A BPM Partners White Paper

The Strategic Need to Automate

The Last Mile of Finance

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Table of Contents

Executive Summary

The Last Mile of Finance is a term that describes the business processes and activities that take place between the trial balance and the filing of SEC-required statements and other statutory reports. At present, the Last Mile has become much tougher to traverse due to new regulatory disclosure requirements including eXtensible Business Reporting Language (XBRL) and efforts to enhance Internal Controls over Financial Reporting (ICFR).

The penalties for getting financial statements wrong or filing them late can be extremely costly. They include Security Exchange Commission (SEC) fines and technical defaults on debt and bonds, not to mention negative exposure on stock price and a higher cost of capital. Simply put, organizations have strong motivation to avoid these penalties.

The first year of XBRL filing was 2009, and about 500 public US companies were forced to take the plunge with an additional 1,000 companies doing the same in 2010. Some outsourced the job of XBRL tagging to external resources. Others bit the bullet and learned how to do it in-house, many with the help of an automated system. Regardless of the XBRL solution they chose, the first wave of XBRL filings contained thousands of errors, but companies got grace; the SEC announced a policy of forgiveness for two years from the initial XBRL filing for most unintentional errors in tagging.

Beyond delivering what the SEC requires, CFOs are increasingly expected to provide analytic insights. But they cannot lead organizational change if they are limited by outdated, inefficient processes. A holistic approach to tightening up the Last Mile – bringing it into the 21st century – is found to work well in addressing these challenges. This means establishing a roadmap that covers policies and people – not just technology and processes. Automation helps cut production time, ensure consistent ripple-through of updates, and maintain consistency in footnotes and the Management Discussion & Analysis.

Automation of the Last Mile supports the growth of the CFO's mission, as it builds efficiency and integrates information throughout the enterprise. A purpose-built software solution for the Last Mile can enable finance to navigate the data to catch anomalies, drill down to check details, and map the XBRL tags just once, with automatic carryover to successive reporting periods.

Major companies that have reengineered their Last Mile say they experienced fewer ICFR incidents and that the new automation allowed them to catch errors earlier and prevent misinterpretation from building on top of bad information. They say it was worth the time and effort to learn XBRL and do the tagging in-house, and their financial statements were finished faster. Auditing, analysis and transparency were facilitated. It is estimated that for every item that had to be block tagged in the first year of XBRL filing, that number leaps by a factor of ten when companies are required to detail tag financials and footnotes in the second year of filing. The need for an automated solution is clear.

Business Overview

If the financial cycle in public companies is a marathon, the “Last Mile of Finance” is one of the toughest, as CFOs race for the tape. The Last Mile of Finance covers the processes and activities that take place between the trial balance and filing of a company's 10-K, 10-Q, etc. (including XBRL-tagged disclosures) and other required reports. Fail to complete the final stretch of the race, and all your efforts before that Last Mile mean little.

Companies face significant challenges with the financial close and reporting process, and they become more complicated with new requirements like XBRL. By June 2011 all public companies will have to provide an XBRL-tagged, interactive version of their financial statements.

The Last Mile of Finance is a breeding ground for management reporting and governance risks with the intense pressure of the SEC deadline looming. Follow a 10-K report back in time from its filing, and you often find significant inefficiencies. Less typical, but potentially very costly, are the financial errors and internal control failures that can also arise.

Companies need to adopt a holistic approach to the Last Mile of Finance, a strategy that involves defining a roadmap for improvement to address processes, policies, people and technology issues. Solutions should aim at blending these elements to improve the efficiency, governance and quality of the financial close and reporting.

Automation of the Last Mile aligns neatly with how forward-thinking, strategy-minded CFOs now gear their thinking and allocate their time and energy. Finance leaders who focus on integrating information across the enterprise are found to outperform their counterparts by delivering more accurate business insights and higher levels of efficiency in finance. A holistic approach to the Last Mile – not limited to processes and technology – boosts finance effectiveness and the CFO’s ability to deliver analytic insight. It also greatly lessens the chances of late filings or the need to restate results.

Business Challenges in the Last Mile

New accounting rules, new reporting rules such as the SEC's XBRL mandate, and compressed reporting deadlines require a more rapid close process. That is easy to say, but not easy to do. Increased regulatory scrutiny has resulted in more demands on financial disclosure. To up the pressure further, penalties for submitting statutory reports with mistakes are greater than in the past. The XBRL challenge is significant enough that many companies could not take it on; they offloaded it to external resources, usually a financial printer, which requires coordination that can slow up the report process.

Late filing is one failure outcome that, in itself, justifies automation of Last Mile processes. It is a situation that companies are motivated to avoid. Late filing can bring a "cascading series of adverse consequences."[1] It can trigger not only SEC penalties, but also default provisions in credit agreements and indentures. In many cases, bond issuers are technically in default if they do not mail the required reports within 15 days of the SEC deadline.

This regulation has opened the way for aggressive bondholders seeking to take early profit. In late 2008 a number of courts rebuffed the strategy of Wilmington Trust of buying bonds that were trading well below par, and then seizing on a technical default – late filing – to demand a windfall payment. There are other adverse consequences, though. Short sellers in the stock market flock to late filings because market participants anticipate the public dissemination of 10-K information, and they care about the SEC deadlines. When this information does not arrive, "no news is seen as bad news" by investors.[2]

Producing financial statements under great pressure, with a manual process, can lead to errors that force a restatement. A GAO study on the consequences of restatement of financial reports found that, on average, the stock price drops by 10% in the three days following announcement of a restatement.[3]

Restatements trigger public concern and cause investors to fear that management is incompetent or intentionally attempting to defraud investors. If the restatement touches on revenue or expense recognition, the loss in value can be exaggerated and longer term. As

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[1] **Companies Face Big Risks with Late SEC Filings,** Joshua P. Agrons, Richard P. Bourgeois and Natasha S. Chowdhury,*"The Corporate Counselor,"* Law.com, December 2006.

[2] **Are SEC Reporting Deadlines Meaningful? The Paradox of Late 10-K Filings,** Derek Dalton, Steve Buchheit, Susan M. Murray, Rawls College of Business, Texas Tech University, Lubbock, Texas, November 2009.

[3] **Restatement of Financial Statements,** Bischoff Finley & LeBlanc, *Tennessee CPA Journal,* April 2008.

one would expect when confidence is lowered, a company's cost of capital often rises if it announces a restatement.

Publicly traded companies now must satisfy SEC Final Rule Release No. 33-9002 (Interactive Data to Improve Financial Reporting), which requires financial statements and narrative disclosures to be filed along with quarterly and annual reports. XBRL is a distinct tagging process, alongside the standard reporting processes used to create 10-Qs and 10-Ks. It is a technical challenge to create complete and accurate SEC filings in this new format.

As such, it is a new burden for finance, one more area to verify that data is carried through correctly if updates are made, not to mention the need to tag (apply a meta-label to) data. There are two approaches to XBRL: outsource the job to the financial printer, or do it in-house. The latter, in most practical terms, requires automation of XBRL tagging to avoid adding too much time to a deadline-driven process. Outsourcing it to a financial printer is costly and eats up time in discussion and coordination.

Bolt-on applications for XBRL tagging are commercially available but can be difficult to use, and many integrate poorly with a company's underlying financial reporting process and software. The requirement to create XBRL tags associated with each line of a financial statement, as well as the supporting schedules, footnotes and disclosures, is difficult in the first year of filing, and it becomes more challenging in the second year of filing as the SEC requires detailed tagging of much more information, such as that found within the footnotes.

Common errors committed by US companies filing XBRL financial statements in 2010 included:

- Failure to tag financial statement schedules.
- Incorrect element selection – selected elements that were too narrow or too broad.
- Inconsistent use of elements.[4]

In time, companies will build up their in-house expertise, and their company taxonomy will be widely understood. Until then, companies are seeking integrated XBRL solutions that hide the technical aspects and enable finance and accounting professionals to complete tagging without worrying about the technical infrastructure of XBRL. While software applications are commonly used for reporting today, in many cases the changes in report requirements exceed the flexibility of current systems. Regulatory change, new rules such as those on currency and minority interests, and the reconciliation between existing and evolving financial standards pose challenges. Older systems do not adapt easily.

Businesses tend to lack supporting documentation and a well-defined set of controls to govern how they carry out Last Mile processes. Most rely on Microsoft desktop applications

[4] **Deloitte Top Nine Interactive Data File (XBRL) Filing and Tagging Errors, 2010**.

to track and trace documentation, notes, reports, approvals and all forms of control – if controls are in place at all. Relying on a manual set of controls is risky, and audit costs for maintenance are high.

Preparation of financial statements is often hampered by inconsistent work flow. If a change is made, is there any assurance that it gets the right approvals and cascades to other areas? A properly designed automation solution should at least provide reminders to verify that carry-through is done properly.

Market Trends Favor Automation and In-House Last Mile

Each year BPM Partners conducts a survey on business performance management and related topics, speaking to executives and finance professionals in senior roles. The 2010 BPM Pulse Survey found that finance executives continue to rank financial reporting as a primary business challenge. It's clear that the traditional methods of handling financial statements are undergoing change, and will change more.

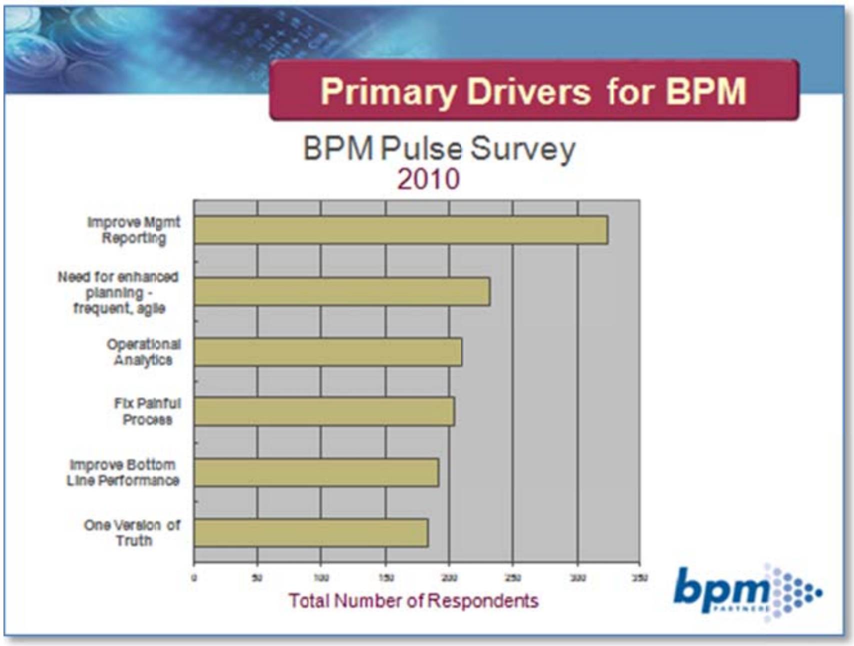

Figure 1- Primary business drivers for an enterprise performance management initiative.

The job of the CFO also continues to evolve, as borne out in studies such as the IBM 2010 Global CFO Study. This study found that CFOs are increasingly expected to provide more strategic insights to help their company grow. This is not a shift away from their mission of budgeting, money management and cost containment; rather, it signifies the addition of new responsibilities to find new ways to drive growth.

The IBM study defined four categories of CFOs and finance departments: scorekeepers, disciplined operators, constrained advisors and value integrators. Value integrators focus more than others on integrating information across the enterprise. They exceed their counterparts in two very important respects: delivering accurate business insights and optimizing finance efficiency. A holistic approach to the Last Mile of Finance will boost finance efficiency and the ability to deliver analytic insight, and will support CFO evolution to become stronger value integrators.

Outmoded processes in the Last Mile and elsewhere restrain bandwidth – and prevent CFOs from contributing as strategic thinkers to the extent they wish. When they are tied up with manual tasks and catching errors in spreadsheets, they can't apply a broader vision to the business effectively.

2009 can be considered "Year One" of XBRL, as that is when the mandated use of XBRL in financial statements began for the biggest filers (large accelerated filers with a public float exceeding $5 billion). Many companies required to submit XBRL statements in 2009 had their financial printers do the tagging – the "outsourced" approach. Approximately half of the second wave of filers (in 2010) chose to do the tagging themselves, with software that builds the taxonomy mapping into the reporting process using either a bolt-on approach, where the tagging occurs after completion of the report, or the built-in approach, where the tagging occurs as part of the report-creation process.

The built-in approach requires learning XBRL skills in-house, but is less manual, less costly and more efficient than the bolt-on approach, says PricewaterhouseCoopers partner Mike Willis, a founding member of XBRL International, a global consortium to which XBRL US belongs[5].

The initial filing group applied thousands of incorrect tags in their Year One filings, and both XBRL US and the Securities and Exchange Commission say they expect that errors will continue to be commonplace in Year Two, when the number of elements required to be tagged increases by as much as a factor of ten.

A key motivation to automate the tagging process is to limit the possibility of making mistakes. Corporations currently have limited liability on their XBRL submissions for the first two years of filing in the SEC mandate, during which time they are not liable for unintentional XBRL mistakes made in their submissions. They are feeling their way into this new area with some trepidation, but they are wise to start now and learn from any challenges prior to the onset of penalties.

Financial statements and the types of information in the footnotes that require tagging change slowly. Once an automated tagging system is configured, the same (correct) tagging process repeats in subsequent filing periods, as a matter of course. The broader the scope of tagging automation, the less chance of mistakes happening.

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[5] ***18,000 Tagging Errors in XBRL Filings So Far***, David McCann, CFO.com, October 12, 2010.

Companies with stronger ICFR – Internal Controls over Financial Reporting – are less likely to restate their financial statements. Among the primary reasons for inadequate ICFR are manual and error-prone processes in reporting that provide minimal visibility, accountability and audit trail. Software solutions for the Last Mile automate and validate financial reports so existing accounting staff can focus on the analysis and proper application of GAAP or FASB rules, which further reduces risk for the business.[6]

[6] **Two Years and Counting, A Review of Sarbanes-Oxley Section 404 Reporting,** Kathryn E. Scarborough and Mark H. Taylor, June 2007, http://www.journalofaccountancy.com.

Old Method versus New Process

Historically, the close-to-report process has been handled with manual processes involving multiple spreadsheets, various word processing files and use of unsecured emails to circulate report drafts throughout the organization.

Software solutions are now available to automate the creation of full SEC filings, such as Annual and Quarterly Reports (including XBRL), as well as other critical reports including Board Books, Management Reports, Earnings Releases, etc.

> "Making the tagging aspect an integral part of automating the close-to-report process allows more time to review the statements and uncover any errors that might have crept in."
>
> **Robert D. Kugel, CFA - SVP of Research, Ventana Research**

The more tangible benefits to automating the Last Mile and handling the XBRL tagging process in-house should include:

- Faster close-to report cycles.
- Improved transparency.
- Reduced likelihood of errors in XBRL and interactive reports.
- More flexibility for late changes before compliance deadlines.
- Fewer manual errors in report arithmetic and inter-report carryovers.

The more intangible consequences that are more difficult to evaluate include:

- Better, more informed decision-making.
- Greater ICFR (Internal Control over Financial Reporting).
- Improved data integrity and reporting accuracy in an increasingly complex environment.

Success Examples from Client Deployments of Last-Mile Automation

- A Fortune 500 healthcare insurance provider:
  This healthcare services provider chose a decentralized approach to financial reporting, using an automated reporting solution to produce its 10-K and 10-Q reports and XBRL-tagged disclosures. The solution automates cross-checks to help catch and correct mistakes earlier in the close-and-report time period. It provides supplemental statistical breakdowns, customized workflows by division, and features that handle the content and presentation of the Management Discussion & Analysis.

- A telecom services provider with millions of customers:
  This diversified communications firm wanted investor reports to be ready at the same time as financial reports. Its automated Last Mile system handles earnings releases, benefits reports and board reporting, while bringing consistency to all reports. Automation has improved auditability, brought consistency to supporting records and Safe Harbor statements, and allowed one-place updating of information that ripples across entities and reports. Moreover, it reduced paper consumption.

- A multibillion-dollar global media and entertainment company:
  This household name now uses an automated Last Mile solution for its 10-K and 10-Q reports, press releases and internal analysis reports. Before the implementation, its goals included staff reductions, XBRL compliance, integrating supplementary information, and replacement of a tedious manual process for document management. Less than six months were needed to migrate the entire Last Mile process into the automated solution. The company is now able to handle XBRL tagging in-house, and has gained better control over changes. The XBRL taxonomy rolls from period to period, requiring fewer adjustments each cycle. Automated links to its consolidation system make it easy to control accuracy and changes, ensuring they cascade out correctly. The system has also become the platform for handling Management Disclosure and Analysis items, and feeds into press releases. Workflow encourages collaboration among accounting, legal and tax staff. Internal data validations help detect anomalies and boost accuracy.

> "There's no question that the built-in approach [to XBRL tagging] is superior — and for reasons beyond efficiency and cost.
>
> "Control your own destiny rather than rely on a third party. It's a plus to learn XBRL for yourself."
>
> **Chief Accounting Officer, Health Insurance Provider**

How to Move Forward

When assessing the opportunity to stay ahead of statutory requirements, a good starting point is to estimate the potential value of improving your internal processes. This internal assessment should include such questions as:

- What are the current resources dedicated to external reporting?
- What is the average cycle for external reports (10-Q and 10-K)?
- What fees are currently budgeted for external XBRL tagging resources?
- What exposure (risk) has already been identified in current close-to-file processes?
- Could the resources currently allocated to external reporting be leveraged elsewhere in the finance organization?

With a handle on the scope of your initiative and potential costs and penalties to avoid, the decision process can follow the lines of similar performance management or business intelligence activities. You would need to secure senior sponsorship, develop a business case, allocate a budget, fully document existing business requirements, and build an experienced deployment team with both internal and external resources. Initial activity will involve conducting an audit on existing systems and seeing if any can be leveraged or if new systems need to be considered.

Finally, it is advisable to think about how this initiative ties into other performance management and business intelligence activities. Creating another data/application silo is not healthy in any organization, and statutory reporting is one example. Having an overall roadmap for financial, operational and strategic performance management in place, and identifying how automated external reporting and XBRL play a role in that roadmap, allows an organization to better align existing and future technology initiatives.

Summary and Conclusion

Optimizing Last Mile processes carries an ROI that is not difficult to achieve because the potential downside of late or restated SEC filings can be so extreme. In addition, given the advantages of handling XBRL tagging and interactive report preparation in-house, it's inevitable that most companies will get to the point of implementing systems to enable this task.

Learning XBRL takes time and effort, but that goes with any new software system. Once an automated solution is adopted for the high-value process of close-to-report finance work, additional benefits pile up. The company will see improvement in the speed, auditability, ease of production and reliability of regulatory and compliance reports, press releases and other public disclosures as it extends usage of the report platform. With the number of items that require tagging leaping tenfold after the first year of XBRL tagging, there is urgency behind the decision to handle XBRL in-house or farm it out to a financial printer.

A holistic approach to the Last Mile does much more than liberate staff from existing manual and error-prone reporting processes. It will also free up CFOs to spend more time contributing strategic insights. This has increasingly become a part of what companies expect of their CFO: ensuring the nuts and bolts processes are correct, and then staying clear of them to help make long-term decisions.

About Clarity Systems, an IBM Company

Clarity Systems, an IBM Company, delivers software solutions to the Office of Finance. Our software helps large and mid-market organizations around the world automate their external reporting processes to support the production of regulatory and statutory reports. Our unified applications help CFOs reduce risk while simultaneously improving operational efficiency. Clarity Systems was acquired by IBM in October 2010.