SOX Without Losing Your Shirt

by Jim Love and Alex Resnick

Since the US Sarbanes-Oxley Act (SOX) first hit corporate radar screens, an entire cottage industry has emerged devoted to pointing out its negative impacts. Shortly after the act passed, Scott Nealy, CEO of Sun, described Sarbanes-Oxley as "buckets of sand into the gears of the market economy." The criticism continues to this day and, if anything, has increased in its vilification. One commentator recently described SOX as the "the worst affliction visited on public companies in the past 70 years" [2].

There is some merit to the criticism. Financial Executives International (FEI), in a survey of 217 companies with average revenue above US $5 billion, put the cost of compliance to the individual company at an average of $4.36 million [3]. As global competition intensifies, anything that adds to the costs of doing business is going to be seen as having an unwelcome impact.

When you look at the average numbers, the impact is unquestionable. But when you look beyond the averages to the experience of individual companies, a different story emerges — and some questions *do* get raised.

Why are the costs of compliance so much lower in some companies than in others? For example, why does Affiliated Computer Services (ACS), with $3.8 billion in annual revenue, require 20,000 staff hours to comply, while Dell, at $35 billion, says it needs about 5,000 [1]? Is it possible that not all of the costs stem from the legislation itself, but from *how* it's being implemented? Also, we hear a lot about the costs, but we rarely see anything about the *benefits*. Is this because there are no benefits at all?

Maybe we are just contrarians, but neither of us thinks Sarbanes-Oxley is the end of the world. After all, how can anyone say that any public company shouldn't have controls in place that at a minimum prevent a material misstatement of the company's financial position? This isn't a totally uninformed opinion. We both come out of large accounting firms, and both of us have had extensive experience in process improvement in highly controlled financial environments. Over that time, we have heard all too often that any controls will inevitably add inefficiency. Time and again, we've proven that to be a myth. Poorly implemented controls do rob companies of efficiency, but well-designed and well-implemented controls can actually improve efficiency by cutting out waste and errors. Even if some additional overhead is necessary, we've always found efficiencies can offset these costs if you redesign the process while implementing the controls.

But perhaps SOX was somehow different. Perhaps (contrary to all our previous experience) there was something about the law that inevitably made compliance a hideously expensive exercise in frustration. Still, someone had to ask the question — can you comply with SOX without losing your shirt?

CONTROLS *AND* EFFICIENCY?

Last year, in a joint pilot project with the accounting and IT areas of an international mining company, we got the chance to find out. The results — as the participants themselves will attest — showed that we were able to leverage process redesign to both improve efficiency and increase the controls for SOX compliance. In the process, we were able to achieve substantial cost reductions, dramatically reduce cycle times, and drive service improvements. In one improvement, we cut over $5,000 a month in overtime. In another, we were able to pull six precious hours out of a month-end reporting cycle.

True to form, some last-minute compliance measures added

during the final audit in other areas have consumed some of these gains. The accounting department is not, after all, an island unto itself. But overall, the gain is still a net positive *and* the group is committed to keep driving the improvement process to gain further efficiencies.

Given all that was accomplished, it may come as a shock that the project was nearly canceled before it began. Concerns were raised that our project would complicate and ultimately delay the compliance efforts. This company, like many others, had placed a freeze on improvement projects until the SOX compliance effort was completed.

Bad advice is buying the idea that you improve controls by slapping them on top of a process and then living with the inefficiency.

This started us wondering how much of the reported costs of Sarbanes-Oxley are due to, as Jerry Sonnenfeld, associate dean of the Yale School of Business, put it, "a bad law or bad advice" [1]. Bad advice, from our perspective, is buying the idea that you improve controls by slapping them on top of a process and then living with the inefficiency. If this is how compliance has been implemented, it's no wonder SOX costs are so high. People will solve the problem that you give them. If you ask for controls, they'll give you controls. If you ask for efficiency, they'll give you efficiency. We had to prove you could ask for both.

Impossible, you say? As an industry, we've done it before. When we first introduced development methodologies, the resultant hue and cry was enormous. Bureaucracy! Overhead! Lost productivity! Yet today, as development shifts overseas, does anyone seriously argue that a CMM Level 5 development environment is *less* efficient? When we first implemented change control, we heard the same complaints. Yet in many IT shops the time lost to failed implementations has more than offset any additional steps.

We have met resistance before and have learned some lessons from it. First, those who treated these changes in a negative manner, focusing solely on compliance, tended to experience greater inefficiencies. In these companies there was great resistance and — all too often — failure. Those who treated the changes as opportunities to improve the current processes not only found benefits, but also had higher success rates.

EFFICIENCY REQUIRES FUNDAMENTAL CHANGE

Efficiency isn't something you can paste onto a process. In order to realize efficiencies, you have to make some fundamental changes to the way things are being done. And for many companies, change is difficult. No wonder. Change only happens when a number of key things come together. First, all the people involved must be able to:

- Clearly see both the problem and its root causes
- Believe that they can actually solve the problem
- Take ownership of the problem
- Be motivated to implement a solution (or at least not be prevented from doing so)

In addition, the group has to have the tools and skills to succeed. In our case, this meant finding a way for all the stakeholders to understand the processes, clearly identify the problems, and design solutions that would hit that delicate balance of increased control and efficiency. This is no simple task. As anyone who has tried to implement the "perfect business rules" has discovered, even relatively simple business processes — especially those that require time to complete or contain a number of steps — are incredibly complex.

Given how difficult it is to make changes in the average company, it's no surprise that some might pick what seems like the "safer" route of focusing only on controls to existing processes and accepting the inefficiency. But, as Scott Nealy stated, that amounts in many cases to "pouring sand into the gears." Simply adding controls to a process may result in too many controls, redundant controls, and controls that are misplaced in the process. In these cases, inefficiencies are added that are far larger than the

steps required for the control. The net effect is often that the overall control of the process is actually *reduced*.

THE PROCESS

Fortunately, the people who brought us in had experiences that allowed them to see the potential value of the process improvement approach to SOX compliance. In the end we did get the opportunity to proceed, but in a very focused pilot effort within a very short window of opportunity. In effect, we had to stay one step ahead of the rest of the compliance efforts, which increased the pressure on all of us to come up with clear and *measurable* gains.

Measurement is critical. Over the years, we've worked with a variety of different tools and approaches. We've been heavily influenced by the work of Taichii Ono, who developed Toyota's legendary process improvement methods, and James Womack, who took those forward to create what is now called Lean Thinking (or simply, "Lean"). We've followed others as well, including Six Sigma, Kaplan and Norton's Balanced Scorecard, and the work from the group Jim had headed with the DMR (now Fujitsu Consulting) Center for Strategic Excellence, which was documented in the best-seller *The Information Paradox* [5]. While each of these methods has its own particular areas of focus, they all rest on a fundamental assumption that measurement is the way to leverage performance gains. We believe and have demonstrated that the *right metrics*, *implemented correctly* and *made visible*, can be used to pull processes into alignment and expose areas of inefficiency.

The project presented another obstacle — or opportunity. Under our approach, the participants had to take control of the process and make the discoveries for themselves. We were using a cross-functional team with people from a number of areas. Few, if any, of these people were trained in even the basics of process redesign. In an organization that was already feeling the stress of Sarbanes-Oxley costs and deadlines, we had to get results in a few weeks, not months.

Physician, Heal Thyself

As a result, we began by redesigning our own process. Taking only the essentials from each of the various methods, we created an approach we called "Performance Advantage." It offers a faster way to get a cross-functional group to learn how to analyze and improve a process and to execute those improvements.

The basic process mapping and analysis were taken directly from Lean, which has become the gold standard for eliminating waste from corporate processes. The beauty of Lean is that instead of mapping a process, it maps a value stream, which is a process flow with a twist. It scrupulously measures each step in terms of its time, resource usage, and — most importantly — its contribution to value. Lean also features a wonderful concept called a "Kaizen blitz," a short and focused approach to implementing incremental improvements. It was very close to what we were trying to do.

The right metrics, implemented correctly and made visible, can be used to pull processes into alignment and expose areas of inefficiency.

Because we had to deal with control as well as efficiency, we borrowed a few other techniques from Six Sigma, such as the Pareto analysis it uses to analyze deviation from a standard and to focus on areas of greatest improvement. As a base, the combination of Lean and Six Sigma gave us the best of both worlds — a focus on value and elimination of waste with a strong emphasis on maintaining a standard of compliance.

The Power of Post-It Notes

To these foundations, we added some facilitation techniques that allowed the participants to create process flows in real time. We needed to involve the whole group and let them see the inefficiencies as well as the areas where controls were required. To do this, we used a decidedly low-tech method of process mapping. We used Post-It Notes to itemize the "steps" and "swim lanes" to indicate the persons or areas that execute the step. We then put these on a wall using large whiteboards improvised with white plastic "static sheets." The result allowed the group to fully participate in both the development

and validation of the process. It also had the benefit of being very easy to change. Everyone could see the process and nobody would avoid revisiting a step because they'd already "gotten it right."

We actually have to fight with groups from time to time to keep this low-tech approach. Inevitably someone brings out a "more efficient" way of doing the process mapping — usually with some software program. But while a computer-driven process is fast and avoids the transcription that we have to do, it presents a big problem — the high level of interaction in our low-tech process disappears. The group is off to one side while one or two people hover over the little screen and try to "get it right." Decisions are made in this micro world without discussion or debate. Worse still, changes are sometimes made to suit the way the process mapping software works. Unlike our inherently messy and easy-to-change swim lanes, once you get it looking pretty on the computer, there's an unstated resistance to revisiting any part of the process.

I Can See Clearly Now

As groups are constructing these wall-sized flow charts, they are also gathering and validating a lot of information on the process steps. Even passers-by occasionally get involved, asking questions or offering a correction or new fact. While at the corporate or departmental level it's surprising how little is known about end-to-end business processes and how they work, we never cease to be amazed at the amount of knowledge that most groups have when they come together. They know the time each step really takes. They know its purpose — if it has one. With a few guidelines, they manage to plot, map, and analyze even complex processes. When we'd told this group how much waste there was in the average process, we could see their disbelief. Now they could see it clearly: wasted steps, inefficiencies, and duplication of controls.

We were all amazed by the speed at which we could work. We had been prepared to keep the scope small, but we managed to map the *entire* month-end process. The company had been trying to do this for months, but together our group did it in a matter of days. That alone saved countless hours in the SOX compliance process. Plus, it had another benefit. Because the group had mapped the process, there was a much greater awareness of how it worked from end to end and how each individual's work affected the work of others. They saw beyond their own piece of the process — some for the first time.

THE BENEFITS

Awareness itself generates benefits. We discovered a number of duplicate and even unnecessary controls on the first pass through. Many times two people discovered they checked for exactly the same things. If they could trust one control, they could save many steps. Some controls or steps may have had relevance at one point, but if they had, the rationale was long lost. But few companies have ways to remove controls.

For example, there was a program written some time earlier to transform data in order to transfer it from one system to another. This step was on the critical path of the month-end process. If that program failed, a specialized IT support person had to be called in. If the job failed to run overnight, it had to be re-run the following night, thus delaying the whole process by a day. When this happened, the group would have to work significant amounts of overtime to catch up.

This process had been a source of conflict between IT and the accounting department for a number of months. Memos had been written. Escalation had occurred. Nothing had been done. Any change to the process would, from an IT perspective, have violated the general control principle that this kind of job had to be run by IT.

Once our group tackled the issue, with representatives from all the affected areas, we made an amazing discovery. The potential risks of IT releasing control of this process were nonexistent. The business already had strong controls in the process that would catch any problems before they would get into the month end. The resolution to this persistent problem occurred so quickly that the victory might have gone unnoticed. Fortunately

for us, we were measuring each gain we made.

LE RESISTANCE

By the end of the first week, the group was making it look easy. They were making observations, they were debating, and they were busy removing the inefficiencies from their processes. What a contrast to the first day! On that day, the group did *not* welcome us with open arms. We had a committed sponsor with the vision to try this new approach, but his own team had strong reservations. Their defensive postures, furrowed brows, and cool looks all spoke volumes. One participant summed up their feelings to many nods of approval: "So you think we can work harder, huh? Prove it!"

Once again we had to confront a tenacious and destructive myth that has permeated business culture: the only way to productivity is working harder. Given the past decade of cuts, it's hard to blame employees for feeling this. But it's not only wrong, it's a real barrier to change.

Why? We need the passionate involvement of a group of people to discover and make changes. Implying that they are not working hard isn't exactly endearing. Furthermore, today's employees are a much more suspicious and cynical lot — often justifiably so.

In order to be successful, we had to somehow gain their trust. One way to do this was to make sure that we also focused on the rewards that *they* would experience. What could increased efficiency mean to *them*?

We asked. And we found a number of things they strongly disliked. While this group would certainly do overtime, they didn't really like it. Family and other priorities were very important. We found that many of them hated the idea of redoing work. Others had projects that they wanted to get to — one had a backlog of reconciliations. There was also a real desire to meet deadlines and to be acknowledged for that. Respect of the rest of the organization was very important to them.

Understanding and communicating how gains in efficiency could benefit them was the beginning of building trust. If you want buy-in, make sure that the group trusts that what you are selling has real value for them as well. It's obvious perhaps, but rarely done.

TRUST ME

Trust is often confused with empathy or caring — which is where it starts. But as author Robert Shaw points out, there are actually *three* aspects to building trust: concern, acting with integrity, and results [4]. People, especially in a corporate setting, trust those who get results.

All too often employees learn to trust in a negative sense: "We tried that before," "Management will never go for it," and so on. Trusting in this sense defeats most change before it gets started.

It's amazing how quickly the phrase "they'll never buy it" can shut down all creativity.

When the problem is senior management, we've developed some tricks to deal with it. SOX has its own unique equivalents. Now it's not management but the *auditors* who "will never go for it." This attitude can explain a lot of lost efficiency. Improvement requires some creativity. Creativity often starts with an "off the wall" suggestion that grows into a very practical and profitable idea. Even though we all know this, it's amazing how quickly the phrase "they'll never buy it" can shut down all creativity.

Before we even got started, talk of what would and wouldn't be acceptable was already creeping into our discussions. We had to get past this. We asked the superintendent of accounting (the local controller) to act as the proxy for the auditors; he would rule on what would go forward and what would not. The group was thus empowered to bring forward creative ideas. The superintendent played his role perfectly — never ruling anything out, but asking very pertinent questions.

Note that we *didn't* promise every idea would be accepted. We only committed to its being considered. Nor did we let the group get away with sloppy work — a business case and risk analysis were

required for each recommendation. However, we did let them try new ideas and set their own, very realistic goals. If we wanted the group to trust us, we had to trust them.

Sometimes it's tempting (especially under time pressure) to step in and tell people what the problem is. Likewise, we could speed up the process by just doing some things that we know how to do better than the group (or think we do). But doing that would be a devastating mistake. You have to trust and let the group both take — and keep — ownership of the problem.

The problem wasn't that the consultants were incompetent — it was that *the consultants had developed the solution*.

Why is this question of ownership so important? We once met with the CEO of growing telecommunications company, who explained that he had worked with another consulting firm on a contingency-based fee. Members of this firm had come in and identified a great deal of savings. They had gotten the buy-in and sign-offs of the various groups across the company. They had written a report, identifying and documenting each item. Then they left.

The problems arose when the CEO tried to implement the recommendations. Suddenly people found previously undiscovered flaws, changed circumstances, and a host of other reasons why the recommendations were flawed. The changes were never implemented and the savings never found.

The problem wasn't that the consultants were incompetent — it was that *the consultants had developed the solution*. As a result, it was the consultants who owned the solutions and not the staff who would have to implement the recommendations. From that day forward, we vowed that, as facilitators, we would not take ownership of the solution.

BUILDING THE TEAM

We have to trust the teams we're given, and at times we can have trouble getting some of the people we'd really like to have. Because we insist on cross-functional teams, we may get groups that have never worked together as a team.

For this reason, we start off with some specialized team-building exercises. On this project, we tried some tools from a field called Neuro-Linguistic Programming (NLP). NLP looks at failures in communication in terms of the way individuals have learned to process information. We like this technique because the analysis reveals some patterns of behavior that are very relevant to the type of group work we are doing, particularly when differences in patterns lead to conflict.

For example, there is a pattern that examines how people receive their validation. Some of us find our measure of validation externally. It could be approval from respected persons, or it could be a need to look at comparisons or benchmarks. Others find their validation internally — they "trust their gut" or their own internal process. You can spot this pattern any time you see some members of a group looking to "get more facts before they decide" and others saying, "Let's just DO something."

No matter which side of the issue you are on, it's incredibly hard to deal with "people like that." We're not very good at hearing the other person's point of view, and pressure for time or results just makes it worse. Groups break down into conflict or stalemates.

But what if it's *not* "people like that" but simply the way we have come to process information? That's what NLP suggests. We try to make these different patterns visible and help the group see them for what they are. They are our "meta-programs," and we all have them.

Don't Fence Me In

It was during this project that we made a very interesting discovery, which we have since observed a number of times. If true, it begins explain why some people — and in this particular case, IT people — might resist the imposition of process and controls.

One of the key patterns in NLP relates to how people understand and deal with procedures. Some people see a task as a set of end-to-end steps, and they follow procedures very well. Others see a task

as a set of options. People in the "options group" design processes very well, but they are not good at repeating the same steps over and over. They always have to "improve" things. This behavior is incredibly irritating to the people who want to follow the process, stop rehashing it, and just accomplish something.

In our large group, the HR and accounting people were, almost without exception, very comfortable with *procedures*. The IT staff, on the other hand, had a nearly off-the-scale orientation toward *options*. This explained why some of the IT people seemed to be tuning out during the crucial process mapping phase — especially when it got detailed and repetitive. Identifying this behavior as a pattern allowed the group to make some very necessary adjustments to the process. It helped people understand why they were frustrated — and why they were frustrating others.

Solving the Phil Problem

For example, one senior IT person whom we'll call Phil (not his name) was constantly leaving the group to deal with some kind of emergency. We worried that the group would consider this behavior rude or question his level of commitment. In reality, Phil cared a great deal and had made real contributions — he was just *extremely* options oriented. It was simply unbearable for him to repeat a process over and over — especially at the level that proper validation required. When it came to brainstorming solutions, however, he was first-rate and totally engaged.

While we never focused on any person individually, we discussed several of the major behavior patterns and challenged the group to look to find their own patterns and the patterns of others around them. We encouraged them to come up with potential accommodations, and it was interesting to see how they did that. In Phil's case, the group would assign him to investigate different options while they continued to work on the detailed areas of the process. He didn't get a free ride, but he did get a break. The group still insisted that Phil sit through process reviews, but as "fresh set of eyes." In short, they made some natural and creative adaptations to accommodate his style.

On more than one occasion, we saw people consciously change or modify their approach to try to get a point across. There were conflicts, especially when time got tight, but surprisingly few. Often the group would have these under control before any intervention was needed.

IT'S NOTHING PERSONAL

One of the reasons we fail to see unconscious patterns is that we treat them as conscious behavior. And we are not very kind in the way we do this. As human beings, we have a tendency to rationalize our own behavior and demonize that of others. When we are late, we have a good reason. When others are late, how do we *really* feel?

One of the most heated arguments we saw was over a seemingly simple issue: how the hours people worked were recorded. Members of one group always recorded their time improperly. That caused the HR accounting people great problems when it came to reconciling and balancing. One person suggested that this occurred because the offending area "just didn't give a damn." Another member of the team who had worked in that area was extremely offended.

We were able to defuse the argument by discussing how the problem happened. Once we got to that discussion, we found the real root cause was not attitude but the effect of a misplaced control. In fact the accounting people were surprised when we suggested that they (who had seen themselves as victims) we're actually part of the problem.

It turned out that the control was placed far too late in the process. It shouldn't have been in accounting; it should have been at the time of entry. But it wouldn't work perfectly there due to some additional complexities. It seems that the offending group didn't get the correct codes in a timely fashion, so they found creative ways to enter their time. Why didn't they get the right codes? Because someone had decided that it was necessary to put a control on the issuance of codes. Rather than redesign the process, the control had been moved up to accounting, where the errors were caught — but at enormous cost.

Moving the control to prevent the error could actually increase the efficiency, lower costs, and make the jobs of all involved more rewarding. If there was any doubt about the need for a cross-functional team, it ended at that point. You simply cannot see or begin to fix these types of problems without everyone at the table.

EVERYTHING IN ITS PLACE

This experience got us wondering again just how much of the SOX costs result not from putting controls in place but *where* and *how* they are put in place. When new controls are put in place, are old ones removed? How many are really necessary? Is there a process to ensure that all controls are justified and constantly questioned? We have just seen how fixing a problem in one area creates a bigger problem in another area.

The exercise we went through, and have repeated since, shows how important it is to ensure that controls are implemented with an equal eye toward efficiency. It takes a cross-functional team, an effective process, and often vigorous debate. That debate can only occur if the controls and their impacts are measurable and visible. In the cold light of day, it is difficult to avoid the real problems.

With our cross-functional approach, it is also less likely that problems will manifest themselves elsewhere. If you follow the right process, the task of designing and maintaining your solutions actually becomes much easier. The focus shifts from the way it is to the way it could be, and truly novel solutions emerge.

MYTH MANAGEMENT

We are pleased to report that our pilot group has held onto much of what they won despite additional SOX initiatives that have had an impact on them. More importantly, they now believe that they don't have to accept inefficiency as a price of control. We took a small yet valuable step toward shattering the myth.

We don't expect that we've come up with all of the answers, but we do hope we've raised some questions and inspired others to ask similar questions. Why? We feel that, like so many other corporate myths, the idea that controls are inherently bad needs to be tackled and, if possible, debunked. Without that dedicated effort, we risk allowing yet another corporate myth to triumph. And that's when we all lose our shirts.

REFERENCES

1. Jones, Del. "Sarbanes-Oxley: Dragon or White Knight?" *USA Today*, 19 October 2003 (www.usatoday.com/money/companies/regulation/2003-10-19-sarbanes_x.htm).

2. Powell, Scott S. "The Folly of Sarbanes-Oxley." *Hoover Digest*, Spring 2005 (www.hooverdigest.org/052/powell.html?GRAB_ID=132341450\&EXTRA_ARG=\&HOST_ID=5\&PAGE_ID=106).

3. "Sarbanes-Oxley Act — Cost of Compliance." *Wikipedia* (http://en.wikipedia.org/wiki/Sarbanes-Oxley_Act#Cost_of_Implementation).

4. Shaw, Robert Bruce. *Trust in the Balance*. Jossey-Bass, 1997.

5. Thorp, John. *The Information Paradox*. Revised edition. McGraw-Hill, 2003.

Jim Love is a founder and Managing Partner of Performance Advantage, a consulting firm specializing in implementing strategies that increase corporate and departmental performance. Prior to founding Performance Advantage, Mr. Love headed the global community of practice that dealt with governance and value at DMR Group and its successor, Fujitsu Consulting. That group went on to pioneer a number of innovative approaches to corporate and IT governance. Much of their work is described in the best-selling book The Information Paradox*. Mr. Love's clients have included large companies such as Bell Canada, Inco, Cisco, Royal Bank, and a host of others. He is a frequent speaker at industry conferences.*

Mr. Love can be reached at jim.love@performanceadvantage.ca.

Alex Resnick is the President and founder of The Catalytics Group Inc., a management consulting firm specializing in improving strategic execution through enhanced use of technology. Mr. Resnick is a Chartered Accountant with over 30 years of international business and technology consulting experience. He is a published author and respected speaker at international conferences.

Mr. Resnick and his management team built a highly successful technology-based consulting firm that merged with Deloitte in mid-2000. He joined the firm as a partner but found the draw of entrepreneurial leadership too strong to ignore. The Catalytics Group is the outcome of that passion.

Mr. Resnick can be reached at alex.resnick@catalytics.net.