Sarbanes Oxley and Changes in Internal Controls: Experiences from Danish Companies in a Structuration Perspective

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Abstract
The Sarbanes-Oxley Act of 2002 has had significant impact on internal control systems in the companies that are required to comply with the act. Companies from other countries than the US can be required to comply with SOX if they are e.g. owned by a US parent company that is registered on a US stock exchange. Around 300 Danish companies are currently owned by US corporations and thus required to comply with SOX. This paper looks at the experiences of 4 Danish companies in implementing an internal control system that complies with SOX requirements. Giddens’ structuration theory is used to interpret the findings. The main conclusions are that SOX compliance has led to significant changes in the internal control systems of these companies by standardizing the control system and promoting one type of control system that legitimatize and enforces certain control practices. The study also indicates that a SOX compliant internal control system can be at odds with Danish control culture leading to implementation resistance. Furthermore, SOX is seen as a management tool as much as a compliance standard increasing management control and power. Finally, internal control is viewed as a “necessary evil” that has to be made as unobtrusive as possible, embedding it in information systems and organisational routines.

Keywords
Sarbanes-Oxley Act, internal controls, structuration theory, management accounting, management control

1. INTRODUCTION
At the start of the new millennium, financial frauds and bankruptcies in well renowned US companies such as ENRON, WorldCom, Tyco, Parmalat and Hollinger International Inc. sent shock waves through the business world. Trust in financial information in annual reports declined, trust in auditing firms as the watchdogs of the financial markets and investors eroded and general trust in the institution of financial markets was threatened (Baker et al., 2006).

Financial crises have spurred reactive institutional reactions in the past (Heier et al., 2005). This time the US institutional reaction to ENRON and other scandals was threefold (Baker et al., 2006). First, there was a legal reaction where laws were enacted to strengthen internal control frameworks and increase the accountability of external auditors. Second, the monitoring of corporate ac-
Accountability was strengthened with the emergence of new institutions such as the Public Company Accounting Oversight Board (PCAOB) in the US. Third, there was a professional reaction in accounting and auditing institutions taking measures to ensure the independence of accounting firms.

The legal reaction was spearheaded by The Public Company Accounting Reform and Investor Protection Act of 2002, more popularly known as the Sarbanes-Oxley Act (SOX) after its main architects, Senator Paul Sarbanes and Representative Michael Oxley. The Sarbanes-Oxley Act has brought about an extensive reform of the US financial markets. As such it has changed internal controls, auditing and management accountability in thousands of companies around the world, setting the standard for how internal controls are to be designed and assessed (Instill, 2006). Furthermore, similar legislations are emerging in several countries as well in the European Union.

The aim of the study is to understand the changes taking place in the internal control systems of 4 Danish companies that have to comply with the Sarbanes-Oxley Act. Giddens’ structuration theory is used for this purpose to make sense of the changes taking place and framing the consequences of the act in these companies. We use structuration theory as a sense making theory and as a sensitizing device and not as an empiricist theory presupposes certain empirically provable relations (Scapens & Macintosh, 1996).

The empirical work was based on case studies in 4 Danish companies carried out from September to December 2006. The companies were therefore selected as to conform to several criteria:

1. Owned by a US stock exchange registered corporation thus necessitating SOX compliance.
2. In the process of or finished implementing SOX
3. Of a size that required a formal internal control system
4. Willing to allocate time and give access to their documents in connection to the SOX implementation.

After the selection process 4 companies agreed to participate in the study. The characteristics of these are shown in table 1.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Company 1</th>
<th>Company 2</th>
<th>Company 3</th>
<th>Company 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Respondents</td>
<td>Compliance consultant</td>
<td>Compliance manager</td>
<td>Business controller</td>
<td>Compliance manager</td>
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<td></td>
<td></td>
<td>Compliance consultant</td>
<td>Consultant</td>
<td></td>
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</table>

Table 1: The case companies

The data collection process was based on 2-3 interviews in each company with managers responsible for the SOX implementation process or responsible for compliance generally. Also the companies gave access to different documents including descriptions of internal controls, presentations, project plans and management reports. Interview data was analysed using coding and condensation of transcripts.

The paper is organized as follows: The next section describes structuration theory in general and section 3 looks at how it has been applied in management accounting and control research. Section 4 presents the Sarbanes-Oxley
Act and explains its requirements. Section 5 describes the changes taking place in the companies included in the study. These results are discussed in section 6 followed by some concluding comments in section 7.

2. STRUCTURATION THEORY

In sociological theory much effort has been used to argue for the influence of societal structures on behaviour and - vice versa - the role of behaviour or agency in constructing, maintaining and changing social structures. Theories giving priority to the importance of structure we call the functionalist or structuralism tradition and the ones focusing on agency we call the hermeneutic tradition (Giddens, 1989). Functionalistic theories see individuals as steered by impersonal objective social structures of which they are part. Hermeneutic theories regard individuals as actors that create their own reality by conscious decisions and actions.

Structuration theory is developed primarily by Anthony Giddens (Cassel, 1993; Cohen, 1989; Giddens, 1976; Giddens, 1979; Giddens, 1982; Giddens, 1985; Giddens, 1989; Giddens, 1994). The point of departure for Giddens' structuration theory is that ultimately structure and agency are interlinked and recursive. The reductionistic view that one can be separated from the other ultimately falls short of the aim of fully explaining social action, change and stability. The aim of structuration theory is to combine the two dimensions of structure and agency in a single framework (Cohen, 1989).

Giddens defines structure as the “rules and resources recursively implicated in social reproduction; institutionalized features of social systems have structural properties in the sense that relationships are stabilized across time and space” (Giddens 1986: p. xxxi). That is to say structures are the codes, templates, rules and formulas that structure and organize society, sometimes without us noticing. Macintosh & Scapens (p.136) call this the “DNA” for social interaction and action (Mackintosh & Scapens, 1990).

Agency on the other hand is defined by Giddens as the intentional acts of individuals in social settings that actively constitutes social life (Giddens, 1989). Individuals or agents are capable of acting and interacting based on their own interpretations, free will and preferences with effects of actions ranging from intended to unintended. Agents will usually be able to explain their social actions and reflexively monitor and provide explanations and rationales for the flow of social life of which they are a part and create.

In structuration theory these two dimensions are combined where individuals reflect on their world and change their behaviour but are at the same time governed by social structures on which they draw on in their behaviour (i.e. agency). Giddens writes: “Structuration theory is concerned with the interplay of agents’ actions and social structures in the production, reproduction, and regulation of any social order” (Giddens, 1994: 174). This is to say that agency and structure are complementary, coexisting and recursive. It ultimately gives no meaning to prioritize one above the other as agency and structures are mutually dependent. Machintosh & Scapens name classical economic theory and Marx’ radical economic theory as examples of theories that focus on structure and ignore to a large extent human agency (Machintosh & Scapens 1991: 136). The main point is that although social structures are created by human action and transgress time and space, these structures are the very medium of their own creation through the agency of individuals (Giddens, 1976: 121).
That action and structure presuppose one another is what Giddens calls the “duality of structure”, where the patterning of practices across time and space presume that the structuring properties themselves are trans-situational (Cassel 1993). On the duality of structure Cohen (1989: 241) explains: “Structural properties are recursively implicated in concrete modes of praxis as both the conditions agents require to reproduce institutionalized conduct and as the reproduced outcomes of this conduct. This is the essence of structuration theory. Giddens uses the example of language to illustrate this (Giddens 1982: 33). In using correct language that is understood by others, we at the same time are contributing to the reproduction of that language as a whole. The duality of structure encompasses how the structure – language – is both the medium and the unintended consequence of social practice. However, because social actors have a free will, they are able to modify the rules on which they draw on in any social action. Therefore, at each point in structural reproduction there is the potential for change (Cassel, 1993: 13).

Giddens also defines a system as the reproduced relations between actors or collectivities, organized as regular social practices and then social systems as the system of social interaction: “To study the structuration of a social system is to study the ways in which that system, via the application of generative rules and resources, and in the context of unintended outcomes, is produced and reproduced in interaction” (Giddens, 1979: 71). The difference between systems and structures is explained best by the statement that systems are not structures but that systems have structures (Roberts & Scapens, 1985: 446).

Structuration – i.e. the interplay between structure and interaction (agency) - has three dimensions according to Giddens: signification, domination and legitimation. As structures and interaction co-exist in a recursive relationship then there is a need for some mediating mechanisms between the two if social life is to be explained. This is what Giddens calls modalities of structuration (Giddens, 1989). Signification structures provide meaning through individual or collective interpretive schemes that regulates the communication of social interactions. Domination structures involve the facilities enabling allocative and authoritative sources of power and legitimation structures provide the shared set of values and norms, defining what is ideal adequate and appropriate, thus providing points of reference for sanctioning certain behaviour in social interactions.

Figure 1 shows these dimensions and how structure and interaction are linked through modalities.

Figure 1: The duality of structure (Giddens, 1989: 29)
An analysis of structures of signification starts with communicative action (or what Cohen calls concrete praxis) and moves through interpretive schemes to structures of signification. The communication – interpretive scheme – signification column isolates the semantic aspect of rules in the connection between concrete praxis (or interaction) and structure (Cohen, 1989: 242). This involves identifying events, utterances, contexts etc. and analyzing how they contribute towards structures of signification. In Giddens’ terminology communication is equal to generation of meaning in a social context.

Interpretive schemes can be viewed as properties of the structures of signification. Giddens ascribes here priority to the meaning of signs in interpretive schemes. Structures of signification are comprised of a variety of codes in structures of signification and signs can be interpreted in a variety of ways depending on contexts and the agent doing the interpreting. Interpretation could be influenced by culture, age, status and language of the interpreter.

The sanction – norm – legitimation column effectively isolates the normative aspect of rules in the duality of structure (Cohen, 1989: 243), where norms are implicated in sanctioning procedures and behaviour but with those same norms supporting structures of legitimation, defining what is good and bad, allowed and not allowed. Giddens does not equate understanding of norms with following them as in between legitimation and signification there is the power – facility – domination column. That is an employee might understand the need for control, understand what the control does, accept that control is necessary, but will choose not to practice that control or try to circumvent it.

An important part of structuration theory is power and domination in organizations and in society – captured by the power – facility – domination column. Cohen has introduces the term “administrative systems” in this context as a synonym for the self-reflexive mode of system organization. Within administrative systems the “reproduction of activities, the consequences of activities, and systematic relations across time and space are coordinated and controlled through the exercise of administrative procedures which ultimately are meant to serve the intentions of superordinate agents….administrative systems therefore are power systems...” (Cohen, 1989: 148). There are two crucial concepts in the Giddens conceptualization of power and domination. One is the concept of the dialectics of control and the other is the split of the power dimension into authoritative power and allocative power. The first, the dialectics of control, views all social systems having inequal distribution of resources, and therefore all systems exhibit some degree of political inequality (Cohen, 1989: 151). However, in systems where results are generated through actions of others, superordinates never have total control over subordinates as subordinates always have the option of “acting otherwise” (Cohen, 1989: 151-152). The dialectic of control thus refers to the universal presence of imbalanced degrees of autonomy and dependence that constitute power relations in systems of all kinds (Cohen, 1989: 152). The degree of autonomy and dependence may vary between social systems (in our case organizations depending on context). Thus structures of dominations are not imposed upon agents who have to behave accordingly. Nor are domination structures created by the free will of agents. “Rather, structures of dominations, as asymmetrical distributions of resources, are routinely and repeatedly regenerated as agents draw upon the more or less numerous and effective forms of resources available to them during the course of system reproduction” (Cohen, 1989: 153).

The other distinction between administrative power and allocative power basically refers to the ability to control behaviour and the ability to control matter.
The former ability is administrative power and is defined as “the coordination and control over the timing and spacing of human activities (Giddens, 1985). The ability of the power holders to do this depends on their facilities to make this happen – i.e. coordinate and control numerous activities across time and space.

A central element of the interaction dimension is how individuals behave, which Giddens has modelled in what he calls the stratification model of action (Giddens, 1979: 56) which is shown in figure 2.

![Figure 2: Stratification model of interaction (Giddens, 1979: 56)](image)

In the stratification model Giddens proposes that individuals routinely monitor their actions and behaviour as well as the social and physical aspects of the contexts (what Giddens calls “the object-world) in which they move (Cassell, 1993: 92). In what he calls practical consciousness, Giddens distinguishes between reflexive monitoring and rationalization of action from its motivation. Monitoring and rationalization of actors, Giddens states, are bounded. That is the accounts actors are able to provide for their actions take place within a socially defined space influenced by conscious and unconscious motivation as well as the context of social encounters. This opens up for examining motivations and conditions for actions that are not acknowledged by the actors themselves. It can also be used to look at unintended consequences of action, where actors do not behave in a way that would be expected or where actions do not have the intended consequences. Which is what Giddens calls “the unintentional consequences of intentional conduct” (Giddens, 1979: 59).

Within this model of action, Giddens defines routines and routinization as a fundamental concept of structuration theory (Giddens, 1989: xxiii). In day to day social activity routines carry accepted sets of behaviour across time and space. Routines encapsulate the repetitiveness of social life and establish a sense of trust or ontological security in daily activities (Giddens, 1989: xxiii – xxiv).

We now turn to how structuration theory has been applied in management accounting and control research.

3. STRUCTURATION THEORY AND MANAGEMENT ACCOUNTING AND CONTROL

Most management accounting textbooks define management accounting and control systems (MACS) are set of procedures tools, performance measures and systems that organizations use to guide and motivate all employees to achieve organisational objectives (see e.g. (Atkinson et al., 2004)). Subsets of MACS are internal controls. Internal controls are measures that the company sets in place to encourage adherence to agency policies and procedures; pro-
mote operational efficiency and effectiveness; safeguard assets; and ensure the reliability of accounting data. Internal controls are in the literature divided into categories such as preventive/detective, coercive/enabling, rigid/flexible, administrative/accounting and interactive/diagnostic (Chenhall, 2003).


Roberts & Scapens (Roberts & Scapens, 1985) in turn call for more studies of accounting that see it as more than a technical discipline and as mechanical information systems as it is often described from funcionalistic and systems theory standpoints. What is needed, they claim, are studies of how accounting systems embody systems of accountability and thus in turn embody certain accountabilities in organisations. At the time when the article was written this represented a departure from the view that accounting information was a mirror of the organisation and portrait an objective image of different aspects of performance. For this purpose they propose Giddens’ structuration theory as a suitable framework as it focuses on the duality of structure, where action, interaction and behaviour of actors is governed by and in turn creates and recreates social structures such as accounting and control. Using this theory and other like it “we can begin to gain an understanding of the way accounting practices contribute to the production and reproduction of organisational life” (Roberts & Scapens 1985: 447). Applying structuration theory to accounting the authors reach a series of conclusions. One is that “although accounting systems are designed to bridge physical distance they can only do it in a certain way. In being carried out of the context in which it is produced and into contexts where different interests are operative, the significance attached to accounting information undergoes a series of subtle transformation” Ibid: 452. Thus accounting systems and accounting information are not objective technical entities but have a social significance and impact that needs to be researched.

Roberts and Scapens (1985), Scapens & Macintosh (1996) and Macintosh & Scapens (1991) argue that structuration theory is potentially valuable as it allows us to conceptualize management accounting and control as modalities of structuration which mediate between action and structure (Scapens & Macintosh, 1996: 677). The three dimensions of structuration, legitimation, signification and domination are useful for studying management accounting and control in its organisational context and what roles it plays in the life-world of managers, employees and other organisational stakeholders. Structuration theory opens up for the social and the political dimensions of management accounting and control (Scapens and Macintosh, 1996) and how to understand the interplay between accounting structures and personal interactions (Baxter & Chua, 2003; Roberts 1990). It should be noted though that management accounting and control is not the only carrier of interpretive schemes, moral norms and resources influencing organizational actors as Boland has pointed out (Boland, 1996). Other influences could be management style and culture, production philosophies and human resources practices.

The value of structuration theory is mainly that it “sensitizes researchers to the way (accounting) systems can give legitimacy to the actions and interactions of managers throughout the organisation” (Macintosh & Scapens, 1991: 151). This is because accounting systems set forth “values and ideals about what ought to count, what ought to happen, what is deemed fair, and what is thought to be important. These systems institutionalise the reciprocal obligations and
rights of managers throughout the organization” (Ibid: 153). That is to say the operation of accounting and control systems can be analyzed in terms of individuals drawing on and reproducing structures of signification dominance and legitimation providing another perspective on management accounting and control than the traditional scorekeeping, attention directing and decision-making perspectives (Roberts & Scapens, 1985).

Regarding interpretive schemes, management uses control systems to interpret past results, take action and make plans. This means that management accounting and control provides meaning to organisational events and actions. By applying rules, techniques and measurements it provides interpretations which are then acted upon by organisational actors. It basically provides the organisation with a language for communication where, on an overall level at least, there is an agreement about terms and definitions. Machintosh & Scapens (1996) show how a new accounting based signification structure proved pivotal in the turnaround of GM under the management of Alfred Sloan in the 1920s. The authors see this interpretation structure, based on calculations and accounting terminology, as providing a model of management for the automobile industry that would last half a century.

Regarding legitimation and norms, these communicate values and ideals about what is approved and what is disapproved. Management accounting and control provides organisational actors what constitutes “good and bad” behaviour or performance by supporting underlying “positives” such as “increase shareholder wealth”; “minimise costs” and “increase revenues”. At the same time rules obviously define the negative – i.e. what conduct is not acceptable. Lynne finds evidence in her case study of a large UK gas company of the importance of accountability structures in legitimizing certain actions (Conrad, 2005). Who reports what to whom and what actions are initiated on basis on the reports are key processes.

Managers at all levels use various facilities to coordinate and control organisational participants. Management accounting is linked to power through e.g. facilitation activities such as monitoring of performance and allocation of resources where certain organisational actors can exert influence on the behaviour of other actors – i.e. have power over others. Power is again linked to the ability to impose sanctions on the actors over which power is exerted. This means that through the link to the “power” structure, some members of an organisation can use accounting to hold other members accountable for their actions and have the facilities to dish out sanctions and rewards to those members if they stray away from what is considered good behaviour. Conrad (2005) gives an interesting account of the power structure in a large gas company in the UK but also how this power structure is affected by the political aspects of the gas industry.

As accounting disembeds time and space it also re-embeds these when local actors – i.e. the practitioners and users of accounting knowledge – engage in a process where accounting mechanisms are related to local contexts. Accounting timeframes define budgeting cycles, reporting frequency and creates spaces such as departments, cost centres as well as relationships between them regarding transactions, allocations and delegation. Thus accounting influences behaviour through the enactment of local actors. When an management accountant prepares an annual budget to be implemented in a company along with variation control and follow up activities, he or she is re-embedding the abstractions of time and space imposed by the accounting rules and techniques inherent in the budgeting process. Thus management accounting and
control influences and is influenced by both social structures and actions of organisational actors. Structuration theory is a way of showing how accounting is involved in the institutionalization of social action (Machintosh & Scapens 1996).

The literature seems to indicate that structuration theory is a valuable tool for describing and making sense of management accounting and control in certain contexts. It can be used both to describe how management accounting and control is implicated in organisational change and to show how management accounting and control contributes to organisational stability or resistance to change. It can not however be generalised or used as a predictor for how management accounting and control will develop.

We now turn to the Sarbanes-Oxley Act and describe its main characteristics and its requirements regarding internal control in companies.

4. THE SARBANES OXLEY ACT

What are the requirements of Sarbanes-Oxley?

The Sarbanes-Oxley Act is by no means the first of its kind. Historically it has been preceded by acts that were intended to improve corporate governance and increase accountability. These include, for example, the Securities Act of 1933 and the Foreign Corruption Act of 1977, both of which focused on internal controls, financial reporting and the role of external auditors (Baker et al., 2006; Byington & Christensen, 2005; Heier et al., 2005).

In general terms, the Sarbanes-Oxley Act’s provisions apply to four types of companies (PwC, 2003):

1. Domestic US registrants
2. Foreign private issuers, also referred to as ‘foreign registrants’ in the Act
3. Subsidiaries of US registrants (only to the extent that some information applies to the consolidated financial statements) and
4. Potentially, companies planning a US registration in the future.

In addition, the Act appears to have set a benchmark for companies in Europe, Oceania and Asia that have an interest in enhancing corporate governance, including risk management and internal controls (ITGI, 2005; PwC, 2003). Thus the Act has global implications for corporate governance and the development of internal control systems.

SOX is different from earlier legislation in that it makes the Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) legally responsible for (Kendal, 2004; PwC, 2003; SOX, 2002):

1. Establishing, evaluating and monitoring the effectiveness of internal control over financial reporting and disclosure
2. Designing, establishing and maintaining ‘disclosure controls and procedures’ and reporting on the effectiveness these.
3. Disclosing to the audit committee and external auditor any significant deficiencies and material weaknesses in internal controls for financial reporting and any fraud (material or not) involving anyone having a significant role in those internal controls
4. Disclosing whether, after their most recent evaluation, significant changes occurred that affected internal controls for financial reporting and whether any corrective actions were taken with regard to signifi-
cant deficiencies and material weaknesses.

Although CEOs and CFOs have always been responsible for the validity of the information in the annual report, SOX extends this responsibility to the internal controls as well. Furthermore, the demand for responsibility for adequate internal controls is backed up with the threat of legal prosecution and punishment if not complied with.

Complying with Sarbanes-Oxley: Internal controls

The Sarbanes-Oxley Act does not define internal controls as such. However, the PCAOB Auditing Standard No. 2, which interprets the Act in the context of auditing, defines internal controls as (PCAOB, 2004):

“A process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements” (p.147).

The primary control related requirements of SOX are shown in table 2 (PwC, 2003).

<table>
<thead>
<tr>
<th>Section of SOX</th>
<th>Requirements</th>
<th>Internal control system implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>301</td>
<td>Establish a process for anonymous complaints of employees to audit committee (SOX, 2002: 32).</td>
<td>An independent process for employees and managers for submitting communications to the audit committee.</td>
</tr>
<tr>
<td>302</td>
<td>Establish the responsibility of the company signing officers (the CEO and the CFO) for setting up an internal control system, evaluating the effectiveness of this control system and making public the results of the evaluation (SOX, 2002: 33).</td>
<td>Places unambiguous responsibility for the development, assessment and documentation of the internal control system.</td>
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<tr>
<td>401</td>
<td>Require financial reports to reflect all adjustments identified by auditors. All off-balance sheet transactions have to be disclosed and pro forma figures have to be</td>
<td>Require the internal controls to contain checks on inclusion of off-balance sheet transactions and pro forma reconciliations and whether auditor adjustments have been included.</td>
</tr>
</tbody>
</table>
Reconciled with Generally Accepted Accounting Principles (GAAP) figures.

404 Require that the annual report contains an internal control report which must:
- State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
- Contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting. The external auditing form is to attest to and report on this report (SOX, 2002: 45).

409 Obligation to report on rapidly changing financial conditions to the public (SOX, 2002: 47).

The internal control system has to contain monitoring and evaluation mechanisms for changes in financial conditions.

<table>
<thead>
<tr>
<th>Table 2: Primary SOX compliance requirements related to internal control systems</th>
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<tr>
<td>The PCAOB requires companies to adopt an internal control framework by which its practices can be assessed. It mentions the Committee of Sponsoring Organizations (COSO) (COSO, 1992) as one framework, but other frameworks can be used as well. Most companies adopt the COSO framework through, which seems to have become the de facto standard for the development and assessment of internal control systems in practice (COSO, 1992; COSO, 2004; Shue, 2004).</td>
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<tr>
<td>In the COSO framework, and thus by default in the SOX compliance process, control is achieved through internal control activities such as:</td>
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<tr>
<td>1. Authorization of transaction and activities</td>
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<td>2. Segregation of duties (custodial, recording and authorization functions)</td>
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<tr>
<td>3. Design and use of documents and records</td>
</tr>
<tr>
<td>4. Adequate safeguards of assets and records</td>
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<tr>
<td>5. Independent checks on performance.</td>
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<tr>
<td>COSO also stresses that internal control is conducted in a control environment, influencing the control consciousness of organizational actors. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the organizational actors; management's philosophy and operating style; the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the board of directors. This is similar to what Chenhall (2003) calls control culture. Another central element in the COSO guidelines is risk assessment and management. COSO recommends that companies initiate a risk assessment process with the aim of analysing what threats the company faces and what control</td>
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-11-
activities are needed to manage these risks. Risks include, for example, the risk of fraud and misappropriation of assets. COSO has in fact released an update of the 1992 framework where risk has become a central element of the internal control framework (COSO, 2004).

When SOX came into effect in 2002 companies scrambled to implement its requirements. In many cases companies approached SOX compliance in what has been called an ‘all hands on deck’ approach (McNally & Wagaman, 2005) where companies threw employee hours, external consultants and investments into the compliance effort without a full vision of what it should contain. Accordingly companies reported that the costs of SOX compliance were significant. Different sources estimate that companies around the world spend billions of dollars on SOX compliance projects (CRA, 2005; Fernandez, 2005). However, SOX compliance is a continuous effort that requires it to be integrated into business processes, policies and information systems. Compliance projects have in later years focused on this, aiming to make the compliance process more effective and efficient through e.g. the use of automated controls and IT controls (ACL, 2005).

5. EXPERIENCES WITH SARBANES-OXLEY IN A DANISH CONTEXT

In Denmark approximately 300 companies are directly affected by SOX as these are partly or fully owned by a US company. The 4 case companies selected for this study were all owned by American corporations registered on a US stock exchange and thus required to implement the requirements of Sarbanes-Oxley before 31/12 2006.

Generally the implementation process started in the beginning of 2006. Usually the US corporation provided some sort of guidance in the form of guidelines, specific requirements for the design of the control system such as a standard set of controls that had to be in place as well as the procedures for monitoring these. Some adjustments had to be made during the process though. As one of the respondents said:

*There are some controls that are applicable in a company of 400,000 employees that are not quite relevant to a company with 500 employees….but there were very few controls that we did not adopt from the standard in one form or the other (Company 1).*

The standard from the US parent company also included specific procedures for describing and monitoring the controls afterwards including specification of the control objectives, risk assessment guidelines, testing procedures and guidelines for assigning responsibility for the control.

Usually the implementation process started with a scoping study determining what processes were to be included and what controls were to be included. One company had 18 specific processes and 150 controls to go through. Another had 280 controls at the start of the project where 2/3 did not pass the tests set up for them. After the SOX project there were 205 controls as some controls had been merged, automated or disbanded.

The implementation process itself was anchored in the company through either a special SOX manager or through a manager in the accounting department. Consultants were used extensively in all cases.
You cannot avoid use of consultants in projects of this type. Only if the company has a lot of “fat on its body” and with employees to spare, which is not the case with us (Company 3).

Efforts were made to transfer knowledge from the consultants to the employees who would be responsible for managing the SOX compliance system in the future. Also experiences with letting consultants run the SOX project were not always good. In one of the companies the SOX project was initially run by consultants loosely overseen by one of the employees in the accounting department. The project was not achieving the desired results, missing deadlines and creating considerable implementation resistance as employees saw the project as "the consultant's project". Top management thus decided to hire two SOX specialists and set up a separate SOX department referring to the CFO. One of these specialists notes:

Of course there is resistance. SOX is bureaucracy. For an employee in R&D the best thing in the world is to do R&D, not to control or be controlled. They think controls are restrictive, non-value adding and hinder them in their work. But there is no way around SOX (Company 3).

Furthermore, the respondents could see a link between the implementation resistance and company culture.

We are an innovation company with an entrepreneurial spirit and a lot of engineers who do not always see the sensibility of good controls. Also things that were possible in the old days are not possible today. For example once managers could allocate up to 1500 euros without authorization. So if there was a Christmas party that cost more than that then there would be several receipts of 1499 euros. In the past a R&D manager could keep a project alive because he thought it was exciting although there was no business case. This is not possible any more. SOX is a step on the road to developing a more mature management and business processes (Company 3).

It also seemed that interpretation of control guidelines from the US corporation were rather strict in the beginning of the SOX process. One company employee came with an example:

When a client rang us for advice in the old days we collected these phone calls and billed the client once a month. With the new controls in place we were required to bill the client for each individual phone call and not only that but to get him to sign an agreement that we had delivered this service to him. So, in principle, for a client that called us 20 times a month we had to bill him 20 times and get him to sign 20 agreements. This just did not work (Company 1).

After a while these procedures were changed to more flexible procedures.

In general, top management support is seen as crucial for SOX project success. In one of the case companies the SOX team got allocated 15 minutes at a company vice president meeting to give an update on the SOX project. The 15 minutes became 90 minutes with the chief executive officer saying at the end of the meeting “This is one of the most important projects we currently have running”. In another case company the CFO wrote an e-mail to an accounting manager who had not tested certain controls threatening to fire him if he did not shape up.
All in all top management attitude towards SOX seems a positive one. According to one CFO in one of the case companies:

*It (SOX) gives top management an opportunity to tighten things up and get a picture of what's going on in the company. SOX is just as much a management tool as it is a control and compliance tool (Company 2).*

According to the compliance manager of company 1:

*I am sure that (company management) has discovered that SOX is a management tool. It introduces COSO in the back door, which all companies ought to have in place anyway….Now a manager can change outdated routines and really see what's going on in the processes he is responsible for…with a legal requirement to back him up (Company 1)*

Information technology has been used extensively to support the implementation effort. In general the companies used software such as Lotus Notes and Microsoft Project as well as various office software such as MS Excel. However, special documentation software and process modelling software were also used. According to those managers who used this software the documentation of business processes, description of controls and documentation of control tests required some sort of a systematic approach to record keeping, reviews of documentation and verification of results. One company also had specific software for the operational phase of SOX including document management software with sign off functionalities for signing off on tests of controls.

The SOX project had led to various changes in internal controls – both in general control set up as well as regarding how IT supported internal controls.

The types of internal controls in use in the case companies varied. Usually there was about 50/50 split between preventive and detective controls with the emphasis on developing more preventive controls as these usually are cheaper to maintain and test than detective controls. This also included building preventive controls into the IT systems such as validity checks, field checks, completeness checks etc. Regarding preventive controls that consisted of authorizations the aim was to make these more effective and efficient with the use of information technology, enabling electronic authorizations by managers.

An example of a control process was described by the business controller of company 1 regarding training courses, which for a consultancy company is a significant employee expense.

“For example, employees get permission from their managers to sign up for a course. When an employee has been on the training course the bill is sent to our company and it is scanned into a database. It is sent electronically to the employee who then can check that the price is right and the training course is the one he participated in. After verifying this he sends it to his manager who will check if it’s the same course and the same price he authorized. Both the employee and his manager have to log their authorizations and verifications in the database. The manager then sends it onwards to accounts payable who then pay the bill” (Company 1).

Earlier this process was manual and based on paper documents being sent back and forth. It was prone to lapses in control as employees or managers did not authorize or verify expenditures or lost documents and bills. Today everything is scanned into the database and is sent electronically. The system re-
minds employees and managers of taking action and it is not possible to proceed or send documents before verifications and authorizations have been performed in the system. Control is thereby embedded in the process through the information system, speeding up the process, standardizing it and increasing its transparent in connection with SOX reviews.

This link between information technology and the implementation and performance of internal controls was recognized by most. This includes the role of information technology in enabling efficient and effective internal control and the control of use of information technology in its own right.

*It’s difficult to separate IT form the whole process as it is such a fundamental part. Some controls like access controls span across different processes and areas and can not be separated.* (Company 2).

One of the case companies had to program additional functionalities to its accounting information system so the user activities within the system (such as field changes, allocation of user rights, certain transactions etc.) could be monitored and logged. This log was then used to monitor effective segregation of duties as these are often closely linked with what user rights the employee has within the system.

Information technology has an important role in “embedding” the controls. An example described by one of the respondents is the creation of a new creditor in the accounting system of one of the case company. There are 20 fields that have to be filled out when creating a creditor. The system automatically checks if there are no letters in numbers fields, that post codes and addresses actually exist, that the user has the necessary user rights to create the creditor etc. If some of these do not pass then the creditor can not be created. Another example is the calculating wages for employees in another company. The registration of billable hours is done in one system and transferred to another system for calculation of wages and benefits. The system automatically checks employee numbers, completeness, and generates a log of mismatches, errors and changes that has to be checked before wages are released for payment. Third example is the system checking whether an order has been received before allowing a payment to be processed, or that products have been ordered before allowing an invoice to be issued.

The automation of internal controls was an area that was seen as having potential for improvement in the future. Although automation would save money in the long run, it would require specific initiatives to automate the controls. As one manager put it:

*I think most companies required to comply with SOX are just trying to survive until 31/12 2006. After that we can start looking at what controls to automate and make the internal control system more effective. Right now – having SOX thrown at you is like having your pants pulled down – everything is exposed and you scramble to cover up* (Company 3).

Also, not all controls can be automated. For example reconciliations between bank statements and accounts often have to be performed manually, although in some cases possibilities of linking the ES system to the banks system through electronic banking were being examined.

One interesting development mentioned is the emergence of specific compliance management software that could be “plugged into” the company ERP.
system and used for monitoring controls, reporting on user behaviour and generating logs. These systems in some cases would also have functionalities for managing the SOX compliance process after the initial implementation meaning functionalities for testing controls, documenting tests, describing controls, modelling business processes, sign-offs and authorizations. An example given of this type of software is Virsa from SAP. Virsa enables for example logging of user activity in the system bypassing the SAP systems own logs which were described as cumbersome and demanding a lot of processing power.

All companies stress that the ultimate goal is to build control into day to day activities, automate controls and make internal control as inconspicuous as possible. As one manager put it:

Let’s face it. Internal control is not a core activity. It’s an important activity but it is not what makes us money. Internal control has to be integrated into your job so you can do it as you do your normal job as fast and effectively as possible (Company 4).

All of the case companies mention the difference between the “control culture” embedded in SOX framework and the Danish control culture. This often revolved around the difference between preventive and detective controls. As one manager put it:

Here we have Ms. Hansen whom it has taken years to get to the point where she can make decisions and allocations with the trust of her superior. Now she suddenly has to apply for authorizations from her boss for every single thing. And he has to apply for permission from his boss. This leads to a certain feeling of mistrust (Company 1).

Another example:

In my opinion there has been a move towards detective controls in Danish companies in the past years. You trust your employees and not having to check every single thing they do increases your flexibility. Detective controls show you trust your employees. And then SOX arrives and bombs you back to the Stone Age (Company 2).

The difference in control culture was also mentioned to be related to company size and organization. The companies operating in the US and having to comply with SOX are seen as bigger than the Danish companies and thus control procedures are more formal with a focus on “controlling from a distance”. According to one manager:

If you have an accounting department with 25 employees then the control dialogue is totally different from a Danish company with an accounting department of 5 persons (Company 3).

Also:

The Americans have this preference for hierarchical organization that is so different from the Danish way of organizing. So yes there are some cultural differences (Company 2).

When the implementation project was finished then the SOX process would have to be made continuous, which presents its own challenges according to the case companies. One of the companies had intentions of merging the SOX
process with the annual quality management auditing process. The company is certified according to the ISO 9000 quality management standard. According to the SOX manager the overall compliance management process inherent in ISO 9000 and SOX does not differ all that much, meaning testing and documenting the results of tests, making managers responsible for improvements. Thus, for this company, and merging the ISO 9000 auditing process and the SOX compliance process made sense.

Regarding the issue of what value SOX might have for companies there was agreement on that SOX definitely has no short term financial value. It takes up a lot of manpower and is expensive to implement. But it is a legal requirement and thus can be classified as a cost of doing business. Its value is primarily as a management tool to shake up the organisation, eliminate old routines, improve control processes and in the words of some of the managers “get control”. Also SOX has a signal value to the outside world signalling that the internal control system of the company has a certain standard. SOX also has a preventive effect in that it reduces risk of certain control failures from happening. However:

_I don’t think SOX has a value in it self. But is has a signal value. Like if you have downward adjustments in your performance three times in the third quarter it signals that something is not very well managed. SOX compliance could prevent that (Company 3)._”

According to the case companies, the future will mean more complex and faster changing corporate environments. Thus the focus on corporate governance and compliance will not decrease. On the contrary, there will emerge more rules and regulations focusing on securing quality information to stakeholders and hindering management and employee fraud. Auditing regimes will move even more from auditing transactions to auditing the internal controls governing these transactions. Also SOX will influence legislation in other countries. However:

_Thinking SOX will put a stopper for fraud and false financial reporting is naïve. Human creativity in that regard is quite impressive. I think SOX will have implications for European legislation but will be adapted to European conditions (Company 4)._”

In the future, after SOX compliance projects are finished and the SOX process becomes operational, the automation of controls will become a primary issue as well as embedding controls in and supporting controls with information technology, especially ERP systems. ERP system vendors will also integrate compliance even more into their systems with additional functionalities like automatic sample creation from e.g. total number of purchasing orders, controlling validity checks in legacy systems, and addressing risks and controls in linking ERP systems in supply chains.

6. DISCUSSION

The Sarbanes-Oxley Act is the results of a series of critical events that shook the business world and convinced business institutions and legal institutions that something had to change. SOX represents change in the social system of governance touching the social institutions and practices of business, auditing, internal control and financial reporting. Thus SOX is a reaction to a critical situation where “the public” was loosing trust in the institution of financial reporting, the control system of the audit and the integrity of business managers.
If we look at the issues SOX addresses in its wider institutional context across geographical boundaries, different institutions have similar agendas regardless of where they are in the world. At the end of the day financial markets, regulation of accounting information, trust in the quality of externally reported financial information, protection of company assets and the need for valid internal information for decision making is similar in the developed economies. The institutional catalyst of the SOX legal framework, i.e. fraud and false financial information, is also easily transferred to other societies. Therefore the ideals and principles implied by SOX - such as order, control, true and fair information, error free information and reduced risk of fraud – has a universal appeal.

However, this does not mean that the risk addressed by SOX is the same in all countries, markets and cultures. The financial collapses of the large companies in the US that spurred the passing of SOX had consequences for the investors, managers and employees due to the characteristics of the US financial markets, the way pension funds were managed by the companies themselves, the accounting requirements facing the companies and the pressures faced by the managing directors. Although similar cases of financial frauds are abundant in the rest of the world (PwC 2005), none have come close to the scale represented by the US cases. In Denmark for example there have been very few cases where financial reporting fraud has caused significant losses to investors, loss of trust in the market or criminal charges being pressed against managers and/or the public accountants. So although SOX means less risk of financial reporting fraud in a US context, it is not certain that this is also the case in a Danish context. In fact, the case studies indicate that at this point in time, the main effect of SOX is internal – i.e. tighter internal controls, more preventive controls, less trust and less risk of errors or employee fraud. The case companies see little external benefit of SOX, at least at this point in time.

Using structuration theory to frame the changes taking place in the companies, implementation of the requirements of the Sarbanes-Oxley act seems to affect the interpretive schemes used by managers (signification), affect the facilities used by managers to coordinate and control other members of the organisation (domination) and affect the values and ideals that legitimise certain behaviour (legitimisation).

As mentioned earlier the SOX does not actually specify how an internal control system should be constructed although guidelines point towards COSO as the framework that should be followed. In the case of the Danish companies COSO was not very visible to the persons interviewed. But examinations of internal documents show that COSO is reflected in e.g. guidelines from the parent company, presentations of the SOX and reports from implementation efforts of the parent company. Or as one manager put it: “SOX is COSO in the back door”. Even so, the control view inherent in COSO becomes a part of the interpretive scheme – i.e. defines what internal control should look like and what existing internal control systems should be evaluated against.

In the companies interviewed, a significant part of the internal control system was now seen as “SOX controls” and the process of internal control now has to “be in compliance” with externally defined criteria. This represents a significant change in the companies interviewed. Before SOX internal controls were a company specific affair. Each company developed its own internal control system based on management needs, company culture and other contextual variables. Although internal controls were usually assessed in the context of the external auditing process there was no generally accepted standard on which
the internal control system was to be based. There was no external criteria or single authority that the internal control framework had to comply with. Today, with the advent of SOX, COSO has appeared as the control framework of choice and the interpretations of the PCAOB shows how an internal control system has to be constructed to comply with SOX.

Thus, the “language” of internal controls seems to have changed in the case companies with the advent of SOX. The interpretations of SOX by the parent company as well as other stakeholders mediates between the signification structure and social interaction in form of a communication mechanism for making sense of organizational activities – in this case the internal control system. SOX compliance process embeds in the activities of management and employee’s definitions, concepts and notions for interpreting internal control and what constitutes good internal control practice. But it is no longer just up to company management to define what constitutes good internal control practice. This has become an interpretation process including the parent company, consultants, the external auditors and company management – based on guidelines and interpretations of the SOX, publications from the taking into account guidelines and requirements from PCAOB and the text of the Sarbanes-Oxley Act.

Turning to legitimation in the framework of structuration, implementing a SOX compliance system, organization and processes legitimises changes in management accounting and control practices based on legal obligations and in the Danish context on the subsidiary ownership by American or other companies registered with the SEC.

These changes have been easy to legitimise because “it’s the law”. Or as one manager said: “We try to argue the business case of controls such as fewer errors but when push comes to shove we can always say “It is the law - there is no way around this”.”

Management accounting and control has been shown to play an important role in defining the norms of organizational activity – i.e. what is allowed and what is not allowed (Macintosh & Scapens 1985) Thus they provide a part of the moral underpinnings of the signification structure. The SOX process seems to affect this by changing the reciprocal rights and obligations of employees and managers performing internal control system. SOX requirements set standards for what is approved and what is important and what is trivial. For example, authorizations appear as a crucial element in internal controls and thus authorization structures are designed and embedded in internal control practices and in information systems. Employees, in some areas, now have to apply for authorizations for initiating activities where earlier it was their decision. Having the external auditor checking the internal control structure periodically is now legitimate and a part of the internal control process. Public reporting on the performance of the internal control system is now required, making it an integral part of the internal control process.

Thus SOX standardises and legitimises one type of internal control system and makes the control activities inherent in this system preferable to others. Authorisations, independent checks and automation of controls become the preferred cornerstones of the control system. Detective controls are downplayed and manual controls have to be tested and the results controlled.

This has led to conflicts in some of the case companies as Danish control culture and US control culture clash. Danish control culture has been described as
non-hierarchical based on trust and empowerment of employees (Nørreklit et al., 2006). Managers trust employees to make the right decisions and act in the best interests of the company. Performance of employees might be checked periodically but is based on detective controls after employee dispositions and transactions have taken place (see Nørreklit et al. 2006 for a discussion of the difference between Danish and US control culture). The internal control process that has to be in place to comply with SOX was sometimes seen as “un-Danish”, “top-down” and “de-powering”. It is difficult though to judge whether one control culture is better than another. Here we merely state that there seems to be a change in the way control was carried out in the case companies, with the emphasis of SOX based internal controls sometimes differing from existing practice, creating tensions and conflicts. Whether this tension will continue, whether the new practice will “colonize” and change Danish control or whether some Danish model of internal control will evolve, remains to be seen.

Focusing on the domination dimension the passing of the Sarbanes-Oxley Act and the subsequent implementation of its requirements in companies all over the world has illuminated several power issues. First of all there is the power relationship between government and private companies. SOX can be seen an attempt by the US government to “control the internal controls” of companies through standardization, legislation and the institutionalization of control assessments. This could be seen as a step in the continuing development of internal controls as has been pointed out by Hailer et al. (2005). The requirements of SOX standardize the definition of good internal controls, how control should be performed, that companies should publicly report on internal control quality and how controls are to be assessed.

The second power issue is the position of the US economy in the global economy. SOX applies to US companies but also to companies in other countries that become subjected to it through their affiliations, ownership and stock market registrations. Therefore a US law has impacts on companies in other legal areas than ones subjected to US law. Although managers in these countries could not be prosecuted according to US penal law, they are required to comply with the law as they are accountable to the parent company. If they are not in compliance the parent company can take measures including firing the managers in question.

The third issue is the power of one system of internal control over others. The Sarbanes-Oxley act embodies certain ideas of how an ideal internal control system should be designed. It takes a specific framework (the COSO framework) and lifts it to a status of an ideal internal control framework if companies are to in compliance.

The fourth power issue is the power of management over employees. In the case companies SOX was also seen as a management instrument which enabled management to “take control” and find out “what was really going on”. In a global economy, managers have to trust other managers and employees, often over organisational, cultural and geographical distances. This “trust at a distance” (Roberts & Scapens 1985) becomes more difficult as operating environments become more complex and the differences between those who have to trust and those who are to be trusted increases. Roberts & Scapens (1985) theorize that managers would in this context be expected to invest more heavily in accounting information, cross checking validity, increased surveillance and elaborate systems of control. In their words, “accounting information systems may cease to act as a vehicle for developing mutual understanding, and become instead the principle means which senior managers unilaterally seek
to both advertise and enforce their expectation" (Robers & Scapens 1985: 453). As the saying goes: “Trust is good but control is better”. It is only to be expected that some managers look favourably at SOX and the idea of extending the scope and depth of control through an externally verified internal control system in all of the company’s global operations.

Finally, SOX is a way of standardizing the process of internal control and provide management with the rationalization and motivation to change internal control systems according to SOX requirements. The requirements of SOX and the PCAOB on how internal control systems should be constructed is a way of making the internal control process part of organisational routines allowing the same type of internal control to be carried out year after year in all affected business processes across organisational and geographical boundaries. As the managers in the case companies note, internal control has to be routinized and integrated in business processes and embedded in existing routines to minimise potential detrimental effects on performance.

7. CONCLUSION

This paper has described some of the experiences of 4 Danish companies in implementing an internal control system that conforms to the requirements of the Sarbanes-Oxley Act. These experiences have then been interpreted and discussed by using Giddens’ structuration theory.

In the companies examined the implementation of SOX highlights the role of an internal control system to cement change – i.e. stricter internal controls – in the organisation through legitimisation, significations and domination mechanisms. The internal control system is a vehicle of change carrying new control definitions and interpretations of control into the enterprise.

SOX sets the structure that affect the agency of internal controls in companies. The effects of SOX on internal control systems are constituted by human agency but are at the same time the medium of this constitution – meaning the replication of a certain type of internal control system in any context. Therefore SOX is a vehicle that carries a certain type of internal control system, that companies have to implement to be in compliance. This in turn shapes the social practice, which internal control ultimately is, across time, physical space and organizational space. Complying with SOX legitimises a certain form of control system - i.e. one that is top down, policy driven and emphasizing preventive control structures. The question is if this form for control structure is at odds with what is required of companies in contemporary competitive environments - i.e. to be flexible, be responsive and attentive to customer needs. If control systems are becoming more coercive, more standardised and imply more administrative overheads they ultimately could have an impact on company competitiveness.

This certain type of control is also carried into other cultural contexts such as the Danish one. But is this standardised control system the right one for all cultures, all contexts and all organisations? This study has shown that a Danish manager does not necessarily arrive at the same conclusion as his American counterpart when interpreting what constitutes effective internal control. What the American views as a sensible control system the Danish employee could see as a systematic declaration of mistrust by management.

Thus SOX promotes one form of management ideology which is that of “Tayloristic” internal control system where the manager is the nexus of control and
authorises activities by employees, supported by an external assessment force (the external auditor) which ensures that the internal control system conforms to certain externally defined criteria. Managers have the allocative resources over information systems and internal control procedures as well as the authoritative resources necessary to harness the actions of employees and get them to conform to the requirements of the SOX. The question remains if this is the right form for control systems in all contexts and cultures.

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