Controllers

After four years of dancing on the head of a pin to the tune of Sarbanes-Oxley (SOX), the accounting community is more than a little weary of dealing with the complex accounting and reporting environment in the U.S. So emphasized a panel of corporate controllers who gathered at Financial Executives International's (FEI) annual Current Financial Reporting Issues Conference last November to present their views on what's keeping them up at night and to make recommendations for simplifying corporate financial management in America.

What's Keeping Corporate Controllers Up at Night?

By Ramona Dzinkowski

The predominant grievance was the complexity and quantity of U.S. GAAP, the ultraconservative audit environment that currently exists that has translated into unprecedented levels of restatements in America, the ever-growing demand for skilled accounting practitioners who can keep ahead of the curve, and, finally, managing these issues within a global and increasingly complex business environment.

MANAGING COMPLEXITY

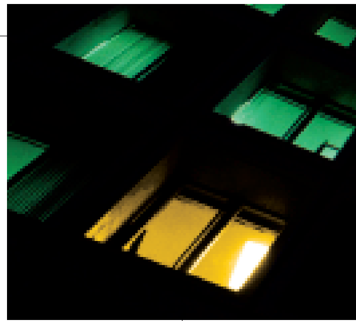
According to James Barge, senior vice president and controller of Time Warner Inc., the current complexity in the reporting and regulatory environment has been directly responsible for the growing number of financial restatements in America, has done nothing to increase market protection, and has created a culture of fear that didn't historically exist in the U.S. accounting community. Barge says, "If you just look at the number of the restatements, they're at record levels. There were 1,600 restatements in the last four years. That's four years into 2005. Midway through 2006 there were already 260 restatements. So we're on the path for another record-breaking year of restatements. To put that in perspective, well over 10% of registrants have restated financial statements in the last four years. I was fortunate enough to practice public accounting for 15 years and never be involved [in a restatement] or have a client restate financial statements. I think that was pretty much the norm, not the exception. I don't think that's the norm anymore, and I don't think the markets are any more well protected today than they were then." Furthermore, he adds, "When I think of the regulatory environment, I think also of litigation. Some of that can be good, but it creates a fear factor that often leads to narrower and narrower interpretations—which leads to more rules, which leads to complexity, and then creates, in many cases, a vicious cycle."

Barge goes on to note that the standards setters and regulators can't undo the current situation on their own, encouraging both the preparer and audit communities to do their part to remove the complexity in the system. He explains: "As a profession we have to pull together—and that means preparers, auditors, standards setters, and the regulators—to reduce complexity where we can and really try to move forward in a more positive way.…From the preparers' perspective, not backdating options would probably help. That's an issue that's very unfortunate. It certainly doesn't build confidence. Bottom line is that we have to have, and take responsibility for, better compliance. From the auditors' standpoint, I think there should be a greater allowance of an acceptable range. I don't think there should be a restatement where people have made reasonable good faith interpretations."

COMPLEXITY IS ABUNDANT—KNOWLEDGE IS SCARCE

The second major issue keeping the accounting community up at night is filling the ever-growing demand for skilled accounting practitioners who can keep ahead of the complexity. In this regard, accessing and maintaining accounting talent is key both at home and abroad, as is designing the right organizational structures to support them. As Kenneth A. Kelly, Jr., VP and controller of McCormick & Company, Inc., explains, for some companies in the U.S., even attracting accounting talent to their corporate head office has been a challenge. Kelly says, "The marketplace has been pretty difficult, particularly for us. We're located in Baltimore, and the whole Baltimore, Washington corridor within the past three or four years has been sucked dry of accountants." Meanwhile, he adds, "It's not just the U.S. either. We're having the same issues in our foreign operations—in the U.K. and China. China's been very challenging in terms of getting talent."

To this end, McCormick & Company has attempted to retain competent accounting talent by making it a priority issue in their operations around the world. The company's global CFOs meet four times a year to focus on employee retention strategies to make sure that they can meet the current and future demand for experienced, globally competent accounting practitioners. Kelly says, "We've brought some focus to the issue. With the marketplace being as tight as it is, we wanted to make sure that we could retain our good people." Every year the company does a specific review whereby they gather a list of critical accounting talent—leaders that they are grooming for the future, as well as a list of current talent down the line that they can't afford to lose right now without leaving a big hole in their human resources. From this, they consult with their Human Resources department to make sure that the right development plans are in place for these specific individuals as well as for the other human resources of the firm in each location. At the same time, the company set up an 18-month in-house finance training program in partnership with a local university to keep their accounting staff on top of current issues in strategic finance. In addition to ensuring that they had appropriate skills in-house, they also focused on opening up the lines of communication between themselves and their auditors and improving the overall audit-client relationship. As Kelly explains, the company wasn't exactly sure where the boundaries lay in terms of asking for information or help from their auditors: "We found an iron curtain where we weren't allowed to talk to our auditors. Nobody knew exactly what we were allowed to talk to them about or what they were allowed to talk to us about. I think, at least in our case, a lot of that has eased up. We've drawn the boundaries about what their responsibility is and what we need to do. I think that's worked." Kelly says the relationship has improved. "In fact, now a pretty good relationship exists where we expect them to do certain things, but we know they can't do other things. They can't do conclusions for us, they can't solve problems for us. But they can help us with the process. They cannot make the decisions for us, but they will help us gather the facts."



STRUCTURES THAT WORK EVERYWHERE

Finally, controllers are concerned about how to turn the complex accounting and reporting culture in the U.S. into something that is operationally manageable in a diverse global environment. Companies operating internationally are attempting to ease the burden of having to transport U.S. GAAP into local accounting cultures, languages, and systems, in a variety of ways, keeping in mind that local cultures matter. Accountants are playing a lead role in creating processes to ensure seamless financial management in their operations around the world.

As Marsha Hunt, VP and corporate controller of Cummins Inc., explained, in addition to local accounting and regulatory complexity, business models are becoming more involved as companies expand operations outside the U.S. Under these circumstances, the standards have become very difficult and complex to apply, particularly keeping in mind local business environments. "As business moves are becoming global, and finance is a strategic part of management, it becomes even more difficult and complex [to interpret the rules] within the company structure," Hunt says. She goes on to explain how Cummins, as an international company, has been focusing on creating the right infrastructure to manage complexity while being responsive to diverse local environments. "What we've been working on is how to build the right support structure—how to take a company that's operating in a decentralized manner, centralize [the accounting knowledge] with position descriptions so that we're making a judgment that is consistent across the company," she adds. She explains that doing that in a culturally friendly way was critical so that certain cultures that may have felt threatened would understand that the head office was there as support and not necessarily there to challenge what foreign offices were doing or to limit their opportunity for growth. To this end, their internal control management team has become responsible for sharing best practices throughout the organization. Hunt emphasizes, "They're not just a grader in terms of whether or not controls are operating effectively. They're actually helping support those controllers in entities that are growing with what they should be thinking about. We've tried to use this as an opportunity to plan dialogue within our financial locations and to reinforce their skill set." At the same time, in addition to having U.S. GAAP experts in each country, Cummins has developed a separate group that is focused on making sure processes are consistent and standardized across the company. "The more standardized, the better for everyone," she says.

IS THERE RELIEF IN SIGHT?

Change is in the wind, not only for U.S. companies but for all companies around the world that have been struggling with the complex U.S. accounting and reporting environment. According to the Securities & Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), the International Accounting Standards Board (IASB), and the Financial Accounting Standards Board (FASB), life will be getting simpler next year—and, they hope, clearer. The U.S. is on the road to simplifying U.S. GAAP by moving toward more principles-based standards, and the FASB and the SEC seem to be on the same page with this. Both bodies recognize that the complex, rules-dominated system of accounting and disclosure that has evolved in the U.S. may not be a viable option in the long run.

Says Bob Herz, chairman of the FASB and arguably the most influential man in the standards-setting world, "I'm concerned about the trajectory of our system—whether it can be sustained. The world is complex, modern business is complex, and they're doing complex transactions. Then you put on top of that complexity a mass of volume of detail of GAAP and SEC rules. So you've got natural complexity combined with rules complexity as well." In reference to the nature of complex systems, Herz notes, "When you combine all the types of complexity, the result can be failure because the system cannot handle that.…"

The SEC has also embraced the view that principles-based standards are the better option and more likely to enable companies to accurately reflect the underlying economics of the firm. SEC Chief Accountant Conrad Hewitt says, "I think that we all want principles that reflect the accounting economic substance of the transaction. Maybe over the years the rules have overtaken the principles. There are a lot of forces that drive the desire for more and more guidance....It's kind of interesting because not more than six to eight years ago accountants felt that anything that wasn't specifically prohibited was okay, meaning that overly aggressive interpretations of the literature could emerge. Now I think it is in the other direction, meaning that accountants think that anything that isn't specifically permitted must be wrong, and [this] potentially results in some overly conservative interpretations. I believe, and my staff does, too, that the right answer is of course between these extremes. Accountants need to become more comfortable applying the literature that is out there in ways that are consistent with the underlying principles and the economic substance of the transaction and provide transparent information to investors."

HARNESSING COMPLEXITY

What will help controllers sleep at night? The regulators and standards setters have a few things up their collective sleeve. First, U.S. GAAP are being developed in cooperation with the IASB, and, going forward, all U.S. GAAP will be built with the view to "conceptually" harmonizing accounting standards around the world. Second, the FASB has specifically said that in the future it will tend not to provide detailed guidance on specific issues of accounting and has asked the corporate accounting and auditing community to please cooperate. Third, the FASB, the SEC, and the PCAOB are all trying to encourage a more communicative relationship between auditors and their clients. (SOX and related rules over auditor independence effectively muted the discourse between companies and auditors over alternative accounting treatments and soured many a relationship between client and audit partner. This helped to create an ultraconservative audit environment and increased the reliance on rules by both parties.) Fourth, the FASB is at the edge of completing a large codification project for U.S. GAAP that, when finished, will provide a single directory for all the U.S. accounting literature that now appears in a variety of different sources.

Meanwhile, the SEC will work toward minimizing the costs associated with listing on an American exchange by providing more guidance to management regarding SOX 404 materiality and testing. This might help lure foreign companies back into the U.S. market while stopping the IPO flight out of the country. The PCAOB will revise Auditing Standard No. 2 (AS2) in hopes of encouraging American auditors to shake the extreme conservative approach that they have taken toward internal control audit and testing. Finally, the SEC will continue its quest toward increased transparency, comparability, and accessibility of financial information through its XBRL (eXtensible Business Reporting Language) adoption project. Whether domestic or foreign, companies first past the post with XBRL will likely have more analyst coverage than non-XBRL companies.

A CONVERGING WORLD

What does this mean for U.S. companies operating in an increasingly complex global business environment? As U.S. GAAP and the International Financial Reporting Standards (IFRS) converge, foreign firms reporting under the IFRS who want to access U.S. capital markets will probably be allowed to file with the SEC without reconciling to U.S. GAAP in three years or less. American companies entering Asia and other foreign markets will find it less daunting to operate in countries where the IFRS are the norm. Foreign accounting paradigms will no longer look so foreign, and U.S. companies that want to acquire foreign firms may find it easier to incorporate IFRS accounting frameworks and systems into their global enterprise. In addition, for U.S.-based firms that operate internationally under U.S. GAAP, finding local accounting talent who have experience with U.S. GAAP has been a challenge, and exporting U.S. accounting talent abroad hasn't always been possible or timely. The more U.S. GAAP reflect principles-based standards, the more easily transferable accounting designations and accounting experience will be between various regions around the world.

Ultimately, having the FASB, the IASB, the SEC, and the PCAOB all working toward simplifying the U.S. accounting and reporting environment...........priceless. ■

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