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Regulation and Compliance: The Business Challenge of the Millennium

A White Paper

Executive Introduction

Regulation is no new phenomenon; it has always been there. Taxes; one of the early examples: stem from thousands of years ago; property ownership recording and building constraints have been with us for centuries.

But, more recently, legislation has brought us a raft of challenges to business operations. Business integrity, market trustworthiness, customer protection, shareholder rights and risk management have been with us for some time, while the need to protect ourselves and each other from newly emerging, actual or perceived evils has spawned a completely new breed of executives: Corporate Governance Officers.

Strategies for meeting competition have contributed immensely to the need for additional regulatory control as “globalisation” demands many businesses to operate offshore and across different currencies and fiscal regimes. Later in this document, we will look at some of these challenges and consider their origins and some of the dangers from which they seem intended to protect us all.

Measurement of compliance has become a positive process: it is no longer acceptable to “prove” compliance by having not been found guilty of non-compliance. Proof of compliance now *demands* that processes are in place to validate virtually every aspect of operation to ensure that it *does* comply. It is not enough to prohibit discriminatory behaviour in the workplace, for example; logically every e-mail, whether outbound or circulated internally, must be edited and checked for compliance. Neither is it enough to require that we do not do business with prohibited organisations; every transaction must be validated to ensure that we satisfy the requirement. We must scrutinise every aspect of our businesses - and expect to be scrutinised even more rigorously by the regulators.

But compliance, while it undoubtedly represents a real and expensive business overhead, with compliance projects consuming as much as 100,000 hours for the biggest US corporations, is not without its upside. Business surveys suggest that the organisation with a fully working set of compliance management systems or tools can show a premium on share value of up to twenty percent over its under-prepared competitors.

Another key challenge facing the business is to be seen to comply, whilst ensuring that the processes, systems and procedures do not strangle the business. Avoidance of “paralysis through analysis” is achieved through definition of the right levels of monitoring, ensuring the processes are not micro-managed and decisions taken where they really matter.

So, while positive compliance is not an optional bullet: it has to be bitten sooner rather than later: it does represent something of an opportunity. In addition to enhancing share value, compliance is a gateway through which businesses must pass if they are to do business with governmental and commercial organisations who demand compliance with selected regimes.

Non compliance can carry some significant corporate and even personal penalties. It really doesn’t bear thinking about.

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The Boardroom View

Ownership of compliance resides at the highest level in the organisation.

The regulatory bodies that define the rules of compliance are requiring nothing more than that management take full responsibility for the commercial ethics and the proper and accurate financial reporting of the organisation under their control. No longer is it acceptable to hide behind the audit statement and to adopt the philosophy that "*a problem moved is a problem solved*".

All Board members; executive and non-executive; must understand the reality and the implications of various compliance regimes and take the necessary decisions and actions to meet the demands of regulators and to satisfy (and, ideally, exceed) the expectations of shareholders and business partners at every level.

They will (regularly) look at business goals and objectives, re-assessing the risks and opportunities associated with each, and select the best approach towards each risk area. Board members will demand that this process results in the generation of a catalogue of risk-management plans reflecting the various strategies preferred for the address of each risk.

Some risks will be addressed by modification or elimination of a specific goal or objective while others will be surrounded by control and reporting processes which will confirm compliance with the regulations appertaining to them.

Board members will "hand down" the tasks associated with allocation of responsibilities and deadlines for the actions leading to initial achievement a compliant environment and the implementation of continuing processes which will detect any potentially non-compliant business activity and highlight it for resolution.

Board members will be aware that, while they are the "owners" of the metaphorical vessel of commerce, The CEO is on the "bridge" while information technology represents the "engine room". Communication will be through the leadership of the corporate governance function, and board members will require that they understand the ownership of this function very clearly and demand regular confirmation of compliance and, wherever appropriate, notification of any additional areas of real or perceived risk which imply vulnerability to non-compliance.

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The Compliance Function and Business Operations

Here is where the thinking gets done and the decisions taken in terms of how the business must move forward if it is to comply with the regulatory regimes that apply to it. And how to avoid generation of time wasting "noise" associated with identification and resolution of areas of insignificant risk.

Following are some of the major points that would be included in a major project plan targeting delivery of compliance.

- What compliance items should we be looking at and how will we manage them.
  We need to be sure that we know which regimes apply to us and to "verbalise" (that is to take the compliance rules out of the source and translate them from "compliance-speak" to behaviour that we understand in the business).
  - Sarbanes Oxley
  - MiFID
  - Employment and Labour Laws
  - Discrimination Laws
  - Health and Safety regulations
  - ISO Standards
  - Basel 2
  - Information Security Standards
- Where will we find these items in the business?
  - Sales
  - Finance
  - Marketing
  - IT
  - Human Resources
  - Legal
  - Purchasing
  - Operations
- How will we Assess the business
  - Define the areas of risk
  - Pinpoint the parameter values that contain risk
  - Evaluate compliance strategies
  - Select compliance strategy (ies)
- Define and implement the processes or tools to contain risk on a continuing (or cyclic) basis
  - Internal procedures
  - Directives
  - IT solutions
- Monitor, Analyse, Report and Confirm Compliance

Execution of a project plan containing these elements will deliver compliance, regardless of the mix of regimes under which the business must operate, but again, management must guard against demoralising and expensive time-wasting focus on the insignificant or the unimportant.

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Compliance and Information Technology

Preparation for Action: Get your House in Order.

Information Technology is the essential player in the drive for compliance, and the magnitude of the part that it has to play cannot be overemphasised. But, ironically, while it is IT that provides the major part of the means to assure compliance positively, IT operations represent the single biggest area of risk of non-compliance.

If IT is to confirm that every operation that takes place in the organisation and which impacts the balance sheet complies with the regulations that apply to it, there must be no disconnect between operations and IT. Every IT system must reflect what actually happens in operations and every operational activity, however infrequently it may occur, must have a corresponding process in IT. Clearly defined controls must be in place at each stage of every process and in the IT process which reflects it. *But as we reconcile these processes, let us see IT as a tool for delivering additional business values, enhancing the customer experience, adding to operational efficiency and increasing efficiency and feeding back improvements to operations and not merely as a necessary operational cost.*

In fairness, not all IT systems meet strategic operations needs and some may be poorly integrated with the operational processes that they are meant to serve. Customer Relationship Management is a frequent example of a good idea that has not delivered on the expectations driving its selection. Where investment in an IT system is not delivering the expected return, the organisation will view each such case as an area of risk and must develop a risk management plan to address the issue.

A sound IT environment which accurately reflects the operations of the business is a prerequisite to the leveraging of IT to control, manage and report on compliance.

The UK Office of Government Commerce (OGC) has compiled a library of best practices for IT service management. The Information Technology Information Library (ITIL) has been adopted internationally as the de-facto standard for IT Service Management, defined as BS15000 and as ISO20000.

Effective implementation of the structures and practices associated with ITL and ITSM assures sound IT Governance and this will provide the foundation upon which other aspects of Corporate Governance and Regulatory Compliance can be developed.

For organisations which are affiliated to businesses in the USA or which have operations in the US, the standard for IT compliance and the required framework in management and assessment of controls is COSO (Committee of Sponsoring Organizations of the Treadway Commission). COBIT (Control Objectives of Information and Related Technology) is a framework which focuses on IT processes while operating under the wider view of COSO.

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Getting it together

The regulatory regimes under which a business operates are defined by geography and business sector. The process of selection of the appropriate regimes is made in the section of this paper "The Compliance Function and Business Operations".

Where compliance is achieved by the establishment of internal controls or directives, the effects of any operational changes will be reflected by changes in IT systems and operations which monitor and report contraventions and demand remedy.

The need to monitor existing operations to identify and report areas of risk and/or non compliance associated with the way we do business, mandates the use of an IT tool or system. There are several of these available and many organisations have used their internal resources, in collaboration with their auditors, to implement them.

Most IT based compliance tools are based on the concept of monitoring the content of all transactions against parameters whose values contain "compliant behaviour". Most frequently, the items tested are extracted from "log files" residing the files and databases of the presently executing business systems. Where this approach is practical, and this is dependent on the nature of the existing systems and the criteria for compliance, the solution is the most financially cost-effective and the least disruptive in terms of the need for changes in installed systems.

A database will be populated with risk management plans linked to a diary system in with responsibilities allocated to specific individuals with deadlines for completion. Careful preparation of a series of checklists from the controls set in those RMPs will enable monitoring teams to review compliance quickly and effectively without being overwhelmed by low level detail.

Some auditing firms have seen compliance as an opportunity to generate significant service revenues and have developed their own, or licensed third party IT tools which they implement as a part of an elaborate (and therefore expensive) series of exercises.

The most cost-effective route to compliance could well be based on collaboration between the business' internal IT Team, an experienced vendor implementation team, and the auditors.

It is, of course, the auditors who have to sign off on the strategies to deliver compliance, and to confirm this compliance, and its associated stakeholder value, in the Audit Statement attached to the Annual Report.

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