Intangibles in a Continuous Reporting Schema

Miklos A. Vasarhelyi
KPMG Professor of AIS
Rutgers Business School

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Outline

- **Preaching to the choir**
- Most interesting things already happened by the time a bookkeeping entry was made
- Obstacles and fallacious basic assumptions
- Some lessons from XBRL
- A continuous reporting schema
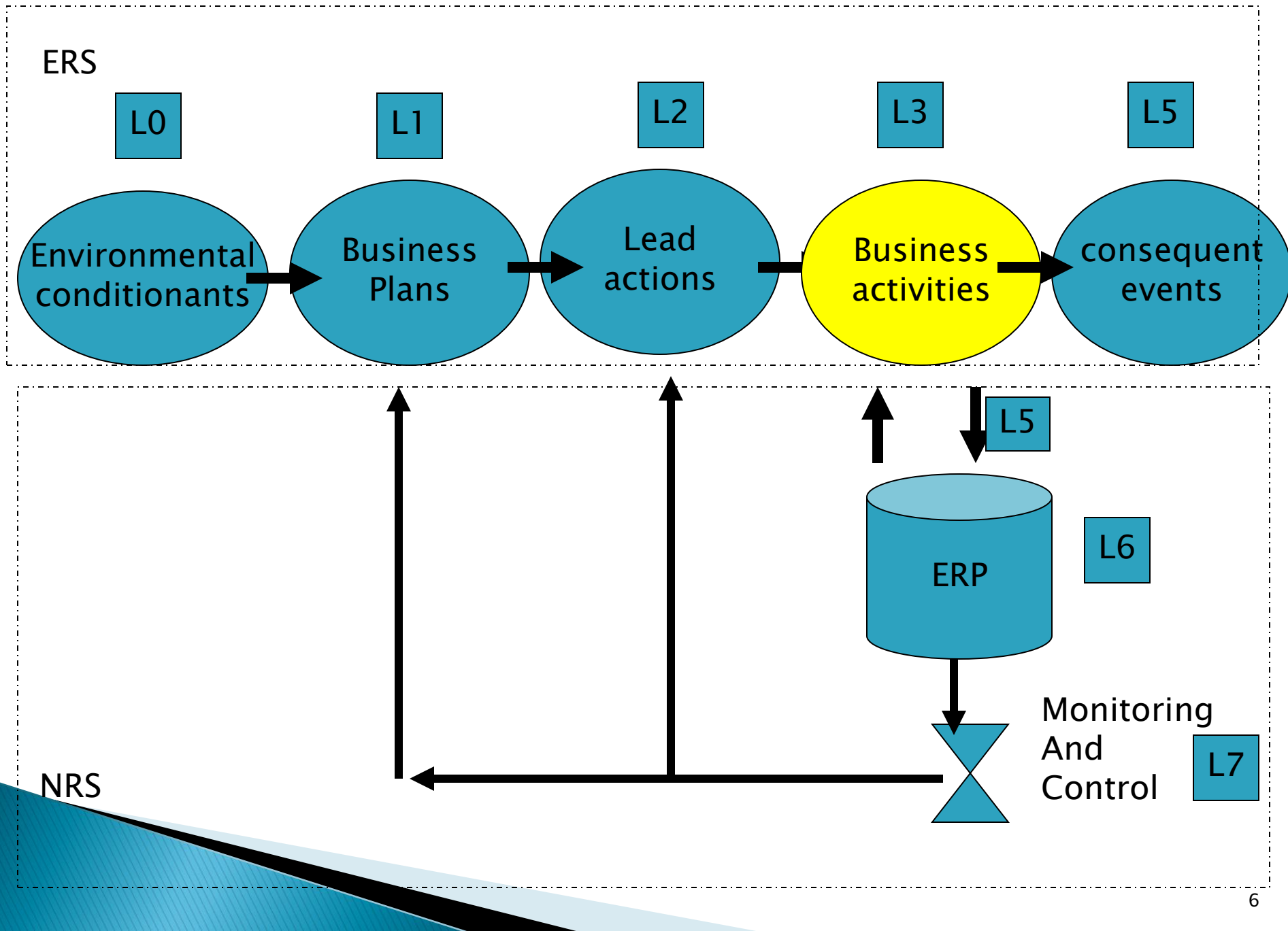- Further speculation

Preaching to the choir

- Measuring business requires a more comprehensive model than the current public reporting schema
- Basic assumptions are not valid
  - One report to all
  - Must be simple
  - Must be deterministic
  - Must be conservative
- We have changed from an industrial to an information society where many physical valuations are irrelevant
- The economics have changed
  - Of reporting
  - Of auditing
  - Of information distributions

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Bill Mc Carthy

"Most interesting things about the operation of a business entity have happened already by the time a transaction is booked"

ERS

L0 Environmental conditionants

L1 Business Plans

L2 Lead actions

L3 Business activities

L5 consequent events

L5

ERP L6

Monitoring And Control L7

NRS

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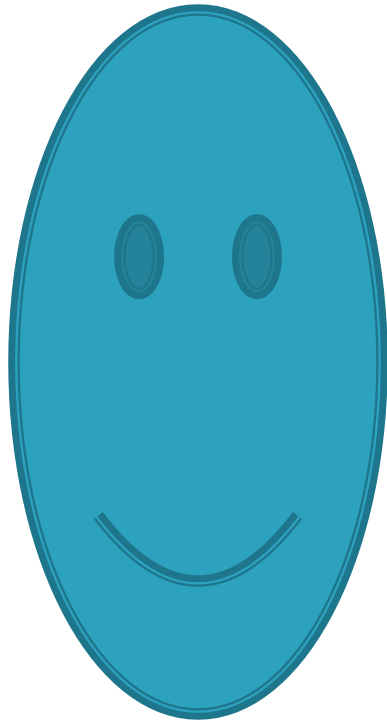
▸ Further speculations
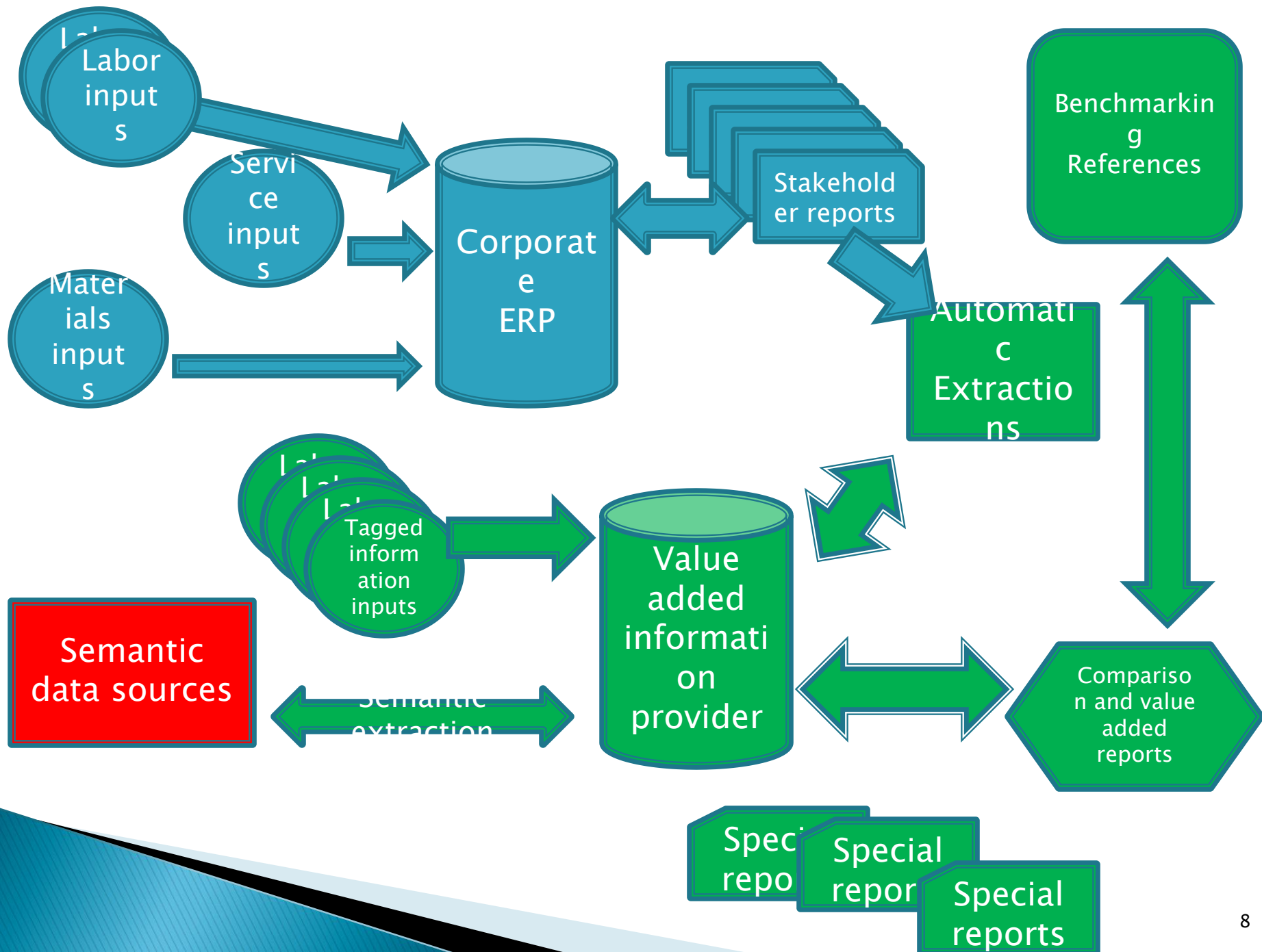
Environmental, mental and expressed verbal content

Verbal content and its semantics Including quantitative assessments

Tagged limited verbal and numerical content

Numerical content

Financial measurements and databases

XML expressed utterances

Traditional Financial statements

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Axioms

- Tagging will force substantial standardization of reporting
- Tagging will create a language of its own
- Tagging will lead to greater granularity of data
- Tagging will accelerate the route to continuous reporting
- Universal tagging will follow tagging by sectors

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The Problem

- Improved information technology allows for more frequent, timely, customized and intelligent business performance information.
- Business has become more complex, more rapid and less tangible.
- Internal reporting partially adjusted (e.g. ERP) but external reporting remained in the pencil and paper age.
- External reporting offers vanilla ice cream only and consequently auditing have a huge expectation gap.
- Financial reporting and audit firms have lost credibility.
- Financial statements have lost value relevance.

Objectives of the four parties

- ## The User
  - ◦ Wants recommendations that will increase his wealth.
  - ◦ Finds it difficult to identify financial advisors that can be trusted
  - ◦ Does not understand financial statements and doubts their reliability
  - ◦ Doesn't want to be out-maneuvered by the insiders and the big traders.
  - ◦ Welcomes hot tips.

The reporting entity's management

▶ I want to raise money at lower cost.

▶ I want to do it legally.

▶ I want to keep my job.

▶ I do not want to be evaluated at every step of the process (micro managed).

▶ I want to make oodles of money.

The Regulator

- Wants to be protective of the small investor.
- Wants the capital markets to function in an orderly fashion.
- Wants confidence in the financial markets.
- Wants to satisfy power-brokers, friendly politicians, and current & potential contributors.
- Wants to keep his job and increase his power.
- Wants good/positive legacy.
- Wants to build political capital and create contacts for future jobs in the private sector.

The Public Interest

- Wants to be protective of all investors particularly the small investors.
- Wants the capital markets to function in an orderly fashion.
- Wants the public to have confidence in the financial markets.

The Solutions page 1

- Getting away from GAAP's "cookie cutter" approach
  - Regulated disclosure of "raw" information to be analyzed by technology based financial intermediaries
- Use of a new type of intermediary that will rely on intelligent expert systems for customized interpretation and analysis of the "raw" ' financial data
  - That has access to corporate transaction details
  - That has a variety of models of measurement available
  - That makes information available as requested
  - That blocks agreed upon (confidential) details

The Solutions page 2

- Use of intelligent expert systems to alert investors to significant events in real time.
- This requires continuous monitoring of critical variables.

Solutions

◦ Variables are more sensitive and less sensitive to certain events, consequently different reporting structures may be needed under different circumstances and industries

◦ Larger diversity in reporting but a reasonably common base of data availability

◦ Different frequencies of reporting at different entities

◦ The users are different and they get different information

◦ Users get the traditional audited report and incremental tailored information

Solutions

- ◦ Progressively we walk away from the traditional report
- ◦ Processes, divisions, and corporations have their own reporting rhythms, these are respected
- ◦ Comparability data is made available by the reporting entity, the intermediators, and by the public good entity

Solutions

▶ The assurance model
  ◦ Traditional audit for the traditional report
  ◦ Mainly however, process assurance a la SysTrust
  ◦ Mainly audit by exception and control monitoring
  ◦ Users may "protest" an audit prior to any litigation
  ◦ Upon protestation the auditor performs additional works and issue a more detailed probabilistic report

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Further speculation

- The incremental cost of information provisioning has changed, with little cost of providing ERP based information
  - The cost is mainly disclosure reluctance, competitive impairment and litigation concerns
- There is need for statutory requirements of non-financial disclosure and points of comparisons
- There is need of a much wider set of entities to disclose

Continuous Reporting
Continuous Assurance

Transaction assurance, Estimate assurance, Compliance assurance, Judgment evaluation

Analytic monitoring level

KPIs: Marketing/Sales Ratio
Inventory turnover
Intra-company transfers

· Drill Down
· History
· Distribution

Relationship level

Sales change = Incremental Marketing cost * 2.7 +- 12%

E-Care queries = number of sales * 4.1

Delay relationships

· Drill Down
· History
· Distribution

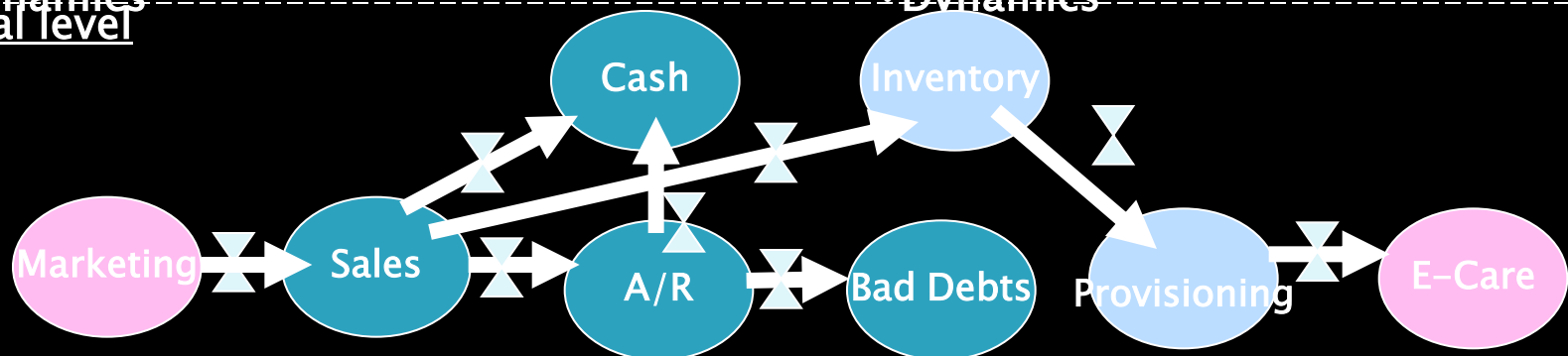## Data level

· Investment
· Regions
· Clients
· Dynamics

· Product detail
· Regions
· Clients
· Dynamics

· Collection
· Aging of receivables
· Clients
· Dynamics

· Inventory
· Distribution
· Ownership
· Dynamics

· Drill Down
· History
· Distribution

Structural level

Marketing → Sales → Cash

Sales → A/R → Inventory

A/R → Bad Debts → Provisioning → E-Care

Inventory → Provisioning

Further speculation (2)

- The reporting model has to leave its comfort zone into estimates and multiple valuations
- The reporting model must become stochastic
- The reporting model has to become more frequent
- The concepts of "internal" and "external" accounting need to be re-evaluated