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NATIONAL LABOR RELATIONS BOARD


What it has got to do with you?

Jose Klein



Compliance Management

The cost of non-compliance

 By Shyaam Sunder

Compliance, the very word could be a turn off to some as it is associated with docility. Yet system agility is the key in maintaining compliances. Businesses proudly choose words accountability, transparency, ethics etc. to establish their genuine business intent by complying with local laws and a professional culture. So, if this title turned you off and you aren't reading this article, you are not to blame. However, it seems that you are reading and so we will make it worth your time.

Compliance can actually be a delight too as it could potentially get a business organization into a club of exclusives which in turn could open out premium business opportunities and markets. Certifications such as ISO, CMM, ISAE, etc. have fit this category and businesses have complied with them exhaustively. Vendors sporting these certified approaches to service a business problem ease the head ache involved in vendor selection.

Credit rating agencies, market watchers, employment quality watchers are all eyeing the business from a compliance perspective. Given that it's the most tangible, (next to an annual report) visible, show of the quality of commitment to stakeholders, this is hardly surprising.

Broadly, compliance, to a business, can mean reporting into the law or complying to a signed contract with a client. Either way, there are details that must be presented; there is means to compliance; and finally the culture to comply.

There is complexity in compliance too. It is manifest in (a) its role in competitiveness of a business offering, (b) its mandate in respecting the statutory demands of local markets, (c) the means (technologies) adopted to compliance, (d) maintenance for posterity across business-lines with variable levels of growth and volumes, (e) product distribution channels, (f) differential tax structures along the supply chain, and (g) lastly global accounting standards and the compliance thereof.

- The decision to go multi-national was made long ago and business have since realized that localization, an important business enabler, is not a one-time effort but a continuous activity that changes in scope and scale as business complexity grows. A process foods manufacturer cannot just sport an FPO certificate to outsell competition. A consumer community could be important in taking feedback on whether a product fits a local lifestyle. The sheer variety in feedback proliferate the complexity and can often create a variety of recipes, albeit with small variations.

- In complying with the law, growing federalism implies a layered approach to comply with the federal, state, and county (or district) level demands. As an example, the need to operate out of populous metros has meant extra tax handling and reporting.

- The level of technology adoption (which could be denting an ideal level of automation in compliance), can be a problem. Some governments permit electronic filing, while others are on the way to this enablement.

- Business volumes grow too, into several trillions of dollars and many brand offerings. Maintaining compliances on several 100s of business transactions is very different than maintaining them on several 1000s in a given time frame.



- Channels are regulated differently. The Internet reduced interaction costs and created new connects in compliance.
- Compliance to the law is driven by the supply chain elements such as value add etc.; the legal borders that it cuts through, and the differences in commercials therein; etc.
- Financial and payroll statutory compliances are similar. Data is maintained for posterity. Reports are drawn up in time. Sometimes reports are maintained in multiple formats – say US GAAP standards and a local reporting standard. They stay prepared for a future where old acts (GLB say) could be revived.

The complexity is borne out in numbers too. Popular studies have shown that following:

- The cost of non-compliance is three-times the cost of compliance, typically, the magnitude of which is usually several millions of dollars. Opportunity costs are the highest in cost structure of non-compliance, followed by management overheads and others. Opportunity costs are loss of business or realization or poorer margins.
- The biggest cost of compliance is the management overhead implying that it's an activity best outsourced. Its manifest in the coming together of legal, audit, IT and other horizontal services in organizations.
- The cost of non-compliance is usually business opportunity loss. There is potentially a dip in revenue per employee, given that employees may be ignoring their core tasks in order get around a compliance requirement.

*Rougemont, a Swiss writer once wrote that, social confusion has now reached a point at which the pursuit of immorality turns out to be more exhausting than **compliance** with the old moral codes. The reader is left to imagine the context! Given the business complexities of today, the parallel is easy to see.*

In the human resources domain, compliance is two distinctive imperatives. One has to do with employees' personal income taxes and the statutory reporting. The second is behavioral – that which seeks to protect employees; creating a conducive work environment – essentially an optimality between business demands and employability. In the first category are slab based income taxes, investments that help employees get a tax break, wage floors, legal garnishments, provident fund, business expenses credits, benefit deduction credit, etc. The broad schema is largely the same across countries given the prevalence of the progressive income tax structure. Yet, the differences in the slabs, tax variables, formats in reporting etc. make it a complex construct.

In the second and more complex category, comes concept of shift rotation, minimum days off, recertification (training) and the like. Airline crews go through a lot of behavioral training. Airlines maintain compliances strictly, rotating crews and insisting that pilots' certification is renewed periodically. In security services for instance, a security guard is not allowed to go on for more than eight-nine hours and has to mandatorily work outside of their domicile. In various nations, manufacturing organizations for instance, maintain rosters that show shift patterns that workers are expected to follow and actual execution. Injury assessment reports, grievances, court cases also fall under this category. Industry and legislative region-wise there are rules to be followed and norms to be maintained.

One way to managing such compliances, (which is the main subject here) lies in understanding cost structure of compliances. The impact that it has (compliance spending) on operational leverage of an organization is also an important measure.

- Compliance is cross functional – it involves IT, the line of business, legal, internal audit, security, finance and accounting etc.
- Each of these functions bring in a distinct competency
- IT for instance enables processes that work towards compliance. IT is often the biggest cost element in compliance – perhaps due to software maintenance and reconfiguration consulting
- Scanning the environment for changes in legal environment and contracts, is another intense function. HR and Legal have a role to play and organizations are known to spend a significant amount of time in interpretation and policy creation.
- The line of business must be sensitized to the business op-

portunities that compliances can create, the costs involved and the limits that it creates. Statistically, studies have shown that 75–100% of compliance costs are absorbed by the business. They are not passed to clients. These costs can be seven per cent of the total operational costs in some industries.

- Data security and privacy is another major concern. Compliances (as mentioned earlier in this article) is best bought out as a service due to huge horizontal costs. It is not uncommon to find organizations buying the infrastructure from the cloud and even services through BPO or BPAS vendors. These vendors are able to capture cost efficiencies by repeating the same compliance process for many customers. Thus data security and privacy can be an escalated concern. Specialists are hired on contract to consult but with a majority of organizations expecting an increase in compliances and regulation, these are sure to become permanent positions – orchestrators who will work cross functional teams and vendors (service providers) to comply with.
- The importance of the F&A function cannot be understated.
- Compliance costs can be seen to affect EBIT and sure to feature in expensed out elements as well. F&A gets to see the cost elements everywhere.
- Compliances needs data feeds from F&A. Whether it is employee statement of annual earning or provident funds, the data has to come from accounting
- Regulations now require organizations with large market caps to maintain internal controls as well and audit these internal controls.
- Operational leverage is bettered when compliance are outsourced. Though vendors don't guarantee compliance, they are known largely to maintain them and are proficient in handling the costs. This last aspect pleases the F&A department.

Put simply, as with any cost structure, compliance cost has direct costs such as wages of people involved in compliances process; indirect costs such as compliance managers; infrastructure; and annualized costs such as audits, software and reporting.

There is a tendency to over rely on technology when it comes to compliances. Though processes are largely streamlined and events logically dovetail, human intervention remains a necessity, given the exceptions in the process. A healthy mix between automation and exceptions handling is achieved knowing that an upward swing in exceptions can cause an upward swing in costs to compliances. Upward swings usually occur when there are changes in regulations and / or new regulations are evolving. These can't be helped. Employee training (to maintain compliances) can be controlled. New concepts such as Gamification etc. are being employed to encourage employee understanding and agility in compliances.

Over the years the number of business transactions and the sheer variety forced us to work on concepts such as Big Data and the Grid Computing. **L&C**



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