Invoices are manually reentered into an accounts receivable system. Payments are recorded against these invoices.	3
Accounts receivable is integrated with the order entry (OE) system. All invoices created in OE are included in a customer's A/R. When payments are received, the system provides a list of all open invoices. Partial payments, write-offs and credits can all be applied directly within the system.	5

▶ **What controls ensure that amounts reported in the G/L reconcile with the various supporting systems (Order Entry, A/R, etc)?**

	Points
All journal entries are manually entered into the system based on the amounts contained in the supporting systems. Adjustments are booked when discrepancies are found.	0
Entries are made to the accounting system manually. All accounts are reconciled by Accounting monthly.	3
All systems including A/R, A/P, order entry and deferred revenues are integrated with the G/L. Subsidiary ledgers are maintained directly in the system. Manual entries are not permitted to the G/L accounts impacted by these systems. A complete audit trail is maintained by the system for all activity impacting the G/L.	5

▶ **What controls ensure that components of a contract that renew automatically (e.g. maintenance) are appropriately recorded and renewed in the correct period?**

	Points
Renewable components of a contract are entered into a spreadsheet by Accounting. At the time of renewal, an invoice is created manually and entered into the A/R system.	1
Renewals are maintained in a spreadsheet, manually created invoices are reviewed by management for errors.	3
Renewable components are managed within the enterprise system and are set up automatically at the time of order entry. The system stores the start and end dates for the period, and provides a routine to select renewals for processing based on expiration dates.	5

- ▶ **What controls ensure that adjustments to renewable components of a contract are properly recorded and reflected in a customer's invoice?**

	Points
Invoices are manually generated based on the information stored in the renewal spreadsheet. Adjustments are then booked to the customer's A/R account after invoicing.	1
Statements are generated offline based on information stored in the renewal spreadsheet. Customers are given 30 days to notify company of any changes. After 30 days, the information is reentered into the A/R system and invoices are generated.	2
All renewal information, including the current start and end dates and the correct pricing to renew at, is stored directly in the enterprise system. The system generates a pro forma statement based on the information in the system. Adjustments can be made to the pro forma. Invoices are generated based on the information contained in the pro forma.	5

- ▶ **What controls prevent unauthorized changes to transactions in the system?**

	Points
None.	0
Manual notes describing changes.	1
Complete audit trail of all transaction including date and user ID.	2
Complete audit trail combined with security controls preventing unauthorized users from modifying or creating transactions.	5

- ▶ **What controls ensure that changes to deferred revenue schedules are properly reflected in the G/L?**

	Points
Manual notes.	0
Spreadsheet gets updated for future reference.	1
Manual adjustment in G/L.	1
Change is made in enterprise system, which automatically makes appropriate updates to the integrated G/L.	5

RESULTS

Score	Sarbanes-Oxley Section 404 preparation level
0-30	Most of your processes are manual and in spreadsheets. There is considerable compliance risk because of the lack of appropriate internal controls and the risks of human error inherent in manual processing.
30-60	You have some control mechanisms in place, but are still relying in too many areas on manual processes. This may lead to errors and indicates weaknesses in your internal controls. Additionally it indicates a high cost of doing business because of considerable operational inefficiencies.
60 +	Congratulations, it appears that you have implemented numerous automatic internal controls and at the same time are operating very efficiently.

The foregoing test should help you to begin examining your own internal processes. It is not intended to be comprehensive but rather to suggest to you certain areas where your internal controls may be vulnerable. A more comprehensive evaluation can be conducted with the assistance of your financial, legal and business advisors.

ABOUT SOFTRAX

Softrax Corporation is a leading enterprise software company providing revenue management solutions that fundamentally change the way technology companies manage, analyze and predict their revenue streams. Softrax delivers business-critical solutions to hundreds of customers.



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