

White Paper Series:  
Flexible Global Compliance Architecture  
What does it Mean to Chief Financial Officers?

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## Executive Summary

With the emergence of new laws and regulations today, companies must balance between performance and conformance to meet the requirements of all key stakeholders. Boards of directors and senior management are challenged with devising business models and integrated solutions to meet obligations such as enabling customers to find quality and price competitiveness, providing satisfaction to investors with the value of the organization's products/services and results, and demonstrating to regulators adherence to laws and regulations. Meeting such varied obligations, which evolve and change over time, should not be a static, separate and discrete function of the organization but rather an outcome.

Compliance is often perceived as a cost associated with the right of doing business. Often its value is not intrinsically clear. However, analysis indicates that conformance with compliance demands is not merely an item for cost management, but also something that can be executed and leveraged to provide increased transparency, lead to business performance improvement, and ultimately increase shareholder value through clear demonstration of achievement of stakeholder demands.

The people, processes and technologies supporting an organization's compliance obligations often take on multiple forms, making it a key requirement to ensure that they are effective, efficient and sustainable over time. In particular, systems must provide visibility over all relevant data and any issues around the globe, flexibility to utilize data and resources to cover the various stakeholder needs, and integration capability within an IT landscape that is often quite heterogeneous. As a result, addressing governance and compliance obligations tomorrow means implementing a flexible global compliance architecture today.

This paper presents the challenges and opportunities associated with meeting the governance and compliance requirements posed by stakeholders today, and discusses key success factors, using illustrations of existing solutions by the leading software company SAP.

## Introduction

With the heightened focus on corporate governance and internal control in today's business environment, organizations require effective mechanisms for meeting stakeholder needs and demonstrating compliance. Stakeholders include its customers, employees, suppliers, investors, auditors, and regulators. Development and implementation of compliance mechanisms can represent a significant investment and tends to divert attention away from business performance objectives. Nevertheless, regulators and market dynamics make it clear that compliance is not a choice but rather a basic requirement and cost of doing business.

*“A significant challenge, which is also a tremendous opportunity, is realizing the benefits of effective internal control, which includes having far better information, a stronger basis for decisions and much improved financial reporting.”*

*(Dennis Nally, Chairman and Senior Partner of PricewaterhouseCoopers, 2004)<sup>1</sup>*

It therefore becomes important for companies to identify structures and tools that can effectively reduce the amount of effort required and to integrate compliance into the fabric of the organization. Technology plays a significant role in enabling the aggregation, analysis and reporting of information, be it for performance or conformance objectives. Using SAP as an illustrative example of types of solutions that can be considered, we will explore what a flexible global compliance architecture means for a finance function, characterizing the common themes emerging from the myriad of compliance requirements today, evaluating the cost and value side of typical implementations, and presenting the value proposition of a flexible global compliance architecture.

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<sup>1</sup> PricewaterhouseCoopers Financial Services 2004 Audit Committee Forum, New York, November 11, 2004.

## A Compliance on the board agenda

Compliance comprises the organizational model, processes and systems used to ensure adherence with laws and regulations, internal standards and policies, and expectations of key stakeholders such that the organization can further its business model, reputation, and financial condition. Compliance requires various activities, touch points to line management, and aggregation of information with consistency and measurability.

*“The topics of corporate governance, Sarbanes-Oxley and internal controls have long since been on the agenda, yet appear to have been drastically underestimated. It is critical not to allocate these issues merely to the Finance area as has often been done to date, but rather to make them a task for all business areas of a company, such that formally meeting the requirements of the law also leads to the often needed improvement of internal controls.”*  
(PwC Barometer Survey Respondent, July 2004)

The role of the Board and senior management in compliance matters is critical in terms of tone at the top and delegated accountability throughout the business, through effective use of people, process and technology. Ultimately, compliance should be an outcome of business activity, not a back-office function of an organization.

### 1 Why compliance matters

While compliance may once have been thought of as a discrete function and matter of avoidance of regulatory fines for an organization, corporate governance and internal control legislation have elevated it to a matter of protection of an organization's reputation and value. Boards and senior management are henceforth required not only to be well informed and provide guidance to the business, but also to engage in the communication and monitoring of adherence to compliance requirements across the organization.

Compliance failures impact ratings by analysts, investors and rating agencies, and thus the company's stock price. Investors pay a premium for shares of companies demonstrating effective governance and internal control. 80% of investors are willing to pay a premium for a well-governed company; average premiums range from 30% for Eastern Europe to 13% for North America.<sup>2</sup>

Furthermore, a study conducted by Business Week magazine<sup>3</sup> identified a correlation between board governance and financial return, indicating that companies with the highest rankings show the highest financial returns.

Moody's Investors Service have indicated their expected reactions towards disclosure of material weaknesses in internal control over financial reporting, expressing lesser concerns regarding individual weaknesses discovered in controls over specific account balances or transaction-level processes, provided that management takes corrective actions. However, material weaknesses relating to corporate governance matters (e.g., poor tone at the top or inadequate risk assessment practices) call into question whether management is effectively able to manage the business. Such weaknesses would be most likely to result in lower credit ratings for the company.<sup>4</sup>

Developments show that stakeholders are shifting their focus from maximum gains at all cost to sustainable growth, where effective governance, risk management and compliance are fundamental requirements. This is confirmed by respondents to the Financial Times Special Report on the World's Most Respected Companies (Nov 2004) who indicated that they respected companies demonstrating durability, stability and continuous growth over the long run. To ensure that reputation and value are maximized, an organization must meet the objectives it derives from its customers, suppliers, employees, investors,

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<sup>2</sup> McKinsey study on stock prices and corporate governance (2002)

<sup>3</sup> Melvin (2003)

<sup>4</sup> Moody's (2004)

regulators and other stakeholders. These obligations, taken together, constitute what may be called the operating rule base of the organization, where each rule (e.g., internal control assessment to meet regulator expectations, quality management programs to meet customer expectations) requires specific compliance activities and involves a myriad of business units and processes. The challenge is to keep such rule base current and the organization focused on an integrated approach to the fulfillment of such obligations.

## 2 Corporate governance and compliance demands

Corporate governance and compliance demands facing companies today include laws, regulations and standards with specific actions and reporting required. While certain industry-specific measures have emerged over the years, additional legislation and discussion has come about more recently in response to corporate scandals seen since 2001. Documentation and evaluation of internal control is intended to provide transparency, which in combination with good governance practices, may not entirely preclude corporate scandals but are critical to achieving the satisfaction and support of stakeholders, in particular regulators and investors.

The following presents a non-exhaustive list of examples of recent corporate governance and compliance demands that have arisen across different countries, subject to individual company interpretation as to applicability and further requirements.

- The Sarbanes-Oxley Act, stock exchange listing standards and associated guidance by the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (USA) requires corporate governance and internal control evaluation and reporting, in particular relating back to specific financial statement assertions, and including not only the organization's own processes but also outsourced processes.
- Loi de Sécurité Financière (France) heightens requirements of boards of directors and requires management internal control assessment as well as attestation by the external auditor.
- Anti-bribery Law 231/2001 (Italy) amends the Italian criminal code and implements the OECD Anti Bribery Convention to heighten the identification and punishment of companies and individuals who engage in bribery transactions.
- Federal Government 10-Point Plan (Germany) reinforces board responsibilities and required reliability of financial reporting.
- Corporate Governance Code and Tabaksblat (Netherlands) focus on improved transparency, checks and balances, and controls over board member remuneration.
- Anti-money laundering legislation (US and international laws) establishes analysis and reporting requirements for detection of suspicious activity using financial instruments.
- European Commission law proposals for mandating increased transparency, efficient internal control, and stronger director and management responsibilities.

Such laws and regulations supplement the various industry-specific measures that have been gradually implemented over the years, such as for example:

- ISO for the manufacturing sector requires documentation of processes and testing of quality measures.
- The Health Insurance Portability and Accountability Act (HIPAA) requires that healthcare organizations safeguard the privacy of personal data about patients and also apprise consumers of their privacy policies.
- US Food and Drug Administration Title 21 CFR Part 11 establishes requirements for electronic records and signatures.

- The FDIC Improvement Act ("FDICIA") for banks requires documentation and evaluation of internal controls.
- Basel II focuses on minimum capital requirements, supervisory review of capital adequacy, and market discipline for financial institutions to encourage safe banking practices; it issued guiding principles for the evaluation of internal control and requires specifically financial and management information to be compiled as a basis for risk management practices and increased transparency towards creditors.

Further standards receiving attention and presenting implementation challenges include:

- The Enterprise Risk Management Integrated Framework of the Committee of Sponsoring Organizations (commonly referred to as COSO II) provides a framework and application guidance for enterprise risk management, establishing a basis for measuring and managing risk not only on a strategic level as an impact on key performance metrics, but also on an operational level, as the values of project and opportunities change.
- International Financial Reporting Standards development represents the movement towards comparable financial information through a convergence of US Financial Accounting Standards and International Accounting Standards (for non-SEC filers), requiring changes in reporting and valuation, and in the transition period parallel sets of books and valuations.
- Accelerated financial close is becoming a requirement to provide to investors more timely information on the organization's result, forcing discipline, transparency and efficient management systems. Some of today's leading companies are able to publish their results within 10 days of their quarterly close.

In addition to external requirements, companies also have certain internal compliance procedures, which call for action to ensure the viability of the business and reputation protection. For example:

- Corporate code of ethics to ensure that staff comply with the organization's standards of conduct and thereby enhance and protect its reputation.
- Business continuity planning requires periodic identification and documentation of the essential business processes, documentation as to why these processes are relevant, assessment of risks and controls with a particular focus on IT controls (e.g., continuity of processing must be ensured and data/systems should be adequately backed up), escalation and reporting of changes or issues.
- Financial policies and procedures require strict adherence such that data is processed and analysed consistently.
- Risk and quality measures may impose ongoing evaluations or spot-checks to ensure the products or services produced meet professional standards and support the brand name and reputation of the organization.

These laws and standards impose a heightened level of rigor and transparency. The broad reach of these requirements around data capture, analysis and reporting make it necessary for companies to ensure they develop adequate and well conceived methodologies, supported by reliable processes and systems. Key objectives include:

- Transparency of information, as may be achieved through visibility over business processes and systems used as input for compliance activities.
- Accountability, as may be achieved by controls over hand-offs between different processes and systems.
- Data integrity, as may be ensured by adequate access controls and audit trails.

- Control testing capability to ensure process and system effectiveness, including tracking of any remediation efforts required.
- Flexible analysis and reporting of data to meet the needs of the various internal and external stakeholders.

The key challenge in meeting the myriad of compliance requirements posed externally and internally is integration. Too often it is found that each initiative establishes its own tools with minimal integration with existing systems, causing significant manual efforts of data capture and analysis, and redundancy in touch points to line management. For example, companies may maintain detailed policies and procedures including inherent risk and control descriptions on a portal as part of their governance framework, compliance check lists for certain quality standards, risk assessment survey tools and loss event databases for Basel II operational risk, and a separate process and controls database for Sarbanes-Oxley compliance. Each new system requires administration, training and support, and is often regarded as a tedious addition to the responsibilities of the various line management members involved.

*“The systems changes we have had to go through in recent years have been enormous. The costs to keep up with the changes on the regulatory side are enormous.”*  
(Brian O’Brien, Vice-President of Finance, Yamanouchi Pharma America Inc.)

*One of the objectives of the adoption of International Accounting Standards and Basel II is to obtain a unified environment of financial administration, control and informative statements extraction. “Given the challenges presented by the adaptation to the new requirements, the organization aims to create a modern strategic organizational management platform”*  
(Sergio Maccotta, National Bank of Greece)<sup>5</sup>

Companies have begun to develop new procedures and systems to gather various kinds of information required for internal and external reporting in connection with compliance initiatives, as for example Sarbanes-Oxley compliance.<sup>6</sup> By implementing disclosure controls and procedures, an organization maintains records that include material information about the risks faced and the compliance with its code of ethics up to the assessment of effectiveness of those disclosure controls and procedures. Cascading the responsibility and rolling up the results of compliance activities is not a simple task. In particular, sign-off should be supported by consistent and timely completion of compliance activities down the line, which requires a corporate schedule to be established and enforced.

*“The problem is the pace of change. When does it end? And, what’s the real cost of compliance? People are starting projects that may never get finished because the rules change. And, no-one knows the cost of messing up.”*  
Andy Coulter, head of marketing and business planning at Misys Retail Banking.<sup>7</sup>

Streamlining of compliance efforts without compromising the results of each initiative and also keeping pace with changes in regulatory requirements is increasingly becoming a mandate for the board and senior management to manage the cost and value side of compliance.

### 3 Task for the board and senior management

Boards and senior management must ensure that business information gathered is understood by the right people to allow an adequate reaction. The need for concise and timely information is heightened today. Boards and senior management cannot provide the

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<sup>5</sup> SAP Press release of December 21, 2004.

<sup>6</sup> Bienenstock (2004)

<sup>7</sup> Stanley, Georgina (2005)

direction and support needed, make educated decisions without relevant, timely and accurate information and communication. For many companies, dashboard reporting and escalation triggers are therefore needed more urgently than ever.

*“Transparent business processes with daily closing was impossible in the past. The closing cycle time for the company has been reduced from 15 days to one day, so that we can make a just-in-time delivery of information for decision-making processes. We now have a better performance management process in place. With the availability of timely and relevant information in an easy-to-understand format, we are now able to transform our operational data into information which can be used in an intelligent manner to better improve our business.”*

*(Yoon Yeo-Young, E-business Team Leader, 2003 Outlet)<sup>8</sup>*

Compliance is not only a matter of regulation, but a way of doing business. As a result, compliance has become a key board agenda item, and senior management is challenged to set the tone at the top of the organization and ensure measurement of:

- Conformance with requirements established by internal and external stakeholders, including achievement of a culture of business integrity and ethical values.
- Performance and value management, including achievement of effectiveness of the compliance process through leverage of technology.
- Integration of governance and compliance obligations across business areas.

*“The implementation of Sarbanes-Oxley requirements offers companies an opportunity to revisit their financial reporting and risk management processes with a view to improving them through the use of modern IT applications.*

*Modern software solutions such as mySAP ERP not only enhance dramatically the efficiency of internal procedures. Moreover, if properly implemented, they can effectively support a SOX compliant system of internal control over financial reporting through their tight integration of different financial-reporting related modules rolling up to a uniform real-time corporate wide consolidation; system-driven access and matching controls; transaction audit trails and many other valuable aspects strengthening a company’s overall control environment.*

*Last but not least, many companies today realize the substantial effort and diligence required to meet the high control documentation, assessment and testing standards imposed in particular by SOX Sec. 404. Effective Compliance Management software specifically designed to meet said standards such as the SAP MIC Tool available within mySAP ERP provides an indispensable support of corporate-wide documentation and testing procedures through central task scheduling and workflow functionalities as well as uniform documentation standards.”*

*(Dr. Werner Brandt, Chief Financial Officer and Member of the Executive Board, SAP AG)*

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<sup>8</sup> SAP, Customer Success Story: Retail: 2003 Outlet (Korea) – Development of an integrated IT landscape has allowed the company to become a transparent business with accurate data and the scalability to cope with expansion.

## B Evaluating the cost and value of compliance

An evaluation of the impact of compliance or of non-compliance is a fair starting point to determine necessary actions and priorities. Compliance failures often cause harm to reputation and brand, relationships with business partners and society, employee morale and commitment to excellence in addition to regulatory fines incurred. Conversely, compliance can be seen to positively impact each of these areas. As compliance relates to conformance with internal and external requirements, it requires a focus and understanding of key stakeholders and their demands on the organization. Yet stakeholders – such as regulators, investors, customers, suppliers, and others – ultimately require the organization to achieve a balance between conformance and performance. Excessive focus on one at the detriment of the other can jeopardize the viability of the organization.

A major challenge and cost factor are the adoption and integration into the business of new or changing compliance measures, demanding activities from data capture and analysis to reporting. For most compliance initiatives, an approach that best integrates with existing processes and systems will be least burdensome to the organization and most sustainable over time. This requires a holistic view of compliance.

*“Enterprises that choose one-off solutions for each regulatory challenge that they face will spend ten times more on compliance projects than their counterparts that take a proactive approach.” (French Cadwell, Gardner Research Vice President, 2004)*

*“Ad hoc or departmental approaches to compliance will provide neither the needed efficiency nor effectiveness. Compliance should embrace enterprise wide processes; it should be managed and supported by owners, well-designed systems and appropriate technology.”*

*(Gartner research, Rozwell, 2004)*

While year-one compliance typically involves considerable efforts to understand the new requirements and determine how they can best be implemented within the organization and within the required timeframe, the expectation to demonstrate value from such efforts is growing. Companies are therefore challenged to leverage the momentum gained through the compliance efforts, prompting line management to help the business converge on objectives such as performance improvement, simplification and integration.

The cost and value discussion typically goes through four phases: first, pressures to manage the cost associated with the compliance effort; second, leveraging such compliance activities to achieve greater transparency in process execution and reporting; third, streamlining business processes and systems as a result of the improved transparency; and ultimately, demonstrating shareholder value gains through enhanced communication with stakeholders.

### 1 Cost management

Compliance is often perceived as a burden for companies. For example, “the cost of completing Sarbanes-Oxley corporate governance legislation has risen to \$5.1 million for the average large US organization, with a further \$3.7 million in ongoing compliance bills” according to the Financial Times.<sup>9</sup> Also, 51% of U.S. and European multinational companies covered in the PricewaterhouseCoopers’ Management Barometer Survey of November 2004 indicate that they expect to increase compliance spending by an average of 23 percent during the next 12-24 months.

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<sup>9</sup> Financial Times, “Average US group faces \$5 million compliance bill,” Nov 12, 2004.

*“The costs to the company to keep up with the changes on the regulatory side are enormous.”*

*(Brian O’Brien, Vice President of Finance at Yamanouchi Pharma America Inc.)<sup>10</sup>*

The PricewaterhouseCoopers’ Management Barometer Survey published in November 2004 indicates that 44 percent of senior executives do not have a clear view of its total compliance spending. And of the companies who tend to have a clear view of such spending, this often does not include remediation costs, penalties, fines, lost revenue and lost management time when tracking. These findings suggest that the ability to accurately track costs and measure value, even by companies with a clear view of the costs involved, is incomplete at its best. Hence, the challenge is not only to reduce compliance costs, but also to first assess the cost.

Determining the total cost of compliance should consider the following:

- The *Cost of Maintenance* captures the costs incurred by the organization to perform and promote compliance and risk management throughout the organization. Certain maintenance and support costs already exist for infrastructure and systems; these should also include costs for regulatory reporting, compliance management and checking systems, records retention, risk management and other compliance systems. Allocated costs for internal systems such as ERP/GL, CRM, HR, transactional/operational systems should also be included.
- The *Cost of Non-Compliance* captures the costs incurred by the organization as a result of non-compliance with external rules and regulations or internal policies and standards, e.g., penalties and remediation costs. Moreover, such non-compliance events typically lead to a loss of investor confidence, translating into a drop in share price.
- The *Cost of Governance* captures the costs to govern and manage the business, establishing the tone at the top, guidance from the board and senior management.

Each of these components must be identified and evaluated to understand a company’s total cost of compliance --all costs incurred by the company to be in compliance with external and internal rules, regulations and standards, including costs to respond to and remediate failures. Once such costs are made transparent, the question that follows is how they can be reduced and what trade-offs may be involved. Specifically:

- Firstly, an organization must identify how it might reduce any costs of non-compliance, such as regulatory fines or response to adverse publicity associated with compliance obligations. Well known examples of such cases include Enron, MCI Worldcom, Ahold, Parmalat, and other companies that were accused of accounting fraud and required significant clean-up action. Reducing the event of non-compliance and associated costs requires establishment, evaluation and maintenance of internal control to ensure that mechanisms are in place to prevent or correct such incidences. Hence the cost of non-compliance may involve an initial increase in the cost of maintenance of the compliance management function and systems.
- The second point of focus is then to reduce the cost of maintenance through effective use of people, processes and systems, leveraging such existing resources or integrating them to jointly achieve various compliance objectives such as calculation of exposures and capital figures for Basel II and aggregation of financial reporting risks for Sarbanes-Oxley. Operational risks are often directly or indirectly related to controls required to ensure all assets, liabilities and transactions are completely and accurately reflected in financial statements at the appropriate values. Regardless of the ease or speed of achieving such synergies, it is important for any organization to strive for efficiency in compliance management and monitor the cost of compliance.

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<sup>10</sup> Myers, Randy, CFO.com, “Sarbox and IT: The Long Haul,” Jan 19, 2005.

*“A common platform based on standardized data, processes and content allows for the information to be universally understood and used in a variety of ways. Increasing speed, efficiency and quality of reporting represents a definite competitive advantage in terms of administrative efficiency, stockholder transparency and internal decision making.”*  
(Dr Jürgen Hörtig, Vice President of Corporate Projects, 2003)<sup>11</sup>

Realizing that year-one compliance is not the end of the battle and compliance costs do not dissipate on their own, but that requirements evolve over time and compliance programs need to be adjusted to meet evolving objectives, a compliance architecture should be flexible and wide-reaching to be most valuable to the organization over time. Such architecture should also provide transparency over business processes and results.

**Illustrative Example: SAP Netweaver functionality allows for the linkage and integration of systems used across the business. Business Warehouse, in turn, facilitates the extraction and analysis in various different forms. Such IT architecture components can help organizations leverage existing information systems for purposes of compliance, remain adaptable to changing demands and contain the cost of maintenance associated with compliance.**

## 2 Transparency

As a result of extensive compliance efforts, often reaching far into the organization for data input and evaluation, many companies are seeking to achieve greater transparency and reliability of systems and processes. This is prompted not only by Sarbanes-Oxley requirements for documentation and evaluation of internal controls over financial reporting, but also FastClose and IFRS conversions and other such compliance requirements.

Such efforts typically result in various deliverables to support the requisite reporting requirements:

- Flowcharts of business processes
- Documentation and assessment of internal controls
- Accountability and hand-offs between different systems and processes
- Mapping of IT systems and processes
- Identification of risks (categories differing based on nature of the assessment required) and controls
- Performance indicators

Once these tangible results are achieved, the next step – and one that often lacks adequate follow-through – is analysis and evaluation of the data from a business standpoint rather than merely from a compliance standpoint.<sup>12</sup> All too often are quick solutions implemented and everyone goes back to business as usual in silos, without leveraging the potential benefits of the newly gained visibility over the business and identifying ways of working more effectively. For example, one business area may be under-utilizing certain system functionalities (e.g., checks and balances, reporting capability) as compared to another business area, and as may be learned through comparison of business processes and practices.

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<sup>11</sup> SAP AG, “Customer Success Story – Chemicals: Degussa AG – Degussa accelerates consolidation and streamlines reporting with SAP SEM-BCS, 2003: The company has achieved integrated legal and management consolidation with highly flexible reporting.”

<sup>12</sup> PricewaterhouseCoopers, Menzies, Christof (Hrsg.), Sarbanes-Oxley Act, Professionelles Management Interner Kontrollen, Schäffer-Poeschel Verlag, 2004.

Achieving transparency presents a challenge in terms of people, process and technology: communication between and among operating departments and administrative functions has often been lacking, resulting in breakdowns and errors. In addition, leadership and tone at the top need to actively promote transparency such that it becomes reflected in the way business is done and processes work. Transparency is ultimately a requirement for compliance, not only from a conformance but also a performance standpoint.

*“Compliance is not merely a matter of doing what is required, but rather doing it in such a manner that it furthers the organization’s objectives.”*

*(Christof Menzies, Partner of Governance, Risk & Compliance Practice, PricewaterhouseCoopers, 2005)*

**Illustrative Example: Dedicated solutions of SAP such as that for Basel II or Management of Internal Control (MIC) help to draw out the requisite information to allow analysis of compliance data across an organization.**

### 3 Business performance improvement

Compliance imposes a degree of introspection and discipline in meeting business process objectives. As a result, loose activities tend to get more formalized; opportunities to streamline processes are identified; work-around mechanisms are sought to be eliminated; accountabilities and ownership are more firmly established. The challenge, nevertheless, lies in leveraging the momentum achieved from such compliance efforts to assess how to make the best use of the achieved transparency to improve business performance and transform the negative energy often resulting from a bureaucratic compliance process to positive energy around value creation.

*“You have to guard against complacency to make sure that you are alert to possible breakdowns in controls and to ensure that you pursue continuous improvement in controls and documentation”*

*(Dan Farrell, Senior Vice President for the energy company TXU Corp.)<sup>13</sup>*

For example, Sarbanes-Oxley compliance has required organizations to identify any process and control weaknesses and define action plans to remediate those in time for period-end reporting. To remedy a highly fragmented financial consolidation and reporting process, short-term action may be necessary to provide comfort that errors are prevented or detected. However, a longer-term action of integrating systems for improved reliability should likely be explored to better serve the business.

Performance improvement opportunities resulting from a compliance exercise focused on IT (e.g., IT control effectiveness evaluation for Sarbanes-Oxley, business continuity planning, other process integrity initiative) can include for example:

- Business process improvement, prompted by process and control evaluations and resulting in the elimination of redundant controls, remediation of control effectiveness issues.
- Business process or control issue identification and tracking through establishment of metrics and analysis of trends of actual results against plan to provide a basis for understanding the underlying reasons for processing failures. Correcting these causes can improve system accuracy, completeness of processing and system availability.
- Harmonization of processes that operate differently unnecessarily.
- Leveraging process documentation for consolidation of business activities into shared service centers or outsourcing to third parties based on cost/benefit analyses.

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<sup>13</sup> Myers, Randy, CFO.com, “Sarbox and IT: The Long Haul,” Jan 19, 2005.

- Optimization of management reporting across the organization: is information accurate? Is it the right information? Is it timely? Is it available when required and reported in the right period of time? Is it the latest available? Is there transparency and access to underlying data to allow for further analysis and provide comfort to management for sign-off on compliance obligations?
- Enhancement of security and reliability of systems: can authorized individuals gain access to the system as necessary (in particular for the consolidation and communication of financial information)? Are security violations identified and reported timely?
- Automation of workflows and linkages between systems, even integration of different systems across a heterogeneous IT landscape.

Optimisation that can be driven from compliance initiatives should not be underestimated. Experience shows a number of organizations, including BP and GE that have engaged in business process simplification initiatives with expected return calculations making the investment worthwhile for the business as a whole.

**Illustrative Example: Reengineering of business processes requires information systems to support such changes. SAP modules enable execution according to a given process design by establishing workflow, roles and responsibilities and other key attributes. Work steps can be modified as necessary to continually support the business as it evolves.**

## 4 Increasing shareholder value

Seeking to generate value is a natural driver of a business, and compliance should be no hindrance but rather an enabler. Once costs of a year-one compliance implementation have been contained and the transparency resulting from the compliance exercise has been realized and leveraged for business performance improvement, these gains can be translated into value for shareholders.

For example, operational risk capital projects under Basel II can lead to lower cost of capital, as a result of better ratings, supported by robust risk management systems.<sup>14</sup> Furthermore, proactive operational risk management helps to reduce operational losses, directly impacting efficiency ratios and subsequently earnings. Finally, dedicated risk management efforts and systems are found to support improved process and client service quality.

To effectively increase shareholder value as a result of compliance, it is critical that compliance be ensured through a robust compliance process and systems, such that management can refocus its attention on its core business activities.

*“The pressure to demonstrate regulatory compliance is all too often coming to dominate the board agenda, forcing to one side key issues such as innovation, customer focus, strategy formulation, calculated commercial risk-taking, and transparency about all these true driving forces of shareholder value.”*

*(Financial Times Special Report on the World’s Most Respected Companies, Nov 2004)*

As stakeholders change, the ability to keep pace and make decisions to change in step with them is the challenge. Flexibility and strength through collaboration will be essential for preparing for the years ahead.<sup>15</sup> In particular, considering the need for real-time

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<sup>14</sup> Maheddine, Yacin and de la Mora, Fernando

<sup>15</sup> The Economist, The Economist Intelligence Unit 2005, “Business 2010: Embracing the challenge of change” 2005.

information and the high burden associated with regulatory compliance, technology must be viewed as a key enabler for addressing the rising demands of stakeholders.<sup>16</sup>

**Illustrative Example: SAP Strategic Enterprise Management (SEM) brings together business planning and simulation, business consolidation, strategy and performance management, and stakeholder relationship management, driving focus and discipline for senior management for meeting stakeholder demands.**

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<sup>16</sup> PricewaterhouseCoopers, "Integrity-Driven Performance," 2004.

## C Value proposition of a flexible global compliance architecture

In light of the multiple forms of compliance required by external and internal stakeholders, companies are often found to have implemented disparate IT tools yet failing to establish a truly flexible and global compliance architecture, able to support multiple and evolving requirements. In the development of a suitable compliance architecture, it is essential to consider specific functionality requirements, ability to integrate with underlying systems, and fit with the organization's IT strategy.

The reality today is that information is often kept isolated and unstructured by different owners responsible for its creation and updating; documents have to be uploaded manually whereas a standardized appearance may not always be ensured. As a result, extensive efforts in quality assurance are necessary to retain the information needed for compliance electronically. This poses a threat in terms effectiveness, efficiency and sustainability.

### 1 Effectiveness

An effective compliance architecture is one that clearly defines, measures and meets the objectives set out by the internal and/or external requirements. The tolerance of stakeholders – regulators, analysts and investors alike – for ineffectiveness in meeting compliance requirements in today's environment is very low. Compliance is considered a necessary part of doing business, and non-adherence generally signals carelessness or poor management. Hence compliance is not a choice but a condition for doing business, and the measures of effectiveness vary by obligation.

For example, Sarbanes-Oxley compliance can be measured in terms of successful testing of internal controls in relation to their adequacy and operation to ensure reliable financial statements. However, company executives expect an array of challenges and difficulties in meeting the requirements of the Sarbanes-Oxley Act, as expressed in a Management Barometer Survey of March 2004. In particular, 21% of the executives have concerns about ineffective IT-infrastructure (e.g. systems are not integrated).

Characteristics of an effective compliance solution include:

- Structured workflow and defined success measures based on an understanding of the compliance requirements, clear roles (including shadow-roles or substitutes, to ensure continuous attendance to compliance obligations), and segregation of duties or critical authorizations to ensure that compliance activities can be tracked and verified, and that compliance objectives can be met fully and in a timely manner.
- Access at the various levels of compliance responsibility (e.g., corporate, business units) to the information required for the defined compliance activities.
- Reliability of any assessments to be made, including cut-offs for given assessment periods, effective testing procedures and results documentation, roll-forward of unresolved issues from prior periods, as may be supported by dedicated control testing applications.
- Issue identification and tracking over time, including leading indicators of potential compliance failures, facilitate the escalation and resolution of such crises. In particular, such compliance architecture will help enable real-time reporting of issues to help address the SOX Section 409 real-time reporting requirement.
- Monitoring and reporting of workflow, exceptions, status and other targeted reporting with meaningful classification of information to support decision-making and further reporting, considering the adequacy of information and communication across the organization - is the information accurate? Is it the right information? Timely? Is it available when required and reported in the right period of time? Current?

**Illustrative Example: SAP supports compliance effectiveness through:**

- **Industry-specific solutions for specific compliance obligations, such as Basel II, 21 CFR Part 11, Sarbanes-Oxley, including defined user concept, workflow and reporting.**
- **Auditing tools for such solutions**
- **Business activity monitoring to be leveraged by such solutions**

Key measures of success of an effective compliance process and system include:

- Access/input by all requisite parties.
- Prevention or timely detection and remediation of errors or fraud.
- Sign-off by management on the basis of reliable supporting data.

## 2 Efficiency

Companies often use many different technology solutions across compliance processes. For example, consider a risk and loss database for Basel II, a spreadsheet-type application cataloguing and evaluating controls for Sarbanes-Oxley, and a workflow-supported calendar and account analysis tool for accelerated closing requirements. The multitude of compliance tools typically draws in different ways on the same underlying company data.

How to extract, analyze and maintain such data efficiently for compliance purposes remains a challenge. While it can be done discretely and manually, such an approach becomes burdensome and disconnected from the operation of the business. Moreover, data integrity becomes compromised the more it is maintained in separate forms. Organizations with implemented ERP systems (software systems designed to support and automate an organization's business processes, typically including manufacturing, distribution, personnel, project management, payroll, and financials, tailored to specific industries, and used for purposes of business planning, execution and support, expanding towards broader business needs, including compliance management; such systems draw on object-oriented programming, relational databases, client/server architecture and open-system portability<sup>17</sup>) benefit from a more integrated systems landscape where such data can be maintained in one place and extracted for analysis of different types as necessary. An ERP platform provides a structure that lays the foundation for cross-functional business processes and lowers the total cost of ownership by reducing the need for custom integration and offering a complete lifecycle management.

*“An integrated approach reduces risk by leveraging proven systems and allows businesses to improve operational efficiency while meeting regulatory requirements. The result is increased transparency both inside and outside the enterprise.”*  
(SAP, *Creating Shareholder Value from Your Compliance Initiatives*, 2003)

*“Real IT portfolio management is not just about cost containment, but providing a focus on how to leverage IT to maintain, grow and help transform the business effectively”*  
(John Van Decker, Senior Vice President of META Group)<sup>18</sup>

Hence, to achieve efficiency in the management of compliance obligations, the compliance process, data capture needs, analysis requirements, and reporting capability need to be evaluated and optimized, considering the underlying data sources. In particular, automation of compliance management, as can be achieved through integrated systems, has been shown to positively impact compliance in terms of awareness of rules and responsibilities, demonstration of expected behavior, and monitoring and reporting to

<sup>17</sup> hyperdictionary.com: Enterprise Resource Planning

<sup>18</sup> PricewaterhouseCoopers, “IT Investment Portfolio Management – Translating IT Governance Objectives into Corporate Performance,” December 2004.

support an effective compliance management program. Furthermore, engraining conformance into the fabric of the organization, while emphasizing the required balance with performance has been shown to create a process-optimization mindset.

Characteristics of an efficient compliance solution include:

- Structured process for data feeding the compliance process requirements.
- Automated controls relating to:
  - Security (e.g., password protection, single sign-on, encryption procedures, centralized role-based user access, audit trail, digital signatures) to reduce the risk of processing unauthorized transactions, protect the integrity of data, and generate accurate reports.
  - Configuration (e.g., requirement of authorizations above certain thresholds) to bring the established compliance process workflow and corporate compliance calendar to employees (e.g., prompting for action and providing timely reminders) rather than requiring them to comprehend and follow additional procedures to satisfy their compliance obligations.
  - Built-in logic (e.g., sequential numbering of documents, minimizing potential for duplicates and contributing to the ease of auditing) to reduce the amount of testing required.
- Automated testing capability, drawing on built-in systems logic and other systems characteristics of operational controls, generating reports to provide assurance as to control effectiveness based on pre-defined testing procedures (most readily applicable to automated controls).
- Automated monitoring and reporting capability, including real-time exception/issue reporting based on predefined criteria and thresholds, reporting to internal and external stakeholders, using predefined standard views and reports to provide compliance status and results.

**Illustrative Example: SAP supports compliance efficiency through:**

- **Sourcing data from different underlying systems using Netweaver**
- **Configurable controls within its compliance solutions**
- **Dedicated compliance functionality (e.g., digital signature capability, monitoring and reporting tools for consolidation and closing processes, automated controls testing offered by partner solutions such as Virsa or Approva)**
- **Linkage of compliance workflow with email**

Key success measures of an efficient compliance solution include:

- Reduced resource requirement for data entry, analysis and reporting, both at the compliance project office level as well as at the various touch points within line management.
- Reduced efforts required for testing of controls.
- Reduced total cost of compliance over time, including cost of maintenance and total cost of ownership of tools supporting the compliance process.

### 3 Sustainability

Compliance is not a one-time activity but rather an obligation that needs to be managed durably. Systems supporting compliance should therefore be integrated and flexible to be able to respond to new and evolving requirements over time. Individual compliance solutions aim to draw on underlying company data for purposes of analysis. Yet the

degree to which such data is then used and maintained in isolation for purposes of conformance with a given rule as opposed to remaining an integral part of the business process and being reviewed in the context of managing the balance between conformance and performance still varies.

*“Accountability and workflow embedded into compliance management allows for a sustainable program over time. The most important benefit for a compliance solution is that control/process assessments, testing and sign-off activities are scheduled, and workflow tasks are sent to each responsible person.”*

*(Al Hunt, Director of Internal Audit of THQ, SAP MIC Customer Statements, 2004)*

*“Basel II is more than a regulatory challenge. We see it in the fuller context of integrated enterprise management linking internal processes with external requirements.*

*(Rainer Stober, IT Project Leader of Basel II Implementation at DZ Bank, Germany, 2002)<sup>19</sup>*

Sustainable compliance solutions must be able to run on top of existing systems, integrating them into cross-functional, end-to-end business systems that enable execution of enterprise-wide strategies with greater ease and efficiency. Such strategies require more than a short-term focus and a flexible platform for the definition of compliance obligations, document management, collaborative workspace and knowledge management, and monitoring and reporting needs.

While effectiveness and efficiency form a prerequisite, additional characteristics of a sustainable compliance solution include:

- Enterprise-wide approach and systems architecture to support multiple compliance obligations, distinguishing between the different requirements of each (e.g., requirement to test controls or not) and cross-utilizing information to support related initiatives (e.g., Sarbanes-Oxley, Basel II, ISO).
- Streamlining of compliance processes across the organization through a common user interface or compliance portal that provides an integrated "look and feel" to all compliance programs within the organization.
- Integrated document management, linking to other systems, and enabling electronic storage of documents relevant for given compliance obligations, respecting specific security and reliability measures (e.g., version control, period-freeze requirements, verification that information is derived from an authorized source, only authorized modifications).
- Accountability across the business to support the balance of performance and conformance objectives, through inclusion of compliance objectives in balanced scorecards or other measurement and reinforcement mechanisms.

**Illustrative Example: SAP supports compliance sustainability through:**

- **Sourcing and cross-utilization of data from multiple applications using Netweaver**
- **ESA architecture / composite applications design for ease of integration with other systems**
- **Leveraging of documentation system / ArchiveLink**

Key measures of sustainability of compliance include the following:

- Ownership of compliance obligations and a common approach are shared across the business, including synergies between different compliance activities.
- Increased transparency over business operations and compliance activities.

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<sup>19</sup> SAP SAPHIRE Lisbon 2002 Conference Presentation

- Linkage and balance of conformance and performance goals.
- Identification of business process improvement opportunities.

*“Putting governance in a broader context is how we can truly assure shareholders and stakeholders that what we’re doing inside the company is competitive, drives market share, creates returns for investors, and also avoids compliance of other problems.”*  
(Leif Johansson, President and Chief Executive Officer of the Volvo Group)<sup>20</sup>

*“Governance, risk and compliance should be regarded as an integrated set of concepts. When applied holistically within an organization, they can add significant value and provide competitive advantage.”*  
(Samuel Di Piazza Jr., Chief Executive Officer of PricewaterhouseCoopers)<sup>21</sup>

A study conducted by Institutional Shareholder Services<sup>22</sup> evaluated German companies in terms of corporate governance, considering criteria including the composition and independence of boards of directors and financial reporting processes. SAP rated strongest of all in Germany, suggesting not only a commitment to delivering such services to clients but also a demonstrated ability to achieve such standards internally. SAP uses its own applications such as Management of Internal Control and Operational Risk to support governance, risk management and compliance activities, and drive such values within their own organization.

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<sup>20</sup> PricewaterhouseCoopers 8<sup>th</sup> Annual Global CEO Survey “Bold Ambitions, Careful Choices,” January 2005.

<sup>21</sup> PricewaterhouseCoopers 8<sup>th</sup> Annual Global CEO Survey “Bold Ambitions, Careful Choices,” January 2005.

<sup>22</sup> RatingAktuell-Express 4/05, January 26, 2005

## Conclusion

Corporate governance and compliance obligations take a myriad of forms and tend to evolve and be supplemented over time. A focus on cost reduction, followed by a realization of transparency, leveraged for business process improvement in order to ultimately increase shareholder value is the true compliance challenge. A flexible global compliance architecture therefore becomes key to better informed management decision-making, improved compliance and corporate trust in an increasingly competitive business environment.

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