



SECTION - 7

EMERGING TRENDS IN FINANCIAL REPORTING

This Section includes

- **The actual state vs. the desirable state**
- **Information Overload**
- **Emerging Trends in Financial Reporting**

7.1. THE ACTUAL STATE VS. THE DESIRABLE STATE

- 7.1.1 Management Information System (MIS) has gained tremendous importance over a period of time in the world of corporate finance. In the past, thick monthly reports to management were the norm. There are still some companies who believe in quantity over quality. In many companies, managers and executives are drowning in data. The finance team foists reams of information on them every month, churning out huge reports stuffed with rows and columns of numbers. It is like a data dump.
- 7.1.2 Finance executives basically report everything, giving other executives 40 or more PowerPoint slides, full of tables, thousands of numbers, and expecting them to pick out key messages and key information. It is generally too much to take on board.
- 7.1.3 The internal reporting process needs to be overhauled, stripping out “irrelevant” details to focus on “what really drives the business.” The need of the hour for the corporate analysis team is to produce a slim booklet and the data contained inside more focused, more graphical and more colorful, with major deviations against budgeted targets marked in green (favourable) and red (adverse). The non-financial data and reports should include metrics on operational efficiency and customer satisfaction, along with progress updates on groupwise initiatives such as the implementation of Customer Relationship Management (CRM) software and supply chain rationalization, among other things.
- 7.1.4 If this kind of more streamlined, targeted way of reporting is practised, management committee and board meetings will be more productive. The top management can focus not only on understanding and highlighting the relevant issues, but can also discuss the action plan.
- 7.1.5 Ultimately, organizations should adopt a more “interactive” model of management reporting. They should move financial data out of the general ledger into a data warehouse, putting the onus on managers and executives themselves to sift the data and create their own customized reports and “what if” analyses. That way, all that will be left to be circulated on a monthly basis will be a standard top layer of information — “the bare essentials.”



- 7.1.6 This vision is shared by plenty of finance executives around the world. Many, in fact, have already spent time and money addressing it, investing in business intelligence or performance management software from the likes of Cognos, Hyperion and SAS. “By giving managers the option of access to much more data on their own systems, you don’t have to have such a voluminous package on a monthly basis,” says Daniel Bednar, deputy CFO of Bureau Veritas, a •1.4 billion inspection and testing agency based in Paris, which rolled out a SAS Information Delivery Portal in 2001.
- 7.1.7 “The role of finance should not be simply to consolidate and report the numbers, but to help people understand what is going on in the business and make the right decisions”.

7.2. INFORMATION OVERLOAD

- 7.2.1 Of course, improving decision-making is the *raison d’être* of management reporting. As a core competence of the finance division, it is up at the top along with matching costs against revenue and ensuring that taxes are paid.
- 7.2.2 However, it is surprising how often the process goes awry. Once companies have gone through improvements such as standardizing data, for example, by agreeing simple definitions of operating profit throughout the group, many stop there and end up producing monthly reports that are mere “memorandums of data”.
- 7.2.3 Even with the recent proliferation of software tools that allow managers to do much of the number crunching themselves, management reports remain stubbornly thick and unwieldy. According to a survey of 400 large companies worldwide undertaken recently, finance teams report an average of 132 metrics to senior management each month. That is far too many. “Most management reporting has become a function of the data that is available, rather than the information that is actually needed”.
- 7.2.4 What’s more, such reporting tends to put too much emphasis on historical financial performance: in the sample cited above, 83 metrics were financial and 49 operational. The preponderance of financial measures is to be expected as it is what finance understands best and what it’s most comfortable with. But that doesn’t necessarily help managers who could use better insights into trends and exceptions within their businesses. In addition, the cost of preparing, analyzing and checking this information is often a major burden on finance.
- 7.2.5 The reporting also has to be standardized for a time period and the reporter/ reportee link also to be properly established. Too much of tinkering and doing it too frequently would defeat the whole purpose.

7.3. EMERGING TRENDS IN FINANCIAL REPORTING

- 7.3.1 Even with this push to pare down data and to give managers the ability to produce their own reports, monthly reporting won't become extinct. There will always be a need for actionable, summary-level information.
- 7.3.2 The summary of a report titled "Financial Reporting Supply Chain", brought out recently by the International Federation of accountants is quite illuminating and is appended at the end of the chapter.

The Numbers Game:

Unilever:

This the reason, for example, why the finance team at Unilever are making efforts to cut down the volume of data produced, while putting more weight on forward-looking internal and external metrics such as regional sales forecasts, market share, competitor pricing and broader economic indicators. They have pioneered this new approach to support their growth agenda while giving the executives interactive analysis capabilities, providing a common approach to financial analysis and also communication.

Unilever used a tool from a U.K. vendor, Metapraxis, Empower.NET, now, each month the managing director and CFO of each country receive a simple, ten slide executive summary that doubles as an interactive dashboard, through which information can be filtered and personalized. What was once a thick, static batch of reports is now stated to be lean and dynamic. It has become a one-stop shop for information, a way for senior managers to find all relevant strategic and tactical information in a standardized format.

There have been other benefits too, not least in speed — consolidated regional data is now reported up to group level in four days, down from eight — and the information gathering burden on the regional finance staff is lighter.

Magyar Telekom:

When it comes to the distillation of key performance data, however, few finance executives can match the record of Klaus Hartmann, CFO of Magyar Telekom, the HUF604 billion (\$2.92 billion) Hungarian telecom firm formerly known as Matáv.

Like its parent, Deutsche Telekom, the company uses SAP's Business Information Warehouse, the data warehousing core of mySAP Business Intelligence, that enables managers to process large amounts of operational and historical data according to their own needs. But that wasn't installed until January of this year. When Hartmann arrived at the firm in November 2000, finance was going to town with a string of hefty, standardized reports. Complaints from the executive committee soon echoed in his ears. " 'We're being killed by too many reports,' they told me. 'It's hard to read them all and find which ones are essential.' "



So Hartmann set himself an ambitious target: to condense key monthly financial and non-financial data into a single sheet of double-sided A4 paper. For a while the experiment succeeded, but after a few complaints of strained eyes Hartmann relented, switching to a three-page summary using a larger type size. The document includes income statements for all four lines of business — fixed line, mobile services, data services and internet services — showing variance against forecasts; a group cash flow statement; a full capex breakdown; and key operational data such as tariffs and minutes of usage. In PowerPoint format, the presentation runs to around a dozen slides, but the three-page hard copy is still in use today, despite a groupwide move away from paper-based reporting. As Hartmann observes, “some people like to have something in their hands, a document they can leaf through.”

FINANCIAL REPORTING SUPPLY CHAIN

Current perspective and directions

SUMMARY OF KEY FINDINGS

In recent years, there have been significant efforts to change and improve financial reporting. What is the result of these change? Has the financial reports process become better or worse? Have the financial reports become more or less relevant, reliable and understandable? What should be done next? The International Federation of Accountants (IFAC) commissioned an independent global survey of the participants in the financial reporting supply chain to get feedback on these questions. In June and July 2007, the survey group conducted a global survey that yielded 341 responses from around the world and from all parts of the financial

reporting supply chain, including users, preparers, auditors, standard setters and regulators. The survey group also conducted 25 telephone interviews from August to October 2007. This report is based on the findings of the global survey and interviews, as well as on additional research.

Participants in the survey and interviews were asked about their opinions on four areas of financial reporting supply chain:

Corporate governance, the financial reporting process, the audit of financial reports and the usefulness of financial reports. Below is a brief overview of the findings that are discussed in more detail in the report.



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Survey Results on Corporate Governance

Corporate Governance has improved and the balance between costs and benefits has become better. (See page 11.)

POSITIVES

- Increased awareness that good governance counts
- New codes and standards
- Improved board structure
- Improved risk management and internal control
- Increased disclosure and transparency

AREAS OF CONCERN

- Governance in name but not in spirit
- Development of a checklist mentality
- Overregulation
- Personal risk and liability for directors and management

FURTHER IMPROVEMENTS

- Continue to focus on behavioral and cultural aspects of Governance
- Review existing rules
- Further Improve quality of directors
- Better relate remuneration to performance
- Expand view from compliance Governance to business Governance

FINANCIAL STRATEGY

Survey Results on the Financial Reporting Process

The financial reporting process has improved and balance between cost and benefits is about the same. (See page 16.)

POSITIVES

- Convergence to a single set of global financial reporting standards.
- Improvements to regulations and oversight
- Board of directors/management taking ownership of financial reporting
- Improved internal control over financial reporting systems
- Improved technology for preparing financial reports

AREAS OF CONCERN

- Transition to International Financial Reporting Standards (IFRS)
- Complying/reconciling accounts to different financial reporting standards
- Complexity of financial reporting standards
- Liability restricting process

FURTHER IMPROVEMENTS

- Continue convergence to one set of financial reporting standards
- Simplify and clarify financial reporting standards - more principles and fewer rules
- Ensure that boards of directors pay attention to quality of financial reports
- Provide additional education and training for preparers

Survey Results on the Audit of Financial Reports

The audit of financial reports has improved and balance between costs and benefits is about the same. (See page 22.)

POSITIVES

- Improved auditing standards and processes
- Increased awareness, commitment and competence of auditors and audit committees
- More risk-focused audits
- Greater auditor independence
- Improved quality review and auditor oversight

AREAS OF CONCERN

- Reduced scope for professional judgment
- Overregulation
- Liability fear leading to boilerplate audits and lack of innovation
- Liability auditor's communication with external stakeholders
- Limited choice of audit firms
- Increased audit cost relative to perceived benefits

FURTHER IMPROVEMENTS

- Continue to focus on independence, objectivity and integrity
- Converge to one set of global, principals-based auditing standards over time
- Ensure consistent use of audit standards and safeguarding of quality within audit firms
- Improve auditor's Communication, both internally and externally
- Consider limited/proportionate liability for auditors
- Remove barriers that limit choice of auditor

Survey Results on Usefulness of Financial Reports

The relevance and reliability of financial reports have improved, but the understandability of financial reports has not improved. Respondents preferred annual reports to real time or monthly information, found analyst presentations useful, and would like to have more business-driven information. The survey also showed mixed results about the usefulness of XBRL. In addition, paper financial reports remain useful. (See page 28)

POSITIVES	AREAS OF CONCERN
• Better financial information due to improved standards, regulation and oversight • More disclosure and comparability in financial reports • Improved reliability • Increased emphasis on narrative reporting • Easier access to financial information	• Reduced usefulness due to complexity • Focus by companies on compliance instead of essence of the business • Regulatory disclosure overload • Use of fair value • Difficult and often changing financial reporting standards • Lack of forward looking information
FURTHER IMPROVEMENTS	
• Improve communication within the financial reporting supply chain • Include more business-driven information in financial reports • Better align internal and external reporting • Improve users' access to electronic data, for example, XBRL • Encourage short-form reporting focusing on the material issues	

Next Steps

The results of this survey are clear. Participants feel that the three key areas of the financial reporting supply chain—corporate Governance, the process of preparing financial reports and the audit of financial reports—have clearly improved in the last five years. Unfortunately, however, they do not feel that the products of this supply chain, the financial reports, have become more useful to them. To resolve this situation, there needs to be continuing effort made by all participants to discuss and debate the purpose and objectives of financial reporting so that the information that is reported best suits the information needs of the wide range of users.



Better Performance Reporting and Analysis

Increasingly, finance and business unit managers are seeking to respond to threats and opportunities more quickly and to reallocate resources more authoritatively and dynamically.

Sam Knox and Celina Rogers, CFO Research Services February 21, 2006

A forward-looking and analytical view — the ability to conduct what-if analyses, for example — goes to the heart of much of what finance and business unit managers need to manage their companies amid increasing competition, regulatory oversight, and higher investor and board expectations. Executives need to be able to report timely, accurate data on historical performance, to be sure.

Increasingly, however, finance and business unit managers seek to respond to threats and opportunities more quickly and to reallocate resources more authoritatively and dynamically.

In this study, we sought to explore finance executives' views on their ability to report and analyze financial information. What do their companies do well? Which stakeholders are well- or ill-served with information and analysis tools? And what barriers do companies face when trying to improve their financial reporting and analysis capabilities?

In addition, we wanted to understand how executives' views on these and other matters vary according to their companies' strategy for finance systems technology — that is, do companies that have invested aggressively have different views on their ability to gather, report, and analyze information?

To gauge finance executives' opinions on these topics, CFO Research executed an electronic survey to readers of *CFO* magazine in November 2005. Our research program gathered a total of 164 responses from senior finance executives — more than half of whom work for companies with \$1 billion or more in annual revenue. Our solicitation to participate in the survey was focused on senior finance executives and, as a result, respondents' titles are typically chief financial officer (30 percent), vice president or director of finance (33 percent), and controller (16 percent). Respondents come from a broad cross-section of industries, with the manufacturing, financial services, consumer products, and wholesale/retail trade industries particularly well represented.

Queried on their satisfaction with the ability of their finance teams to execute a list of reporting and analysis activities, senior finance executives say they are broadly satisfied with their teams' performance. Fully 86 percent of respondents are somewhat or very satisfied with their transaction-processing capabilities, and nearly 80 percent of respondents express this view of their external reporting and regulatory compliance capabilities. It seems clear from this data that companies' investments over the last several years in basic financial management technology and process improvements have paid off.

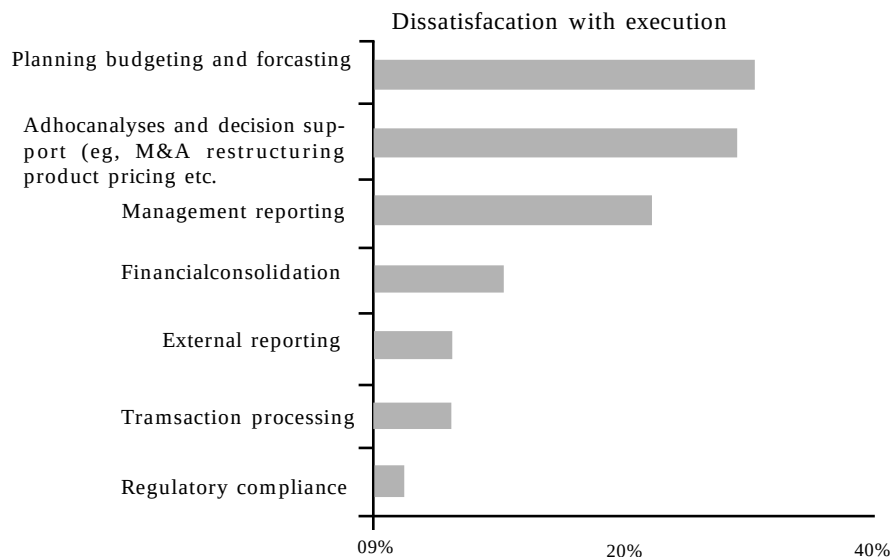
But management reporting and the elements most closely tied to a company's ability to plan and execute company strategy are rated less favorably by survey respondents. As shown in Figure 1, respondents express greatest dissatisfaction with their abilities to plan, budget, and

forecast, to conduct ad hoc analyses, and to support business decisions such as M&A restructuring, product pricing, and so on.

These results are wholly in line with recent trends in finance and in business more generally, as companies have responded to the pressure of heightened regulatory scrutiny and higher investor expectations by investing heavily in transaction processing, basic consolidation and reporting, and compliance technology and systems.

Figure 1. Forward-looking, analytical view is rated most poorly by senior finance executives.

How satisfied are you with your finance team's ability to execute core finance activities?



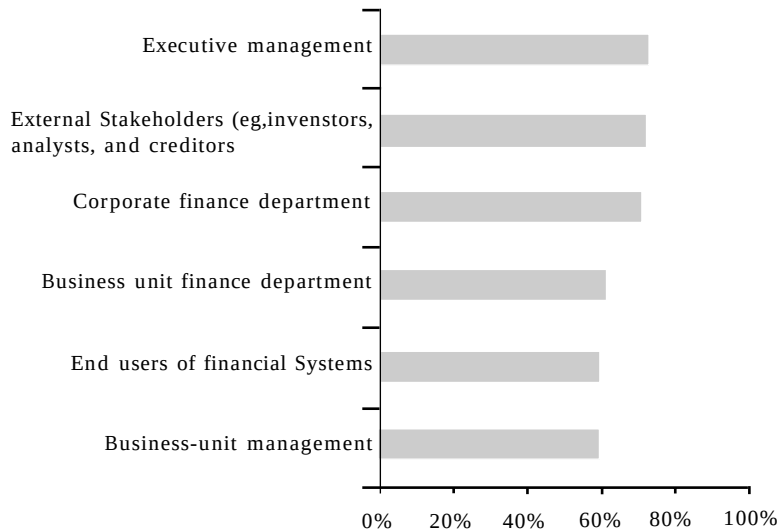
(Percentage of respondents choosing "some what dissatisfied" or "very dissatisfied" on a satisfaction scale)

Companies may well be taking on sophisticated information and analysis initiatives in stages, investing first in systems and processes for historically oriented reporting activities and postponing investments to support forward-looking activities such as planning, budgeting, and forecasting, ad hoc decision support, and internal reporting to decision makers.

Survey data on stakeholders' satisfaction with their access to timely and accurate performance data shows, on one hand, a largely satisfied community of investors, executives, and managers within finance and business units. More than 70 percent of top executives and external users of company performance information are somewhat or very satisfied with their ability to get timely and accurate performance data, say survey respondents (see Figure 2).

Figure2. Those closest to doing analytical work and making operating decision are least satisfied with their access to information.

How satisfied are the following stakeholders with your company's ability to provide timely, accurate, reliable information on business performance?



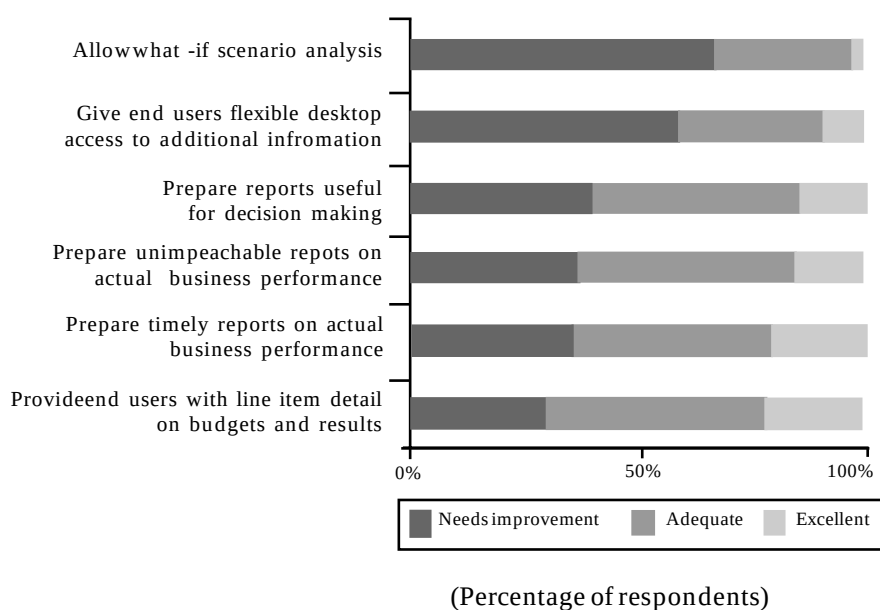
(Percentage of respondents choosing "somewhat satisfied or very Satisfied on 1-5 satisfaction scale)

Less satisfied, says the survey data, are those who rely on such information — and seek to build on it with additional analysis — to make day-to-day operating and investment decisions. Financial systems end users and the finance and general management teams of business units are consistently less satisfied with their access to high-quality information. Thus, those who are most likely to be called on to work with information to create plans, make decisions, and do other analytical work — rather than reviewing the work of others — are least satisfied with the information at their disposal.

In an effort to understand which pieces of management reporting and analysis are most in need of improvement, we asked finance executives to rate how well their processes and systems equip them to meet a broad array of reporting and analysis objectives. A majority of survey respondents say their processes and systems to allow what-if scenario analysis and to give end users flexible desktop access to additional information needs improvement (see Figure 3). Tools for static reporting on business performance and even on line-item details in budgets and results were rated more favorably.

Figure3. Dynamic use and analysis of performance information requires improvement more often than static reporting capabilities

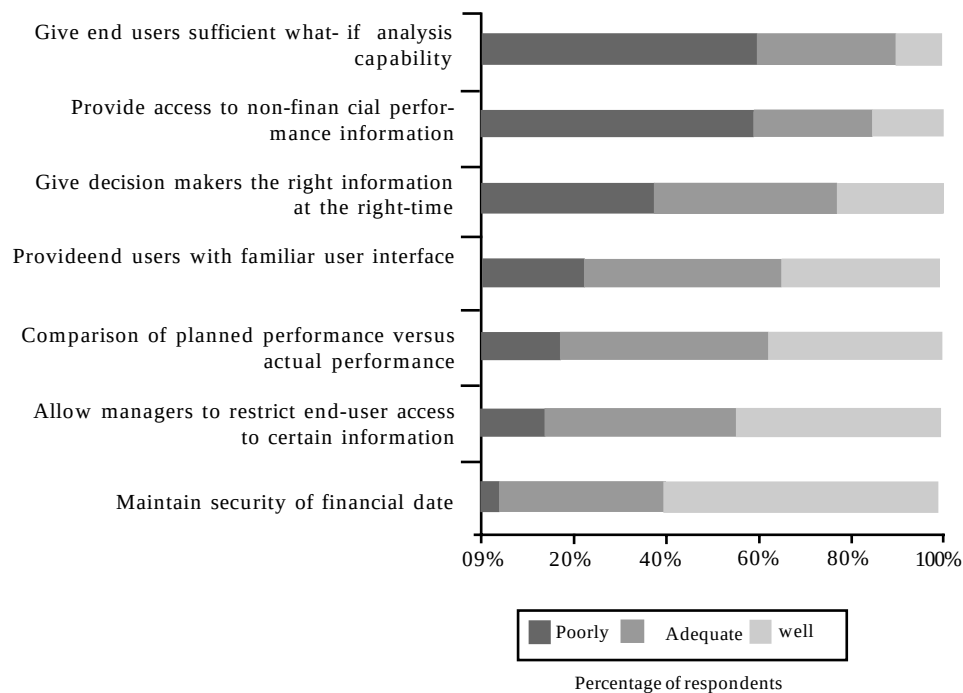
How well do your processes and technology support the following management reporting objectives?



In a separate question on broader finance system issues — including security and access privileges and performance tracking against plans — analytical, ad hoc analysis capabilities emerged again as a source of dissatisfaction. While a majority of respondents say their systems maintain suitable security and 44 percent give high ratings to their control over end-user access, a solid majority give poor performance ratings to both their what-if analysis capabilities and to their access to non-financial performance information (see Figure 4).

Figure4. Tools and information required for day- to-day decision making are rated poorly

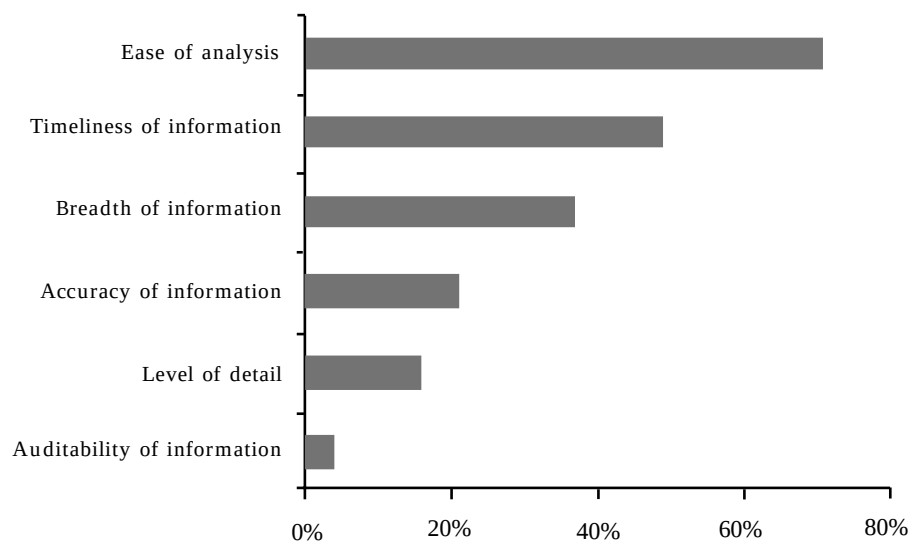
How well do your processes and Systems support the following activities?



A majority of respondents call for improving the timeliness of information, and more than one-third say broader sources of information (that is, more types of information) is a top area for improvement that would deliver business benefit (see Figure 5). But respondents' call for easier analysis again comes through loud and clear in the data, as 71 percent say improving the ease of analysis of their performance data would yield the greatest business benefit.

Figure 5. Better analysis tools yield business benefit

In your opinion, improving which two of the following attributes of your Company's financial information would yield the greatest business benefit?



(Percentage of respondents; respondents were allowed to choose two items)

Transparency Is Everyone's Responsibility From the University of Virginia: Both finance and non-finance executives learn that "the better the financial reporting, the better the valuation."

"Marie Leone, CFO.com July 30, 2004

Nearly three years after Enron filed for bankruptcy, corporate accounting scandals continue to make headlines.

In the past few months, for example, the Securities and Exchange Commission charged Siebel Systems with violating Regulation Fair Disclosure (Reg FD) for the second time in four years; the SEC charged Lucent Technologies with "fraudulently and improperly" recognizing \$1.15 billion of revenues in 2000; and a Pentagon official told Congress that "significant deficiencies" have been found in Halliburton's handling of billions of dollars of government work in Iraq.

What happens next to executives at those companies is anyone's guess. But professors at The Darden School of the University of Virginia have found a way to put such cases to good use in a course aimed at helping executives cope with the broader regulatory fallout. "Our program will be driven by situations pulled from the headlines, so we can focus on corrective and preventive measures," asserts Mark Haskins, a professor of business administration at Darden.

The course's intent, however, "is not to dwell on the headlines," says Haskins, "but to use them to galvanize the conversation and understand the root causes."



“Financial Stewardship in a World of Financial Scrutiny” is designed to bring managers up to speed on various “accounting shenanigans” by supplying them with a “heavy dose of financial expertise,” according to the professor. To that end, the three-day session covers six finance topics: the external reporting environment; financial-statement analysis; shareholders’ information needs; the Securities and Exchange Commission’s Reg FD; company-valuation criteria; and creating shareholder value.

That’s a lot to cram into a short course, Haskins acknowledges. He explains, however, that the program isn’t meant to be an exhaustive exploration of the topics but rather a discussion of “key insights derived from big issues.”

To be sure, Haskins and his co-instructor, Kenneth Eades, also a Darden business administration professor, plan to plunge into some heavy legal territory, notably the Securities Acts of 1933 and 1934, Reg FD, and the Sarbanes-Oxley Act of 2002. They intend to pay special attention to the financial-statement-certifications that Sarbanes-Oxley mandates for CEOs and CFOs and on the cascading impact of those signoffs on operating managers. What’s more, the professors aim to discuss financial-reporting transparency, including revenue-recognition policies, management’s disclosure and analysis, the debate on expensing stock options, and pension-fund liabilities.

But the intent of the course isn’t to provide a mastery of the rules. Instead, Haskins wants attendees to leave the classroom with a better sense of how to spot accounting games, such as those involving irregular revenue-recognition. The professor also hopes to help attendees develop skills to handle the internal pressure to “make the numbers at all costs.”

Like other reform proponents, Haskins believes that the new corporate reality demands greater financial transparency. He points out, however, that many executives forget that transparency is not relegated to green-eyeshade types in the finance department. The responsibility for accurate financial reporting ripples through the entire organization — is why the course targets more than financial executives.

Indeed, most of the course’s participants likely will be referred to it by CFOs with holistic views of financial reporting, according to the professor. The range of attendees, Haskins thinks, will include finance chiefs, sales and marketing executives, and general managers of divisions or business units. On the other hand, the program isn’t likely to resonate with not-for-profit executives or owners of small family businesses because of its focus on public-company topics.

New this year to Darden’s executive-education curriculum, the course will be held from November 16 to November 19. The course will be based on case studies to show how executives can make practical use of the tactics and strategies, according to Haskins, but theories of financial-statement preparation and corporate valuation won’t be ignored.

Participants, who will be taught how to derive valuations for their own companies, are encouraged to bring their employers’ financial statements to class. The valuation instruction will include the use of net-present-value, internal-rate-of-return, and cash-flow analyses. In the end, however, Haskins hopes that students should come away with a firm understanding that “the better the financial reporting, the better the valuation.”