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Q&A on Financial Governance Market Trends

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Financial governance is an emerging market providing technologies to improve controls, auditability, financial reporting assurance and compliance. CIOs and CFOs need to understand the impact of this market on their finance system strategies.

ANALYSIS

The financial governance market focuses on applications to improve governance, risk and compliance (GRC) initiatives in the office of finance. Although ERP and corporate performance management (CPM) applications focus on financial transactions and performance management, respectively, financial governance applications provide management capabilities that target process efficiency improvements/opportunities in financial controls, auditability, financial close management, related compliance initiatives, and financial and regulatory reporting assurance.

The following issues are at the forefront of our clients' minds concerning financial governance.

We have ERP and CPM applications in our company. Why do we need financial governance applications? Aren't the capabilities of financial governance built into these products?

Although some financial governance capabilities are built into ERP and CPM applications, they may not be sufficient. When compared with the functionality in newer technology solutions, these applications may not have enough functionality to provide financial governance. For example, consider the following cases:

- ERP controls in financial management processes are present in ERP solutions, but these are primarily at the transaction and budget control levels. There are fewer higher-level controls built in that consider groups of transactions, such as the number of checks paid to a vendor in a specified time period.
- Analytical audit controls that span feeder applications and general ledgers (GLs) to catch inconsistencies in how data is passed and transformed from one application/process to the next typically are not built into ERP solutions because these activities are outside the ERP system's control. These controls can continuously monitor the quality of the financial data and not just be performed during an audit.
- Financial analytics are typically not strong in ERP solutions and usually require additional investments in business intelligence (BI) reporting tools or analytics geared to a specific domain set of transactions or balances, such as GL or accounts payable (see "Using CPM and BI to Improve Compliance Initiatives").
- CPM solutions typically focus on the execution of business plans to metrics and specific targets. Although data quality and governance capabilities exist, they usually do not offer financial governance functionality. All CPM solutions have financial analytics, but they don't have much else that a financial governance solution needs. Some vendors are bundling CPM with some elements of financial governance to create a new industry term called "financial performance management"; however, this mixes two related, yet distinct, disciplines — performance management and financial governance. Financial governance solutions contain transaction management and reconciliation capabilities that are outside the realm of CPM.
- CPM solutions usually lack sufficient process management capabilities to effectively enable the "last mile of finance" (see "Taking a Holistic Approach to the Last Mile of the Financial Close"). Additional financial process management tools are required for all the closing activities in the financial consolidation system, as well as the offline processes in other solutions, such as CRM. Solutions for financial process management should not

just be in the post-GL process. Rather, they need to be integrated across the financial management spectrum.

What compliance challenges are finance organizations facing, and how can financial governance help?

The typical enterprise response to compliance initiatives, such as Sarbanes-Oxley (SOX), was to spend too much money on manual processes to run adjacent to automated systems, while the technology investment went to security and other IT initiatives. The biggest investment made in the finance area for compliance has been in the proliferation of Microsoft Excel in the financial organization, and why not? Excel isn't expensive to deploy, has many clever finance-types that are at the expert or "legendary" level, can be deployed without the help of the IT organization (which, according to finance, can't act quickly enough to meet compliance demands) and can get in place quickly. To avoid "material weaknesses" during audits, companies built up an arsenal of Excel patches in addition to ancillary manual processes to document and prove financial controls. Still, many companies report material weaknesses and significant deficiencies in internal controls.

The majority of compliance issues have not been met, and a seemingly endless stream of new rules and regulations require attention. In 2008, for example, the tax area has been a big focus (such as FIN 48) in the U.S. Internationally, there are SOX-like regulations in Japan, Europe and Canada (see "SOX and 'EuroSOX' Are as Similar as They Are Different"). At the same time, many organizations took SOX too far, have too many key controls to manage and are looking to streamline what is in place. Many companies have done a lot of things right but do not have an internal control system to protect the integrity of financial reporting. The current debate on the shift from U.S. generally accepted accounting principles to International Financial Reporting Standards will be a compliance issue should U.S. companies be allowed to choose which to use in the future. The impact of compliance on financial processes will be significant based on our conversations with CFOs and financial professionals.

What are the five best practices in financial governance? Is there a general approach that is recommended?

Financial governance is an emerging market, so the best practices related to its implementation are also emerging. Many companies select components to address a particular painpoint, and then realize that they have chosen a more tactical than strategic route. We have observed the following best practices in the market:

- **Take a holistic approach to compliance.** Global finance organizations will face a range of financial compliance regulations. Consider current and future exposure from a regulator compliance perspective. Many of the financially focused regulations will be concerned with creating financial statements, and the controls and assurance processes around them.

- **Although Excel is affordable, understand technology alternatives.** As mentioned earlier, Excel has been used extensively to address compliance requirements, such as creating offline reconciliations and financial reporting, and documenting financial controls. Understand the total cost of ownership to maintain these processes in addition to manual processes, in the compliance ecosystem, because many of the costs are indirect and not always obvious. Excel appears affordable, but it requires a lot of manual support and is error-prone. Financial governance is better in all aspects and is the *right* technology alternative.

- **Leverage a financial governance suite where possible.** Gartner has identified eight components of the financial governance market (see "Financial Governance Will Emerge to Enhance Financial Controls and Regulatory Reporting"), and it is possible to tactically choose point solutions for much of this functionality. It is unlikely that one vendor will provide all the components; however, more vendors are addressing multiple components, as evidenced by ERP-based offerings from SAP and Oracle, the acquisition of Movaris by Trintech and the gradual development of partnerships among point-solution vendors. Suite-based offerings will reduce the need for multiple user interfaces, limit inconsistent master data management and, potentially, reduce the overall cost of technology for financial governance.

- **Take advantage of financial governance components in CPM and ERP suites.** All financial governance components require integration to other financial management systems, such as CPM and ERP. It is unlikely that you will be able to buy all components from one vendor. Financial controls integrated with ERP suites should be leveraged, where possible. Financial consolidation applications from CPM suites, such as SAP and Oracle-Hyperion, should also be leveraged. Financial analytics from BI and CPM vendors, such as SAP and Cognos, can provide solid solutions to understand the quality of the results and improve financial governance.

- **Ensure that there is an effective finance and IT partnership.** Finance is often enamored with new technologies and perceives the IT organization as being slow to change. Excel-based financial governance proliferation is often the evidence of a lack of partnership between the finance and IT organizations. These two parties must effectively partner to understand how to leverage technology to reduce costs and improve governance. This may mean selecting solutions from vendors other than the vendor that implemented the enterprise's ERP suite. It may also mean leveraging more of the components from the ERP vendor. Whatever the balance may be between ERP and non-ERP solutions, finance and IT must ensure that they are in sync to select the best strategic approach to this emerging market. A financial governance solution should be in harmony with the selected enterprise GRC platform.

How does financial governance coexist with an enterprise GRC platform?

The enterprise GRC (EGRC) platform is focused on providing GRC capabilities across the enterprise in a multiregulation, multidiscipline, global approach (see "The Enterprise Governance, Risk and Compliance Platform Defined"). The EGRC will have multiple constituents with focused needs. The evolution of the market shows that the EGRC focuses more on risk and targets the chief risk officer. Financial governance is a cut of the EGRC that is focused on finance. The CFO must work with the chief risk officer to ensure that these two initiatives are complementary. Companies that have an EGRC strategy will need to ensure that financial governance components and suites are selected that are consistent with this platform.

How will the financial governance market develop?

Although financial governance is an emerging market, significant momentum can be observed on the end-user and vendor sides. It is a fragmented market and has not universally evolved into standard suite-based offerings. The entry of new financial governance vendors and solutions is dynamic, so the market will continue to develop. Many professional service organizations will build customized solutions, such as reconciliations, that may come to market with real applications at some point.

During the next three to eight years, the financial governance market will consolidate into large ERP and platform vendors, such as IBM, Microsoft, Oracle and SAP. This will occur much faster than the adoption of these solutions by end-user organizations. Organizations should monitor this activity and balance tactical solution requirements with more-strategic and holistic requirements. Make tactical selections based on a three-to-five-year payback and revisit these decisions in that time frame. By then, there will be more-mature solutions from the larger vendors. By 2012, financial governance will have emerged as a critical management pillar of financial management applications. ERP vendors will combine CPM and EGRC platforms, and add modules for financial governance, including modules from financial governance independent software vendors. Service providers will offer financial governance as part of financial business process outsourcing.

Which vendors cover the financial governance market?

The financial governance market is developing. While best-of-breed applications attempt to target specific pain points, some suite-based solutions are emerging. ERP vendors are beginning to accumulate many of the components in the office of finance, and CPM vendors have consolidation solutions and are considering expanding beyond core CPM components. Organizations should choose point solutions where they can achieve pragmatic value to improve financial governance initiatives. The financial governance market is comprised of best-of-breed, ERP, CPM and BI vendors. Table 1 shows a representative sampling of the vendors (this is not meant to be totally inclusive).

Table 1. Sample Listing of Vendors Providing Financial Governance Capabilities

Component	CPM Vendors	Financial Governance Specialists
Financial Consolidations and Reporting	All CPM vendors	None
Interentity Transaction Management	ERP vendors (Lawson, Oracle and SAP)	None
Reconciliation Management	Most offer intercompany reconciliations only	BlackLine, Chesepeake System Solutions and Trintech
Financial Controls and Compliance	ERP vendors (Lawson, Oracle and SAP) Some CPM vendors considering offerings	170 Systems, Achiever Business Solutions, Archer Technologies, Axentis, BWise, Cura, Mega International, Methodware, MetricStream, OpenPages, Paisley, Protiviti and Qumas
Financial Close Management	Oracle and SAP Some CPM vendors considering offerings	Trintech
Access Controls, Segregation of Duties	Oracle and SAP	ACL Services, Approva and Oversight Systems
Financial Risk Management	SAP and SAS	Algorithmics
Financial and Audit Analytics	Cognos, Oracle and SAP	ACL, CaseWare IDEA and Oversight

Source: Gartner (April 2008)

Why are financial consolidation applications in CPM and financial governance markets?

Financial consolidations are used for management and regulatory/external consolidation requirements. In the context of CPM, financial consolidation applications create the consolidated view of financial results that are a crucial part of a BI and performance management strategy. BI tools cannot deliver this capability, so financial consolidation suites will continue to be an important part of CPM functionality. However, financial consolidation applications are an important part of financial governance because they provide governance over the financial reporting process. They are also an important component of financial governance because they provide a controlled, auditable and visible environment for assurance during financial statement preparation. Financial consolidation applications serve the same function in CPM suites, where they are a staple application of performance.

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