Appendix 3.05.2 What the reporting companies say

The Future of Financial Reporting: Insights from the FSN Modern Finance Forum on LinkedIn – FSN/Workiva Survey 2017[1]

Link: for the FSN site:
http://www.fsn.co.uk/channel_financial_reporting/fsns_future_of_financial_reporting_shows_cfos_are_not_ready_for_an_era_of_self_service_reporting#.WqkISGfA_Mg
Link for the report:
https://www.workiva.com/sites/workiva/files/pdfs/thought-leadership/future-financial-reporting-fsn-report-20170606-j11831.pdf

This was a 2017 survey of 977 senior financial professionals from 23 industries the majority of which come from Europe and North America[2] Just under 75% of the respondents were from Europe (around 57%) and North America. Just under 33% of the respondents worked for companies which had more than 5,000 employees. But the majority of the respondents worked for small to medium sized companies. So the survey is biased towards companies that are smaller and outside the FTSE 350. The cross section of sectors included samples from the following sectors which were well represented: automotive, banking, consulting, manufacturing, mining, pharmaceuticals, retail, technology.

Their opening shots are worrying:

- More than 50% of respondents said reporting involved huge amounts of manual checking every time a change is made
- 60% of respondents said they spend too much time cleaning and manipulating data
- 43% of the senior finance executives surveyed don't even know how many business-critical-spreadsheets are in use
- 40% of boardrooms do not have a complete view of the business

Even if you abstract all the non-European and non-US firms that still leaves very significant numbers in the survey. It is a cross section.

Self-serving reporting
Defined as basically giving people access to the data and analytics tools they might need so that that individuals can run their own analyses, interrogate the data, etc. This type of reporting, which is on the increase, seems to indicate that there are serious concerns of data integrity including financial data that make-up the financial statements. Some 55% of respondents were concerned that internal controls were not working and that their data may suffer integrity issues. There was also too many CFOs grappling with rigid reporting process

CFOs have lost their grip on reporting
The survey found that financial reports are being weighed down by unnecessary information as finance professionals fail to get a proper grip on an 'increasingly bloated and convoluted reporting ecosystem'. At a time when the volume of available data is increasing exponentially,

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[1] https://www.workiva.com/resources/future-financial-reporting-survey-2017
[2] The Future of Financial Reporting Survey 2017 Insights from the FSN Modern Finance Forum on LinkedIn, FSN Publishing Limited. 2017
https://www.workiva.com/sites/workiva/files/pdfs/thought-leadership/future-financial-reporting-fsn-report-20170606-j11831.pdf

there will invariably be a rise in the type and amount of information corporate boards and shareholders will require. Externally, organisations are being compelled to add more data to their financial reports by regulatory requirements, while internally, companies trying to stay ahead in their industry will be keen to track and monitor more diverse information.

Too much reliance on spreadsheets

This was a slight surprise. The survey found:

- 69% of CFOs rely on spreadsheets to plaster over their reporting processes
- 46% of organizations are dependent on the IT function to make changes to their reporting
- 71% of organizations depend on spreadsheets for collecting data across the majority of their business units
- 49% of organizations are unable to change their organizational structure without major delays to their reporting

One might think that spreadsheet errors were few and far between with listed companies. But as we saw in Chapter 7 with Conviviality, on a turnover of £1.6 billion and a profit of £18m, a spreadsheet error made the forecast profit change by many millions of pounds. It has been reported that this made a difference of over £5m – one report put this as £10m (City A.M.)[3]. That is significant on what was thin margins.

Losing control

More than half of CFOs confess to spending too much time manually checking every change, and in 57% of the survey cases, only one person can work on the report at a time. (This may not be representative of UK's larger firms).

Unexpected error anxiety may be more serious than CFOs realise. They found that 90% of respondents were concerned about two or more aspects of the reporting process. And that in terms of losing sleep over unexpected errors, 62% of respondents worried about missing reporting deadlines and only 3% do not lose sleep over their reporting process or deadlines

A system in crisis

The survey concludes:

> 'The litany of other issues that dog organisations with concerns about unexpected errors is symptomatic of a reporting ecosystem in crisis. These organizations are hindered by the weakness of the reporting process, and boards are delayed from making critical business decisions over concerns about the accuracy of the data'.

Productivity is under threat

The survey comments:

> 'Time-poor CFOs are struggling to keep up with their growing list of responsibilities. The only way they can take on the more strategic role their position now demands is to

[3] Link: http://www.cityam.com/282241/bargain-booze-owner-conviviality-issues-second-profit

> make the most productive use of their time, but this survey shows they aren't managing to do that with their financial reporting duties'.
>
> 'Mired in manual reporting methods like spreadsheets and outdated desktop applications, CFOs spend their time worrying about errors and delays because their processes are technologically archaic.
>
> 'A lack of investment in back-office systems is becoming a serious hindrance to productivity, and in the case of financial reporting, could be the source of a major error leading to reputational damage'.

Around 54% of respondents said their reporting processes involve huge amounts of manual checking every time they make a change.

Headcount being squeezed
The pressure to reduce costs and headcount was forever present. The survey found that 25% of organizations have reduced their finance headcount over the last three years, and that 40% of organizations have kept their finance headcount flat over the last three years.

Problems in the boardroom
But financial reporting is consecutive, and the board is at the very end of complex process, fraught with challenges and risks that will impact the dependability of what is reported in the boardroom and affect the ability of the board to make effective decisions.

Only 61% of senior finance executives say the board always has a complete view of business performance. This means many corporate boards are making their decisions with 'one hand tied behind their back'.

Statutory reporting falling short
Almost half of senior finance executives believe the statutory reports are too complex for investors to understand, while 64% say the information in them is too late to be relevant to investors. To this end, 77% of respondents believe investors need more frequent but simpler reporting requirements in order to properly understand the performance of the business.

- 47% of CFOs believe the reports are too complex for investors to understand
- 46% of CFOs say XBRL has not made the impact it was expected to
- 64% of CFOs say statutory reporting is too late to be relevant to investors
- 77% of CFOs say investors need more frequent but simpler statutory reporting to understand performance
- 52% of CFOs say investors should be able to query statutory reporting for themselves

Note, we found that authors did not want more frequent reports. Just more reliable information whether in reports, messages or meetings.

Analysis of the FSN/LinkedIn/Workiva Report/Survey[4]

This survey takes the viewpoint of the preparers of the financial and corporate reports. From their viewpoint, it is a question of not being able to keep up with technology, the pace of regulatory change, and being faced with inadequate internal controls at a time when accounting and finance are being squeezed to reduce their headcount.

Now this is biased towards the smaller company, motherless our interviews reinforces the same sort of feeling from the FTSE 350 with one exception. Their accounting systems are off-the-shelf software packages and by and large worked well though often required much more support than the software companies realised.

However, for the FTSE 350, such issues as losing their grip, reliance on spreadsheets (at the end of the reporting line), error tracing and correction. Expanding responsibilities, a never ending and increasing set of regulatory requirements and governance, failure for internal controls to keep up or be adequate (notwithstanding what the narrative says), the politics of their boardroom and the process of sweeping minority views under the carpet.

In all this disruptive chaos, you have to superimpose a steady pressure for headcount reduction and yet increasing demands for information despite a changing and exponentially increasing (so it seems to the preparers) regulatory environment.

Looking at the outsourcing companies discussed in Chapter 6, Krish's gut feel from interviews that the two paragraphs above apply to nearly all of them. That seems to be well documented by the SC on Carillion. Our view, is that neither the longer-term ex-financial director (Richard Adam [2007 to 2016]), nor Zafar Khan [January to September 2017] seemed to fully comprehend the gravity of the situation. It was only the most recent financial director, Emma Stone [September 2017 to the firm's demise] who understood the severity. Being a whistle blower earlier, her protestations of problems, and noted in boardroom/committee minutes, were not understood (Krish's view) or heeded by the other senior managers. Press reports and the SC seem to agree.

> Emma Mercer is the only Carillion director to emerge from the collapse with any credit. She demonstrated a willingness to speak the truth and challenge the status quo, fundamental qualities in a director that were not evident in any of her colleagues. (SC Paragraph 100)

[4] https://www.workiva.com/resources/future-financial-reporting-survey-2017

ICSA Report

ICSA (The Institute of Chartered Secretaries and Administrators) or The Governance Institute is the professional body for governance. This report released by their recruitment arm (The Core Partnership) in April 218, found that companies were divided on the quality of annual reports[5].

Chartered secretaries and their staff governance professionals believe:

Companies are required to disclose too much information in their annual results

- Agree (i.e. negative about annual reports) 39%
  - Self-congratulatory waffle
  - Regulators are too isolated from real business life
- Disagree 38%
- Unsure 23%

Annual reports are useful for stakeholders

- Agree 78%
  - Defenders of the annual report said the information that companies are required to disclose is "extremely useful" in giving investors and others a comprehensive understanding of the company, its culture, its business and its longer-term prospects. It is also the only time the non-institutional shareholders are given the chance to see a comprehensive report from the company's board that is not governed by marketing spin, and is the best way to provide the necessary transparency on performance
- Disagree or undecided 22%
  - Disclose too much information
  - Annual Report has become a source of "obsolete information and unnecessary expense" which could be used for more critical matters or investing in better governance practices.

Peter Swabey, policy and research director at ICSA, said:

> "The crux of the matter lies in the amount of time, money and resources required to produce a once-a-year product that is read by a very limited audience.
> "Certain information might more usefully be reported online, while it would also be beneficial if companies could move away from boilerplate to report on more bespoke matters of relevance to them and their stakeholders."[6]

Two interesting issues raised. One is the purpose of the annual report is for non-institutional shareholders, and the concept of placing some of the annual report on the firm's website.

[5] https://economia.icaew.com/en/news/april-2018/companies-divided-on-quality-of-annual-reports

[6] https://economia.icaew.com/en/news/april-2018/companies-divided-on-quality-of-annual-reports