

Sarbanes-Oxley Sets New Standard for Controls ***World Energy Exchange process management and tracking*** ***support SOX compliance.***

Some laws sit on the books forever without notice. Others reach out and touch us from the moment they come into law. Such is the case with the Public Company Accounting Reform and Investor Protection Act of 2002 -- known more commonly as Sarbanes-Oxley or SOX. Whether you welcome, fear or disparage SOX, it is a fact of modern business life.

The act itself is a jumble of legal requirements designed with one primary goal in mind -- restore the trust of investors in publicly held companies following the loss of confidence that flowed from the well-publicized troubles experienced by Global Crossing, Parmalat, Enron, and WorldCom. At the basis of that trust-building initiative are requirements for new levels of transparency in how businesses operate, document what they do and report financial conditions.

Rule makings issued by the Public Company Oversight Accounting Board (PCOAB), which was created as part of SOX, have worked to clarify some of the early concerns about its requirements. These are certain to evolve over time. Notwithstanding its lightning-rod-like affect on businesses and potential cost implications, Sarbanes-Oxley is law.

As publicly held companies have scrambled to comply with SOX, a new market segment has emerged to provide software and services that address compliance issues. These offerings tend to focus on process management, documentation and reporting. World Energy's Exchange online reverse energy auction platform fully supported much of this functionality well before such issues ever came to fore.

SOX's Key Points

The Sarbanes-Oxley Act has a number of major provisions that directly impact publicly held companies. These provisions generally include¹:

- Certification of financial reports by chief executive officers and chief financial officers
- Ban on personal loans to any Executive Officer and Director
- Accelerated reporting of trades by insiders
- Prohibition on insider trades during pension fund blackout periods
- Public reporting of CEO and CFO compensation and profits
- Additional disclosure
- Auditor independence, including outright bans on certain types of work and pre-certification by the company's Audit Committee of all other non-audit work
- Criminal and civil penalties for violations of securities law
- Significantly longer jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements.
- Prohibition on audit firms providing extra "value-added" services to their clients

- including actuarial services, legal and extra services (such as consulting) unrelated to their audit work.
- A requirement that publicly traded companies furnish independent annual audit reports on the existence and condition (i.e., reliability) of internal controls as they relate to financial reporting.

There are 11 "titles", or specific sections, in the act that deal with how publicly held companies are to behave with respect to reporting financial conditions and the supporting documentation for how they achieved those numbers – such things as contracts, for example. Within those 11 titles are several sections that are important to the World Energy Exchange community. These includeⁱⁱ:

Section 302: Corporate Responsibility For Financial Reports.

The CEO and CFO of each issuer shall prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." A violation of this section must be knowing and intentional to give rise to liability.

Section 404: Management Assessment of Internal Controls.

Requires each annual report of an issuer to contain an "internal control report", which shall:

- (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
- (2) contain an assessment, as of the end of the issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

Section 409: Real Time Disclosure.

Issuers must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis.

From World Energy's perspective, Sections 404 and 409 are of particular interest due to their requirement on reporting of internal controls, processes and material changes. Section 302 derives at least a portion of its requirement through compliance with Sections 404 and 409. Clearly, procurement of energy supply of the magnitude in which

the World Energy Exchange online reverse auction platform is utilized is subject to wide ranging levels of scrutiny.

In support of the need to effectively manage internal processes and controls, the PCOAB has issued guidelines for rendering opinionsⁱⁱⁱ.

"The main point of these guidelines is that management should use an internal control framework such as [Committee of Sponsoring Organizations \(COSO\)](#) (which describes how to assess the control environment, determine control objectives, perform risk assessments, and identify controls and monitor compliance). Companies have almost uniformly elected COSO as the standard when choosing an internal control framework.

COSO is a [U.S.](#) private-sector initiative, formed in [1985](#). Its major objective is to identify the factors that cause fraudulent financial reporting and to make recommendations to reduce its incidence. COSO has established a common definition of internal controls, standards, and criteria against which companies and organizations can assess their control systems."

COSO Key Concepts

- *Internal control is a process. It is a means to an end, not an end in itself.*
- *Internal control is affected by people. It's not merely policy manuals and forms, but people at every level of an organization.*
- *Internal control can be expected to provide only reasonable assurance, not absolute assurance, to an entity's management and board.*
- *Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.*

World Energy Exchange's Fit in the Compliance Spectrum

The World Energy Exchange provides a procurement environment for buyers and sellers of energy. The Exchange includes a variety of modules designed to enable the procurement of energy supply at the lowest possible price while providing step-by-step process management and detailed documentation throughout pre, during and post auction periods. The platform's key attributes support SOX compliance.

The software and business processes inherent in the Exchange provide self-documenting due diligence that meets the most stringent guidelines. The Exchange provides a set of modules that enable users to address pre, during and post auction needs.

The Deal and Task Management module creates an audit trail of all the steps taken to run a successful transaction documenting original due date, completion date, clock time on task, and out of pocket costs associated with the tasks. Procurement specific web pages track all information provided to suppliers - including transcripts of supplier calls, supplier invitations, usage profiles and desired contract parameters - to assure that all suppliers are playing on the same level field.

The unique Anglo-Dutch design of the Exchange's reverse auction is the most robust price discovery engine available. The Anglo aspect creates a competitive bidding environment that causes suppliers to aggressively bid their prices down. The Dutch part creates a best and final "last bid blind" process that delivers the lowest price available in the market on that day. Blind bidding tends to force those competing in the auction to offer the lowest possible price, absent any fat in their margins. In fact, about 20 percent of the time, low bidders outbid themselves at the moment before the auction closes.

Included as part of any Exchange auction transaction are date and time stamping of bids, comparison of each bid with utility standard offer rates, as well as automated stop times, which ensures the integrity of auction events and creates audit trails and a self-documenting capability essential to Sarbanes Oxley Section 404 compliance. The Exchange is also tied to the Atomic Clock to ensure that when the auction ends at noon, it is precisely noon, eliminating any doubt about the ending time.

Finally, the Portfolio Management incorporates fully auditable, end-to-end portfolio management functionality, providing energy buyers with a real-time data warehousing and database management solution that stores and tracks monthly usage information, analyzes contract and facility performance and incorporates the additional back office capabilities to fully automate the end-to-end cycle of energy purchasing, contracting and consumption.

Its transparent, auditable documentation and reporting processes are compliant with SAS 70 Type I & II requirements and were designed with Six Sigma principles to ensure the highest levels of quality and consistency.

According to the SAS 70 website, the "Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA). AICPA is also a COSO member. A SAS 70 audit or service auditor's examination is widely recognized, because it represents that a service organization has been through an in-depth audit of their control activities, which generally include controls over information technology and related processes.^{iv}

All World Energy processes are 100% auditable, from pre-auction planning and development, to bid-by-bid tracking during the auction, to follow-on contract management post-auction.

Passing the Scrutiny Test

Scrutiny is nothing new to the energy supply business. Federal and state regulatory bodies have governed the purchase and sale of supply for much of the past century. However, as energy markets have become increasingly deregulated, the need for well-defined procurement processes and the associated documentation trail is even more crucial.

Recently, World Energy supported a major eastern US utility with procurement of wholesale supply that is sold to the utility's end retail customers. The state public utility commission played a proactive role in this procurement, to the point of signing on to the Exchange during the auction to observe the bidding process in action. Not only did the utility meet its pricing goals – i.e., it got supply at a lower than projected price – the regulator was completely satisfied with the transparency of the reverse auction process. The regulator was impressed with the completely neutral affect the blind bidding process had on decisions to contract. No supplier was favored over another. Price and ability to provide supply to contract terms were the deciding factors.

In situations where a company experiences a major energy supply cost increase, for example, that results in lower than expected sales and subsequent financial performance, the documentation process inherent in Exchange can be utilized to substantiate that all necessary due diligence was exercised in the supply procurement process.

At the end of the day, Sarbanes-Oxley is intended to restore trust by requiring new levels of corporate documentation and verifiable reporting. World Energy operates in a narrow channel – energy supply procurement – of the broader business spectrum. Energy costs make up a fundamental portion of operating costs for nearly all businesses. The World Energy Exchange is enabling those responsible for supply procurement to not only meet their basic business function of achieving the lowest price for energy supply but also to support stringent SOX compliance.

ⁱ Wikipedia

http://en.wikipedia.org/wiki/Sarbanes-Oxley_Act#Overview_of_the_PCAOB.27s_requirements

ⁱⁱ American Institute of Certified Public Accountants

http://www.aicpa.org/info/sarbanes_oxley_summary.htm

ⁱⁱⁱ Wikipedia

http://en.wikipedia.org/wiki/Sarbanes-Oxley_Act

^{iv} SAS 70

<http://www.sas70.com/about.htm>