



## **3 Steps to Sustainable Compliance**

by Eric Krell

### **Executive Summary**

If you're a CFO, your job depends on how well your company's compliance capabilities hold up over time. That's the chilling message of a recent study, which found that more than 60% of CFOs from companies that reported material weaknesses were pushed out the door within three months. People and technology represent two of the most important success factors of Sarbanes-Oxley compliance. This article examines how leading companies address those factors while presenting three steps to sustainable compliance.

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The soaring costs, disruptive staffing effects and complex IT-control issues associated with the Sarbanes-Oxley Act call to mind an equally chilling compliance hurdle. Unlike Year 2000 (Y2K) compliance, however, the Sarbanes-Oxley Act will not melt away on January 2.

CFOs, controllers, internal audit directors and other finance executives charged with ensuring their company's adherence to Sarbanes-Oxley over the long haul must address two major compliance challenges: people and technology. Finance executives who successfully address those two challenges will greatly reduce ongoing compliance costs and free their organization's internal resources to focus more on generating value and less on documentation, testing and remediation.

Organizations with compliance programs that falter will face greater scrutiny from external auditors and the U.S. Securities and Exchange Commission (SEC). And a new study finds that the majority of CFOs who fail to effectively sustain compliance may pay with their jobs.

### **Making People and Technology Compute**

Recent compliance-status reports from public accounting firms, finance and accounting (F&A) consultancies and research organizations consistently identify IT controls and documentation as the two most challenging aspects of Section 404, which represents the Sarbanes-Oxley Act's most comprehensive requirement.

The Financial Executives Research Foundation (FERF) conducted interviews with senior corporate-finance executives at 20 Fortune 500 companies to learn more about their control self-assessment processes, documentation tools, training activities, approaches to sustaining compliance in subsequent years and other facets of their Section 404 initiatives. Information technology access controls and adequate documentation were the most pervasive control issues that finance executives identified in their discussions with the FERG.



Documentation is a people-intensive process. It requires employees – lots of them – with deep knowledge of key financial and business processes and a keen understanding of the technology that supports the processes. Yet most compliance initiatives have suffered, to varying degrees, from insufficient human resources. A Jefferson Wells International study of 200-plus senior-level Institute of Internal Auditors (IIA) members identified “insufficient resources and/or time constraints” as the number-one Sarbanes-Oxley compliance challenge.

### **The Race for Resources**

But few small to mid-sized companies have deep enough pockets to immediately hire large numbers of new finance, accounting and internal audit managers. Organizations that can beef up their F&A ranks and internal audit departments must out-bid both resources-hungry external auditing firms and the Public Company Accounting Oversight Board (PCAOB), which expects to nearly double its workforce in 2005 to help execute its Sarbanes-Oxley mandate of inspecting some 600 public accounting firms on a regular basis.

Given the surging need for accountants and internal auditors and the fierce competition for those resources, it makes sense for companies to leverage technology to strengthen their compliance efforts. First, however, most organizations must develop a better understanding of the internal controls surrounding the systems that support key financial and business processes. Deloitte & Touche LLP identifies “lack of effective controls over the IT environment” as one of the top threats to Sarbanes-Oxley compliance.

### **Comply or Pay the (Ultimate) Price**

Why should the human and technological compliance challenges rank as top priorities for CFOs during the next 12 months? Their jobs may depend on it. An A.R.C. Morgan study of existing data about disclosed weakness reported by roughly 350 SEC registrants produced some sobering findings, including the following:

- More than 60 percent of CFOs from companies with material weaknesses leave or are pushed either immediately before the disclosure or within three months of the disclosure;
- Auditing fees typically increase by 150 percent when weaknesses are reported;
- More than 65 percent of filers with disclosed weaknesses restate earnings causing significant shareholder impact (people, training, consultants and technology costs are also significant); and
- More than “86 percent of material weakness disclosures so far appear to have been discovered by the external auditors and not by management (or consultants) as part of their compliance projects.”



### Starting Down the Path to Sustainable Compliance

Those findings alone should sufficiently motivate senior finance executives to improve compliance processes. Doing so quickly requires that companies possess a savvy blend of accounting and technology skill sets. CFOs can start to strengthen long-term compliance efforts through the following approaches:

1. **Hire the right skills.** When QuadraMed Executive Vice President and CFO John Wright re-staffed much of his finance team after the company moved its headquarters from Northern California to Northern Virginia, he sought four qualities in his new hires: integrity, public-accounting experience, internal auditing experience and systems expertise. Ongoing compliance with Section 404, Wright emphasizes, cannot be achieved simply by assigning more people to monitor internal controls. Rather, he adds, the right systems and processes can strengthen the monitoring process.
2. **Train the right people the right way.** The Big 4, Protiviti, Jefferson Wells, Parson Consulting and other firms that provide compliance services to companies generally agree that ongoing compliance requires business process owners to assume responsibility for monitoring internal controls in their areas. Finance managers, compliance officers and/or internal auditors often must teach process owners how to execute their controls-monitoring responsibility. The bank reconciler needs to know the most common signs of fraud in her area. Employees in the accounts payable function should understand whether the automated control governing approvals for fulfillment of large invoices is switched on in the accounting system. The vice presidents and sales directors in charge of overseas sales should be familiar with the U.S. Foreign Corrupt Practices Act. The IT and finance professionals installing or upgrading the ERP systems should understand the importance of revenue recognition issues and how those decisions are handled by the application.
3. **Ensure that technology helps rather than hinders.** It is widely agreed upon that some type of tool is necessary to sustain compliance efficiently and effectively. To date, most companies have used in-house software to help monitor, maintain and store internal control documentation, according to the FERF. Organizations that have purchased compliance software and are satisfied with their investments tend to be closely involved with the ongoing development of the software. Dissatisfied compliance-software customers tend to cite similar complaints: the tool was too big or too small for the organization's compliance needs; the implementation was too rushed; or the tool did not possess sufficient accounting/auditing aptitude. Regardless of which type of solution the organization selects, the tool should cause minimal disruption. The solution should require minimal training, integrate smoothly with the existing systems infrastructure and come at a reasonable price given the eye-popping price tag of compliance to date.



CFOs who invest in the right people, training and technology will greatly lessen the compliance burden their companies bear in the coming months and years. Finance executives who fail to do so may suffer the consequences of causing their companies to endure Y2K-esque compliance mobilizations year after year.

*About the Author*

*For the past seven years, Eric Krell has covered the BPM space for Business Finance magazine and several other business publications. He regularly interviews leading CFOs, Finance Directors, Controllers, Analysts and Consultants about BPM best practices.*