Compliance & Controls

Balancing Increasing Scope & Change With Efficiency

BLACKLINE

TOP OF MIND ISSUES FOR COMPLIANCE
SPOTLIGHT ON COMPLIANCE & CONTROLS: FAST FACTS
A CHANGING COMPLIANCE, REGULATORY & REVENUE LANDSCAPE
A CHANGING RISK FRAMEWORK
MANAGING CONTROLS AROUND FINANCIAL REPORTING
HOW GROUPON ELEVATED CONTROLS IN THE MIDST OF GROWTH

CFO
PLAYBOOK

“Companies with material weaknesses were 80% more likely to have future fraud disclosures compared to firms with strong controls.”

—INTERNAL CONTROL WEAKNESSES AND FINANCIAL REPORTING FRAUD, AMERICAN ACCOUNTING ASSOCIATION, AUGUST 2017

Top of Mind Issues for Compliance

Effectively managing internal controls to support financial reporting is now top of mind in our complex regulatory and operating landscape. Accounting and finance organizations are challenged to operate efficiently and drive strong comprehensive controls amidst shifting risk.

Growing Operating & Regulatory Complexity

Globalization, intercompany trade, and mergers and acquisitions have increased the volume of transactions that impact the close. They've also created more silos and risk in downstream financial and regulatory reporting.

The regulatory environment itself has also grown, increasing exposure while placing

FAST FACTS

SPOTLIGHT
COMPLIANCE
& CONTROLS

CURRENT STATE →

READY FOR MORE EFFICIENCY

80% of respondents reported improving the efficiency of the SOX function as their top priority.[3]

GAP BETWEEN LEADERS & LAGGARDS

Bottom quartile organizations spend 10 times more on controls and compliance as a percentage of revenue than leaders.[4]

pressure on precious accounting resources to cover even more bases.

For example, accounting, tax, and treasury face increasing intercompany reporting challenges with Base Erosion and Profit Shifting (BEPS) tax rules. These same teams face a widening storm of regulatory requirements—from new IRS tax rules to new FASB revenue recognition standards. All of these factors are competing for resources that are also required for The Sarbanes Oxley Act (SOX).

It's no wonder that over fifteen years since the introduction of SOX, improving efficiency is still a top priority for financial executives.

In a survey conducted by The SOX & Internal Controls Professionals Group, study respondents identified improving the efficiency of the SOX function as a top objective, followed by ensuring compliance with SOX and other regulators, and strengthening organizational relationships across SOX owners.[1]

Material Weaknesses Elevate Fraud Risk

Weaknesses in controls create fertile ground for fraud risk. A 2017 study by the American Accounting Association found that companies with material weaknesses were 80% more likely to have future fraud disclosures compared to firms with strong controls.

In fact, when evaluating 127 unique fraud cases, researchers found a strong association between weak entity-level material weaknesses and future fraud revelation. They concluded that "the issuance by an auditor of an adverse internal control opinion is a 'red flag,' indicating a higher probability that managers are committing (unrevealed) fraud."[2]

Audit Costs Rising

With regulators' heightened focus on control failures, audit costs are also on the rise. In fact, a recent study by Protiviti of nearly 500 companies found that audit costs are larger than ever.

SOX/Internal Controls Priorities

SOURCE: FEI

WHAT'S TOP OF MIND →

AUDIT COSTS ON THE ASCENT

On average, 48% of organizations saw their audit costs rise from 2016 to 2017.[5]

HARMONIZATION IS A CHALLENGE

63% of SSC leaders said harmonization across ERPs and processes is their number one challenge.[5]

NEXT UP: STANDARDIZATION

55% of organizations focus on process standardization as the next upgrade to their SSC.[6]

Nearly 40% of the companies surveyed are seeing an increase between 16% and 19% in internal costs for their audits, in addition to outside audit fees.

In turn, external audit is increasing their resources and expectations—especially as the focus on cybersecurity intensifies and new auditing standards, such as one recently adopted by The Public Company Accounting Oversight Board (PCAOB), demand greater transparency in auditor's reports.

As a result, accounting teams are becoming more focused on shifting to a self-service model for external audit to minimize time servicing information requests.

Coupling Risk Reduction & Efficiency for Controllers

Research shows a strong relationship between the number of activities in scope and the maturity level of the month-end close process. The more activities in scope, the more stringent and rigorous the process.

Typically, organizations that have a summary checklist for their close process of around 100 activities per entity are managing at too high of a level. Best-in-class companies operate their close process on a much more detailed level, with more than 500 activities per entity.

Something must give: increase resources to mitigate risk or simply run the gauntlet of more risk. Technology innovation offers a solution, and it challenges the old assumptions that low risk of error requires significant investment, while a quick, lean, and efficient process elevates risk on the balance sheet.

It's common knowledge that technology like Robotic Process Automation (RPA) can accelerate the close using repeatable rules, scheduling, and processing of accounts and transactions at scale from multiple sources.

However, there's a much larger opportunity: the ability to oversee and automate controls in detail, while also increasing process efficiency. RPA can dramatically reduce errors in the close and improve balance sheet integrity by strengthening reconciliations.

This playbook provides a perspective on some of the challenges accounting professionals face in a changing regulatory, controls, compliance, and audit landscape, and how they effectively adapt to change.

> "The last mile of finance is ripe for cost reduction and efficiencies. While costs and resource consumption can be reduced by automating processes, the bigger financial impact is in preventing the fallout from penalties, fines, lawsuits, and valuation that results from inaccurate filing of financial statements."
>
> —CFO ADVISORY: LAST MILE OF FINANCE, GARTNER

FAST FACTS

SPOTLIGHT
COMPLIANCE
& CONTROLS

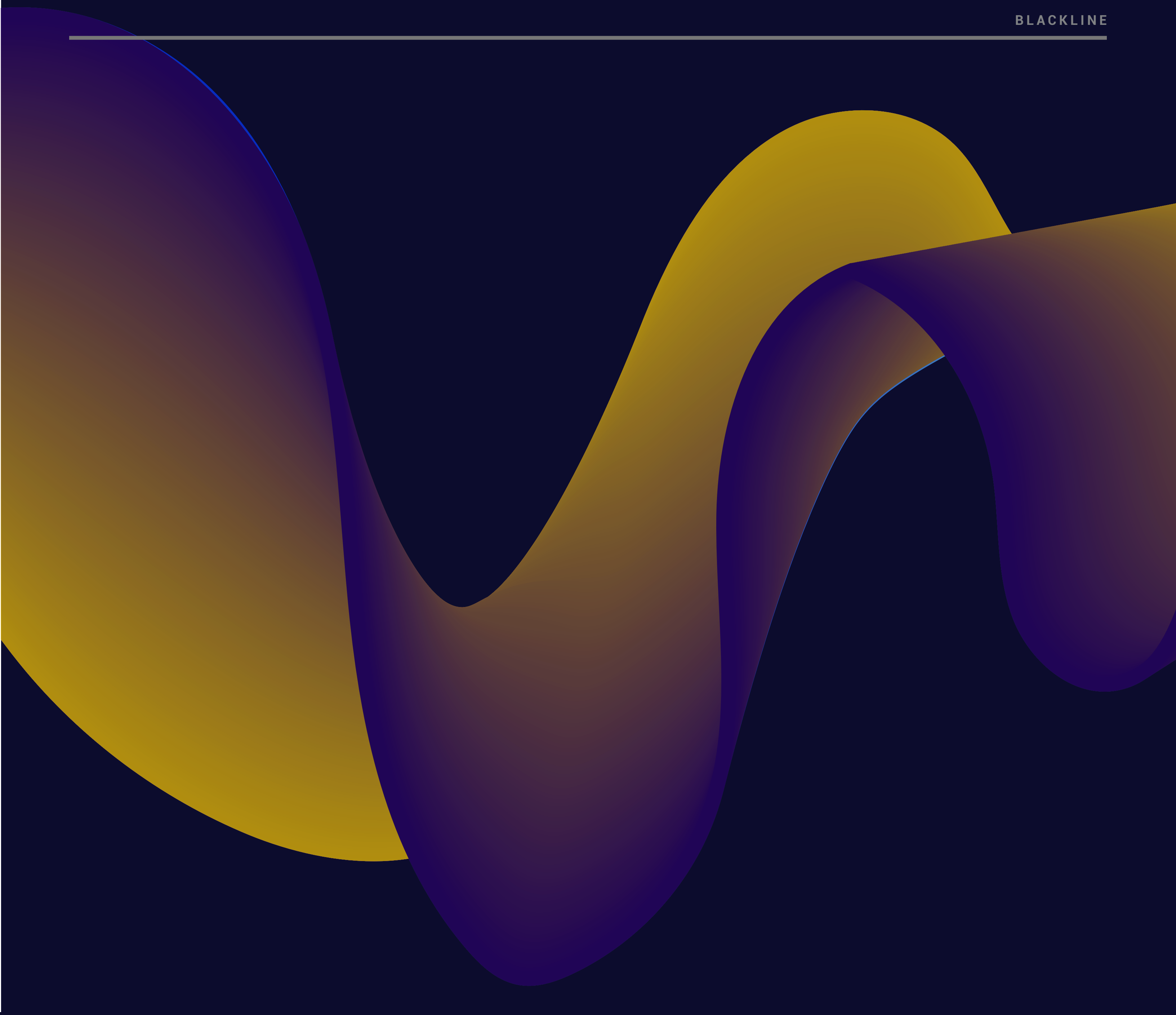
TECHNOLOGY TRENDS →

TECHNOLOGY: ROOM TO IMPROVE

70% of organizations say they still use desktop tools like Microsoft Excel and Word as key components of their SOX/internal controls process.[8]

ORGANIZATIONS THINKING CONTINUOUS

75% of respondents identified usage of continuous monitoring, ranging from fraud detection, transaction monitoring, and performance monitoring.[9]



THE RPA OPPORTUNITY

RPA can route, automate, and schedule 50% to 70% of tasks essential to financial close integrity.[10]

A Changing Compliance, Regulatory & Revenue Landscape

Accounting organizations are at the center of a broad array of change: global tax regulation, domestic tax changes, and major changes to audit reporting. Many are also affected by far-reaching changes that now dictate how they must treat, recognize, and report revenue, given rapidly changing business and operating models.

I.

BEPS Tax Compliance

New Base Erosion and Profit Shifting tax regulations, formulated by the Organisation for Economic Co-operation and Development (OECD) and published in October 2015, will spur the most significant changes to the taxation of international business since the 1980s. The countries directly involved in the OECD BEPS project make up over 84% of the total world economy, and per PwC, 70% of CFOs are concerned about increasing tax burdens from the new regulations.

New reporting requirements for many larger international companies require the creation of detailed country-by-country tax and financial information. In addition, they require a greater volume of data to be disclosed, dramatically increasing compliance burdens.

In fact, companies must consider three new levels of reporting:

- Country-by-Country Reporting: Details on each entity, organized by country; data to include revenues, profits, taxes, assets, transfer pricing, employee numbers and costs, capital, accumulated earnings, and intercompany payments, filed in the headquarter's jurisdiction
- Standardized Information for All Group Members: Global organizational structure; description of business; IP development, use, and transfers; intercompany financial arrangements; and financial and tax positions, filed in each country with operations
- Transaction Details Between Local Entities and Affiliates: Such as the local management team, business strategy, and restructurings or IP transfers, filed in each country with operations

What BEPS Means for Systems & Processes

With a greater need for data and reporting, BEPS will place substantially increased pressure on systems and personnel. This burden will require well-organized document management, data, and workflow systems to increase collaboration across tax, finance, and geographies. Multinationals face the practical requirement of reconciling public financial statements, legal entity books, local tax returns, and templates.

II.

PCAOB Adopts Changes to Auditor's Report

While auditing standards change continually, AS 3101, the latest auditor reporting standard that has been adopted by the PCAOB, marks the first major update to the standard form auditor's report in 70 years.

Auditor reports will soon have to include a new description of "critical audit matters," providing information about the most challenging, subjective, or complex aspects of the audit itself, and promising to lay bare challenges in the audit process.

Communication of each critical audit matter will be required to include:

- Identification of the critical audit matter
- Description of the principal considerations that were used to determine that the matter is critical
- Description of how the critical audit matter was addressed in the audit
- Reference to the relevant financial statement accounts and disclosures that relate to the critical audit matter

What the New Auditing Standard Means for Systems & Processes

The complexity of operations and accounting and control systems will have a significant impact on what ends up being defined as a "critical audit matter." In effect, what was once behind closed doors for readers of audit reports will now be much more transparent.

Providing strong auditor self-service, minimizing long lead times to provide data to auditors, and easing efforts to substantiate balance sheets can all reduce issues covered in the audit report.

III. ASC 606 & IFRS 15: Revenue From Contracts With Customers

A new Financial Accounting Standards Board (FASB) revenue recognition rule, Accounting Standards Codification (ASC) 606 (ASU 2014-09), and International Financial Reporting Standards (IFRS) rule, IFRS 15, impact revenue recognition on a broad range of contractual agreements with customers. The core principle of this new rule is that an organization recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects what the organization expects in exchange for those goods or services.

The new rules affect companies that bundle products and services, have different terms around payments and renewals, have complex sales commission and royalty arrangements, and impact other areas.

What ASC-606 Means for Systems & Processes

The new rule places significant pressure on accounting systems and processes. For most, this means managing allocations to handle performance obligations and timing revenue recognition.

Other considerations include dual reporting on current guidance and future guidance, especially given retrospective adoption. With the new rule touching many different systems, from sales ordering to enterprise resource planning (ERPs) and billing and invoicing systems, it's vital that accounting teams free up resources from typical tasks to adopt rules effectively.

IV. ASC 842 & IFRS 16: Accounting for Leases

More than one-half of respondents in a recent Deloitte survey expect their accounting teams to spend more time on the new FASB and International Accounting Standards Board (IASB) lease accounting standards that require companies to recognize lease assets and lease liabilities on the balance sheet.

For organizations that rely extensively on leases for operating assets, the transition is likely to be labor intensive, especially for lease contracts requiring inventory.

What ASC 842 Means for Systems & Processes

Like ASC 606, this new rule will likely create significant work in collecting and reviewing detailed agreements, particularly for lease agreements across different locations.

Significant planning and adoption is required for reviewing lease tax classifications, enhancing disclosure agreements, and changing financial ratios. With limited resources, it's important to free up accounting personnel from day-to-day, low-value tasks to devote time to reviewing the new rule and updating accounting processes.

A Changing Risk Framework

Risks to organizations now present themselves at a faster pace than ever before. Any risk management strategy must mitigate risk related to not only compliance or operational areas, but also strategic execution issues.

The recently updated Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework recognizes this, and builds on the existing foundation of internal controls to add a layer of strategic enterprise risk management.

Since COSO was first developed in the early 1990s, much has changed—globalization continues on an upward trajectory, business models and operating structures are more complex, distributed business and outsourcing are seeing rapid growth, and domestic and international regulations are constantly evolving.

Technology advancements have also introduced a double-edged sword, quickening and increasing the magnitude of damage that an operational or strategic failure can inflict, while also creating their own new risk landscape, as is the case in the area of cybersecurity.

An increased focus on proactively reducing the risk of fraud, along with greater expectations of accountability at every level across the organization, signaled that it was time for a framework refresh.

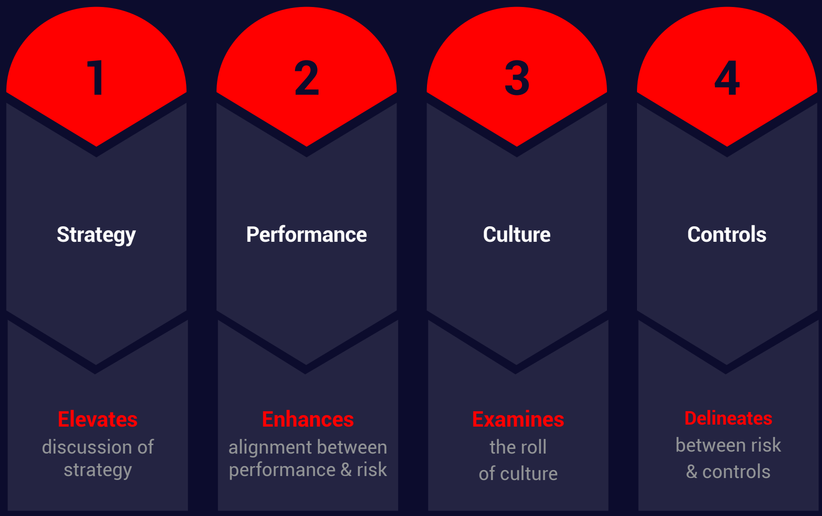
Strong Internal Controls & Strategic Risk Management

It's important to recognize that strong enterprise risk management—effectively managing the response to business risk and better strategic planning—is reliant on comprehensive internal controls.

The updated COSO framework grows from being somewhat controls-focused to having an increased emphasis on culture, meeting performance objectives and goals, and considering broader risks.

More broadly, the framework expands to encourage organizations to consider the impact of technology, such as data stewardship and governance, the role of artificial intelligence (AI) and increased automation, and greater awareness around cybersecurity.

The Updated COSO ERM Framework



SOURCE:PWC

Managing Controls Around Financial Reporting

Managing internal controls around financial reporting is fundamental to governance and compliance. A recent survey by APQC found that top quartile companies spend 13 cents or less per $1,000 in revenue to operate controls and monitor compliance with internal controls policies and procedures. The bottom performing group spent more than ten times that, around $1.40 per $1,000 in revenue.[11]

To make that a little more tangible, for a $10 billion revenue company, that's the difference between $1.3 million and $14 million in costs related to controls and compliance. In the context of risk and compliance, these are resources that could be reallocated to managing strategic risk.

While listing the detailed controls that should be in place for financial reporting is beyond the scope of this document, it's fundamental that organizations balance the need for trust and integrity with timeliness and efficiency.

A big part of the process happens during the financial close period—accounting staff verifying the accuracy or integrity of all account balances in the company's general ledger of accounts and preparing the balance sheet as part of a company's financial reports.

> Companies have invested heavily in the front-end of a financial process, promoting efficient and effective transaction processing through unified policies, procedures, and systems. In the past, this same focus has not been given to the last mile of finance, resulting in manual and error-prone processes.
>
> —BALANCE SHEET INTEGRITY: THE UTOPIAN CLOSE CREATING A LOW RISK, HIGHLY EFFECTIVE FINANCIAL CLOSE, DELOITTE

For many organizations, this remains a manual process, creating significant balance sheet risk or resource overhead.

More broadly, it's essential that internal controls and checklists are fully documented and comprehensive. This means that organizations should ensure that they have a real system in place to identify, accumulate, and evaluate control deficiencies, communicate findings and correct them, and move away from spreadsheet checklists, binders, file shares, or siloed institutional knowledge.

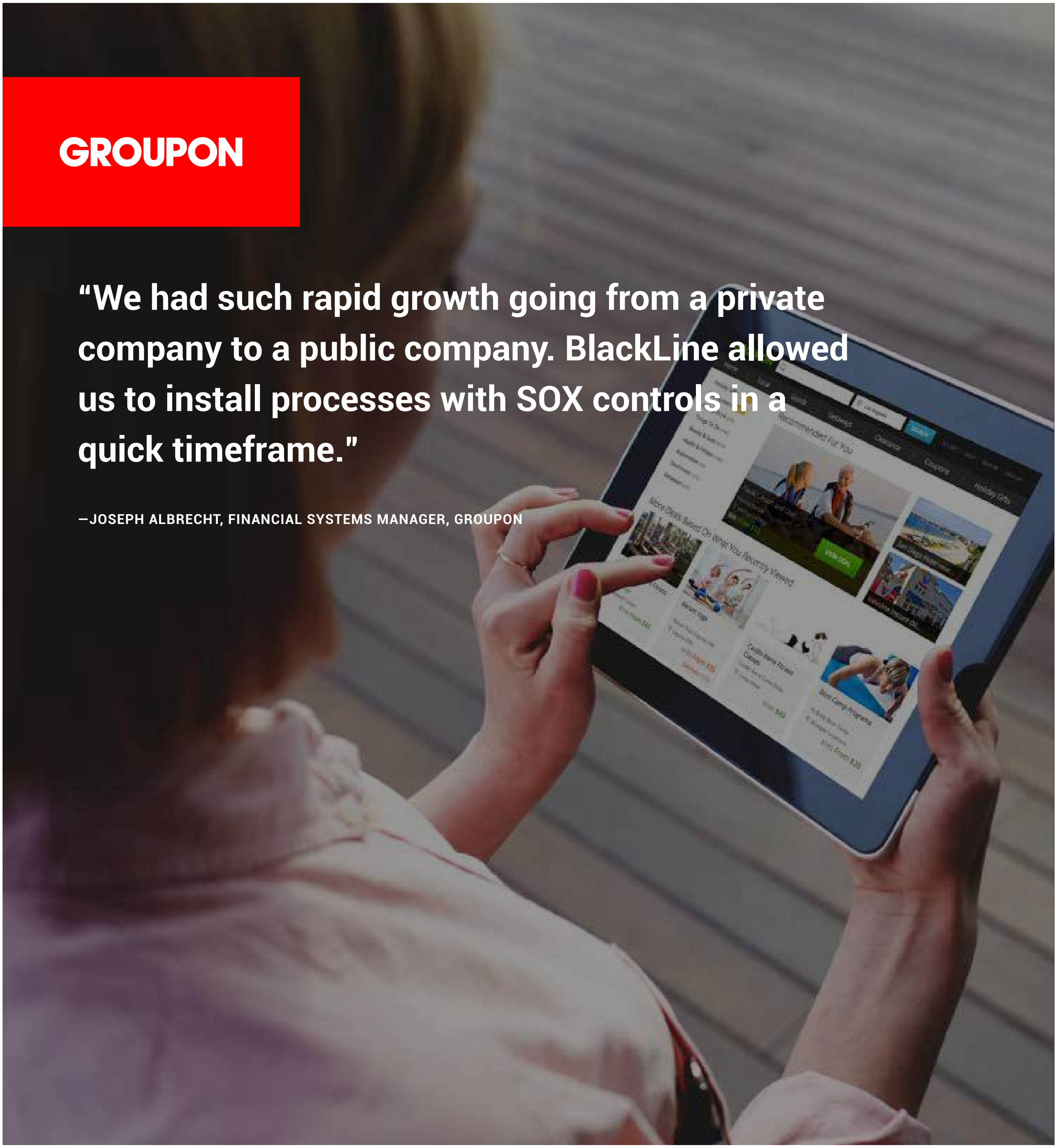
While segregation must exist among transaction processing, authorization, and reporting functions it's often tricky when email becomes the approval vehicle. Integrity should be managed by flagging unusual items and exceptions—which is often tricky in a highly manual environment or one where gut feel plays a major role.

Ripe for Reinvention: Strengthening Controls Through Automation, Centralization & Workflow

With modern technology, improving internal controls for financial reporting is one of the lowest hanging fruits to reduce risk and improve efficiency. Underpinnings include using exception analysis and variance reporting to monitor, review, and reconcile financial activity. Automation can highlight transactions and balances that exceed control thresholds, while ensuring all reports can be reconciled back to the original data.

Workflow can enable strong, auditable sign-offs for reconciliations and other close tasks, while centralization can move checklists from binders, spreadsheets, and tribal knowledge into a managed, version-controlled, digital store.

Modern cloud applications also open new avenues for auditors who can access reports and underlying transactions from one place, with just a web browser—minimizing the need to hunt for data and engage in a back and forth with accounting.



GROUPON

“We had such rapid growth going from a private company to a public company. BlackLine allowed us to install processes with SOX controls in a quick timeframe.”

—JOSEPH ALBRECHT, FINANCIAL SYSTEMS MANAGER, GROUPON

How Groupon Elevated Controls in the Midst of Growth

Groupon is a leading worldwide e-commerce marketplace, connecting subscribers with local merchants by offering activities, travel, and goods and services in more than 28 countries. Based in Chicago, Groupon was launched in November 2008.

By October of 2010, Groupon was available in 150 cities in North America and 100 cities in Europe, Asia, and South America, and had 35 million registered users. Now Groupon serves more than 500 cities worldwide and has over 50 million active users.

Rapid Growth Fragmented Controls & Accounting Processes

For Groupon, going from a one-city operation to a company operating in 40 countries in a few short years caused significant challenges around visibility, accountability, and controls.

"Due to our rapid growth, our global processes began to decentralize, and different regions began using different tools to manage controls and reconciliations," says Joseph Albrecht, Financial Systems Manager at Groupon.

Groupon's reliance on Excel spreadsheets left the company vulnerable to human error. According to Albrecht, "We really needed to find ways to make our processes more efficient and centralize them."

Moving From Spreadsheets to the Cloud

Shifting from spreadsheets to the BlackLine cloud means accounting and finance team members all over the world can easily access financial close data, as well as manage control documentation, sign-offs of close tasks, and storage of the detail.

"We've been able to build a strong foundation once we started rolling out to teams around the world," says Albrecht.

BlackLine also integrates across Groupon's existing ERPs, including Microsoft Great Plains and NetSuite, providing a common, ERP-neutral repository.

Shifting to Auditor Self-Service

One of the key benefits has been streamlining end-of-year reporting and auditor requests. Because all of Groupon's accounting data for every business entity is aggregated within BlackLine's cloud, preparing materials for internal and external audits is as simple as granting auditors secured access to the system.

"It's so much easier for our auditors to go to a central repository and pull the report they need, versus having to track down information in Groupon Russia or Groupon Austria," says Albrecht. "It has also formalized our end-of-year testing, as all of the information we need is in one location, accessible from anywhere in the world."

INDUSTRY
Retail

ERP
Microsoft Great Plains, NetSuite

USERS
261

BUSINESS IMPACT
1. Enabled ongoing scalability of accounting processes
2. Streamlined end-of-year reporting and auditor requests
3. Increased visibility and accountability

GROUPON

[1]SOX Standardization Elusive: The 2016 State of the SOX/Internal Controls Market Survey, FEI, 2017

[2]*Internal Control Weaknesses and Financial Reporting Fraud, American Accounting Association, August 2017*

[3]*2016 State of the SOX/Internal Controls Market Survey, SOX & Internal Controls Professionals Group, 2016*

[4]*When and How Much to Invest in Knowledge Management Technology, APQC, 2018*

[5]*Fine-Tuning SOX Costs, Hours and Controls, Protiviti, 2017*

[6]*Cost of Compliance 2017 Report, Thomson Reuters, 2017*

[7]*Internal Control Weaknesses and Financial Reporting Fraud, American Accounting Association, August 2017*

[8]*SOX Standardization Elusive: The 2016 State of the SOX/Internal Controls Market, FEI, 2017*

[9]*EY Global Governance, Risk and Compliance Survey, EY, 2016*

[10]*Intelligent process automation: The engine at the core of the next-generation operating model, McKinsey, March 2017*

[11]*When and How Much to Invest in Knowledge Management Technology, APQC, 2018*

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