

The Blue Sage Group's Testing Overview for 404 Compliance

Where do I begin?

An effective test project must start with a clearly defined test plan that has been reviewed and approved by all appropriate parties. These include but are not limited to the compliance team, CFO, External Auditor and Audit Committee.

It is important that you base your test plan on your documentation and evaluation findings and results. It is best to take into account all remediation projects and plan to start testing after the remediation projects have been completed.

When do you start the testing phase?

You start testing phase after you have completed documentation and evaluation of controls.

Once all the internal controls have been identified, evaluated and rated you need to select the "key" controls or those controls with the highest risk rating.

You can then design your test plan, draft your scripts and create your documentation templates.

Once you have selected the sub-set of controls to test, you need to get buy in from the auditors that their selection adequately covers the assertions on the significant accounts.

What do you need to know about testing?

1. The "tests" are really procedures that outline how the company will evaluate the effectiveness of both the design and operation of a control. The test will involve gathering relevant evidence that can be used to determine the following:
 - Is the control performing the task it was suppose to perform? Is it preventing activity from occurring if it is outside the normal process?
 - Is the control operating effectively? Is it working most of the time?
2. The standards and best practices for SOX 404 testing are evolving. Testing will vary based on the company, control environment and audit firm. However, most audit firms have agreed on standards for testing controls that are consistent with the PCAOB Auditing Standard No. 2 related to their attestation of internal procedures and controls.
3. The selection of controls to test and the type of test selected should be based on the following factors:
 - Risk of material omission and misstatement
 - Expected effectiveness and efficiency of the specific tests
 - Frequency of control activity and nature of activity, i.e. automated vs. manual
 - Nature and materiality of the items being tested
 - Type of evidence available along with the reliability of evidence
 - Nature of the assertion objective to be achieved
4. Testing allows the company/consultant/auditor to :
 - Determine that the policies and procedures, transaction records, and other control evidence are internally consistent with the actual activities that take place

- This consistency usually provides enough evidence that the assertion on the validity of the control can be made in the assertion report.
5. There are different types of test each with a specific determination in mind.
- A. Design** – These tests are focused on the “effectiveness” of the design to determine if the design will prevent or detect fraud, omissions and/or misstatements.
- These tests usually include the following activities:**
- Interviews of appropriate personnel
 - Observing a transaction to see how the control is applied
 - Actual review of associated documents and reports
- B. Operation.** These tests validate the “operating effectiveness” of controls by focusing on the who, what, when and how:
- Who applied the control? Example who was the approver?
 - How the control was applied? By a system requirement?
 - Consistency with which it was applied? Does the control always occur?
- Tests for operational effectiveness usually include:**
- Interviews of appropriate personnel
 - Tracing a transaction to see the application of the control in real-time.
 - Documents, reports, and electronic file reviews (Samples)
 - Performing the control activity in a real or test situation as part of the testing procedures. Use real or sample information that may be correct or erroneous to see if a preventative control works.
 - Inspecting electronic files and activity logs allow you to retrace the procedure and review activity to ensure controls are working as they were intended
 - Performing reconciliations that compare electronic files and logs to supporting documentation to ensure the activity agrees
6. Test results must be documented and the level of detail of documentation will vary based on the size and complexity of the company, type of IT systems, nature of the controls and the specific assertions. However all documentation should include the following elements:
- The test results with an evaluation of risk for each control tested
 - The documentation should provide evidence to support the test results
 - The documentation should link back to the control evaluations and assessments
 - The documentation should facilitate the audit attestation process
 - Remediation activity should be linked to controls within the test results