Compliance Reporting - An Instrument for Corporate Steering?

by Kai Brühl and Nina Humann

The increasing integration of markets and a volatile global economic development are major challenges for corporate steering. As a consequence, the requirements for legal and regulatory compliance, as well as the expectations of the relevant stakeholders as to the integrity of corporate management, have equally been raised.

Efficient reporting on important compliance issues is essential to enable company management and supervisory boards to fulfil these requirements and to steer the organisation accordingly. Only sufficient and regular information allows the company management to ensure that existing structures and measures are effective in preventing infringements of relevant regulations, or at least to detect these in due time. In addition, information on compliance issues provides an important input into decisions on corporate strategy, such as M&A or international expansion. This article aims to provide a detailed evaluation of the existence and extent of these framework conditions in business practice.

The starting point of this analysis is the recent study “Compliance Management auf dem Prüfstand - Pflichtübung oder Instrument zur Unternehmenssteuerung?” (“Compliance Management on the test bench - A matter of duty or an instrument for Corporate Steering?”) which was published by NTT DATA in Germany. The objective of the study was the analysis of the arrangement, effectiveness and efficiency of compliance management in business practice. To this end, compliance officers and compliance representatives, as well as persons responsible for compliance management and management personnel, primarily from the areas of compliance and internal auditing, were surveyed. The scope was not limited to large and listed companies, but included leading SMEs in Germany and Austria. Figure 1 shows further details of the participant structure of the compliance study.

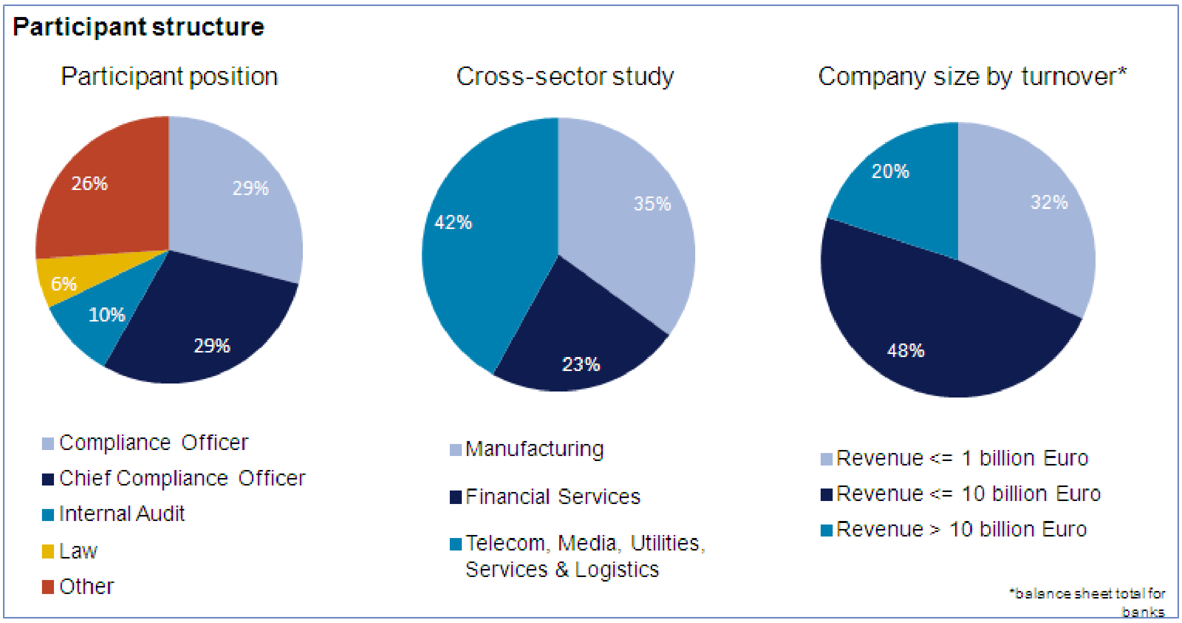

Figure 1: Participant structure of the study “Compliance Management on the test bench”

Successful Corporate Steering through Defined Compliance Objectives and Issues

The compliance management of the companies surveyed had a preventative orientation to facilitate an effective implementation of the compliance objectives and issues that had been defined. This means that almost all companies understood compliance as the fulfilment of relevant legal requirements and internal guidelines of the company (see Figure 2). In order to ensure the continuous monitoring of these objectives, they must find their way into corporate steering; for instance, with the support of adequate compliance reporting to the management.

Figure 2: Objectives of Compliance Management

The majority of the companies surveyed defined the key objectives of compliance management as effectiveness targets driven by regulatory requirements, which include the protection of the reputation of the company (84 %), the reduction of liability risks of the management and supervisory board (74 %) or the prevention of sanctions (68 %).

The realisation of efficiency potentials, such as the creation of an improved foundation for management decision making (26 %) or a higher degree of transparency with respect to the quality of internal structures and processes (23 %) is, on the other hand, targeted less frequently. Considerations of improved efficiencies of structures and processes, as well as the utilisation of such insights in corporate steering, are not deemed to be of prime importance. As a result, compliance management is only able to make an insignificant contribution to corporate steering with respect to the reduction of redundancies, costs or processing times.

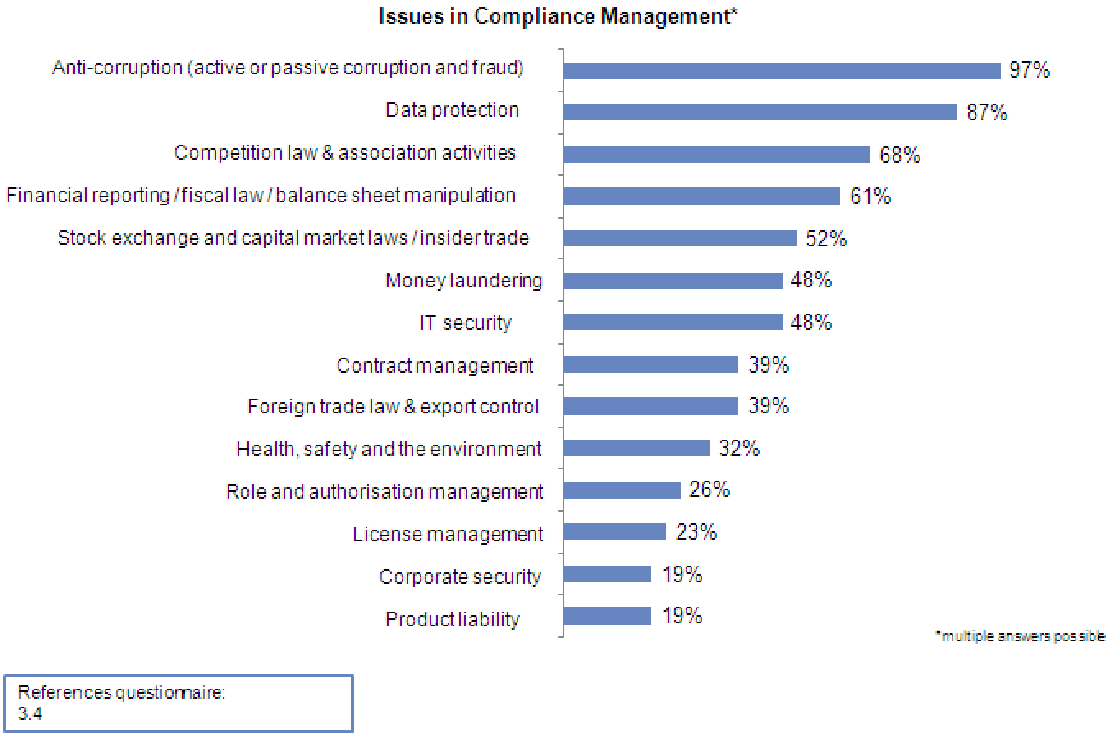

Figure 3: Issues in Compliance Management

With a closer look at the issues that are steered and monitored through compliance management in business practice, it becomes obvious that these are dominated by classical areas (see Figure 3). Almost all of the companies stated that their compliance activities target the issues of anti-corruption (97 %) and data protection (87 %). Given the present and past high-profile compliance breaches of well-known large corporations, this is understandable and reasonable; however, excessive dominance limits the information content in compliance reporting.

The strong focus on classical compliance issues undermines the information supply of decision makers in essential questions of company management. Consequently, the 32 % of companies which fail to manage their compliance with competition and antitrust law systematically will not receive the relevant information through compliance reporting. This applies to an even greater degree to issues of IT security or corporate security, especially since the current NSA espionage incidences demand security issues to be considered in all strategic corporate decisions.

No Meaningful Reports without Statements on Effectiveness

Ensuring the continuous achievement of the defined compliance objectives requires a consistent assessment of the effectiveness of the established compliance elements and the reporting of their results. Not least, the far-reaching liability consequences for management and supervisory organs lead to the expectation that every single company regularly examines the effectiveness of the compliance management it has implemented and reports its results accordingly.

Regular assessment and relevant proof of the same are the foundation for the identification of the requirement for action and timely reaction. In addition, the results of an effectiveness assessment provide valuable indications of optimisation potentials and therefore for the further development of compliance management.

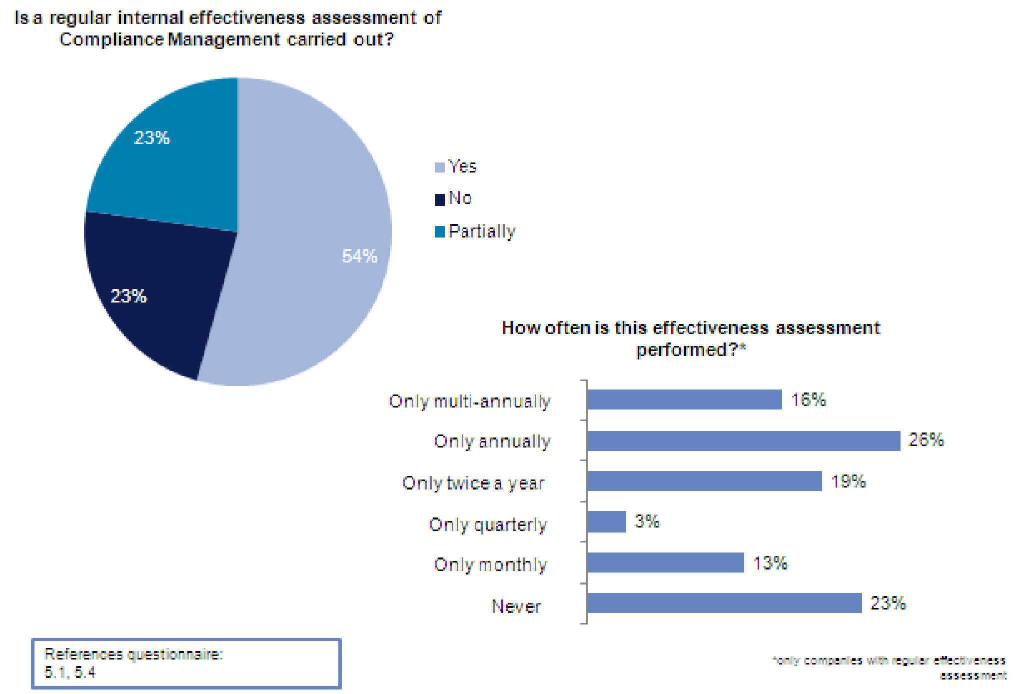

Figure 4: Effectiveness Assessment of Compliance Management

46 % of the companies surveyed assess their own compliance management for effectiveness only partially or not at all (see Figure 4). If a company fails to carry out an effectiveness assessment of their compliance management, it is not in a position to make statements on its competence and effectiveness. As a result, the company is at risk of failure to detect deficiencies and to identify urgent requirements for action. This lack or deficiency of relevant information may create a "false sense of security" among company management despite the existence of serious security breaches.

To ensure current and valid effectiveness assessment results, compliance management must be assessed on a regular basis. 61 % of the companies that regularly assess the effectiveness of their compliance management do so at least annually. This frequency enables the company to stay up-to-date on the current status quo of its compliance management and the transfer of relevant information to the competent actors facilitates a timely reaction to identified deficiencies.

While a monthly assessment (13 %) allows more current results, the additional gains need to be measured against the increased time and cost expenditure. A multi-annual assessment (16 %), on the other hand, appears to be too liberal and therefore not adequate for a timely adjustment of a company's compliance management.

Insufficient Compliance Reporting to the Supervisory Board

The incorporation of insights from compliance management into company management requires an adequate supply of information to the company management and the supervisory organs. In almost all of the companies surveyed (97 %), compliance reporting to company management exists (see Figure 5). These compliance reports primarily address the executive board or the company management in all of these companies. However, in less than half of the companies, the supervisory board is informed through compliance reports. This raises the question of how the supervisory board is supposed to monitor the effectiveness of the compliance management in place on the basis of insufficient information.

While compliance information is reported to the decision makers in the companies, this information is withheld from those responsible for the supervision and control of corporate steering.

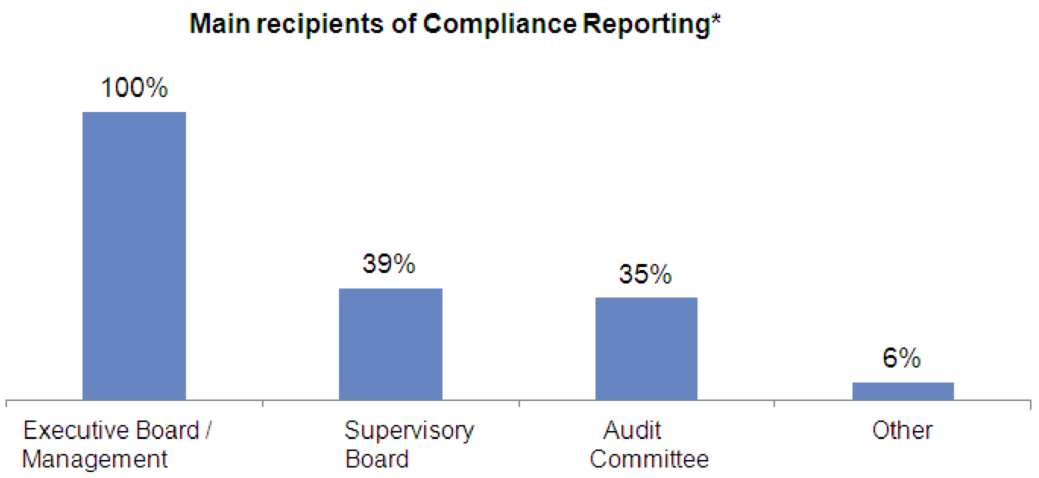

Figure 5: Main Recipients of Compliance Reporting

An effective contribution of compliance reporting to corporate decision making requires up-to-date information. When observing the frequency of reporting, it becomes apparent that the management of all companies is informed of compliance issues at least annually (see Figure 6). In individual cases, compliance reporting is even carried out on a monthly basis.

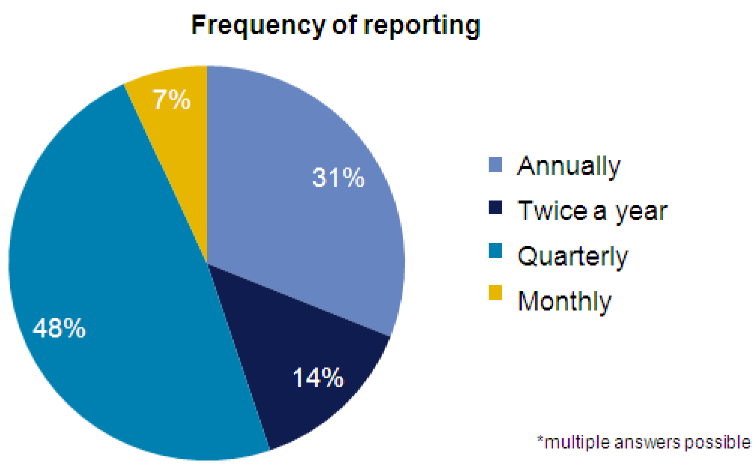

Figure 6: Frequency of Compliance Reporting

In addition to regular reporting, *ad hoc* reporting is crucial for particularly relevant or time-critical compliance information. Yet, in practice, only every second one of the companies surveyed (52 %) has defined such an *ad hoc* process. The remaining companies have not systematically ensured that the company management is informed of particularly urgent issues in a timely manner. This weakens the suitability of compliance reporting as an instrument for corporate steering.

Contents of Compliance Reporting

Once the relevant recipients and the relevance of the compliance information provided to the current situation have been examined, the actual contents of the compliance reports must be evaluated (see Figure 7).

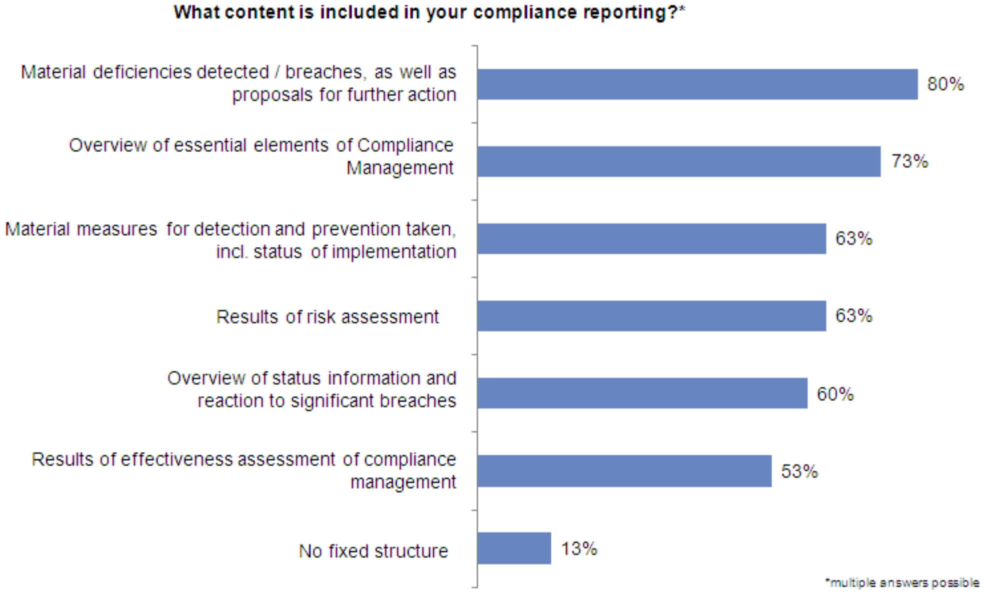

Figure 7: Contents of Compliance Reporting

73 % of the companies surveyed have their own compliance reporting system and the focus of the reports is on information about compliance incidents and the corresponding proposals for further action (80 %). It is particularly striking that only half of these companies (53 %) report on the outcome of the effectiveness assessment of compliance management. This result supports the assumption that the company management is not informed of the adequacy and functionality of compliance management in a consistent manner.

Overall, the information provided tends to relate to individual incidents and resembles an audit report, rather than management reporting. Furthermore, 13 % of the participants stated that their compliance reporting does not follow a fixed structure. Insufficient uniformity of reporting impedes the comparability and interpretation of the information provided over a period of time within these companies.

In order to meet the demand for efficient management reporting, the contents included in the compliance reports must be improved substantially. It is obvious that the authors of the reports are responsible for ensuring holistic and future-oriented reporting. However, the recipients of the reports also need to ask the right questions in order to receive the compliance information they require for corporate decision making.

Integration of Compliance Content into other Reports

Apart from dedicated compliance reports, some companies also integrate compliance information into the reports of other functional areas. This broader distribution of compliance information through its integration into “related” reports meets the requirements of inter-dependent compliance issues. It contributes to an improved overall information supply to the management with respect to compliance issues.

However, the actual picture is far from satisfactory (see Figure 8). Considering the strong orientation on audit reports and reviews, it is not surprising that the integration of compliance content is most frequently actioned in audit reports (38 %). A linkage with the risk report is not very pronounced; at present, (23 %), which highlights that compliance risks are still considered in isolation and not included in overall risk assessment. Financial and controlling reports equally show rather infrequent inclusion of compliance information. A systematic consideration of compliance issues in organisational planning can therefore not be guaranteed.

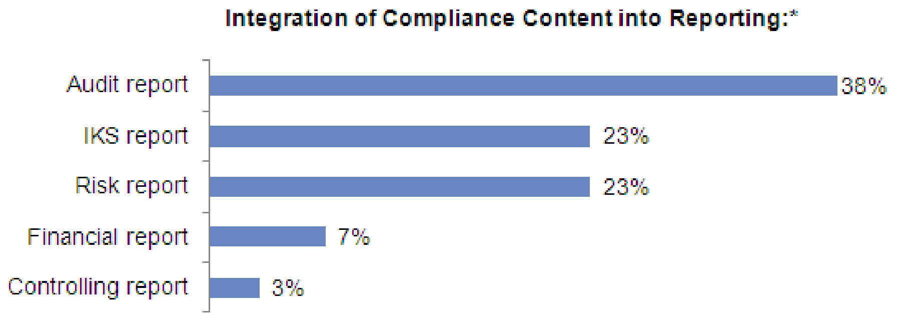

Figure 8: Integration of Compliance Content into Reporting

Outlook

The subject of compliance management has earned its rightful place in business practice. Key challenges exist in the professionalisation of compliance management in the area of tension between regulatory requirements and efficiency objectives.

The current focus of compliance management, as well as the corresponding reporting, is on the establishment of measures for the fulfilment of regulatory requirements. This also means a strong audit orientation and an isolated position in corporate reporting. Efficiency gains and utilisation of insights in the context of corporate steering are not (yet) deemed focal aspects of compliance management. These considerations would require a new approach of existing compliance reporting with an increased focus on strategic issues.

The widely debated holistic GRC management approach, which substantiates risk-oriented steering and monitoring, has not yet been established in the field of compliance. The inherent efficiency benefits of this approach can thus not be realised at present. Instead, current compliance management addresses the relevant requirements primarily through the creation and development of suitable structures and processes.

Despite promising approaches, the current status quo of compliance reporting highlights that it has a long way to go before it can become an instrument for corporate steering. It is therefore even more surprising that this issue is considered neither in the assessment of future compliance trends, nor in the current planning of compliance projects of the companies. On that basis, it remains questionable whether the results of our analysis will change in the near future.

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