IBM

Building Efficiency into Your Internal Controls

The advent of Sarbanes-Oxley (SOX) and other transparency regulations has forced many companies to invest substantial resources in their compliance-related internal controls. And in the course of these compliance efforts, many organizations have sought to improve their general and application controls for financial consolidation and reporting as well.

The following essays discuss opportunities for efficiency and other issues of concern to organizations who are upgrading their internal controls. They are selected from our ongoing series, *Controllers' Corner: Two-Minute Essays on Financial Management and Control*. These essays are authored by industry thought leaders with extensive backgrounds in finance and accounting, and broad experience advising clients on financial processes and systems.

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Internal Controls Need Regular Testing

Gary Simon, Group Publisher, FSN Publishing Limited

The renewed emphasis on internal controls created by SOX and other transparency regulations has forced many organizations to invest additional time and resources in compliance. While the focus of SOX was on controls for financial reporting, many organizations performed audits and reduced the number of general and application controls.

Q. How important is it for organizations to continue upgrading their internal controls and what areas are most in need of improvement?

There is a tendency for organizations to treat the controls environment passively rather than manage it actively as a part of the group financial reporting cycle. Sarbanes-Oxley (SOX) helped to change attitudes and helpfully raised the profile of controls. Nevertheless, once the control environment had been designed and revised principles had been implemented, how many organizations challenged their initial blueprint or reviewed the need for change?

Many assume that controls, once established, are relatively static, but financial reporting is in a constant state of flux, courtesy of new accounting standards and regulatory reporting. In fact the last few years have seen change on an unprecedented scale. This means that application controls, should be reassessed and potentially new controls introduced. But it is not just changes in rules that give rise to challenges around controls. Technology too, can impose the need for change.

Take for example, the so called, "Last Mile" of finance. Over the next few years we are likely to see the introduction of document management and workflow systems to help steer financial statements through the closing stages of production. These new processes will require new controls, such as, who can change a note to the accounts, who can authorize a late change to a schedule, or perhaps who is allowed to open and read a sensitive draft of a document.

The move to "interactive data" (XBRL) and the publication of electronically tagged financial information also gives rise to new risks. What controls will be needed in this novel environment to ensure that anything published is complete, accurate and authorized? What new controls will external auditors wish to see before they give their blessing?

Striking an appropriate balance between controls and risk is central to an effective controls environment. Many organizations tend to over-engineer their controls, placing too many hurdles in the way. Such an approach is both time-consuming and costly. A complex web of controls can also mask real problems. The essence of an effective environment is one that identifies the key controls on which management absolutely depends, as distinct from underlying controls that perform a perfunctory role. A clear understanding of compensating controls, i.e., higher level controls that compensate for weaknesses identified lower down the food chain, will help to avoid the development and management of too many controls.

In broad terms, it is better to have automated controls rather than manual controls. Once created, more reliance can be placed on automated controls. However, organizations sometimes forget that the opposite is also true, i.e., that an automatic control that fails will continue to fail reliably until it is spotted!

The lesson is that controls need to be regularly and frequently tested – a burden that most organizations do not relish but is nonetheless vital. It is quite a problem. Responsibility is often divided between finance and internal and external auditors, with nobody clearly taking stewardship. On the other hand, it is important to avoid a "box ticking" or compliance mentality. The production of financial statements strikes at the heart of an organization and its reputation. Testing financial controls should be thorough and when in doubt, business judgment rather than the completion of a checklist should rule the day.

Regular review of the controls environment, and testing, if appropriately managed, will lead to process improvement. In the long run this is less costly, with the additional benefit that it may even contribute to business insight.

About Gary Simon

Gary Simon is the Group Publisher of FSN Publishing Limited, Managing Editor of FSN Newswire and the author of many product reviews and white papers on financial software. Simon is a graduate of London University, a Chartered Accountant and a Fellow of the British Computer Society with more than 23 years of experience implementing management and financial reporting systems. Simon was a partner with Deloitte for more than 16 years and has led some of the most complex information management assignments for global enterprises in the private and public sector.
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Post-SOX, Internal Controls Still Need Your Attention

Bryan Hall and Bill Marchionni, The Hackett Group

The renewed emphasis on internal controls created by Sarbanes-Oxley (SOX) and other transparency regulations forced many organizations to invest significant time and resources on internal controls.

Q. Now that the Sarbanes-Oxley work is substantially "finished," do internal controls still matter?

Clearly, internal controls still matter. On the one hand, businesses today are watching their pennies and they need to have control over what is important. On the other hand, there is a lot of change going on. Organizations are challenging their business models, challenging their existing processes and adapting to scale to current realities.

A company may have had what they determined to be a stable control environment, but it may no longer be stable. Things change. So controls will continue to matter. No question about it.

When we look at compliance, it still represents a sizable cost for organizations. There are great variations between "world class" companies and the averages for their peer groups. World class organizations now spend about 43% less on compliance than their peers. That is approximately $11 million–per year–for a typical Global 1000 company.

These differences, by the way, appear irrespective of company size or industry. Whether you're looking at a large company or a small company, and whatever your industry, there continues to be a substantial gap between the top performers and the others. So clearly, there are opportunities for cost savings within the compliance area. And it's important to keep in mind the Hackett philosophy that "world class is not a lifetime designation."

In the first couple years of Sarbanes-Oxley there was a lot of debate about what exactly a key control is. We saw organizations define key controls differently. One company might say, "We talked to our auditors, and we can pull back. This isn't a key control." But the reality is that, while maybe it's not something you have to test all the time, nonetheless there was a control there somewhere in your organization that was put there for a reason. Perhaps it can be eliminated, but you need to make sure that removing that control isn't a shortcut that will come back to bite you.

Another company might conduct a review and find that they were more conservative than they needed to be and ended up with duplicate key controls. That duplication isn't really enhancing the control environment, so there may be an opportunity to simplify. One of the mantras that you hear from Hackett is "leading firms simplify and standardize." And nowhere is that more true than in the compliance area.

We also think that the automation of controls to the extent possible is something that organizations should continue to look at. As we said before, environments are changing and what worked two years ago may not work now.

We think the challenge for company controllers is to not be complacent because they got done with SOX. Key controls continue to harbor gaps or present opportunities for most organizations. And all the underlying premises around common systems, common processes, common geography where those processes are performed, are all critical to keeping a good control environment.

About Bryan Hall

Bryan Hall is the Practice Leader of the Finance Executive Advisory Program for The Hackett Group. Mr. Hall has more than 20 years of experience in finance, accounting, systems and consulting, with a focus on transforming the finance function through effective planning, efficient process management and working capital management. Mr. Hall may be contacted at bhall@thehackettgroup.com.

About Bill Marchionni

Bill Marchionni is a Senior Business Advisor for the Finance Executive Advisory Program of The Hackett Group. Mr. Marchionni provides insight to CFOs and other finance leaders, sharing his expertise in the areas of revenue and cost management; working capital management; process reengineering; and strategic planning, forecasting and analysis. Mr. Marchionni may be contacted at wmarchionni@thehackettgroup.com.

> *"There are great variations between 'world class' companies and the averages for their peer groups… And it's important to keep in mind the Hackett philosophy that 'world class is not a lifetime designation.'"*

Controls Integration and GRC – Why It's Important for ERP

Jim Hurley, IBM Global Business Services

The renewed emphasis on internal controls created by Sarbanes-Oxley (SOX) and other transparency regulations has forced many organizations to invest additional time and resources in compliance. While SOX legislation focused on controls for financial reporting, many organizations have also put substantial effort into their general and application controls.

Q. How important is it for organizations to upgrade their internal controls in the financial consolidation and reporting process, and what areas are most in need of improvement?

Sarbanes-Oxley legislation and interpretation by the Public Company Accounting Oversight Board (PCAOB) have deemed that newly designed systems which have a significant financial impact must have internal controls designed, documented and tested in order to receive the annual sign-off on Section 404.

Sign off requires, first of all, that management have effective internal controls in place over financially relevant systems at all times. To confirm this, external auditors must express a 404 opinion on the operational effectiveness of the company's internal controls over financial reporting. And if a project does not pass implied SOX compliance tests at "go live," it will likely result in costly delays or even a re-implementation.

IBM recommends addressing controls throughout an implementation or upgrade project. Our approach is

> *Automation is driving many ERP technology integration initiatives… resulting in improved process efficiency, reduced cost and more effective compliance management.*

based upon the following key value drivers:

- **Automation of controls:** Finance is process and control driven. Manual controls are far more costly and less robust than automated control features available in ERP systems. Therefore, IBM's approach is to implement controls to maximize system/automated features. Automation is driving many ERP technology integration initiatives and helps to optimize controls within key processes, resulting in improved process efficiency, reduced cost and more effective compliance management.
- **Scope of controls:** Our approach addresses the major control types: financial application controls, IT general controls, SOD-compliant security, and IT infrastructure controls for data conversions, interfaces and customizations.
- **Limited implementation surprises:** Addressing control processes too late can result in costly re-work or, in the extreme, a re-implementation due to deficiencies in control processes or failure to achieve 404 sign off.
- **Encourage external auditor involvement:** IBM supports the involvement of external auditors as part of the controls integration and GRC (governance, risk and compliance) approach, which will provide increased awareness, with "no surprises" related to controls at go live.

Continuous-control monitoring tools continue to mature in the marketplace and are viable options in helping companies reduce the cost of compliance. Finance professionals should remember that control and security is a collaborative process. It requires a cross-functional effort in which controls and security-related activities should be incorporated into every phase of the implementation project cycle.

When a project is done properly, standardization, centralization and automation of internal controls can make your compliance program more effective, and in many cases reduce costs related to controls.

About Jim Hurley
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Why Internal Controls and Consolidation Belong in a Single Solution

Delbert Krause, Business Unit Executive, Cognos Software, IBM Information Management

The renewed emphasis on internal controls created by Sarbanes-Oxley (SOX) and other transparency regulations has forced many organizations to invest additional time and resources in compliance. While the focus of SOX was on controls for financial reporting, many organizations performed audits and reduced the number of general and application controls.

Q. How can organizations best upgrade their internal controls and where are the opportunities for greater efficiency?
An important consideration in the financial consolidation process is that of fulfilling control objectives to support compliance requirements–requirements driven by audit, as well as ongoing quality assurance for financial results.

These internal controls are well known and used by many organizations. They run the gamut from “order to cash” and “purchasing” to “production and fixed assets” and more. In many companies, automated internal control discipline can be found in the ERP system, in application extensions to the ERP, or in specialized third-party solutions. Par for the course in quite a few finance organizations is the leveraging of Microsoft® Excel and Microsoft Word documents, along with e-mail, to form a loosely controlled but reasonably effective internal control system.

At IBM, we believe this area should include the close, consolidate, report process and be reviewed as organizations prepare for transforming their financial consolidation and corporate reporting processes. There are three important reasons for embracing internal controls and financial consolidation as a single solution.

1. Collecting assessments and evidence
At many organizations, internal control data is collected outside the consolidation process, many times from the same individuals who provide

that same data for the close process. Not only are these controls inexorably tied to the data itself, but important checkpoints and supporting details exist to support the data in question.

Companies that use IBM Cognos 8 Controller can provide a framework, user experience and training to enable participants in the close process to submit their data just once, reconcile their information with corporate, and sign off on the final submission. Including an appropriate internal control template for assessments blends the internal control experience into one system, one process.

2. Managing the internal control process

Ensuring that internal control activities are completed on time, assigned to one individual accountable for assessment and documentation, and linking the internal control activity to consolidation activities ensures that all items meant to assure financial data quality are accurately fulfilled.

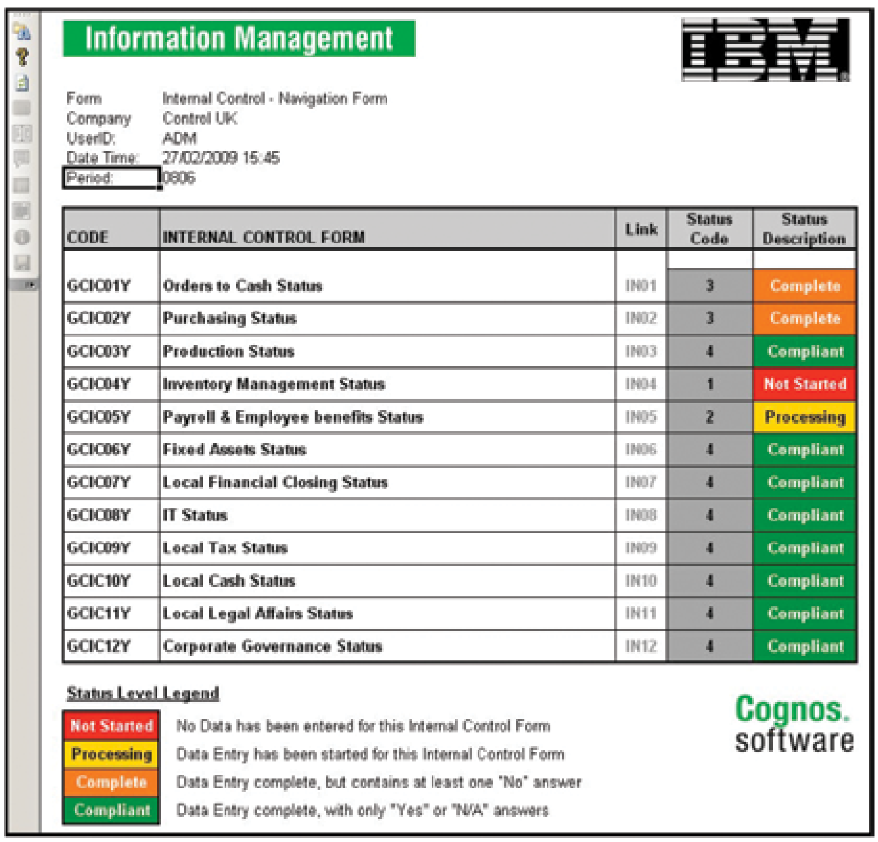
The "final test" for financial data quality requires that both the data elements, reconciliations and accounting adjustments are completed, as well as the controls and supporting documentation. Managing and auditing the stakeholders goes a long way to providing reliable oversight of the data's accuracy.

3. Internal control management and analysis

Controls and data go hand in hand. And not only in the front-end collection (Was the data collected properly? Were the appropriate accounting and policy steps completed–along with attached documentation?) – but also at the back end, at the completion of reporting. But there is another enormous advantage to blending controls and data. That is the ability to analyze and improve the control matrix.

Important questions can be asked and answered here: Are there control areas that require improvement? Do we have the right number of controls and are they in the right place? Are the controls supporting financial drivers material? In other words, does the dollar amount justify the control, or perhaps do circumstances require that the organization implement further controls, given the high dollar volumes and number of transactions?

By having access to the entire control framework, data, and analytics, we can optimize the control environment and prove to internal and external auditors that the controls in place are of the right substance and are tested accurately.



CODE	INTERNAL CONTROL FORM	Link	Status Code	Status Description
GCIC01Y	Orders to Cash Status	IN01	3	Complete
GCIC02Y	Purchasing Status	IN02	3	Complete
GCIC03Y	Production Status	IN03	4	Compliant
GCIC04Y	Inventory Management Status	IN04	1	Not Started
GCIC05Y	Payroll & Employee benefits Status	IN05	2	Processing
GCIC06Y	Fixed Assets Status	IN06	4	Compliant
GCIC07Y	Local Financial Closing Status	IN07	4	Compliant
GCIC08Y	IT Status	IN08	4	Compliant
GCIC09Y	Local Tax Status	IN09	4	Compliant
GCIC10Y	Local Cash Status	IN10	4	Compliant
GCIC11Y	Local Legal Affairs Status	IN11	4	Compliant
GCIC12Y	Corporate Governance Status	IN12	4	Compliant

An internal control navigation form in IBM Cognos 8 Controller enables you to monitor the compliance status of your internal controls.

So, should an organization move their entire internal control system to IBM Cognos 8 Controller? Perhaps a better course would be to instead leverage IBM Cognos 8 Controller as a high-level environment to track and report specifically on those key controls that are related to the consolidation process.

The choice is yours. Whether it involves direct data collection and integration within Controller, or importing the right level of detail from your existing systems, integrating your internal control data into IBM Cognos 8 Controller will enable you to present a single view of the data, controls, and processes in your system.

The measurement and tracking of internal controls is an important extension to IBM Cognos 8 Controller for organizations that desire more discipline in aligning internal controls with financial consolidation. We suggest that you preview the IBM Cognos Internal Control Performance Blueprint from the IBM Cognos Innovation Center for Performance Management www.ibm.com/cognos/innovation-center/blueprints/financial-management.html. This blueprint provides the templates and background you need to deploy 84 standard pre-configured internal controls, modify existing controls or create your own set in your IBM Cognos 8 Controller deployment.

About Delbert Krause

Delbert Krause is the Business Unit Executive, Financial Performance Management Solutions, for Cognos Software in the Information Management division of IBM. In addition to his formal training in finance, Mr. Krause has more than 20 years of experience in consulting, selling, and marketing performance management software solutions for finance, business and IT users. Mr. Krause can be reached at delbert.krause@ca.ibm.com.

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IML14204-CAEN-00