



DATA IN REAL TIME

How to reduce executive vulnerability with virtual corporate governance. — **DAVID F. GIANNETTO**

THE LEGISLATIVE FALLOUT FROM WORLD-Com and Enron has generated unprecedented corporate requirements. The struggle to comply with the Sarbanes-Oxley Act is in full gear, and auditors, managers and executives are all mandated to rise and join the cause.

This is a cause, however, that most of them are still unclear about, and one that is generating more discussion within accounting firm boardrooms than auditors might like to admit to their clients. Unfortunately, part of this debate questions whether yearly compliance audits alone actually reduce the risk executives now face.

While the debates rages, most executives are doing -- and paying -- all they can. So far, Sarbanes-Oxley compliance and ROI have mixed about as well as vinegar and oil.

But help is coming to their aid from an unlikely direction. In a world where business moves at the speed of light, decision-making is decentralized and organizations are spreading out in

a global economy, more data exists than ever. This data offers a significant advantage as it takes an equally impersonal look at the performance of the organization and the actions of its employees. Simply put, data doesn't lie.

Data Doesn't Lie

AT ITS HEART, SARBANES-OXLEY IS ABOUT ENSURING THAT shareholders can rely on the value reported in financial statements. It attempts to do this by holding feet to the fire, and removing the age-old excuse, "I didn't know."

Right now, auditors are reviewing documents and requiring more signatures than ever on monthly reconciliations. But after these sign-offs become the norm, do those signatures really reduce risk? And do they really detect or put a halt to fraudulent activities perpetrated by executives or managers?

By and large, executives would answer "no" to both questions. They would also say "no" to the question of whether or not Sarbanes-Oxley is adding value to the organization -- but this is more likely to be just their frustration talking. In fact, as early as 2002, McKinsey & Co. found that investors weigh a company's



financial performance and corporate governance equally.

It isn't that tighter controls and better corporate governance are not needed. Instead, it is simply that the traditional approach of yearly external audits and cyclical internal audits, do not provide executives with the necessary insight.

Business moves too fast. The issues are complex and influenced by external variables. Diverse management groups with varying agendas make decisions at locations throughout the world. All of these things impact the financial performance of the organization and must be of concern to the executive. This impact of not knowing is just too high.

New Insight

REAL-TIME COMPLIANCE, BUILT ON THE NEW BUSINESS METHODOLOGY of enterprise performance management (EPM), takes a different approach. It gives executives insight into the inner-workings of their business environment. It shows the results of business decisions as they are being made, how they will impact the future and how the key controls operate throughout the organization.

It compares the operations of the organization – those things that happen in the real world – to the financial results they produce. It shows trends and anomalies before it is too late to do something about them, before they become material enough to show up in an audit. In short, it "proves" out the financial statement for the executive, in real-time.

In addition, because it is built on a methodology that focuses on managing more effectively and efficiently, it provides an

ROI uncommon in traditional governance approaches. Consider the following cornerstones to real-time compliance:

- **It projects performance of material financial line items** – We've all seen the impact on the perceived value of a company when the quarterly or yearly earnings fall short of the expected earnings. But these days, should any executives really be surprised when their organizations have fallen short of their projected earnings?

Real-time compliance makes this available to executives and managers with just a click of a mouse, and goes a step further in telling them why their performance will be what it will be. This is done not only at the profit level, but also for each key line item on the financial statement.

It highlights negative trends and suspect transactions, giving business leaders the opportunity to do something about them before it is too late. This provides the underlying foundation for real-time compliance – financial performance is the result of organizational performance, good or bad, valid or fraudulent.

- **It projects the impact of key external business drivers to determine their impact on financial performance** – Almost every organization is impacted by external factors. It could be oil price fluctuations on an airline, the impact of paper prices and availability on a book printer, the changes in financial stability of a pension fund due to foreign currency exchange rates fluctuations, or the reduction in profit the organization will suffer if postal or shipping rates increase.

Although the performance of these indices may be available >

to management, it is often difficult and sometimes impossible to clearly predict their impact on financial performance. Certainly, it becomes impossible for investors to reliably predict this, but putting the impact clearly out in the open prevents future problems by allowing management to address them now.

For those managers who choose not to take action, or choose to take advantage of these external factors, the impact is clearly presented for all to see.

- **It validates reported financial performance through a comparison to the usage of real-world resources and transactions** – Perhaps the most complex and beneficial impact of real-time compliance is the ability to use technology to achieve ends that would be nearly impossible without it. If the organization produces revenue through the sale of goods, there must be a corresponding movement of these goods through its inventory. If revenue is generated by the hourly services provided by employees, then there must be a corresponding number of hours worked by employees.

Although these are simple examples, the evidence to support the reported revenue must be found on an invoice produced within the organization. This, in turn, must be supported by the use of a resource, sale of a product or service, movement of goods or some other action performed by an employee.

Today, there are very few employee actions that are not tied to an application such as an ERP or accounting solution. If the evidence to support reported revenue, or expenses, is lacking, then the reported number is suspect and should receive the attention of management.

- **It performs daily real-time validation that those key internal controls, which impact financial performance, are in-place and working** – Hand-in-hand with the comparison of financial performance with real-world actions comes the ability to check key controls in an automated manner, highlighting when they are not functioning as expected.

Each action taken by an employee is captured. Even dishonest actions leave a trail. Each one is accounted for and retained in the organization's critical information technology applications. These systems retain an enormous amount of data and hidden information, and account for the actions of each employee, regardless of his or her intentions.

Real-time compliance, supported by a business intelligence tool, has the ability to pull and "link" data from disparate sources. This ability allows it to compare the generation of a purchase order, for example, with the manufacturing job required to fill it. Apply and analyze with an impersonal point of view the choice of vendor, price, quantity and timing or other key variables.

- **It provides a clear audit trail for key data used in the calculation of financial reports** – Although Sarbanes-Oxley addresses the "I didn't know" excuse, nothing stands up better than a clear audit trail on key data and financial metrics. A key component to reducing fraudulent activities is always the focus on reducing the "opportunity" to commit them. When a clear audit trail has been established, employees, executives and management feel there is less of an opportunity. Data security is both the first line of defense against corporate fraud, and the last word in defense of sound corporate governance.

Another Advantage

REAL-TIME COMPLIANCE ALSO OFFERS A SIGNIFICANT ADVANTAGE over purely traditional compliance practices because it can provide a significant ROI. Consider this example: Shipping and the associated logistics costs are a top-10 expense account for many organizations and an area where costs are extremely difficult and time-intensive to audit.

Taken alone, each low dollar transaction isn't worth the effort to pursue. Yet as a whole, they represent a large expense and cost a considerable amount of time and expense to validate reconcile and to track down inappropriate charges.

Real-time compliance, supported by a business intelligence tool, can automate this process, perform the daily reconciliation and highlight the individual transactions that were either processed incorrectly by shipping personnel, or were charged incorrectly by the third party. This manual process has now been automated, and the associated employee is then freed up to pursue reimbursement for incorrect charges, deeper analysis of shipping options and so on. The recovered costs provide a quick return on investment.

Beyond specific applications such as this, real-time compliance is centered on a methodology that improves performance of the organization. As such, a well-designed EPM model provides management with better information, allowing better decisions. It focuses first and foremost on the things that truly drive the performance of the organization, and aligns management's effort with corporate strategic goals. It gives insight into the future, allowing management to seize opportunities and prevent failure before it is too late. Over time, these things will also provide an ROI, even if it is more difficult to measure than a reduction in logistics' costs. It is a powerful approach that has already shown great results in building value.

IT applications currently in place predominantly serve to support the auditing, documentation, testing and reporting needs of Sarbanes-Oxley, and put the gathered information into usable reporting formats. This is predominantly due to their original creation by auditors, or those organizations selling to auditors. This software can be extremely helpful in the ongoing responsibility of compliance to Sarbanes-Oxley, but will not directly build greater value for the organization.

Real-time compliance, through its EPM filter, is already looking even further down the road. If Sarbanes-Oxley raises corporate value in the eyes of shareholders by increasing their confidence in sound governance, imagine putting key information about corporate performance in the hands of investors in real-time. With less doubt and speculation, true value rises to the surface.

In the meantime, most executives would settle for better insight into the financial performance of their organization, allowing them to make better decisions today, before they become tomorrow's front-page news. ■

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