

PERFORMANCE AND COMPLIANCE— NEITHER IS OPTIONAL

NEW DEMANDS IN THE AGE OF
TRANSPARENCY



COGNOS®

THE NEXT LEVEL OF PERFORMANCE™



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FORWARD

More than 60 percent of respondents to a recent survey by CFO Research Services and Capgemini identify regulatory compliance as a long-term rather than a short-term issue.¹ This statistic is borne out by leading analysts. They say that in 2005, Global 2000 organizations will accelerate business and IT projects to ensure they are in compliance with leading regulatory edicts.²

As a Finance professional, your primary responsibility is driving performance while ensuring compliance. You must align processes, technology, and investment to support this complex activity. Your colleagues understand that treating compliance as a short-term issue leads to unsustainable cost and effort.

What is your strategy for addressing compliance as a longer-term initiative with the investments you are making today? Can you spend money that delivers on compliance and performance with the same dollar? Is compliance the end game, or is there greater value you can realize from the expenditure of financial and human resources?

Sarbanes-Oxley compliance, good governance, transparency, and performance management are like *matryoshka*, the Russian nesting dolls. Each is inside the other. Your compliance investment can be your end game; or it can be the foundation for greater transparency... and better performance.

Research commissioned by Cognos shows that many forward-looking Finance professionals see SOX compli-

ance as an opportunity, a catalyst, for a better partnership with IT. Long-established but inefficient processes—previously in the “Not broken, don’t fix it” category—are now exposed and can be updated and modernized through IT investments.

As companies step up their efforts related to compliance, IT projects are top of the stack. This paper focuses on the areas of partnership between Finance and IT, between systems and regulations, to answer:

- How you can meet your mandate to gain investor confidence through timely, accurate disclosure at the lowest long-term cost.
- How your investment in compliance will make your company more agile. Realign strategy to take advantage of opportunities and mitigate risk—the core components of better performance.

We will look at these issues from three perspectives:

- How to make your compliance efforts more efficient.
- How to make compliance part of an overall response to the demand for transparency.
- How to leverage compliance and transparency efforts for better performance management.

¹ Randy Myers, *Sarbox and IT: The Long Haul*. CFO.com. Jan 19, 2005.

² John Van Decker, *Corporate Governance and Compliance 2005: Spending Will Not End*. META Group, Jan 18 2005.

MEETING THE REQUIREMENTS OF COMPLIANCE

The United States' Sarbanes-Oxley Act of 2002 addressed issues related to the financial scandals that occurred in the years leading up to the Act's passage. It created a Public Company Accounting Oversight Board (PCAOB) to replace the audit firms' self-regulating apparatus. It further defined the role of the Securities and Exchange Commission (SEC) in establishing accounting standards and prohibited certain business activities of auditing firms. It laid out both specific requirements (e.g., officers of the company must sign key public disclosure documents) as well as more general objectives.

Three sections of the Act have particular relevance to a company's IT requirements and to its IT organization.

- **Section 404** requires companies to include an “internal control report” in each annual report. Management affirms its responsibility for controlled financial reporting structures and procedures, and assesses the effectiveness of these internal control structure and procedures. As part of the audit, the company's external auditor attests to the adequacy of the company's control structures and procedures, noting any “significant deficiency” or an even graver “material weakness.”

- **Section 302** covers periodic attestations. The CEO and CFO must prepare a statement to certify the financial statements and disclosures contained in their quarterly/annual report are “appropriate” and fairly present the operations and financial condition of the issuer.

- **Section 409** is entitled “Real Time Disclosure.” Companies covered by the Act “must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis.”

While all sections of the Act bear attention, Section 404 presents many companies with a major challenge—and opportunity—for constructive change in your systems and processes.

STRAIGHTENING THE COW PATHS

Research commissioned by Cognos shows that almost all companies approached initial Section 404 compliance solely as documentation of existing processes and systems. This was reasonable, considering the deadlines, the consequences of non-compliance, and the risks associated with any significant process change. However, as Ventana analyst Robert Kugel warns, the volume of documentation that resulted indicates circuitous and inefficient processes. Striving to automate such processes without correcting them is tantamount to “paving the cow paths.”

Many organizations recognize the need to overhaul their processes. During the initial Section 404 compliance phase, companies found numerous opportunities to improve their processes and improve the quality and quantity of business controls, for both SOX and other reasons. Before Sarbanes-Oxley, it was hard to find the economic justification for making these process changes. The demands of compliance have provided that justification and impetus to invest where companies should have been investing all along. To regain efficiency lost in an environment with more formal controls, companies understand they must not just pave, but rather straighten, the cow paths.

The damage from failing to correct circuitous processes does not stop at inefficiency. It represents a control risk to you and your company if your compliance efforts are overwhelmed with so many controls to account for bad processes. You need to reduce the number of control points while improving and streamlining your processes.

Now is the opportunity for real change.

“Manual controls are pervasive in many companies, because they are easier to understand, implement, and test. Yet, oftentimes, manual controls can be replaced with IT controls that provide better efficiency and results,”³ says Deloitte Consulting in a paper about Section 404 of Sarbanes-Oxley.

In the same paper, Deloitte goes one step further: “Indeed, IT controls are fundamental to compliance with Section 404.”

THE PERFORMANCE GAP RISKS OF SPREADSHEETS

- Spreadsheets are inherently uncontrollable. They offer no reliable audit trail and lack referential integrity and data integrity.
- Inadequate security features rarely restrict unauthorized access.
- They encourage “islands of information.”
- Even in well-managed accounting environments, consistency is a problem because people often use numbers derived for one purpose in another context.
- You face unacceptable rates of input error, from data entry, rekeying, and cut-and-paste activities.
- Risk of errors and loss of control increase with the number of spreadsheet users, size of the spreadsheet, frequency of changes, and other factors typically found in the financial processes of large companies.

³ Deloitte, *Taking Control: A Guide to Compliance with Section 404 of the Sarbanes-Oxley Act of 2002*, 2004.

BETTER SYSTEMS, BETTER CONTROL

Build quality into your financial systems and processes to eliminate errors, misstatements or potential for fraud before they occur, rather than expending effort tracking errors *after* they have happened. This is the heart of a “TQM” approach to compliance. It is also key to ensuring your compliance systems support transparency and performance management efforts.

IT systems should offer a “clean room” environment where the integrity of the IT system is the key point of control.⁴

Ventana Research asserts well-managed companies can and will efficiently adapt to Sarbanes-Oxley’s plethora of rules by implementing process changes. Companies should have three basic objectives:⁵

- Design quality into processes.
- Simplify – minimize points of control and maximize process commonality.
- Focus on monitoring results as they occur rather than audit after the fact.

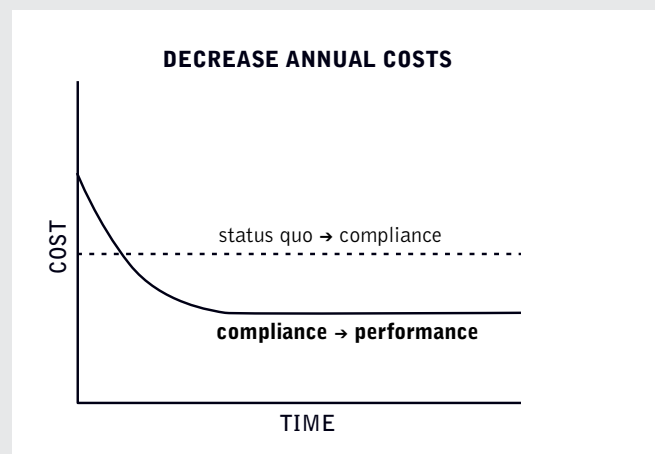
Let’s look at three of these IT systems that relate directly to finance, compliance, and performance: consolidation, reporting, and planning systems.

Consolidation

There are two basic regulatory issues related to consolidation and closing:

- Determining which entities must be included in the consolidated financial statements (e.g., treatment of off balance sheet debt).
- Managing the periodic consolidating and closing process (an area with significant potential for fraud and manipulation).

Changing your consolidation and closing process can enhance your control and reduce the cost of compliance. Financial statement preparation is a complex process with accounting adjustments, currency conversion, eliminations, and other tasks. You should use a system built for that purpose.



⁴ Robert Kugel, *Sarbanes-Oxley's Implications for IT*. Ventana, 2005.

⁵ Robert Kugel, *Sarbanes-Oxley Drives Process Changes*. Ventana, 2005.

In the pre-Sarbanes-Oxley environment, adopting technology to make consolidation and closing processes more efficient did not have the urgency required to make change happen. Today, companies are examining the magnitude of savings (measured in internal headcount and external audit fees) from automating more of the consolidation and closing processes. Fixing processes can save money (counterbalancing the unavoidable higher costs of a more tightly regulated environment), save time, and promote compliance. The value goes beyond cutting cost. The greater quality of the information delivers peace of mind—*Quality leads to accuracy, which leads to compliance.*

Many existing consolidation processes rely on first-generation consolidation software. This first-generation software does not cover enough of the global consolidation functionality to do the job required without support from spreadsheets and manual interventions. Spreadsheets are an enormous risk (see sidebar on page 4). They offer no security, no audit trails, and are prone to data entry and data calculation errors. While some organizations have been comfortable with a more manual process, the risk of errors and accelerated delivery of quarterly and annual financial statements demand a re-visit of consolidation processes.

Recommendations include:

- Institute high-level controls, including a competent audit committee actively involved in governance, a visible internal audit group, and IT systems designed and monitored for control. These initiatives can help define big-picture issues such as which entities are consolidated.
- Move to a more synchronous, centralized consolidation process rather than a bottom-up approach (lower-level entities perform their closing process and then pass the results up to the next level of the company.) This helps eliminate defects and speeds the process.
- Even if you maintain a sequential, bottoms-up approach, eliminate manual data entry and reduce spreadsheet use to minimize the potential for errors.
- Streamline consolidation processes. Make sure that the right information is being collected from the right business areas. Eliminate unnecessary data collection and preparation.

EVALUATING SPREADSHEET CONTROLS

In its paper, “The Use of Spreadsheets: Considerations for Section 404 of the Sarbanes Oxley Act” (June 2004), PriceWaterhouseCoopers recommended five steps for evaluating spreadsheet controls:

- Inventory spreadsheets.
- Evaluate the use and complexity of spreadsheets.
- Determine the necessary level of controls for “key” spreadsheets.
- Evaluate existing “as-is” controls for each spreadsheet.
- Develop action plans for remediating control deficiencies.

As the paper concludes, “For complex spreadsheets that support significant accounts and disclosures, consider whether these “systems” should be migrated to production processing environments to provide an adequate level of control.”

Reporting

Sections 404, 302, and 409 all touch on reporting issues. Making reporting systems work for your compliance efforts involves three aspects:

- Deriving information from more data sources, leveraging the data you have.
- Ensuring security.
- Getting information to more people, and the right people, on a timely basis.

Standardizing reporting systems improves control efficiency and security. Companies should consider this approach. Reporting and business intelligence standardization delivers these benefits:

- Promotes a single version of the truth.
- Helps you understand numbers or information in context.
- Regular insight promotes transparency and reduces the opportunity for fraud.

SOX and other compliance requirements will increase the volume of compliance reports and number of people who receive reports that relate to monitoring processes. These reports ensure that controls and tests are being monitored throughout the organization. Where controls are weak, additional discovery and compensating tests may be performed to detect misstatement, error or fraud. Making the information collected by such a system available to internal and external auditors is a demonstration of the controlled environment required in Section 404.

The proper management and improvement of controls requires a rich, modern layer of reporting. You now have technology choices that combine dashboarding and complex reporting to bring controls reporting, data, and text together with the ability to “drill down” and understand the details behind your information.

More data

As a finance professional, most of the information you work with is found in your financial data sources. However, collecting and showing data from other sources lets you check for inconsistencies in the financial data that might point to fraud.

For example, if a company tracks both the number of shipping containers it purchases and the number of units it produces, it can compare the two to create an alert if box purchases exceed production by some factor. Tracking both financial and non-financial data provides an additional level of security. It is that much harder to engineer fraud in multiple secure systems. Companies also can track their financial systems’ transaction logs to spot unusual levels of activity that might suggest fraud has been attempted or committed.

Security

Monitoring is an essential element of the control process envisioned by Section 404. Companies will need to have a secure reporting system. Stand-alone spreadsheets, in particular, are not a secure method of reporting.

While most large, public companies already have reporting software, their processes and situations are far from ideal. Multiple reporting products drawing on many different data warehouses and data sources are difficult to monitor and control. The requirement for attestations, particularly to address Section 302, means companies need a secure and controlled means of getting numbers for people to attest to, and an efficient way of dealing with the process.

More people

Fraud is easier to commit when information is hidden or distorted. A useful high-level control approach is to disseminate information about financial conditions and transactions more widely through the organization. Certain types of financial fraud can be spotted early if managers at lower levels of the organization can see allocations, purchases attributed to their part of the business, and so on. It becomes more difficult to successfully carry out a higher-level fraud that spreads the impact around if lower-level managers can see expenses or capital outlays that do not exist or they did not authorize. Many companies require successively higher levels of managers to sign off on financial statements within their span of control as part of the periodic assessment process required by Section 302.

Planning

Longer-term compliance thinking can create a virtuous cycle that extends beyond controls reporting to other key financial processes, such as enterprise planning.

Operational data underpins your financial data; operational and financial data underpin your planning data. Your “clean room” approach to operational and financial data, part of your compliance efforts, has the spin-off effect of delivering planning information you can use with confidence. You can take section 404 compliance to a higher level.

In return, trustworthy planning information provides a context or check for your current operational and financial data. This “pay-back” to compliance helps you:

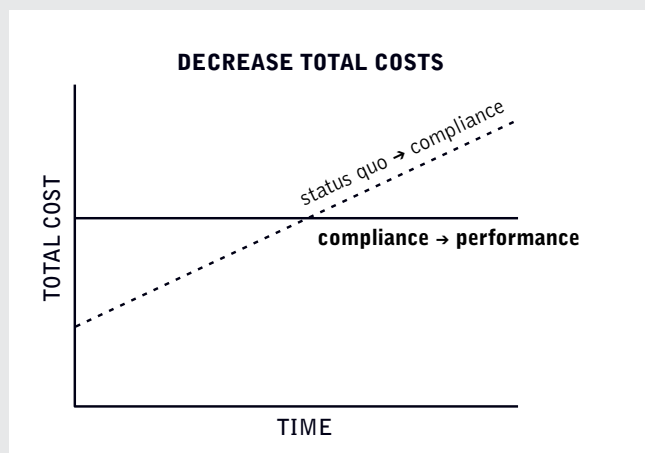
- Evaluate the effectiveness of your controls prior to transactions taking place.
- Put controls in place based on projected or future operational information.

- Influence performance before it happens.
- Drive alignment with strategy and establish accountability.

Planning establishes an expectation for performance.

It helps you determine what to measure, and points out where to analyze. Variances against plan flag parts of your organization or processes for further investigation.

When you go beyond spreadsheets, sophisticated enterprise planning systems can also help you determine the materiality of an event. You can run “what-if” scenarios to forecast the effect of a sudden change, and make disclosure decisions based on the best analysis possible rather than “gut.”



TRANSPARENCY:

FROM COMPETITIVE ADVANTAGE TO NECESSITY

Compliance demands you adhere to regulatory strictures or face legally defined penalties. Transparency demands you adhere to a far broader set of strictures—often at odds with a simplistic approach to maximizing profit. However, the penalties for violating the transparency “contract” can be much farther reaching, and in the end, cost you more than any court-imposed fine.

Transparency is disclosure, but it’s much more, according to business author Don Tapscott. SOX is part of the growing requirement for transparency, but there are other, more significant drivers.

Tapscott points to four major elements that have come together to create a critical mass for transparency in his book, “The Naked Corporation”:

- **Technological:** The Web and new communications devices make more information readily available, and provide the means for people in your stakeholder community to associate with each other and self-organize.
- **Economic:** Business webs replace old-style vertical integration, with company-to-company transparency critical to reducing the resulting transaction costs.

- **Demographic:** The “Echo” generation (children of the Boomers) are better information processors, and accustomed to being “actors” with technology and information rather than passive recipients (e.g. computer games, chat rooms, email versus simply watching TV). These are the people who self-organize against corporations for child-labor, environmental, and other issues.

- **Socio-political:** “People don’t turn to their governments to solve problems. They self-form,” Tapscott says. Often, governments are the ones they’re organizing against. Recent legislation aimed at delivering greater transparency (such as Sarbanes-Oxley) can be seen as late into the game.

Disclosure, Tapscott says, is just one sub-bullet under “Socio-Political Drivers. You have to see the place of compliance in the broader context of demands for greater corporate transparency. This in turn creates more demand for better processes and controls.

As Don Tapscott writes in “The Naked Corporation”:

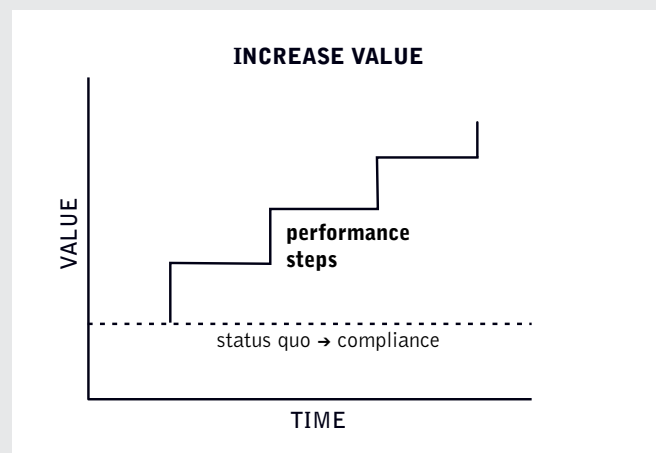
- We’re in a new era of transparency for companies—you are going to be naked.
- If you’re naked, you better be buff.

THE VALUE OF ADDRESSING TRANSPARENCY AND COMPLIANCE

The drivers of transparency and expectations of stakeholders such as institutional investors, business partners, self-organizing interest groups, and employees indicate that demands for greater transparency will continue to increase. Creating systems that stop at regulatory compliance will miss that mark.

Any company that intends to grow and potentially becoming a dominant player in its field will find itself with a larger stakeholder community, increasing the requirement for transparency beyond SEC regulations. Dealing with Section 404 issues may seem insignificant when compared to a sudden public relations crisis or shareholder revolt that can have far longer and more severe consequences than missing a filing.

The value of addressing compliance and transparency is simple: Save money by doing the right job once. As the CFO.com study quoted at the beginning of this guide indicates, business leaders see compliance as a long-term issue. Point solutions may make parts of the pain go away. But competitors will be turning compliance into transparency...and an advantage.



BEYOND TRANSPARENCY AND COMPLIANCE... TO PERFORMANCE

The inbox was once the fixture of every manager's desk. Typewritten memos, faxes, and files came in; letters and projects went out. Email put the inbox manufacturers out of business.

Think of a business world where a true performance system works like email.

You would receive dynamic reports with today's—not only last quarter's—information in them. Reports on controls and processes. What you sold overnight. Inventory levels. Sales pipeline. Manufacturing output. Your business becomes *transparent to you*. With dynamic reports you would have the ability to drill down into the information. If the sales pipeline looked weak, you could find out what region is contributing to that low performance. What product. Or line of business. With this insight, you can begin to project true transparency with confidence to your stakeholders.

With more accessible and current operational and financial data, you can build more accurate forward-looking plans. You can move to rolling forecasts rather than the rigid, and out-of-date, annual budget. A weak regional result may mean upping your marketing spend next month. Or hiring more sales staff. Or shutting the office down.

You can establish a system of controls for compliance. At the same time, gain the means to manage your performance. After all, neither is optional.

A strategic investment in compliance delivers better information. With better information, employees have the ability to perform better, aligned to your company's plans and goals. Enabling each person to perform better is the foundation of better corporate performance.

When CFO Research surveyed financial professionals for its paper on compliance and performance, it discovered, "Interviewees report both a closer intimacy with business operations, and through compliance, additional information on key aspects of the business."⁶

As a result, CFO Research reports, "Such information... gives finance a new view into operations that informs and increases its ability to support strategic planning."

Performance systems, transparency systems, and compliance systems are all built from the same materials:

- Aggregated data from multiple sources.
- Single, consistent version of the truth.
- Operational data that can feed consolidated financial data. Planning data fed from both.
- Easy-to-use reporting that stands on top of the data.
- Core metrics, plans, and reports that let you focus, understand, and make decisions on what matters.

It's like wiring a new building. You can pick cheaper, low-gauge wire initially. But if you have to rip it out and replace it with enterprise-scale materials that can handle your evolving demands later, you do the job twice, and pay more.

⁶ *The Convergence of Compliance and Performance Management—Extending the Impact of Finance Across the Enterprise*. CFO Research Services, January 2005.

THE PERFORMANCE JOURNEY

Making compliance investments within the larger context of delivering transparency and managing performance can deliver greater return to you and your company.

Meeting regulatory compliance can be an opportunity to address fundamental inefficiencies in your performance system:

- Multiple versions of the truth, leading to more discussion about numbers than what to do.
- Misalignment inside and across departments due to a lack of metrics.
- Spreadsheet-based financial consolidation with its high risk for error.
- Traditional planning and budgeting that does not engage the company, and produces inflexible budgets out of date before they're completed.
- No means to understand what's happening right now in your business.
- A single-minded focus on lagging indicators and past results.

Your compliance path to greater performance involves these key steps:

- **Automate recurring management processes** – financial consolidation and enterprise planning
 - Restructure financial processes such as consolidation, delivery and consumption of financial reports for greater efficiency. Better processes means fewer control points.
 - Ensure integrity and accuracy.
 - Identify who is accountable and link to controls.

- **Enable information transparency with business intelligence**

- Report and analyze controls for better management. Determine what controls are on track for audit, are performing well, or poorly.
- Deliver a single version of the truth.
- Ensure quality and expose fraud with “Everyone’s Information System.”

- **Adopt performance management practices enterprise-wide**

- Gain value from planning, scorecarding, reporting and analysis to understand what is happening, what drove the results, and decide what should happen.
- Invest in performance and compliance projects that extend value to your organization.

Choosing to address compliance within a performance context will not slow down your efforts to meet Sarbanes-Oxley legislation requirements. It will not cost more money in the longer-term view finance professionals now take.

Simply meeting compliance requirements does not offer any competitive advantage, but greater transparency and performance management do. Demands for more transparency will not go away, and will only increase. Build the systems now that will let you grow with this need.



COGNOS AND COMPLIANCE, TRANSPARENCY, AND PERFORMANCE

Cognos performance management software delivers the best-practices integration of the management processes of financial consolidation, planning and budgeting, business intelligence reporting and analysis, and scorecarding.

Our software capabilities underpin the systems you put in place to address your compliance and performance systems. Our consolidation software can help you move to a synchronous close, rather than a bottom-up one. Our reporting software offers views into operations, as well as enabling compliance and controls reporting, and the ability to distribute reports across your organization. Our planning software lets you leverage your aggregate, clean data to make plans and forecasts stakeholders can trust. We group these capabilities and others in three main categories, which integrate to deliver performance management.

Enterprise Scorecarding communicates your objectives and focus throughout the organization. Understand what is happening today.

Business intelligence (BI) communicates a common framework for decisions throughout the organization. Understand the “why” behind your performance to date and make the best decisions to put strategy in action.

Enterprise Planning communicates a common purpose throughout the organization. The entire company collaborates to make better strategic and operational plans, drawing on consolidated financial information for financial reporting.



ABOUT COGNOS

Cognos is the world leader delivering an integrated performance management solution—reporting, analysis, scorecarding, consolidation, and enterprise planning.

Industry analysts and experts point to the breadth and excellence of Cognos performance management software as the source of this leadership.

Cognos backs up this leadership with the highest awards for customer service in the industry. More importantly, the return on investment Cognos delivers to its customers is proven by independent industry watchers, and backed up by customers across all major verticals, around the world.

Founded in 1969, Cognos today serves more than 23,000 customers in over 135 countries. Cognos enterprise business intelligence solutions and services are also available from more than 3,000 worldwide partners and resellers.

Leaders choose leaders. Leaders choose Cognos.

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