The cost of compliance

Michael D Tucker
Medgar Evers College, New York, USA

Corporate policy can be affected by government legislation, and regulation. The source of the legislation is from legislative bodies such as US Congress, State, and Municipal Legislatures. Regulation can result from executive orders, or agency directives. Examples of these types of regulation include, Executive orders from the President of the United States, and the Securities and Exchange Commission. Assistance for an organization to comply with the legislation, or regulation; is rarely available from the government agency that generates the legislation or regulation. Accounting and Finance Department management must determine how to comply. Accounting and Finance Departments are facing reductions in trained staff and compliance resources. Given the diminishing human resources for accounting, this article identifies the difficulties encountered in compliance with legislation, and regulation

It is important to note that the accounting profession is experiencing difficulties training and preparing new staff as experienced staff complete their careers. As a result staff are overloaded with objectives with which the organization must comply. A study from the American Institute of Certified Public Accountants yielded the following results

> **Workload increasing**
> The workload most firms are facing appears likely to increase in the near future. More than three-fourths (78%) of multiowner [Accounting firms with more than one partner] firm leaders said they expect growth overall in net revenues from fees over the next three years. Those who predicted net revenues would rise said they anticipated growth by an average of 8% per year over the next three years.
> (…)'Respondents' 'stated' their succession challenges include:
>
> - Finding qualified help at all levels with a long-term commitment to public accounting.
> - Attracting and retaining talent with potential to be a future owner.
> - Not having staff available to take on client relationships.
>
> This inability or reluctance to hire, combined with rising revenue and aging partners, is creating significant challenges for firms, Reeb [Bill Reeb, CPA/CITP CGMA, the CEO of the Succession Institute] said. (…) younger people at firms are starting to push back against continued "workload compression" that forces them to work long hours with no end in sight to the overload. When the younger workers eventually refuse to accept this lack of work/life balance, the managers and partners are the only ones left to do the work. And the staff-level work gets pushed up the organizational chart to people who should be managing and developing business, Reeb said.

(Tysiac)

This article which appeared in the Journal of Accountancy indicated that accounting firms, and by inclusion corporate accounting departments are not hiring enough people to keep up with the expansion of the compliance and other work. The result is that the more experienced staff is overwhelmed with the responsibility of completing the work. Staff members that seek more "work/life balance" leave their respective firms or accounting departments for positions outside of the firm or corporation. When firms attempt to replace trained staff, the only person that would have experience in the compliance area would be the last person that had the job. Another consideration is that even though a firm may have competent staff in one area of compliance, new directives compete for staff attention. Employees, or staff that are overwhelmed with one compliance directive, cannot allocate time to Continuing Professional Education in a new, or an additional area of compliance.

Firms are having difficulty maintaining the trained and competent staff to comply with the varied objectives of competing organizations which demand the compliance. Human resources for people qualified to handle the regulations mandated by Securities and Exchange Commission, the Internal Revenue Service, and the Financial Accounting Standards Board are difficult to find. These are just a few of the organizations that require compliance. There are many others. The Accounting Profession has had a long history of making their staff work long hours to achieve the needed compliance to the regulatory load that exists today. A shift has occurred in respects to the work expectation of the staff. They do not want to work longer hours. They feel pressured to complete assignments based upon unreasonable time budgets. They are not as willing as their predecessors to work more and receive additional compensation. They are willing to receive less compensation, have more job satisfaction, and be able to enjoy more leisure time. Therefore, how can these staff objectives be brought together and result in achievement of the compliance required by regulation?

The approach to a solution

Given the fact that staff is overloaded with compliance objectives, the best solution are to look outside of the accounting staff for assistance in achieving the objective. The cost begins to mount when an organization seeks outside staff and consultants. To reduce cost, serious consideration must be given to functions that can serve primary data requirements of the organization and satisfy the compliance objectives. Another alternative is to have the IT system generate a database of data for the use of programs designed to satisfy compliance objectives. For example, Sarbanes-Oxley requires top management to be aware of most of the financial conditions of the organization within a reasonable amount of time. Management uses, “Data Analytics.” This is a process by which the IT system is designed to constantly deliver information which forms the basis of decision making. The use of Data Analytics provides documentation of a financial condition that existed at the time and the resultant decision by management are achieved. Consultants have advised organizations to choose an “off-the shelf” solution developed for another firm, and then “retro-fit” that solution into its system in order to achieve a compliance objective. Each organization collects similar data in different ways. This is due to the fact that different industries have different regulatory agency requirements. For example, airlines are required to keep track of number of miles flown for aircraft and crews. Pharmaceutical companies must account for all controlled substances before, during, and after manufacture of a drug.

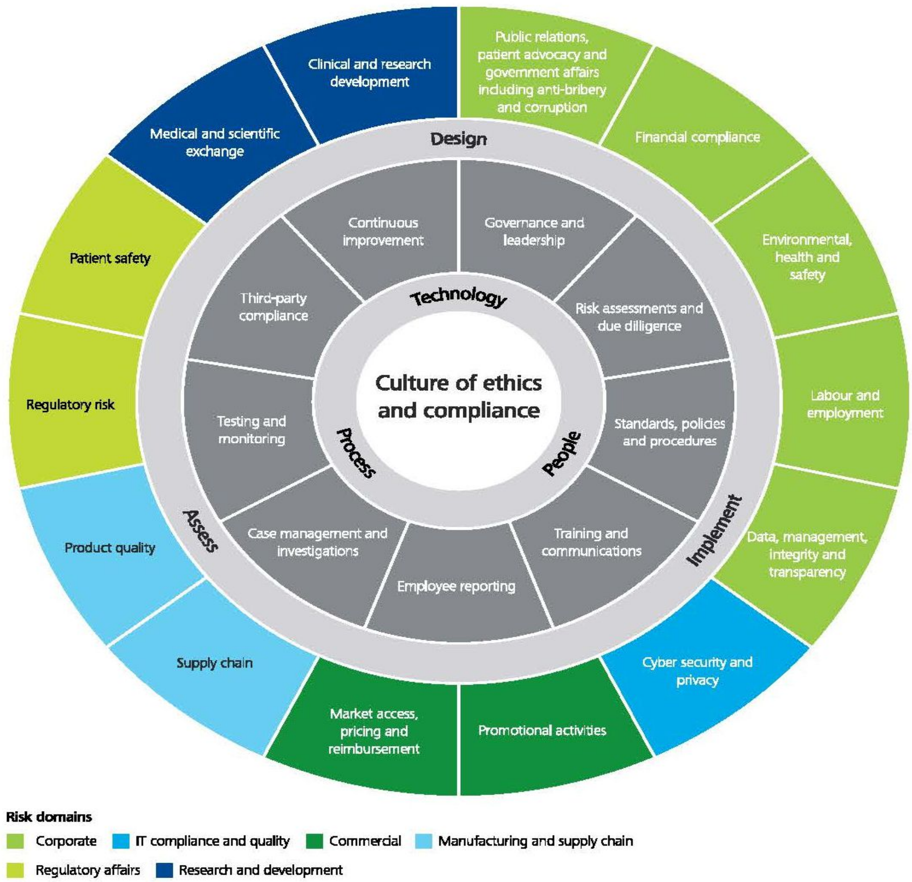
Organizations are principally focused upon the sale of products or services, and support of those activities. To initiate the integration of compliance objectives into the existing system of internal control and procedures, the objective must be clearly defined. For example, suppose the compliance objective is to identify transactions with related parties. Related parties would need to be defined. Are they companies that the organization has an equity ownership? Are these related parties directors and officers of the organization? A database of related parties would be created and would need to be constantly updated. This constitutes the definition of the related party compliance objective.

After definition of compliance objectives is achieved. These and other compliance objectives can be integrated into the data collection and retention process. Then, the data can be summarized and directed to the appropriate officer or department within the organization. This related party compliance objective, would require an integration between the staff and programmed data extraction of the computerized system.

Another technique used to achieve the compliance objective is called Data Mining. Certain types of transactions recorded in database systems are extracted and included into a new database. The initial objective of this database is to provide the basis of a report to a governmental agency, review of results of operations for management, or an examination by committees of the Board of Directors.

Available Compliance Analysis tools that are used to begin the definition of multiple compliance objectives. An example of one of these tools has been provided by the Deloitte Accounting firm which is shown on the next page:

Figure 1. Deloitte compliance risk tool



Source: Deloitte Enterprise Compliance and Life Sciences Compliance Advisory, 2015

(Deloitte: Janet Foutty)

Compliance planning using this or a similar device merges competing regulatory, professional, and corporate objectives. This tool is useful as it allows the organization to continue to incorporate new compliance objectives as they arise. Staff allocation computations can be made to determine how to allocate the compliance objectives to the respective staff groups, teams or departments. The data analytics can be included in the compliance plan. Many firms and organizations seek additional assistance outside of the organization to assist with various compliance objectives.

Management is clearly concerned with the growth in compliance mandates from government. Even though the productivity of many organizations is increasing, and the cost of manufacturing or production of services continues to diminish, the cost of compliance to government has increased significantly. This inhibits the growth of profits for many organizations. "…since 1981 the federal government has promulgated 2,302 manufacturing-related regulations." The cost of complying with these regulations is staggering. Based upon Aravo/Industry Week (Industry Week) based upon a cost benefit analysis that at the current rate of added regulations, it will eventually cost an additional $500 billion dollars which will result in a reduction of manufacturing output alone. What was surprising was the fact that 90% of these organizations or companies do not engage in a cost benefit analysis. As a result consideration is not given to how these regulations or the effort to comply with them can be integrated into the manufacturing, production, or internal control objectives of the organization.

The loss of production or capacity is one aspect of the cost. There are very serious consequences to the failure to comply with these regulations, which will affect the finances or the ability of the organization to function effectively. However, this a list of the obvious consequences:

- Fines
- Financial Commitments and Requirements
- Government Agency Supervision and Reporting
- Delist from Stock Markets
- Loss of license to manufacture and distribute controlled substances (Pharmaceutical, Food Manufacturers, Consumer Goods Manufacturer and Distribution)
- Increased human resource cost for staff
- Litigation

(Aravo/Industry Week)

It would seem logical that as a law or regulation has been in effect for a longer period of time that organizations would become more proficient at compliance. There should be a progression and modification of the system on internal control to respond to the compliance objective. However, it appears that the converse is true.

The Foreign Corrupt Practices Act (FCPA) was instituted during the Carter administration in 1977.

> When assessing the costs of these regulations, it's natural for an enterprise first to think of the direct costs of regulatory penalties. After all, these fines can reach tens or hundreds of millions of dollars.
>
> For FCPA violations, Siemens AG was fined $800 million, Alstrom was fined $772 million, and KBR/Halliburton was fined $579 million. (Siemens was also fined by European regulators, increasing its total penalties to $1.6 billion.) In some cases, FCPA penalties also include the imprisonment of the individuals responsible for the regulatory violations.
>
> However, these settlement costs are hardly the only expenses borne by companies accused of FCPA violations, according to analysis by Professor Mike Koehler of the Southern Illinois University School of Law. Even in the case of Siemens, Anti-Bribery/Anti-Corruption (ABAC) monitoring before and after the penalties created a burden that likely amounted to hundreds of millions of dollars, pushing the total regulatory costs for Siemens possibly close to $2 billion.
>
> (Aravo/Industry Week)

It is interesting to note that the Foreign Corrupt Practices Act (FCPA) was enacted almost 40 years ago, yet companies are still having difficulties with compliance. This indicates that although the legislation may be well understood, the compliance cannot be easily achieved given the current business environment. Legislation can create compliance issues for an organization when the type of transactions for which it was enacted have changed. In 1977 although computers existed, most of the work was done by mainframe computers contrasted to the current use of personal computers and mobile devices.

This is a situation where external consultants can be effective. Instead of training two or three generations of staff, an expert can devise a plan for effective compliance. The Price Waterhouse Coopers website professes the following expertise as it applies to the FCPA:

> To achieve global growth objectives, companies must keep Foreign Corrupt Practices Act (FCPA) compliance as a strategic imperative. Organizations need to carefully

navigate challenging regions while implementing adequate safeguards to deter and detect bribery and corruption. Stated simply, companies need to institute an FCPA compliance strategy that employs a balanced approach with both proactive measures and defensive tactics.

Managing your global FCPA compliance program and controls is complex, and if not effectively executed, you could be met with significant repercussions.

Prevent corruption and protect your brand

Companies should understand their corruption risks, sustain an effective FCPA compliance program, and monitor for potential non-compliant activities. By working with our clients to examine alleged improper conduct (by both employees and third parties), we evaluate, design and implement comprehensive compliance programs everywhere you conduct business.

Our Forensic Services team has "boots on the ground" knowledge from working in over 100 countries, and understand the threats and vulnerabilities that exist across industries and regions affecting both corporate and local operations. We work together with you to conduct complex, multi-jurisdictional anti-corruption investigations in response to internal and government inquiries, and to implement remedial solutions and controls in some of the world's most demanding business environments. Our objective is to ultimately protect what matters most—your brand, reputation, and assets.

Our global FCPA services include:

- Anti-Corruption Risk Assessment
- Forensic Accounting and Compliance Investigations
- Remediation Design and Implementation
- Development and Implementation of Compliance Programs including Internal Controls
- Monitoring and Evaluation of Program and Controls Effectiveness
- Data Analytics to Identify Potential Corruption Threats and Control Deficiencies
- Third Party Risk Management Program and Due Diligence
- Pre- and Post-Acquisition Due Diligence
- Anti-Corruption Training (Design and Delivery)
- Independent Representation and Testimony to Regulators

(Price Waterhouse Coopers)

An external consultant that has experience with the legislation would be able to help the organization put a system in place to comply with the directives of the law. External consultants may not be effective for each and every compliance objective. Therefore, planning by the organization will need to continue to be done for each objective. The approach to compliance will need to be monitored and evaluated at specified time intervals.

After extensively reviewing the compliance objectives, the difficulties, and some potential solutions, the compliance issues will continue to increase in number and complexity. To achieve the desired compliance, there must be an evaluation of compliance objectives for the organization. Once the objectives have been determined, the decision must be made as to whether internal staff will take the challenge of the compliance, a computer system will yield the required data, or an external consultant will provide the system and the reporting necessary to provide the needed compliance with the legislation, or regulatory agency. Consideration of compliance objectives should continue to be studied in each organization to determine whether the existing alternatives to achieving the compliance objectives will be satisfied, or should a new compliance solution be developed.

Bibliography

Aravo/Industry Week. "Aravo." 31 August 2016. *blog.aravo.com.* 5 October 2016.

—. "http://blog.aravo.com/global-2000-companies-face-increasing-regulatory-burdens-and-complexity." 16 August 2016. *Blog Aravo.* 2016.

Deloitte: Janet Foutty, Owen Ryan, Catherine Englebert. "The Challenge of Compliance in Life Sciences:moving from cost to value." 2015. *http://www2.deloitte.com/us/en/pages/life-sciences-and-health-care/articles/gx-lshc-challenge-of-compliance.html.* 6 October 2016.

Price Waterhouse Coopers. "http://www.pwc.com/us/en/forensic-services/fcpa.html." n.d. *Forensic Services.*

Tysiac, Ken. "aicpa.org." 1 9 2016. *AICPA.* 10 9 2016. <http://www.journalofaccountancy.com/issues/2016/sep/cpa-firms-struggling-with-succession.html>.