White Paper
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Consolidation: Laying the groundwork for sustainable compliance

Information Management

Cognos® software

Contents

Abstract

This paper provides an overview of recent changes to US Federal and International Securities Law, and the effect of these changes on the financial administration and reporting of both private and public companies. This paper will examine the deficiencies of current consolidation systems on the market, and the solutions found in the IBM Cognos® 8 Controller, which provides built-in financial intelligence and advanced analysis capabilities to deliver on conformity requirements for consolidation.

Overview

Recent changes in US Federal Securities Law, including the 2002 passing of the Sarbanes-Oxley Act, as well as corresponding shifts in standards of financial reporting on a global scale, mean that compliance demands on organizations are increasing. However, current technologies have failed to keep up with these changes, and companies are struggling to meet the demands of new regulations using systems that are largely inefficient and unproductive.

This paper briefly outlines the new standards for financial reporting and accountability, in conjunction with the current problems facing businesses attempting to conform to these regulations. IBM Cognos 8 Controller enables organizations to adapt to new regulatory and business changes, and to maintain both compliance and performance by providing an integrated solution to financial reporting issues.

Business problems

Compliance is a business reality for publicly traded companies in the US. But as the regulatory climate shifts from immediate response to long-term sustainability, many finance executives are hard pressed to know what the next step is. Where does the organization proceed from here? What are the priorities in terms of changing internal processes and technologies so they're repeatable and effective?

Business drivers

The need for an integrated financial reporting solution has multiple business drivers. The following are a few examples:

Changes to US Federal Securities Law

The Sarbanes-Oxley Act, signed into law in 2002, represents the most comprehensive reform of US securities law since the Securities Exchange Act was passed in 1934.

> *"As US public corporations adapt to the more stringent regulatory climate, they must look for ways to enhance their control and reduce the cost of compliance. For many, the consolidation and closing process has the potential to do both."*[1]
>
> *Ventana Research*

The legislation places a heavy burden on publicly held companies. This became all too apparent in the first year of implementation, as organizations deployed substantial resources, time, and effort to comply with Section 404 reporting and control requirements. The cost? An estimated US$5.5 billion.[2]

With increasingly accelerated filing requirements and more expansive corporate governance mandates anticipated in the coming years, accounting and financial reporting practices must become steadily faster, more visible, and more accurate. Corporations will need to direct significant time and resources to the cause. In effect, complying with Sarbanes-Oxley has become and will continue to be a cost of doing business in the United States.

> *"We haven't had time to think about much else. Strategic planning and new-product research have had to take a back seat to these requirements."*[3]
>
> *Louis P. Valente, Chairman, Palomar Medical Technologies*

> *"Many businesses that thought of this as a "year 2000-like" remediation effort are being shaken to the roots of their corporate cultures by the realization that Sarbanes-Oxley compliance is an ongoing, high-cost event requiring previously unnecessary tracking and documentation of changes in business processes."*[4]
>
> *Gartner Research*

Key sections of the Act at a glance

Section 302 –
Corporate responsibility for financial reports

- Certify truth and accuracy of annual report and other financial statements.
- Establish and maintain internal controls.
- Evaluate effectiveness and accuracy of internal controls; disclose significant deficiencies.

Requires that consistent information be accessible to all authorized users; linkages between operational and financial data to enable deeper accountability; and consistent, automated, and auditable closing and financial reporting processes to minimize errors and misstatements.

Section 404 –
Management assessment of internal controls

- Establish and maintain an adequate internal control structure and procedures for financial reporting.

Requires airtight and auditable transaction and compliance policies, guidelines, and related controls governing transaction systems.

Section 409 –
Real time disclosure

- Disclosure to the public, on a rapid and current basis, any information concerning material changes in the financial condition or operations of the company.

Requires proactive monitoring of material events that meet SEC disclosure criteria; enhanced report preparation and distribution capabilities that support accelerated disclosure; and real time disclosure of changes in the financial condition of the business.

The increase and proliferation of international standards of financial reporting

In addition to the Sarbanes-Oxley Act, other mandates are also gaining influence. The impact of International Financial Reporting Standards (IFRS), the challenges of US and other GAAPs, and the potential merging of related standards on a global basis will affect accounting and financial reporting practices in the coming years.

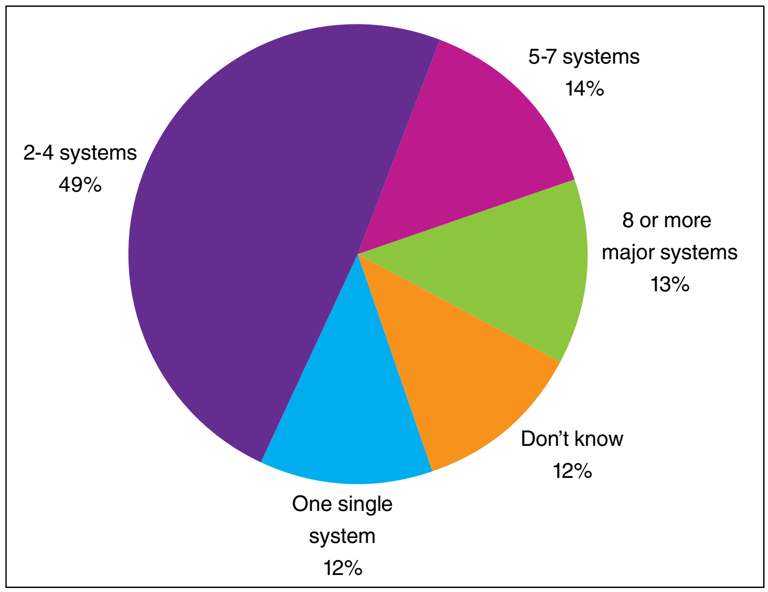
The impact of IFRS

As of 2005, listed companies in all European Union countries are required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS), developed by the International Accounting Standards (IAS) Board. These standards are also being adopted in other nations around the world. The United States is considering convergence of US GAAP standards with IAS/IFRS requirements to stay in step with the trend toward international regulation.

Under the IFRS, companies are required to provide financial statements that fairly disclose their financial position, performance, and cash flows. The goal is to increase financial transparency by setting more comprehensive reporting requirements. This will make it easier to analyze and compare financial performance around the world. IFRS will necessitate changes to existing accounting policies, including segment reporting and financial instruments.

The inefficacy of current consolidation systems

Meeting the consolidation challenge is difficult because organizations use manual, inadequate, or multiple consolidation systems for their financials. The result: they are unable to structure, control, and automate the process for internal and external reporting, and are unable to gain a single, accurate view of financial results.



Number of major systems used to pull financial information[5]

ERP systems

Enterprise resource planning (ERP) and ledger systems are excellent for storing data and managing the transactions that support the business. Companies typically have an array of ERP and other financial data systems, ranging from state-of-the-art solutions to legacy and proprietary data systems.

Unfortunately, ERP and general ledger systems are not designed to easily integrate or consolidate data from other sources. To produce appropriate financial statements, a single aggregated view across all transactional systems is required. As well, these systems do not provide all the necessary consolidation functionality. To ensure the closing process is timely and accurate, the system must handle all the complexities of consolidation—such as currency conversion and inter-company eliminations. What's more, it is not flexible enough to manage the accounting of business changes—such as mergers and acquisitions—in a timely manner.

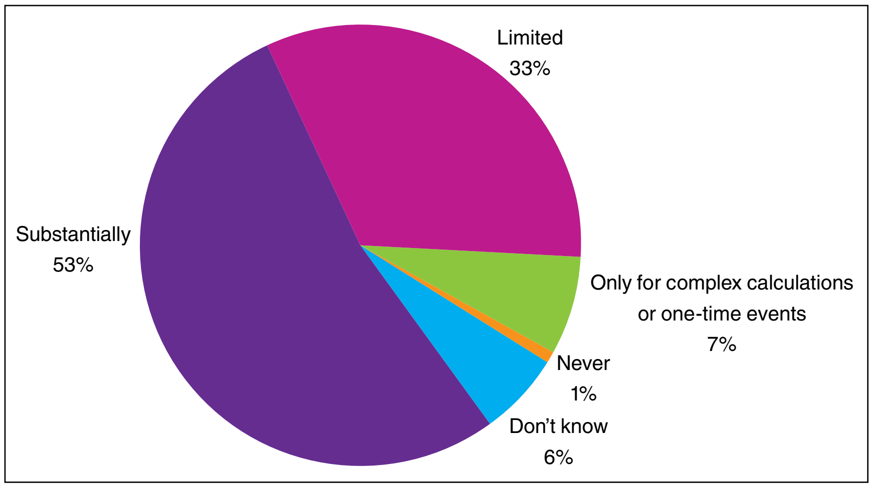
Using manual and inadequate consolidation systems creates inefficiencies, exposes the process to errors, and increases compliance costs. Such systems negatively impact the bottom line, as businesses sacrifice performance initiatives to instead direct time and resources toward fixing errors and re-working the numbers. This can lead to further inspections, audits, and restating of financial statements, which drive expenses even higher.

Spreadsheets

Spreadsheet systems are widely used for accounting and financial reporting. But multiple spreadsheets make each person or department an island of report information. This can lead to duplicated effort and opens the door to inconsistent data interpretation. Who has the right numbers?

In the Sarbanes-Oxley era, internal control risk is directly linked to the degree of spreadsheet use within an organization. Spreadsheets drive unacceptable rates of input errors—from data entry, re-keying, and cut-and-paste activities. Security of spreadsheets is inherently problematic, since communication of information is via emails or shared drives. As well, auditing of spreadsheet content is virtually non-existent, since there is no systemic ability to track who received what information or who made which changes to the data.

As with ERP systems, spreadsheets also lack sophisticated consolidation capability. They don't have the necessary level of sophistication needed to calculate and track important functions such as inter-company adjustments, business changes, and other journal entry changes.



Use of spreadsheets in the closing process[6]

First-generation consolidation systems

First-generation consolidation systems are a major improvement over spreadsheets. These systems integrate financial and operational data, consolidate financials at each level, and allow closing of the books quickly and effectively. Many provide allocations, eliminations, and currency conversion to further accelerate the process.

While these systems have addressed many of the fundamentals and core tasks, they don't address some of the more leading-edge issues: how to address company restructurings and other material business changes in real time, how to provide the required set of accountability and audit controls demanded in the current climate, and how to seamlessly adapt to evolving accounting standards and global business requirements.

> *"Spending will continue to increase in 2005 as companies move from a tactical attack to an ongoing process. As more companies–small cap firms and foreign registrants–enter the SOX fray in 2005, it's apparent that this issue will be with us for some time to come."[7]*
>
> *AMR Research*

Other limitations of first-generation systems:

- Not multidimensional – the inability to link dimensions (such as product, customer, or region) limits views into the business and curtails reporting and tracking performance.
- No auditability or data submission certification capability. Regulatory mandates demand a greater degree of security for certification and collection of submissions from other parts of the organization. This capability is not supported in current systems.
- Each deployment is optimized for one country or accounting regulatory environment, making it difficult to achieve integrated, multi-jurisdictional reporting.
- These systems are often supplemented by spreadsheets and manual intervention, approaches that are no longer viable in this era of compliance.

The solution

Consolidation: The first step in sustaining compliance

The first priority for an organization seeking to change processes in order to maintain compliance is to focus on improving the core systems that directly support financial reporting and accuracy. This means looking at the processes for gathering, consolidating, and reporting financial information results, and finding improvements to deliver the information in a more transparent, accurate, secure, and timely manner.

The goal is to have a consolidation and financial reporting system that helps businesses effectively manage their financials; reduce the risk factors for errors, fraud, and manipulation; lower the cost of compliance audits; and accelerate the closing and reporting process.

Reliable financial data is the backbone of compliance, and a robust consolidation system provides the foundation for accountability. And this is the jumping off point for delivering greater transparency and management of company performance – the broader, sustainable objectives going forward.

Compliance calls for a better solution

> *"Companies should examine the magnitude of savings (measured in internal headcount and external audit fees) they would be able to achieve by automating more of the consolidation and closing processes."[8]*
>
> *Ventana Research*

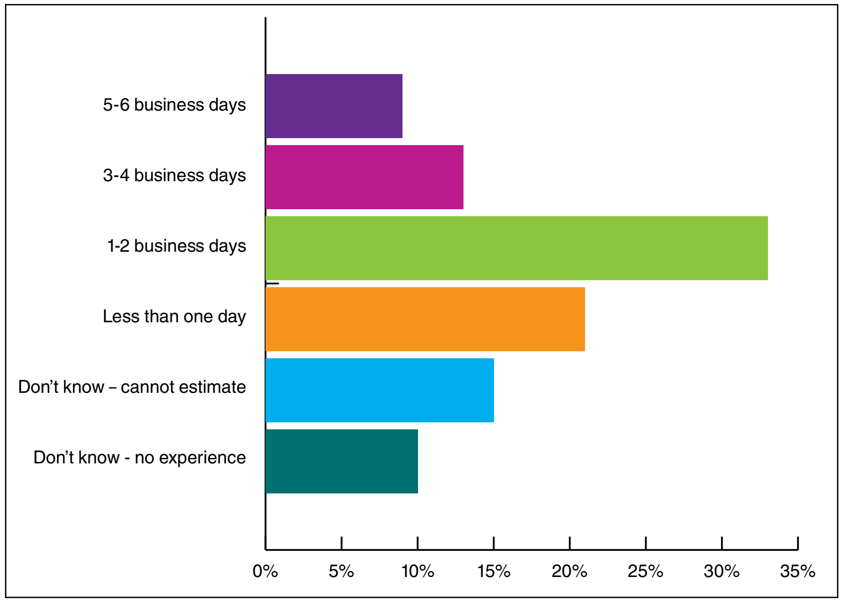
> *"A sustainable and affordable compliance framework must be underpinned by appropriate IT systems."[9]*
>
> *Gartner Research*

Using manual and inadequate consolidation systems creates inefficiencies, exposes the process to errors, and increases compliance costs. Such systems negatively impact the bottom line, as businesses sacrifice performance initiatives to instead direct time and resources toward fixing errors and re-working the numbers. This can lead to further inspections, audits, and restating of financial statements, which drive expenses even higher.

In the current regulatory environment, companies need a consolidation system that streamlines processes, ensures accuracy, and helps control costs. It is essential that the system deliver in these areas:

- A single, centralized platform for all processing and calculations. It is no longer appropriate to provide supplementary processing with multiple systems, spreadsheets, and people.
- Financial reporting from a single version of the truth. Reporting must also support delivery of many styles and types of reports – for example, producing reports across multiple GAAPs – and providing a line of sight from management reports to financial statements.
- Future-proofing of consolidations. As requirements such as IFRS enter the fold, systems need to be able to handle the different consolidation and reporting complexities driven by common accounting standards and reporting.
- Adaptable to business change. The current pace of business requires a new degree of agility and nimbleness in finance. Companies need to quickly incorporate the latest information for analysis or to identify scenarios for mergers and acquisitions. As organizations add and divest new entities, financial results must reflect these changes in a timely manner.

> *"Technology will play an increasingly strong role in making compliance activities repeatable, sustainable, and cost effective in the mid- to long term."*[10]
>
> *AMR Research*



Impact of errors in prolonging close[11]

Introducing IBM Cognos 8 Controller

IBM Cognos 8 Controller provides built-in financial intelligence and advanced analysis capabilities to deliver on today's consolidation requirements. The Web-based platform provides centralized, synchronous financial consolidation. It compresses the time to close, ensures accuracy, and ensures that the business controls directly impacting your corporate reporting process are effective.

You gain true and reliable consolidated financial data, based on a clear link between statutory and management consolidation, which provides a solid foundation for your operational and strategic decisions.

> *"Our use of the Controller product has allowed us to consistently produce consolidated reports at the speed our business demands."*
>
> *Ross McEwan, Head of Finance & Actuarial Systems, AEGON UK*

> *"The multi-dimensionality of Controller offers enormous potential. It provides us with excellent support for our extensive management reporting. All necessary eliminations and adjustments can be performed at an operative level as well as at an organizational level to reflect the current structure."*
>
> *Sweden Post*

IBM Cognos 8 Controller gives you a many-fold advantage in addressing compliance needs:

- Automates the consolidation process.
- Compresses closing times.
- Accelerates reporting times.
- Significantly reduces the risk of financial reporting errors.
- Minimizes compliance costs.

Key features

- **Application approach –** Directly managed by finance, not by IT, for rapid implementation. Eliminates extensive development and programming that adds complexity. Simplifies and automates the definition, structure, and rules of the consolidation process.
- **Single, accurate, corporate view of key information –** Consolidates multiple, diverse ledgers with thousands of operating units and accounts into a single, common, chart-of-accounts structure.
- **Sophisticated, global consolidation functionality –** Provides inter-company elimination and reconciliation, multi-currency translation, complex ownership calculations, and financial consolidation rules to handle multiple reporting and consolidation standards.
- **Leverages existing assets –** Integrates data from existing ERP, transactional, and desktop systems.
- **Provides reporting and analysis on controls and transparency into information –** Mitigates risk and delivers accurate information to support compliance requirements.

- **Built-in finance consolidation intelligence –** Includes pre-defined consolidation functionality and reports that incorporate best practices for managing the consolidation of financial information and delivering external management and corporate reporting.

- **Adaptable to unique requirements –** In addition to statutory dimensions, IBM Cognos 8 Controller provides user-defined dimensionality to support collection and reporting at all levels including cost center, product, and customer.

- **Real-time adjustment to meet new business, environment, or legislation changes –** Easily and rapidly accommodates changes such as mergers and acquisitions as well as reorganizations.

Performance management: The next step

> *"The basic architecture and infrastructure for gathering compliance-related information can be easily extended to provide better business management. Extending the information gathered and analyzing it will help manage key risks. To mitigate the cost of compliance, companies must look for and execute the leverage points that improve business performance."*[12]
>
> *Gartner Research*

Consolidation provides the foundation for accurate, validated, and auditable financial information. To achieve greater transparency and improve business performance, IBM Cognos 8 Controller can be linked with IBM Cognos enterprise planning, business intelligence, and scorecarding solutions through a single corporate performance management (CPM) platform.

Enterprise planning

The visionary CFO strategically thinks about the financial data environment across all time horizons. Financial consolidation delivers the validated, historic results. This creates the starting point for business planning and rolling forecasts – the forward-looking view of the business. Effective planning drives higher levels of predictable financial and operational performance. In terms of compliance, predictability results in fewer regulatory and investor surprises.

The IBM Cognos enterprise planning solution translates corporate objectives into concrete financial and strategic plans. It links operational plans to financial plans, allowing users to see in real time the effects of operational changes on the financial bottom line. IBM Cognos planning tools are optimized for high participation, high frequency, driver-based planning and forecasting, and leverage data from the historic perspective to enhance the forward view of the organization.

Business intelligence

Companies amass large amounts of operational and business data, but it is locked away in disparate systems. As a result, critical information is inaccessible and underutilized. IBM Cognos business intelligence products leverage the information assets within your organization, giving you insight into the Why behind financial, operational, and business performance.

This visibility provides greater transparency, allowing you to drill-down to the root cause of errors and events, and address them systematically. Addressing cause and effect ensures accountability and improves business performance.

The IBM Cognos scorecarding functionality lets you define and monitor critical success factors and measure progress against plans and strategic targets. With this capability, you can identify shifts in trends, model alternative plans, and where necessary, take appropriate action in time to improve performance.

Conclusion

Sarbanes-Oxley and global standards such as IFRS are pressuring companies to improve accounting practices and financial reporting, increase transparency, and achieve greater corporate governance.

IBM Cognos 8 Controller provides advanced consolidation capabilities to address the accountability issues your organization faces. And by integrating consolidation with CPM—planning, analysis, and metrics—you can achieve greater control and management of your company's performance.

Compliance is the new business reality. With state-of-the-art consolidation technology and performance management capability, you can keep on top of the rules, achieve good governance, and stay ahead of the competition.

Compliance and good business practice

> *"We drive our corporate performance through global sales forecasting with support from IBM Cognos 8 Planning. Key figures in our planning processes need to be integrated with other important data, such as financial and non-financial data that has been reported and processed using the Cognos consolidation solution. The link between these two solutions ensures that we have an overall picture for performance management purposes, as well as the ability to examine a detailed breakdown of key figures."*
>
> *Ola Salmén,*
> *Chief Financial Officer of the V&S Group*

The Securities Exchange Act of 1934 was enacted with two basic purposes: to improve disclosure to investors and to prohibit fraud in connection with the sale of securities.[13] The Sarbanes-Oxley Act shares the aims of the 1930s legislation. It reinforces what many have been pursuing as good business practice for years.

The Act's various sections reinforce investors' need for appropriate levels of transparency into the operations and financials of companies where they invest their money. This transparency enables true accountability, and in turn, leads to better decisions and management of company performance.

"Today, as business fundamentals and credible accounting become the new touchstones by which investors judge corporate quality, many companies would benefit if their CFOs gave renewed attention to helping chief executive officers understand the performance of their businesses and to evaluating critical strategic decisions," write Timothy Koller and Jonathan Peacock in the McKinsey Quarterly.[14]

Compliance is a critical driver for publicly traded companies. But improving business practices is just as relevant for private companies. With corporate performance management, you can gain greater visibility into your business, achieve greater accountability, and drive greater predictability and performance.

These objectives are key to business success, whether you are a private or public organization. And ultimately, an investment in performance management will also give your company a true competitive advantage.

About IBM Cognos BI and Performance Management

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

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Endnotes

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