

How Performance Management Aligns with Sarbanes-Oxley

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Turning Compliance Efficiency Into Management Effectiveness

Corporations that must comply with the Sarbanes-Oxley Act (SOX) have spent two years documenting existing processes to ensure there are controls for these risks and there are tests for the controls' effectiveness. It has been time consuming and costly experience. Many companies also face ongoing elevated SOX compliance costs if they do not make fundamental changes to their business and accounting processes to make them more compatible with the new environment. As they make improvements their finance and accounting processes and systems to promote efficiency, companies can and should leverage these changes to promote management that is more effective. Effectiveness, in this sense, includes a faster close, the ability to provide a wider range of quality information to the field sooner, including more operational figures and more predictive performance indicators to improve a company's competitiveness and profitability. Almost paradoxically, companies that do not cut corners on their Sarbanes-Oxley compliance efforts are likely to realize the highest return on their considerable investment.

First Focus on Compliance Efficiency

Sarbanes-Oxley Section 404's impact on companies has been to transform once informal systems that relied on personal integrity, common sense and after-the-fact audits, into more formal systems that are inherently controlled and constantly monitored. Essentially, it is a 'total quality management' approach trying to prevent fraud, instead of relying on audits to spot frauds that already have taken place. Corporations point (correctly) to the high cost of compliance but for most, redesigning processes to reflect this new environment would mitigate the expense. Rather than making process changes haphazardly, we advise a coordinated project. It is more likely to produce efficiency gains as well as a data environment that promotes financial management effectiveness.

What sort of process changes? In our recent Audit and Control research study, respondents cited automating manual accounting processes (e.g., re-keying data, entering accruals, making adjustments) most often as very important to making Sarbanes-Oxley compliance more efficient. Harmonizing the company's charts of accounts and reducing spreadsheet use were also highly ranked. The common theme to these issues is their real cost to a company is usually hidden because the impact spread out and incurred only in tiny increments. However, multiplied by millions of transactions annually, it adds up to real money.

Spreadsheets in particular are a significant source of control inefficiency. Companies typically have hundreds of these feeding core financial processes located on individual desktops or (perhaps even worse) located on shared servers. They are inherently uncontrollable: they offer no reliable audit trail, and lack referential integrity and data integrity. They therefore are difficult and expensive to audit and have been shown to be error prone in numerous studies. The true cost of using spreadsheets in financial processes goes unnoticed because the impact is diffused and companies often do not recognize the role they play in driving overall costs.

Promoting Effectiveness

A majority of companies will find efforts to promote compliance efficiency will produce significant savings in the cost of operating their finance departments. Moreover, structured properly they can use these efficiency initiatives to enhance the value of their finance organization. CFOs should take the opportunity to build on process improvements by

- Shifting resources from managing transactions to value-added activities
- Shortening process execution times
- Improving data quality and data consistency
- Collecting and providing more operational data used to assess performance
- Gathering and disseminating more predictive performance indicators

CFOs regularly express a desire to break out of the bean-counter mold and play a more strategic role in their company. However, it can be difficult to find the time and resources to make this transition feasible. The first requirement to more effective financial management, therefore, is to shift activities and resources away from pure accounting and transactions processing by improving efficiency. SOX compliance requirements have made this a worthwhile effort. Streamlining process changes not only promote operating efficiency in the more formal controls environment, they provide CFOs with the time and resources to invest in efforts to make a strategic contribution.

Some process changes that promote efficiency also enhance effectiveness. Shortening the time needed to complete cycles such as the periodic financial close, procure-to-pay and order-to-cash lowers costs and can improve overall business execution. The shorter reporting intervals for US public companies have increased the value of speeding the financial close and shortening the time required to produce financial statements. Regulatory compliance may be reason enough, but such changes also can shorten management reporting cycles. Integrated order-to-cash and procure-to-pay systems can be inherently more controllable. Moreover, their ability to shorten end-to-end execution can save money, speed cash flow, and increase customer satisfaction.

Improving data quality and data consistency also addresses both efficiency and effectiveness issues. Applied to finance operations, "data quality" means the absence of errors in the original entries while "data consistency" means information derived from these original entries means what people think it means. Minimizing manual processes and spreadsheet goes a long way to reducing the systemic data quality issues. Data consistency is a bigger issue. Even in well-managed accounting environments, consistency is a problem because people often use numbers derived for one purpose in another context. This can produce the "dueling spreadsheets" that prevent people from addressing a pressing business issue because they are too busy arguing about who has the "right" number. Centralizing reporting activities and eliminating stand-alone spreadsheets as an analytic tool for enterprise-wide efforts is one approach to this. There are even solutions that can appeal to die-hard spreadsheet users.

Finance departments provide most of the performance data companies use to assess their performance. Our research consistently finds corporations have plenty of accounting data but lack critical operational data that would provide a more complete view. CFOs should assume responsibility for providing quality non-accounting data to business users on a timely basis. Similarly, companies put too much focus on lagging performance indicators. Leading indicators such as internal metrics (e.g., customer satisfaction, production quality trends, etc.) and external ones (e.g., downstream demand indicators) play a too-small role in managing future performance. Finance departments ought to be the source of reliable leading indicators for their corporation.

A Systematic Approach is the Most Efficient

Just getting by with Sarbanes-Oxley compliance is a penny-wise-pound-foolish approach. Ventana Research concludes that dealing with root causes of fraud control issues by redefining processes usually will produce lasting cost savings for companies. These same process changes, implemented correctly, also will enhance the effectiveness of finance organizations that look for a lasting return on their Sarbanes-Oxley investment.

About Ventana Research

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