Sarbanes-Oxley Compliance for the Commercial Real Estate Industry

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Build fortunes, not spreadsheets.

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Introduction

With the passing of the Sarbanes-Oxley Act in 2002, public corporations and the companies that support them are being held to a higher standard of accountability. Simple disclosure of financial results is no longer sufficient proof for the SEC. Without documented monitoring and reporting procedures that ensure data integrity, executives will be held personally liable for mistakes even if the financials are accurate to the "best of their knowledge."

Section 302 of the Act states that C-level executives must now certify accuracy and completeness of the financial statements, and under Section 404, for all companies with year-ends after June 15, 2004, management must issue an annual internal control report that assures investors that there were effective controls over their operations and financial reporting processes. This report must be signed by management and the independent accountants.

These new regulations will have a widespread impact on the commercial real estate industry, and not just for public REITs. Any real estate company that manages assets or business processes on behalf of a publicly-traded trust, corporation, or financial institution will be called upon by their clients to review, document and monitor each of their internal processes and applications to ensure that effective controls exist to prevent and detect errors or fraud.

Sarbanes-Oxley (SOX) requires that companies identify significant deficiencies across various locations and reporting units that alone or in aggregate may represent a material weakness. This requirement is particularly troublesome for real estate companies that, in effect, serve as fiduciaries on behalf of dozens, hundreds or even thousands of standalone operating entities distributed throughout the country. This problem is further compounded for asset service and facilities management providers in particular that use multiple financial systems and business processes to mange the transactions that support the financial statements.

Most institutions have implemented zone financial systems that provide a level of automated controls. These controls typically include role-based security, transaction audit trails from A/P and A/R to G/L, and limits on deleting and changing data. These controls are also typically focused on accounting personnel and address only certain portions of a business process (i.e. entering a voucher and cutting a check for services previously procured and provided).

Although some companies will only do the bare minimum to document and enhance internal controls for compliance, some companies are using Sarbanes-Oxley as an opportunity to improve their processes and create competitive advantages. To this extent, the traditional processes and create competitive advantages. To this extent, the traditional processes that constitute critical financial functions such as accounts receivable and accounts payable have now become areas of particular focus for senior manages and auditors. Companies seeking to comply with SOX regulations have discovered that these distributed, highly manual processes are exposed for their high potential for error and loose controls, and are prime candidates for consolidation and improvement.

That's where the intimidating task of meeting SOX compliance has a bright side. For those companies willing to take the SOX challenge and turn it into an opportunity, there has never been a better reason to explore alternative solutions that not only help to meet compliance, but reduce non-recoverable costs through the delivery of improved operating efficiencies.

Understanding Sarbanes-Oxley Compliance

SOX Section 404 compliance begins with the meticulous evaluation of all process, transaction and application level controls that are material to a company's business. These controls, inclusive of information technologies, must be supported by documentation that clearly indicates how they are structured to prevent or detect errors and fraud.

Oddly enough, there are no specific SEC guidelines published so far for internal control. One existing standard, COSO ("Committee of Sponsoring Organizations" of the Treadway Commission), is a generally accepted baseline developed in the 1980's that companies have recommended to the SEC for adoption, COSO is simply an internal control framework used for measuring the effectiveness of operations.

Technology and Compliance

When evaluating existing technology and considering new technology, many questions arise. How much reengineering of my existing business processes will be required for SOX? To what extent should we take advantage of SOX requirements and replace existing processes with systematic processes/technology that enable SOX compliance? If we implement a technology, will it create additional chaos with reporting and monitoring requirements?

Companies that have acquired other companies or inherited multiple management processes with their portfolios will face increased documentation challenges as well as regulatory scrutiny.

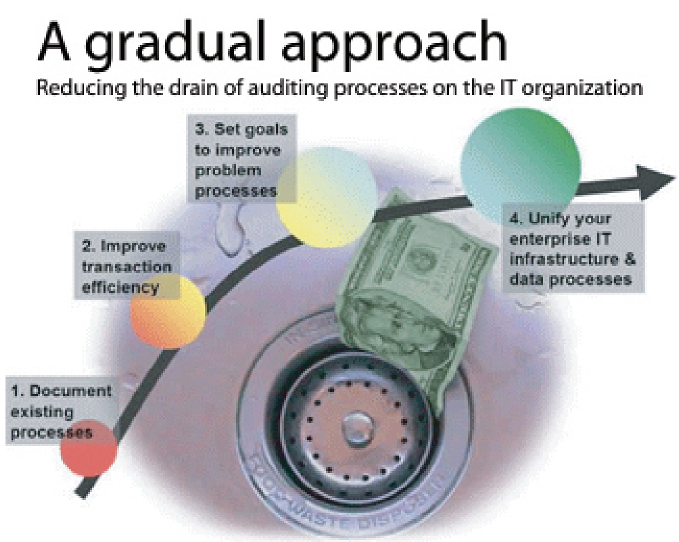
Improving the software that supports business processes can ultimately reduce the level of work required for SOX compliance. Here's how:

1. **Documentation.** Check with the vendor. If the process for using and monitoring the software is well documented, the SOX team already has a head start on compliance for that part of the IT infrastructure, compared to documenting an existing, or manual process.
2. **Consistency.** Replacing a manual process with a consistent, repeatable one across multiple business units reduces the number of different business processes that must be documented and monitored on an ongoing basis.
3. **Reliability.** Providing a secure environment that documents every transaction and every change produces more reliable documentation and improves the accuracy of the audit trail.

4. **Workflow.** If the software enables a workflow process, such as the automated processing of invoice payments, a company is able to ensure that transactions follow the same workflows without deviation, as workflows will be systematically defined by configuration.

Despite these benefits, many executives will be hesitant to change any technology that could impact a business process. But holding off on IT improvements simply because of SOX requirements is like freezing the competitive progress of your business. If you can't change anything this year, what year do you want to start realizing benefits?

Ultimately, the real reason for making sure your IT environment has the proper controls in place is to ensure a more fiscally responsible business. Supporting a SOX review with the best possible data and systems will uncover flaws that would have remained undetected in a "good enough" system. It can become a real flashpoint for improving your business processes in the current year and years to come.



As shown above, the best way to achieve compliance without sapping your personnel resources is to make gradual improvements. Logical places to start achieving better efficiencies and controls are in collections and payables processes.

ARGUS Software's Efforts to Support SOX

ARGUS Software™ understands the Sarbanes-Oxley regulatory implications for real estate corporations – through successful implementations and process changes at hundreds of leading real estate companies and public trusts.

However, it is important to understand that there is no "automatic SOX compliance" software solution on the market today – beware of vendors claiming they can automate responsible corporate governance!

We recommend a gradual "stepped" implementation approach for new customers that are under the gun to achieve a successful audit while striving to improve business processes. As an example, many ARGUS Software customers have started with the cash flow function through the implementation of COLLECT and PAY, automated solutions for the collection of rent and the processing of invoices. These companies are leveraging process and cost improvements while integrating ARGUS Software's process documentation into their reports. Tighter controls for incoming and outgoing cash are just the first step toward reliable accounting procedures.

Due diligence on any significant acquisition or disposition calls for an ARGUS Valuation – DCF™ file as part of the process. You need to reflect significant A&D information on your annual reports. CONNECT integration enables companies to move date into ARGUS Valuation – DCF directly from most property management systems.

On the operational side, ARGUS Property Management™ customers who outsource their property management to ARGUS Software's ASP (application Service Provider) environment can leverage the Statement on Auditing Standards No. 70 (SAS 70) report that will be produced annually beginning in 2004. This report will document and test many general and IT related controls that are part of the ASP by nature – making this deployment option a primary component of a customer's control environment. Related solutions such as ARGUS Lease CRM™ for managing leasing processes, and ARGUS Insight Reporting™ for customized reporting across ARGUS Property Management™ and other data, positively impact the performance of your business by providing faster access to key information and reducing the time required for annual audits.

ARGUS Software's ARGUS Property Budget™ and ARGUS Asset Management™ solutions lay bare the 12-month and 10-year strategic plans for the real estate enterprise, making the complex task of reconciling expectations to results for annual reports simple.

Having security and controls inherent in the system is a drastic improvement over spreadsheets. Fundamentally, when you improve the transparency of your real estate data, it generates improvements in data integrity, and will reduce the time to audit review when compared to manual review and rekeying. So while no solution is effortless to achieve and monitor, the benefits and ease of use increase with each year.

Whatever solutions you put in place, don't just spend resources preparing for a grim audit. SOX can be a catalyst for change that creates a great deal of enterprise value in better data reliability, documented controls and improved efficiencies.

"Firms with decentralized or property-based accounting operations are potentially more susceptible to control and compliance issues. As such, there is likely to be a shift to centralizing critical processes into a more standardized and controlled environment."

Bernhard Wagener
President
Wagener Consulting

Conclusion

Sarbanes-Oxley, coupled with maturing workflow technologies, will encourage many real estate companies to automate greater portions of their business processes. This automation will allow:

- Improved standardizations of processes inherent, in automation
- Comprehensive audit trails for an entire business process
- Better control of reporting and analysis

Thus, while reducing the opportunities for risk in the business process. SOX-enabling technologies also create a platform to efficiently demonstrate and analyze the automated control points. As a result, executive and auditors will have greater and simplified visibility into how work is being completed.

Next Steps

At a recent ISACA roundtable featuring representatives from some of the top accounting and consulting firms, it was generally agreed that there is a major shortage of business talent within companies that have the capacity to bridge IT requirements and financial processes. This resource shortage is even more evident within many real estate companies.

Thriving through a SOX cycle rather than suffering through it will require tech-savvy C-level executives who understand the value of improved controls. CIOs and managers who do not understand how manual, inconsistent business and IT processes can impact the financials will not be able to compete with other, more insightful companies.

So what should you do next?

1. Establish a project team with buy-in at the C-level to ensure that your company tracks and meets the emerging standards of Sarbanes-Oxley.
2. Network with your technology peers in similar real estate organizations, both through personal contacts and industry events such as FUSION.
3. Explore and implement financial technologies that will gradually increase the transparency and monitoring of your financial process.
4. Measure and realize the ancillary business benefits of improved process control.

If you have any questions about how ARGUS Software solutions and experienced services can help your company turn the Sarbanes-Oxley worry into an opportunity for improved processes, we invite you to contact us.