Global compliance

The growing challenge to global companies

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Global compliance–the need to comply with all national requirements that are critical to a company's ongoing business in foreign countries in which it has operations–has become one of the most challenging issues facing home office financial managers in U.S.-based global companies.

The difficulty of managing the global compliance of multinational companies is not new, but the subject has taken on larger importance and urgency as regulators and shareholders demand greater disclosure of deficiencies, and boards and audit committees adopt zero tolerance policies for compliance failure.

These new pressures increasingly expose weaknesses in the practices companies have long relied upon to meet less stringent standards and scrutiny. One of the greatest areas of vulnerability resides in the smaller foreign operating units which have long been treated as low priorities for U.S.-based controller and accounting staffs.

This white paper discusses the difficulties faced by U.S. financial managers in ensuring global compliance, and lays out a four-step approach for identifying and correcting compliance deficiencies in foreign operations.

Setting the stage

Many global companies have scores or even hundreds of small units scattered around the world. Historically, compliance deficiencies in these operations resulted in relatively little impact on the parent company. It has not been unusual for companies to rely wholly on foreign unit management to look after local tax, statutory audit and other regulatory compliance requirements and to intervene from the home office only when a compliance failure constituted a serious threat.

Today the legacy of this laissez-faire approach is the inability of home office financial managers to certify or provide assurance that the company is compliant in all of its foreign operating units.

With rare exceptions, U.S. parent companies have not invested the money or manager time needed to catalog the full compliance requirements applicable to their foreign operations, or to monitor whether foreign unit management is meeting these requirements. Consequently, home office financial managers often lack knowledge about what must be done in each country, when filings and reports are due, who is responsible for doing the work, whether compliance deficiencies exist, their gravity if they do and what, if anything, is being done to correct them.

The problem is compounded when only limited procedures are applied in connection with the review or audit of a small foreign subsidiary's financial statements.

While the worldwide auditor's local affiliate in the foreign country may conduct inventory observations or perform some limited agreed upon procedures, their brief time on-site and the experience level of the staff performing this work often are not adequate to reveal compliance deficiencies.

Even in those countries that require a statutory audit. the result is usually no different. With few exceptions, statutory audits are not designed to investigate or determine whether compliance deficiencies exist in the subject company.

It is not unusual for management in the company's foreign unit to further add to the problem. Foreign country managers of multinationals are well-known for putting as much distance as possible between themselves and home office management. This tendency exists to some degree in almost all companies, but takes on a new dimension if there are local compliance problems that might reflect badly on foreign country management.

As a result, home office financial management often finds itself in the dark with inadequate knowledge, no tools and no resources to judge or monitor the compliance situation in the small foreign units that can create the biggest headaches.

However, the problem of compliance deficiencies is not limited to foreign units under the control of foreign managers. Many U.S. companies attempt to perform the accounting and compliance functions of some of their small foreign units with staff located in the United States. The initial attraction of this approach is obvious. The foreign operation is too small to justify a business office staff. The company doesn't want to find and pay a local accountant in the country to do the work. Home office financial staff is available with time to spare, etc.

Unfortunately, this approach usually ends up producing some of the most serious compliance problems seen. For one thing, the U.S. staff has none of the training and preparation in local regulations enjoyed by even the most modestly skilled professionals in the country where the business unit is located. The U.S. staff struggles to find, understand and keep up with the foreign country's compliance requirements, and usually loses the battle. Furthermore, in many cases the very act of maintaining books and records off-site and of failing to maintain financial records in accordance with the foreign country's accounting standards is, in itself, a serious violation to the foreign country's regulations.

In-house attempts to assess the compliance profile of these home-office operations ends up being a case of the blind leading the blind. Finally, maintenance of the foreign operation's business records at the home office adds significantly to the difficulty and expense of expert review to assess compliance.

Defing the challenge

A small number of minor problems can be dealt with fairly easily. But the real challenge in serious global compliance management is caused by the multiplier effect. Many companies have large numbers of small units in many different jurisdictions. Each jurisdiction has its own unique set of compliance requirements and dates. The challenge of developing compliance checklists and calendars for each jurisdiction and of determining the compliance profile of each foreign unit is daunting, especially in light of tight staffing and limited dollars for travel and outside resources.

Things can become even more daunting when U.S. managers do succeed in pulling back the veil on their operations abroad. More often than not, what they find is not pretty. Compliance deficiencies in value added tax (VAT) registration and reporting are common. Even in small operations these can result in painful fines and even suspension of business.

Also quite common are errors and delinquencies in requirements pertaining to employees. These can include improprieties in the classification of employees, delinquencies or outright failures to make payments or to fund required employee welfare programs and other compliance problems that carry big fines, or worse, criminal sanctions.

Four steps to compliance

Solutions that companies must eventually put in place are not complicated, but they are tedious, time-consuming and not easily accommodated into the already busy workloads of U.S. financial staffs. Nonetheless, here is the work that has to be done.

Step 1—Develop a comprehensive compliance checklist and compliance calendar for each foreign jurisdiction in which the company has operations. This, unfortunately, is not such an easy task. U.S. financial management staff should not attempt to do this on their own, because even with the best manuals and data sources available it is nearly impossible for someone who is not a professional in the foreign jurisdiction to get it right. Don't plan to rely on your foreign company financial managers to develop this information for you, either. You may get good results from a few of them, but others will fail and you will be left with an unreliable patchwork of checklists that fails to meet your most basic needs.

By the same token, you probably won't be able to get much help from your company's worldwide auditor. Most of the largest global audit firms just aren't organized and equipped to provide ground level assistance of this nature to their clients.

The best place to go for this information is to a reputable accounting firm in the foreign jurisdiction –one that does both accounting and audit work with local companies and subsidiaries of U.S. companies and where the partners have ground level knowledge of the basic business rules in their country.

Step 2—Undertake a high level compliance assessment for each of your foreign operating units. The checklist and calendar developed in step No. 1 serve as the roadmap for compliance testing. A high-level or "red flag" review checks to determine whether or not required filings and payments are being made on a timely basis, and whether filings, records, policies and practices required by local regulation are in place. Problem areas and questionable procedures are identified and flagged for a plan of follow up and correction.

Sometimes U.S. staff can be used to carry out this assessment, but the cost of travel and the lack of real expertise regarding foreign compliance requirements generally rule against this approach. In theory, foreign unit staff can also be used, but their lack of independence and possible lack of expertise can defeat the reliability of the assessment.

The best resource is a reliable, English-speaking accountant from a reputable local firm. No more than two days of work should be needed to review and report on a small foreign unit, making this a very cost-effective approach.

Step No. 3—Prepare and implement a follow-up plan to correct compliance deficiencies. Preparation of a follow-up plan can involve a combination of U.S. financial management, foreign country financial management and outside professionals from the country. Implementation of the plan will probably be done by managers and outside professionals in the foreign country under the watchful eye of home office staff.

Step No. 4—Annual update of compliance checklist, and annual compliance plan. The first three steps described here should bring each foreign unit into substantial compliance with the country's regulatory requirements. Regulations change, so home office financial management should update the compliance checklist and calendar at least annually. Together with foreign unit financial managers, they should devise an annual compliance plan to pin responsibility and provide for reporting and monitoring so that ongoing compliance is assured, and everyone can sleep peacefully.

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