7 Bottom-Line Measures of Compliance Program Effectiveness
Introduction

When reporting on compliance program effectiveness, it can be difficult to quantify and communicate the value of investing in compliance. Yet, compliance plays a vital role in a company’s ultimate success: By keeping the company in line with legal and regulatory requirements, the compliance team enables the company to pursue its strategic goals.

But how can compliance officers communicate the successes of their programs—as well as what might have happened in the event of a compliance failure—to ensure continued financial support from the organization? Here are seven bottom-line measures you can use to convey the benefits of an effective compliance program.
Measure 1:
Background Check

To quantify the bottom-line benefits of compliance, first look within your firm. Your company may have experienced its own tough times relative to compliance. If so, pull together data on historical costs incurred from legal and regulatory violations and litigation issues—making sure to include penalties, legal and accounting fees and the time and resources spent to investigate and remediate—and use it as a benchmark to measure how the firm is doing now, and how any improvements have boosted the bottom line.

Fact check:
According to a 2013 compliance survey by Alix partners, a majority of executives (51%) say their companies increased the amount of spending on litigation during the past 12 months, with one in 10 companies involved in bet-the-company litigation in the same time frame.

Pro tip:
“If you think compliance is expensive, you should try noncompliance.”
Paul McNulty
Former Deputy Attorney General
Partner, Baker and McKenzie

Measure 2:
Cost Prevention

In addition to looking within your firm for past compliance missteps, identify specific compliance successes. If your Internal Audit team caught accounting fraud within days of its commencement, if your Environmental Health and Safety Manager identified and corrected a serious safety hazard, or if Human Resources prevented a potential retaliation event from occurring, take note. While you will likely be aware of major “catches” made by your compliance program, reach out to business unit or function heads to identify smaller compliance wins made during managers’ ordinary activity. For each compliance success you have identified, develop a dollar-value estimate of how that event would have impacted the organization. Use similar events that occurred within your company previously or at comparable firms as a guide in developing these estimates.

Fact check:
According to the Ponemon Institute, the average organizational cost of compliance is $3.5 million, while the average cost for organizations that experience non-compliance issues is nearly $9.4 million.

Measure 3:
Industry Averages

After identifying compliance achievements within your company, look at how other firms have stumbled. Details of high-profile cases of securities, labor and compliance violations—including the penalties and litigation costs incurred—can be readily obtained through news reports, and are good fodder for worst-case scenario estimates.
Industry studies are also useful for estimating average business costs tied to compliance breakdowns. For example, the Association of Certified Fraud Examiners (ACFE) estimates that the average organization loses five percent of its annual revenues to fraud, and of those organizations that fall victim to fraud, 58% had not recovered any of their losses at the time of the ACFE survey. These and other studies can be useful in establishing a frame of reference against which to compare your firm’s compliance performance, in addition to arming your team with cost/benefit data for justifying additional expenditures.

**Measure 4: The Cost of Failure**

In addition to looking at firms who have badly—and publicly—failed in their compliance efforts, consider the potential cost of fines levied by the Department of Justice (DOJ), Occupational Safety and Health Administration (OSHA), the U.S. Securities and Exchange Commission (SEC), the Environmental Protection Agency (EPA) and other agencies for regulatory violations. Information about compliance penalties and common violations can be found on agency websites and through industry sources. For example, SEC provides a list of FCPA enforcement actions by calendar year, while OSHA tracks the “Top Ten Most Frequently Cited Standards” each year, along with a running list of the top 25 highest penalties issued to date.

Apart from government fines and legal costs, compliance failures have other organizational impacts, including:

- Productivity losses as human resources are pulled away from other responsibilities to address the situation;
- Business disruption if the firm has to halt production while correcting the problem;
- Revenue losses;
- Operational costs for developing and implementing new controls and processes; and
- Potentially even insurance rate hikes.

**Fact check:**
The peripheral costs of a compliance breakdown—legal and other professional fees, employee turnover, lost business opportunities and loss of brand equity—can drastically multiply the cost of noncompliance to an organization.

**Example A:** Siemens, which settled bribery allegations with U.S. and German authorities for $1.6 billion, also tallied $1 billion in compliance, legal and accounting fees.

**Example B:** RAE Systems, when two of their Chinese joint ventures paid bribes to win business in China, paid $2.95 million in fines and penalties in addition to $4.2 million fees and expenses.
Using your knowledge of your compliance system’s strengths and gaps, as well as recent industry developments, identify several potential compliance risk scenarios your company could face. Make a list of the internal and external parties that would be affected, and if appropriate, talk with internal stakeholders about how those scenarios would impact the organization’s productivity and revenues. Doing so will enable you to reach a realistic and comprehensive estimate of organizational cost of noncompliance—in addition to informing your risk profile and compliance program priorities.

Pro tip: “It takes 20 years to build a reputation and 5 minutes to ruin it. If you think about that, you’ll do things differently.”
Warren Buffett
Chairman and CEO
Berkshire Hathaway

Measure 5: Reputational Impact

Although difficult to predict and even harder to quantify, reputational risk poses a very real threat to any company. In the case of serious legal or ethical lapses that fall under the media spotlight, the company’s very existence may be on the line. The firm may survive a government investigation, but reputational fallout from the event may shake investor, customer and employee confidence—causing investment drop-off, plummeting revenues and high employee churn.

So how can one begin to quantify the cost of reputational damage to a firm? One way to assess the bottom-line impact of reputational damage is by looking at its effect on the firm’s cost of capital. A company known to lack strong internal controls and governance is riskier for lenders and investors to do business with, and this may be reflected in the firm’s credit rating and its cost of capital. Further, studies have found that the market reacts more negatively to announcements of internal fraud than other types of operational losses, providing further justification for the investment in anti-fraud controls.

Reputational damage may also translate into revenue losses. Once news of company misconduct is splashed across the front page, customers may be hesitant to continue doing business with the firm. While such revenue impact may be more acute in some industries or situations than others, reputational damage poses a very real risk to company profits.
Measure 6: Operating Efficiencies

Operational cost savings often come hand-in-hand with the implementation of compliance activities. For example, the implementation of technology-based controls in accounting may not only reduce fraud risk but also eliminate costs from human error, such as overpayments to vendors. The same concept applies for compliance, where technology advancements have given rise to e-learning and software solutions for managing compliance risks, policies and cases—and, better yet, wholly integrated solutions that comprehensively manage these various (and historically disconnected) initiatives and reduce the exposure to human error or gaps created by data disconnects. Tally these operating efficiency gains to further build your case for the benefits of investing in compliance.

Fact check:
According to OCEG’s 2014 GRC Technology Strategy Survey, 39% of organizations adopting GRC technology are driven to reduce costs while increasing the performance of business operations.

Measure 7: Competitive Advantages

Finally, consider how your firm’s compliance program has enhanced its competitive advantage. Many companies today seek out suppliers and partners who can demonstrate they have a solid compliance program in place, and if your company’s compliance program shines, that can give your company a distinctive edge over competitors. Although you might not always know if it was your compliance program or another selling point that closed the deal, conversations with customers and business partners can help uncover whether compliance controls were a factor in their decision.

Fact check:
Firms whose employees rate their organization’s culture high on Corporate Executive Board’s Corporate Integrity Index outperformed peers by more than 16 percentage points in 10-year total shareholder return.
Conclusion

Although it can be challenging to measure the impact of compliance on your business’s bottom line, doing so enables you to more effectively make the case for continuing investment in compliance. By estimating the dollar value of your compliance program, you can help your executives, directors, shareholders and other internal and external stakeholders to better understand how the organization’s investment in compliance is paying off.

REFERENCES

[2] Ponemon
[5] Tripwire
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