TECHKNOWLEDGE

As practitioners in the supply chain profession, many of us have likely heard the rumblings about Sarbanes-Oxley (now referred to in the vernacular of public company discourse as "SOX"). In this installment of TECHKNOWLEDGE, we'll talk about what the Sarbanes-Oxley act of 2002 (H.R. 3763) has to do with the management of corporate supply chain operations.

Is Sarbanes-Oxley Compliance a Supply Chain Technology

Does SOX have implications for your supply chain management strategy and supply chain management technology infrastructure? Absolutely.

This article appeared in the Council of Supply Chain Management Professional's newsletter, *CSCMP Supply Chain Comment*, Volume 39, Jan./Feb. 2005. *CSCMP Supply Chain Comment* is published six times a year by CSCMP.

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WHAT IS SARBANES-OXLEY?

First, let me describe the Sarbanes-Oxley Act in abbreviated terms: Sarbanes-Oxley is Congress's response to the financial shenanigans of Enron, WorldCom, and the generally panicked hysteria that stemmed from the post-dot com bubble bursting in 2001. At its essence, this Act is a series of new rules and regulations that all publicly traded companies must comply with, effective NOW (the compliance deadline was November 15, 2004).

Congress's own language to describe the legislation is that the Act aims "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes…" Now, I'm no lawyer, but isn't the language *"and for other purposes"* just a bit vague? So, where are we now in terms of SOX compliance, and what do we need to know as supply chain professionals?

CURRENT SITUATION

Sarbanes-Oxley went into effect in June of 2003, and is only now beginning to rear its head in CFOs' offices around Corporate America. While there is a 36-page document dated January 23, 2002 issued by the 107th Congress of the United States that provides the specifics in great detail, let's just net it out for our purposes here in *Supply Chain Comment*: ***SOX Compliance is so important that the failure to get it right puts our colleagues and our bosses at risk of going to prison.***

One of the more pressing trends emerging in the nearly three years since the passage of the Sarbanes-Oxley Act of 2002 is the realization by C-suite-level executives of the *inescapability of addressing supply chain visibility and control concerns* in the SOX compliance process.

After three years of contemplation and work since the Act's passage, CFOs have come to recognize that aggregate financial numbers are only as good as the detailed operational numbers that feed into them. Thus, CFOs are now greatly interested in the non-financial business processes that manifest themselves in the balance sheet and income statement. In short, if you haven't heard from someone in your finance department yet, you will. Come to think of it, if you haven't heard from them by now, that could be cause for concern.

The primary driver of Sarbanes-Oxley becoming a focus area for supply chain professionals and the technology teams that manage supply chain operations is the language in Section 404 of the Sarbanes-Oxley Act. Section 404 is the "Management Assessment of Internal Controls" section, and essentially, it extends the reach of the legislation beyond the attestation to the accuracy of the financial reports by the CFO and CEO to also include *a sign off on the control systems* that fed those financial reports.

Furthermore, in October of 2003, the Public Company Accounting Oversight Board issued a proposed auditing standard (PCAOB; Release No, 2003-017) that brought the control and operation of business systems deeper into the crosshairs:

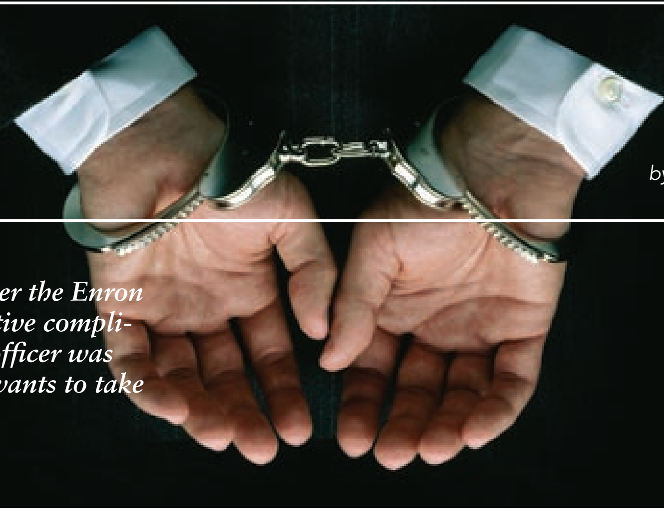
> *"…the nature and characteristics of a company's use of information technology in its information system affect the company's internal control over financial reporting."*

In layman's terms, this accounting board issued a Section 404 "gotcha" for those of us who utilize IT systems to run our busi-

"A typical cross-border shipment…changes hands more than ten times, involves completing and filing about 35 documents, interfacing with about 25 parties, and being in compliance with over 600 regulations and 500 trade agreements that are constantly changing."

—ARC Advisory Group. "Linking Supply Chain Security with Sarbanes-Oxley and The Bottom Line" (August 2004)

Initiative?



by Scott R. Sykes

The rapid death of Arthur Andersen after the Enron case has created an extremely conservative compliance environment. As one compliance officer was recently quoted, "No external auditor wants to take the starring role in Enron II."

nesses. It's the sign off on the supporting control systems, and the utilization of those systems to operate global supply chain processes that brings supply chain technology squarely into the Sarbanes-Oxley picture. As a result of SOX, public companies now must document and secure all business processes ***related*** to financial results.

So, what's the threshold test for a business process to be ***related*** to financial results?

Given the big push in business process reengineering that Corporate America went through in the 1990s, if there remains a business process today that does not at least indirectly ***relate*** to financial results, we haven't found it in my client base. What this means is that *essentially all business processes* ***relate*** *to financial results*, and thus the entire business enterprise is "in scope" for the public accounting firm auditors.

WHAT IT MEANS TO YOU

Which supply chain business processes are most in focus, and which SCM systems are finding themselves "in scope" by the compliance auditors?

The primary supply chain processes to focus on initially are order to cash and procure to pay. These two supply chain processes play directly into the Sarbanes-Oxley compliance process because they're directly tied to the primary financial flows of the business: 1) the booking of revenues and receivables, and 2) the commitments to pay vendors.

While other supply chain processes are also included in the mix, these two should be your focal point if you're just getting started. Within the realm of these two processes, the supply chain technology systems involved in executing and supporting the processes include (but are not limited to):

- order management systems
- inventory management systems
- logistics execution systems (warehousing, transportation)
- supply chain event management systems
- supply chain collaboration and visibility systems
- international trade management systems
- procurement systems
- contract management systems

The biggest challenge we, as supply chain professionals, face in supporting our companies' Sarbanes-Oxley compliance objectives is to first and foremost have a fundamental understanding of our supply chain processes. We also need to be in a position to document and articulate how and where the existing systems *support and control* those business processes. This is no small undertaking.

According to Adrian Gonzalez, director of the Logistics Executive Council at ARC Advisory Group, "Very few companies have a pure understanding of every single party that touches their products from origin to distribution point." Indeed. In my experience, even fewer companies have a pure understanding of the technology and systems utilized to monitor, control, and document those processes.

In fact, many of the SCM processes are (by design) controlled and executed by third-party firms in parts of the world where technology is not yet a primary consideration. Ultimately, the required levels of diligence and good-faith effort needed to control and document these outside (or outsourced) processes will only become fully evident over the course of time.

ACTION ITEMS FOR SCM PROFESSIONALS

Given the ambiguity we find ourselves facing, what should a proactive SCM professional do now to begin working towards Sarbanes-Oxley compliant processes and controls?

1. Do whatever it takes to pass the first test in 2004.

The most important thing for supply chain professionals and our IT counterparts to consider at this point is whether our "as-is" business processes and controls are sufficient to meet the Sarbanes-Oxley requirements as spelled out in Section 404. This section requires that your firm's public auditor "attest to, and report on, the assessment made by the management of the issuer."

In simple terms, after your firm gets a "passing grade" on the financial reports, it needs to get a "passing grade" on the systems and processes in place to control the business as well. If the financials are adequate but the underlying systems, processes, and internal controls are lacking, it'll be you and the IT team staying late and burning the midnight oil to remedy the situation.

2. Identify and prioritize the focus areas for improvement projects in 2005 and 2006.

Sarbanes-Oxley compliance will prove to be a marathon, not a sprint. Looking forward, you should organize your team to work on establishing better controls and processes as a new and critical aspect of your supply chain strategy and mission.

For instance, if one of the findings of your 2004 compliance audit is that your processes are fragmented, and that the hand offs between supporting IT systems have pitfalls, take advantage of this discovery and use the sticky situation to serve as a catalyst for making investments in a more robust business infrastructure going forward.

3. Secure a permanent seat at the SOX table for the supply chain organization.

The implications for supply chain operations stemming from Sarbanes-Oxley are only now becoming better understood. This effort will continue to evolve over the coming years, and the compliance challenges will involve the supply chain directly.

To ensure that your overall effectiveness in supply chain operations is not compromised or crippled by "compliance mandates from above," secure your seat at the table at the outset. This way, your SCM insights can be recognized and weighed on the front end of SOX-compliant process design efforts, rather than as an afterthought.

4. Deploy senior personnel for this effort.

The stakes are incredibly high in Sarbanes-Oxley compliance. Our leaders face court dates and potential prison terms if we fail to get this right. Keep in mind that a newly designed SOX-compliant business process that cripples or reverses an existing SCM business strategy has significant potential to harm the business. Global supply chain processes and business flows can be incredibly complex, and as such, demand the attention and management of your most experienced personnel. This is definitely not a part-time project for your summer interns!

To conclude, complying with the Sarbanes-Oxley Act of 2002 must be a top priority for the supply chain leadership of your company if you are publicly traded, and should not be discounted or dismissed by privately held firms (especially if you trade with public companies).

The level of effort required of you and your team will depend upon your existing IT landscape. As a rule of thumb, the more disparate software applications you currently utilize, the more effort you should anticipate investing in meeting the SOX internal controls standard.

Fortunately, there are a number of resources available to aid us in our quest to master the challenge of Sarbanes-Oxley compliance. Listed below are some of the better ones I've found for those of us in operational roles. ■

Information Resource	My Comments
www.sarbanes-oxley.com	Good general information portal on the Sarbanes-Oxley Act of 2002
www.thecomplianceconsortium.org	Good source of information from leading consulting and software vendors focused on Sarbanes-Oxley and Compliance Best Practices
www.ageoftransparency.com	Blog site of Don Tapscott, author of *The Naked Corporation* (Free Press: 2003)
www.itgi.org	The IT Governance Institute. They publish a guide called: "Control Objectives for Information and Related Technology," or (COBIT)