



# HR Automation Technologies: Supporting Sarbanes-Oxley Compliance and the Drive for Operational Excellence

A Lawson Software® White Paper

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On the whole, human resources organizations have not fully embraced automation technologies. A telling statistic: 92% of HR's "key controls" — fundamental to compliance with the Sarbanes-Oxley Act of 2002 — are executed *manually*.\* Besides making regulatory compliance more labor intensive and time consuming, the lack of automation is hindering HR's efforts to achieve operational excellence and play a more strategic role in the enterprise.

\*Source: The Hackett Group, HR Technology Conference, October 2005

# Introduction

The role of the human resources professional is constantly evolving. During the 2000s, this role has migrated increasingly to that of a strategic partner to the company, with less emphasis on enforcing corporate rules.

Unfortunately, external factors — most notably a barrage of federal and state regulatory requirements — have compelled many HR organizations to devote escalating amounts of time and resources to compliance, diverting the focus away from activities which contribute to the company's strategic objectives.

For HR, the regulatory burden grew significantly in 2002 when Congress, prompted by high-profile accounting scandals at Enron, WorldCom, Tyco International, and other publicly-held U.S. corporations, passed the Sarbanes-Oxley (SOX) Act.

Also known as the Public Company Accounting Reform and Investor Protection Act, SOX mandates, among other safeguards, increased internal documentation, company controls, separation of duties, and independent reporting of financial results. Subsequent to SOX enactment came the adoption of Section 409a of the American Jobs Creation Act, limiting executive deferral of income through qualified and non-qualified programs.

Today, in addition to their usual reporting and operational duties, HR professionals are expected to bring value to the company in a number of significant respects, ranging from operational efficiency initiatives to providing strategic leadership. All the while, they are called upon to assist with — and frequently oversee — regulatory compliance.

And, now SOX compliance imposes a new set of responsibilities on the HR organization, among them: developing and documenting adequate controls, maintaining auditable files, and upholding privacy standards. In the face of issues such as identity theft and increased privacy requirements, there is also an enormous obligation to build and maintain tight access controls for HR information management systems — to safeguard employee-specific financial and personal data pertaining to salary, earnings history, bonuses, wage garnishments, tax identifications, and other sensitive topics.

Within HR's leadership, there is a growing recognition that conventional HR processes and tools simply cannot keep pace with the current and projected demands on the HR infrastructure, particularly with the emergence of SOX-related issues.

This white paper will review some of the essential responsibilities HR must assume in the satisfaction of SOX compliance and audit requirements. The subsequent discussion will look at how HR organizations can deploy automation technologies to help them meet their SOX obligations with less time, effort, and resources — and with a higher degree of certainty.

HR organizations which adopt technologies as described in this white paper, in tandem with key process improvements, enhance their abilities in other important aspects beyond SOX compliance. This paper will also note some of the key strategic benefits of automation: reducing paperwork, manual tasks, and costs, as well as increasing the ability to concentrate on strategic work which moves the company in a positive direction.

# Key SOX Components Require HR Involvement and Leadership

Passage of SOX, which applies only to publicly-held corporations, including international companies listed on U.S. stock exchanges, was intended to accomplish one overriding objective: protect the interests of shareholders.

To the government watchdogs who enforce SOX compliance, this is very serious business — as it should also be to companies which are required to comply. Besides negative publicity, noncompliance can result in significant costs to companies: fines, reductions in share value, lawsuits, and even prison time for the chief executive officer (CEO) and chief financial officer (CFO).

One of the most common misconceptions about SOX compliance is that it only involves a company's finance and information technology areas. In fact, SOX touches almost every HR function, spanning virtually the entire employee lifecycle. Following are several activities which are connected to SOX compliance and require HR participation or oversight:

- Processing and approving new hires, transfers, promotions, and terminations
- Managing executive hiring, incentive plans, stock options, direct and deferred compensation, and supplemental programs
- Maintaining accurate employee data, including security and access restrictions to facilities and systems
- Setting up automated systems to process compensation changes

- Determining the segregation of duties between finance and HR to avoid a conflict of interest
- Producing documentation for review by internal and external auditors

Two SOX components, Sections 404 and 409, are of primary importance and demand special attention from the HR organization.

**Section 404** directs company management to establish, maintain, and report on internal controls. This section comprises five internal control components:

- Control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring

**Section 409** mandates “real-time” disclosure of financial and operational material events which could affect business operations and potentially the stock price.

Both sections pose significant challenges to corporations and their HR organizations.

Because Section 404 does not contain an official definition of “internal controls,” different external auditing firms may use different benchmarks to determine the adequacy of these controls. However, in light of past indiscretions involving prominent public accounting firms, no external auditor wants to be accused of lacking independence from its clients. Therefore, to ensure that adequate internal controls are in place, most auditors are taking a conservative approach.

In this environment, the “standard of reasonableness” commonly used in the HR profession may no longer be an appropriate threshold. Auditors typically will scrutinize policies and processes for multiple reviews and safeguards — also known as “key controls.” They will be especially alert to anything possibly possessing “materiality” under Section 409 (i.e., affecting financial results), as well as information which could be disclosed to shareholders and/or which could impact the stock price.

## Key SOX Components, continued

The language in Section 409 concerning real-time disclosure of material events may also present challenges for HR. Consider some of the HR activities which may affect business operations and stock price:

- Executive hiring decisions and pay programs
- Organizational structure changes
- Stock option program design or changes
- Incentive plan changes
- Change in control
- Severance packages
- Benefit plan changes

In triggering a Section 409-level of materiality, activities within any of these areas requires the filing of an 8-K public disclosure document. It should also be noted that when material issues arise, HR is frequently involved, along with legal counsel, investor relations, and public relations decision makers, in discussing strategies and public announcements.

One other element of SOX which usually involves HR: whistleblower protection for employees who report potentially fraudulent activities to internal or external sources. Publicly-held companies are obligated to designate an internal ethics officer and a mechanism for employees to submit reports without fear of retribution.

In summary, while the CFO has primary ownership of compliance initiatives related to financial transactions, the HR organization plays a vital role in the execution of many compliance activities and in overall company-wide adherence to SOX standards.

# Four Primary Areas of HR Compliance, Encompassing Many Requirements

Compliance with SOX Section 404 requires publicly-held companies to include in their annual report a section on the effectiveness of internal controls pertaining to financial reporting. This information is organized into four broad categories:

- Segregation of duties
- Access restrictions for human resources management systems (HRMS) and filing systems
- Authorization of master data changes
- Other data exchanges and reports

Following are key HR-related security, process, and audit requirements within each of the four categories.

## **Category 1: Segregation of Duties** *Security Requirements*

- Clear separation of plan design and approval from payments
- View versus change access designation
- HR versus payroll controls
- Train new IT users in a non-production environment with fictitious employee information

### *Process Requirements*

- Documentation of decision making and authority levels
- Confidentiality agreements with documentation
- Process to handle changes in user duties or roles
- Adequate understanding of roles

### *Audit Requirements*

- Validation of data sources
- Monitor and audit security setups and access
- Secondary levels of approval

## **Category 2: HRMS Access Restrictions** *Security Requirements*

- Access and change control
- Role-based security functionality

### *Process Requirements*

- Documentation and passwords to secure data
- Employee and manager access defined
- Hierarchy tables established
- Back-up and disaster recovery

### *Audit Requirements*

- Ability to monitor and audit changes to passwords, user access, employee terminations, and hierarchy

## **Category 3: Authorization of Master Data Changes** *Security Requirements*

- Compute and update employee master records
- Edit and delete errors

### *Process Requirements*

- Validation of data or change sources
- Documentation and flow charting
- Workflow applied to change notification
- Updates to master file and tables must be authorized

### *Audit Requirements*

- Review calculations for accuracy
- Audit reports flagging any changes or corrections to master files and tables
- Employee files in key areas secured and reviewed by second party
- Handling of new hires, pay/title changes, and terminations
- Audit interface files

## **Category 4: Other Data Exchanges and Reports** *Security Requirements*

- Identify all inbound and outbound data exchange within HR management system
- Limit report writing and file exchanges
- Access controls on view, print, and send files

### *Process Requirements*

- Accuracy review of changes, report data, and calculations
- Identify and meet all data request and reporting requirements

### *Audit Requirements*

- Authorization for reporting and data access
- Review for data accuracy
- Monitor data exchange or interface requirements

# External Auditors: Looking for Formal Processes, Ownership, and Controls

In a SOX compliance audit, the following elements will come under close scrutiny:

- Documented and repeatable formal processes
- Clear ownership, with demonstrated accountability, of processes and functions
- Key and high-level controls, addressing specific compliance requirements
- Well-defined segregation of duties
- Supporting reports, data feeds, and documentation of approvals

Companies can expect external auditors to examine a number of test scenarios, plan documents, required signoffs, calculations, and feeds to general ledger/financial management systems. In evaluating the appropriateness and accuracy of calculations, auditors will compare them with plan designs. They will also look at accruals for potential compensation and benefit payments, including payroll, incentives, stock option charges under Fair Accounting Standards Board (FASB) 123R, severance pay, COBRA, and 401(k) match.

## Standards for Examination and Testing

Currently, there is no definitive standard for auditing of HR processes and documentation. Thus, the standards will vary from one external auditor and corporation to another. However, HR organizations should be prepared for auditor examination and testing of the following:

### *Recruiting and Staffing*

- Requisition and approvals prior to recruiting and selection
- Headcount reports for employees and contractors
- Budget verification
- EEO-1 and Vets 100 compliance reporting

### *Benefits*

- ERISA compliance
- Attendance and time keeping requirements
- Proper accruals of time-off balances
- 401(k) match
- Proper 5500 and summary annual reports
- Discrimination testing
- Timely notification of COBRA benefits
- Proper entrance and exiting of employees on benefit programs

- Proper feeds to external vendors
- Applicable HIPAA security and compliance
- Employee benefits file segregation and storage security
- Proper accruals of retirement and medical plans

### *Compensation*

- Proper employee setup and removal
- Pay change and transaction management
- Proper segregation of pay files and approvals
- Audit functions
- Accruals
- Calculations of merit, transfer, and promotion increases
- Calculations of incentive accounting
- Administration of stocks and stock options
- Data feeds to payroll and other external vendors

### *HRMS*

- Appropriate, timely entrance and exit of system information on vendors, contractors, and employees
- Separation of files (paper or electronic) between employees and contractors
- Appropriate system and building access controls for employees and management, including HRMS reports, voicemail, email, remote access, data feeds, and data edits
- Appropriate data integrity controls, including employee and manager notification of changes, record audit functions, screen lockout, and workflow process
- Appointment of a steward to oversee data integrity, data privacy, and access approvals
- For international organizations: compliance with data privacy standards in most countries

### *Employee Files*

- Access and security controls for employee files
- Separation of I-9 and benefit files
- HIPAA and data privacy compliance
- All required information contained in proper files
- Record retention and destruction policies followed without exception
- For electronic storage: proper access and safeguards

### *Payroll*

- Accurate pay processing, including tax withholding and deductions
- Appropriate feeds to general ledger
- Appropriate accruals
- Tax reporting and payments
- Transmission of deductions to external vendors for 401(k), health care, stock purchase providers, etc.
- Governmental reporting at all levels
- Separation of pay or pay change approvals from people who process payment

As will be outlined in the next section, workflow automation, coupled with coherent documentation and easy-to-follow audit trails, should be applied to as many of the above processes as possible. Processes which are not documented or cannot be tracked will require additional testing and may lead to deficiency notations in the audit report.

If a deficiency is identified, auditors will consider whether mitigation may be achieved through alternate means or supplemental controls. This applies particularly to situations when a long-term solution is prohibitively expensive; in these instances, a temporary remedy may be allowed.

# Process Automation: Critical to Satisfying Compliance Requirements

Considering the previously discussed business requirements and audit standards, it's easy to understand how SOX compliance can strain even the most well-staffed and competent HR organization. There is also strong evidence that HR, to a large degree, has not adopted technologies which could save substantial time and energy in carrying out compliance efforts. In fact, research conducted by The Hackett Group shows that 92% of SOX key controls in HR are executed manually.

Workflow automation may be applied at multiple levels, such as:

- Employee and contractor hiring
- Absence management
- Data integrity
- Benefit edits and feeds to third parties
- Employee terminations and removal of access privileges to systems and facilities
- Salary changes
- Stock option grants
- Design, approval, and compensation under incentive plans
- Access to HRMS and payroll systems

A word of caution is warranted here: Before implementing workflow automation, companies should take a close look at their current processes and determine whether process reengineering is needed. Automating a bad or ineffective process will only speed up the process; it will not change the outcome.

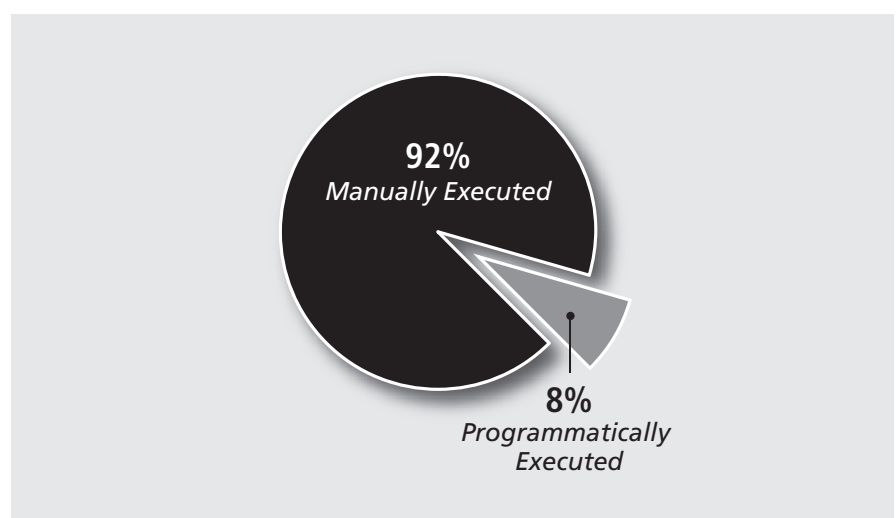
Following are suggested steps for evaluating processes and creating effective automated workflows:

1. Document current processes, using Microsoft® Visio® or other flowcharting software.
2. Identify process bottlenecks and inefficiencies.
3. Reengineer processes, as needed, and build in the appropriate controls.
4. Test reengineered processes.
5. Deploy workflow automation technologies, together with employee and manager self-service applications.
6. Retest the automated processes.
7. Verify that, whenever changes to processes occur, the system captures key data, including date, time, and name of person entering or modifying data in a field.

8. Add secondary approval levels to critical workflows (e.g., requisitions, new hires, pay changes, status changes, hours worked).
9. Confirm that the system provides adequate reports which can be readily accessed and analyzed by HR and other appropriate staff.
10. Identify and implement necessary controls, both automated and on demand.

Linking effective processes with workflow automation can accomplish two important objectives: 1) putting accurate data in the hands of appropriate individuals on a timely basis; and 2) helping to ensure that processes contain sufficient controls and safeguards, supporting compliance with SOX requirements.

## Execution of Sarbanes-Oxley Key Controls



# Using SOX and Business Requirements to Assess Technology Options

SOX does not directly regulate automation technology. However, as discussed earlier in this white paper, by identifying key SOX requirements, a company can effectively assess its technology options. Following are several benchmarks which may be applied to the evaluation of vendors and solutions.

**Core application integration** — helps to ensure access to timely, accurate data — “one version of the truth” across the enterprise, an essential ingredient for SOX-related reporting.

**Single source of employee data** — improves data accuracy through a single database; changes are made in one location, and the system feeds the changes to other applications.

**Comprehensive functionality** — brings process automation through a full range of “hire-to-retain” activities, including recruiting, HRMS, payroll, time management, expense reporting, benefits and compensation management, workforce analytics, accounts payable, general ledger and procurement.

**Flexible, open architecture** — enables easier system customization (e.g., building workflows and key controls), as well as the ability to interface more readily with legacy or best-of-breed systems.

**Digital dashboards** — supporting efforts to stay on top of emerging material situations through “on-demand,” highly graphical data viewing systems.

**Drill-down capabilities** — helping uncover detailed information — a more complete story — behind transactions and data.

**System security** — can be set up to prevent unauthorized access through role-based access to systems and facilities, based on position, not the individual; single sign-on to multiple applications; automated sign-off at predetermined levels of inactivity; and the granting and removal of access privileges, triggered by hires, terminations, and leaves of absence.

**Change notifications** — automatically alerts appropriate parties (employees, managers, HR generalist, payroll, finance, IT, building security, etc.) upon completion of certain employee lifecycle events, such as hiring, terminations, and leaves of absence, while generating documentation of these events.

**Manager and employee self-service** — provides a mechanism for launching automated, documented workflows, such as hiring requests and pay changes.

**Management by exception** — notifies staff as material issues are arising, supporting proactive intervention and timely reporting.

**Automated workflows** — can be set up to provide automated processes for managing key controls and clear documentation for auditing purposes; should include multiple approval levels to accommodate process exceptions.

**Audit tools** — supports a company’s efforts to track when changes were made in the system, and by whom.

**Automated, on-demand reports** — covering such critical areas as headcounts, requisitions, compensation, benefits, leaves of absence, payroll, incentives, COBRA, and stock options.

**Segregation of functions** — pertains particularly to the need for separation between the payroll and HR areas.

**Customized data feeds to vendors** — addresses the integrity of data connections (e.g. accurate information going to the right vendor at the right time) and the security of data itself.

At first blush, the deployment of technologies which meet these requirements appears to be a costly proposition. But, as outlined in the next section, the potential exists for the same solution to support the attainment of strategic objectives and cost-reduction initiatives.

# Elevating HR's Efficiency and Strategic Role

A growing number of HR organizations view SOX compliance obligations as an opportunity to transform their business processes. In doing so, they are defraying the costs of implementing SOX-compliant technologies while advancing their drive toward operational excellence and strategic participation in the company.

Other HR organizations embraced automation technologies well before the emergence of SOX mandates. Their situations may necessitate modifications of existing technologies (e.g., creating new automated workflows and key controls) to satisfy SOX provisions. In other instances, they may already be meeting SOX requirements with current practices and technologies.

The lesson to be learned in either scenario is this: Through a diligent evaluation process, HR can identify technologies which support them in both meeting their compliance responsibilities and in improving business performance.

The following examples point out how some of the attributes discussed in the previous section can also assist companies in achieving important business objectives:

## **Cross-application Integration**

When business applications connect multiple functional areas, such as HR, payroll, finance, and procurement, the company and its decision makers gain not only more accurate and complete data, but better control — the ability to keep processes within corporate parameters.

## **Proactive Monitoring and Notification**

A system of automatic notifications can be a tremendous ally as the company strives to maintain financial stability and sound operational performance. By monitoring a variety of data sources, such a system allows decision makers to receive automatic notifications, according to preset tolerances, while issues are in their early and, it is hoped, most manageable stages. Ideally, notifications will contain pertinent information and contextual links to relevant people, documents and applications.

## **Enterprise Reporting**

A business management system that is designed to work as a cohesive solution will help consolidate data from multiple, even disparate, applications by serving as a centralized hub for analysis and reporting. It can also be set up to present information at the right level of detail for the individual's role and responsibilities. With the utilization of enterprise reporting capabilities, managers and executives should expect to receive higher quality data and to make better-informed decisions with greater speed.

## **Automated Workflows**

Besides documenting processes for auditing purposes, automated workflows serve as a cornerstone of good corporate governance. They formalize and automate "best practices" across a broad spectrum of activities, from spending limits to security measures, strengthening fiscal and operational accountability.

## **Employee and Manager Self-service**

Self-service technologies allow HR organizations to relinquish a diverse range of routine activities. For example, employees can input and manage their own personnel records (e.g., updating dependents), and enroll electronically in benefit programs. Managers can inquire about a direct report's pay history or vacation time, and they can launch personnel actions, such as job requisitions and status changes. No longer saddled with many manual, paper-based tasks, HR professionals have more time to devote to activities which bring value to the organization.

Another critical benefit of self-service is improved data accuracy. Research data suggests that more than 70% of HRMS information is "employee owned." Therefore, by increasing employee and manager access to this data, along with providing the ability to make changes, errors and outdated information are caught and corrected more quickly. Besides ensuring data integrity, self-service ultimately boosts the quality of downstream reports.

# Summary

The question for HR organizations is not whether they'll be pulled into SOX compliance efforts. It's already happening — and the pressures related to SOX compliance will only intensify. Moreover, SOX standards are being adopted by organizations other than publicly-held corporations — even those that operate outside of U.S. borders.

The salient issue is *how* will HR approach its SOX compliance obligations. HR organizations with limited technological capabilities will almost certainly find themselves mired in mountains of paperwork and time-consuming manual tasks. By contrast, technologically-savvy HR organizations, especially those with the right business software, should be able to satisfy SOX requirements with less disruption and lower cost.

While helping HR address some of the most critical mandates pertaining to processes, controls, documentation and reporting, these very same technologies can also contribute to operational excellence and bolster HR's role as a strategic partner to the companies they serve. Indeed, the most forward-thinking HR organizations have already made great strides in reducing their costs, eliminating many cumbersome manual tasks, and implementing tactics to attract, develop, and retain a highly talented workforce.

*For information on how Lawson® Human Resources solutions can support regulatory compliance and operational excellence, please visit [www.lawson.com/software](http://www.lawson.com/software).*

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