Controllers Panel Discussion: Key Accounting and Auditing Issues

Learning Objectives: Upon successful completion of this segment, you should be able to:

- recognize how companies are preparing for the new revenue recognition standard;
- identify the areas audit committees are focusing on;
- indicate what companies are doing about conflict minerals;
- identify the steps companies are taking to accomplish disclosure simplification

Segment Overview: Our cameras were present at the Financial Executives International’s Current Financial Reporting Issues Conference as controllers from a number of corporations shared their perspectives on current accounting and auditing issues. Topics they explored – topics your clients may also be dealing with – include revenue recognition, audit committees, disclosure simplification and the impact of the PCAOB on audits.

Field of Study: Auditing

Course Level: Update

Course Prerequisites: Work experience in financial reporting or auditing, or an introductory course in accounting

Advance Preparation: None

Recommended Accreditation: 1 hour group live
2 hours self-study

Required Reading (Self-Study):

- “Revenue Recognition Realized”
  By Glenn Alan Cheney
  Financial Executive Magazine, October 2013

- “The Last Mile of Finance: Growing Scrutiny”
  By Mary Driscoll
  Financial Executive Magazine, November 2013

For additional information on FEI and FERFPROS, go to:
www.financialexecutives.org and
http://www.financialexecutives.org/KenticoCMS/CPE/CPE.aspx#axzz2r34WHSER

See page 9.

Video Transcript: See page 17.

Running Time: 36 minutes
Outline

I. Issues Discussed

A. Revenue Recognition
B. Audit Committees
C. Impact of PCAOB on Audits
D. Conflict Minerals
E. Disclosure Simplification

II. Revenue Recognition Standard

A. Time Warner: Preparing for Revenue Recognition Standard
   1. Forming cross-functional team
      a. accounting
      b. finance
      c. IT
      d. tax
   2. Looking at incentive compensation plans
   3. Considering disclosure requirements
B. General Electric: Preparing for Revenue Recognition Standard
   1. Interacted with Russell Hodge
   2. Shared with global business controllers
   3. Formed cross-functional team
   4. Talked to audit committee
C. Cummins: Preparing for Revenue Recognition Standard
   1. Spoke with main IT vendors
   2. Thinking about education effort
D. Boeing: Preparing for Revenue Recognition Standard
   1. Preparing for change from milestone delivery to cost to cost
   2. Evaluating transactions
   3. Considering IT system changes
   4. Thinking about education
   5. Engaging external help
E. Cangialosi’s Takeaways
   1. Start now
   2. Form cross-functional teams
   3. Think about changes in controls
   4. Educate on the standard
F. General Electric’s Approach to Training
   1. Comprehensive revenue recognition module
   2. Refresh modules based on specific situations
   3. In person

III. Audit Committee Focus

A. Cummins: Audit Committee Focus
   1. Deep dive on ERM or risk management issue
   2. Education on certain business transactions
B. Boeing: Audit Committee Focus
   1. Risk and compliance
   2. Business issues
IV. Auditors’ Change in Approach

A. Time Warner’s Perspective on Auditors’ Change in Approach
   1. Asking for more documentation
   2. Increased regulatory requirements leading to auditors increasing fees

B. Cummins’ Perspective on Auditors’ Change in Approach
   1. Concerned about auditors’ “audit quality improvements”
   2. Impact of auditors’ documentation requirements on staff time
   3. Implication of SAS 70 reports on quarterly reports

C. General Electric’s Perspective on Auditors’ Change in Approach
   1. Dialogue has been constructive
   2. Concerned about audit firm talent
   3. Getting more documentation requests

D. Public Company Accounting Oversight Board (PCAOB)
   1. They were created in a time of crisis
   2. Their responsibility was to build confidence in audits

V. Conflict Minerals

A. Boeing’s Approach to Conflict Minerals
   1. Led by supplier management group
   2. Engaging external consultants
   3. Investing resources into understanding supply chain

B. Alcoa’s Approach to Conflict Minerals
   1. Identifying conflict minerals in organization
   2. Getting certifications from suppliers
   3. Collecting appropriate information for reporting

C. Cummins’ Approach to Conflict Minerals
   1. Led by a lawyer
   2. Internal audit involved

VI. Disclosure Simplification

A. Boeing: Disclosure Simplification
   1. 18% fewer pages in 10K since 2004 filing
   2. 30% fewer pages in 10Q
   3. Eliminated repetition
   4. Using more succinct language

B. General Electric: Disclosure Simplification
   1. Looking at specific areas
   2. Examining balance within some footnotes
   3. Benchmarking
Group Discussion Option

Instructions for Segment

- As the Discussion Leader, you should introduce this video segment with words similar to the following:
  “In this segment, a panel of controllers at the CFRI conference share their perspectives on the major accounting and auditing issues – topics your clients may also be dealing with – in today’s complex and rapidly changing environment.”

- Show the Segment. The transcript of this video starts on page 17 of this guide.
- After playing the video, use the questions provided or ones you have developed to generate discussion. The answers to our discussion questions are on pages 5 and 6. Additional objective questions are on pages 7 and 8.

Discussion Questions

 Controllers Panel Discussion: Key Accounting and Auditing Issue

You may want to assign these discussion questions to individual participants before viewing the video segment.

1. How are companies preparing for the new revenue recognition standard?

2. What were Ms. Cangialosi’s takeaways with regards to preparing for the new revenue recognition standard? What are we doing within our organization?

3. What are audit committees focusing on today? What are our clients’ audit committees focusing on?

4. How have the activities of the PCAOB changed the auditor’s approach to the audit? What have been the implications for companies?

5. What have companies been doing to deal with conflict minerals? What have our clients done?

6. What have companies been doing about disclosure simplification? What have our clients done?

7. What other accounting or auditing issues are we finding challenging with our clients? What are they doing about them?
# Controllers Panel Discussion: Key Accounting and Auditing Issues

1. How are companies preparing for the new revenue recognition standard?
   - **Time Warner**: preparing for revenue recognition standard
     - forming cross-functional team
     - accounting
     - finance
     - IT
     - tax
     - looking at incentive compensation plans
     - considering disclosure requirements
   - **General Electric**: preparing for revenue recognition standard
     - interacted with Russell Hodge
     - shared with global business controllers
     - formed cross-functional team
     - talked to audit committee
   - **Cummins**: preparing for revenue recognition standard
     - spoke with main IT vendors
     - thinking about education effort
   - **Boeing**: preparing for revenue recognition standard
     - preparing for change from milestone delivery to cost to cost
     - evaluating transactions
     - considering IT system changes
     - thinking about education
     - engaging external help

2. What were Ms. Cangialosi’s takeaways with regards to preparing for the new revenue recognition standard? What are we doing within our organization?
   - **Cangialosi’s takeaways**
     - start now
     - form cross-functional teams
     - think about changes in controls
     - educate on the standard
   - **Response is based on your organization**

3. What are audit committees focusing on today? What are our clients’ audit committees focusing on?
   - **Cummins’ audit committee focus**
     - deep dive on ERM or risk management issue
     - education on certain business transactions
   - **Boeing’s audit committee focus**
     - risk and compliance
     - business issues
   - **Response is based on your clients**

4. How have the activities of the PCAOB changed the auditor’s approach to the audit? What have been the implications for companies?
   - **Public Company Accounting Oversight Board (PCAOB)**
     - they were created in a time of crisis
     - their responsibility was to build confidence in audits
   - **Time Warner’s perspective on auditors’ change in approach**
     - asking for more documentation
     - increased regulatory requirements leading to auditors increasing fees
   - **Cummins’ perspective on auditors change in approach**
     - concerned about auditors’ “audit quality improvements”
     - impact of auditors’ documentation requirements on staff time
     - implication of SAS 70 reports on quarterly reports
   - **General Electric’s perspective on auditors’ change in approach**
     - dialogue has been constructive
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5. What have companies been doing to deal with conflict minerals? What have our clients done?

- Boeing’s approach to conflict minerals
  - led by supplier management group
  - engaging external consultants
  - investing resources into understanding supply chain

- Alcoa’s approach to conflict minerals
  - identifying conflict minerals in organization
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- Cummins’ approach to conflict minerals
  - led by a lawyer
  - internal audit involved

6. What have companies been doing about disclosure simplification? What have our clients done?

- Boeing: disclosure simplification
  - 18% fewer pages in 10K since 2004 filing
  - 30% fewer pages in 10Q
  - eliminated repetition
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- General Electric: disclosure simplification
  - looking at specific areas
  - examining balance within some footnotes
  - benchmarking

- Response is based on your clients

7. What other accounting or auditing issues are we finding challenging with our clients? What are they doing about them?

- Response is based on your clients
Objective Questions

Controllers Panel Discussion: Key Accounting and Auditing Issue

You may want to use these objective questions to test knowledge and/or to generate further discussion; these questions are only for group discussion purposes. Most of these questions are based on the video segment, a few may be based on the required reading for self-study that starts on page 9.

1. A group of eight American and European car companies said that the impact of the new standard on their systems would be:
   a) the need for a complete overhaul
   b) a cost ranging from $100 to $300 million
   c) minimal
   d) difficult to assess

2. Recognizing the questions and problems that are likely to arise as organizations learn to apply a single standard, FASB and IASB have:
   a) extended the transition period
   b) posted a Q&A on their websites to address common questions
   c) formed the Revenue Recognition Transition Resource Group
   d) decided to scale back disclosure requirements

3. Robert Kugel at Ventana Research said that the financial close:
   a) takes about one-half day longer than it did in 2007
   b) has neither shortened nor lengthened since 2007
   c) has shortened since 2004
   d) has shortened since 2007

4. Pascal Desroches said that Time Warner’s approach to preparing for the new revenue recognition standard included all of the following except:
   a) forming a cross functional team
   b) reviewing incentive compensation plans
   c) consulting the tax department
   d) consulting the audit committee

5. Cummins’ main focus in preparing for the new revenue standard has been:
   a) holding meetings with the audit committee
   b) working with its operations group
   c) working with its IT vendors
   d) holding meetings with internal audit

6. The impact of the new revenue standard on Alcoa is likely to be:
   a) non-existent
   b) significant
   c) limited to its aerospace division
   d) limited to its international subsidiaries

7. Time Warner’s approach to training employees on the new standard is:
   a) different from that of the other panelists
   b) similar to that of GE
   c) in the early stages of being planned
   d) to wait until 2016, the year before the standard becomes effective

8. Marsha Hunt is worried that Cummins:
   a) will not have the proper resources to handle future audits
   b) will need to improve its talent base
   c) will need to replace its audit firm
   d) will have to shift resources away from meeting leadership goals to handling audits
Objective Questions (continued)

9. Cangialosi has questioned the propriety of:
   a) auditor requests for more documentation
   b) auditors trying to charge for quality improvements
   c) increasing the size of the audit team
   d) auditors questioning management on things they read in analyst reports

10. With regard to disclosure simplification, Diana Sands of Boeing said that:
    a) they are arguing with their attorneys about how to reduce disclosures
    b) they plan to reduce the number of pages in their 10Q’s and 10K’s
    c) they have significantly reduced the pages in their 10Q’s and 10K’s
    d) they are having difficulty deciding what they can remove from their disclosures
Self-Study Option

Instructions for Segment

When taking a segment on a self-study basis, an individual earns CPE credit by doing the following:

1. Viewing the video (approximately 30–35 minutes). The transcript of this video starts on page 17 of this guide.

2. Completing the Required Reading (approximately 25–30 minutes). The Required Reading for this segment starts below.

3. Completing the online steps (approximately 35–45 minutes).

Required Reading (Self-Study)

REVENUE RECOGNITION REALIZED

By Glenn Alan Cheney
Financial Executive Magazine,
October 2013
For additional information on FEI and FERFP, go to:
www.financialexecutives.org and
http://www.financialexecutives.org/KenticoCMS/CPE/CPE.aspx#axzz2r34WHSER

After 10 years of work, thousands of meetings, and a lot of trans-Atlantic head-scratching, companies around the world are getting their first look at a new accounting standard on revenue recognition.

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are issuing virtually identical standards that do away with literally hundreds of bits of scattered guidance, replacing them with principles-based guidance that could be challenging to United States-based companies.

Much of the current disparity results from disparate standards set for various industries. One objective of the new standard is to do away with industry differences, resulting in more comparable revenue disclosures.

U.S. companies have long called for standards that are less prescriptive and based more on principles. But the judgment required for a principles-based standard may leave corporate and public accountants questioning what they wished for.

FASB board member Marc Siegel is optimistic. “The new standard will replace industry-specific guidance with a single and comprehensive framework for recognizing, measuring and disclosing revenue,” Siegel says. “That single framework will apply across companies and capital markets, making it much easier for financial statement users to compare the final statements of companies across different industries.”

Complex Shift in Accounting Practices for U.S. Companies

The goal of establishing a single framework for something as variable as revenue for all companies – public, private and not-for-profit – in all industries and in all countries has been an unprecedented challenge. Though the new guidance is simpler to grasp, for many companies the change will
mean a complex shift in accounting practices and the need to explain the basis of judgment calls.

Once that shift has been made and the bugs have been ironed out of the guidance, however, the accounting should be simpler. According to FASB, the application of a single set of principles should result in more stable guidance that not only has fewer rules but rules that remain consistent across industries, jurisdictions and capital markets.

Financial Executives International (FEI) tasked its Committee on Corporate Reporting (CCR) to provide cross-industry views on the FASB proposals. The committee includes members from 21 public companies in manufacturing, accounting, software, information technology, health, automotive, petroleum, banking and telecommunication.

PwC LLP partner Chad Kokenge warns that though the standard is not effective for public companies until years beginning after Dec. 15, 2016 (nonpublic entities will have an additional year to comply) organizations need to start understanding the ramifications now.

“Small changes in revenue recognition can lead to big impacts throughout a company’s process,” Kokenge says. “Internal processes will have to change. Depending on the company, sales, information technology, internal control, financial departments and operations may need to change.”

The change will be greater for U.S. firms than companies already following international standards. The amount of revenue recognized will not change significantly, if at all, but the timing of recognition will in many cases become not only different but difficult to track, and the change in timing could impact the timing of profits.

Under the new guidance each good and service in a contract must be evaluated to determine whether it should be treated as a distinct performance obligation or be bundled with other goods and services. Establishing the unit of account is critical as it will determine subsequent steps in the model, allocation of transaction price and, ultimately, the recognition of the revenue.

The transfer of control from the seller to the customer is a fundamental principle of the standard. Each performance obligation must be evaluated to determine whether it is satisfied at a certain point in time or over a period of time.

For the convenience store exchanging a gallon of milk for a modicum of cash, the recognition of revenue is simple. But when the sale of a car to a dealership, involves a promise to deliver roadside assistance to a subsequent customer several years in the future, the accounting gets tricky.

A comment letter to FASB and IASB signed by eight American and European car companies expressed financial dismay based on their initial assessment of how the expected standard could impact their systems:

“[W]e estimate the range of cost may vary from approximately $100 million for some companies to $300 million for other companies, depending on the free or discounted services offered and the [information technology] systems used,” the letter states.

“These estimates have not considered the implications and additional complexities for hedging, taxes, transfer pricing and forecasting. These cost estimates assume the need for an IT solution that will account for the vehicles on an individual basis and a global implementation effort that will likely take three to eight years, depending on the related IT system interfaces.”

Susan Callahan, manager, global accounting and special studies at Ford Motor Co., foresees an onerous and expensive shift with, in her opinion, no benefits to the investor.

“This is going to have system implications and a need for re-education for both our internal analysis and that of the investors,” Callahan says. “It’s going to have process implications. Some people are talking about renegotiating contracts to avoid some of the complexity. The only recommendation I have is that people better get started as soon as this standard is issued.”
Impending Complexity Concerns

The telecommunications industry, especially the cellphone sector, is even more concerned with the impending complexities. The problem is that cellphone sales almost always come with service contracts, and those contracts tend to change over time, especially when customers exchange old phones for new ones. The number of customers and the variety of phones and contracts are staggeringly difficult to track.

Since the standard requires an allocation of revenues by performance obligation over the period of delivery of services, cellphone providers face the headache of determining what portion of the sale has been completed at any given point in time.

Though FASB has recognized the problem and met with telecommunications representatives several times, the board has been unable to formulate a solution that retains the one-principle-fits-all approach while avoiding the prescriptive exceptions that reduce the comparability that the standard is supposed to achieve. Cellphone companies are looking for internal solutions, such as bundled contracts or simpler service contracts, but no one is comfortable with the prospect of modifying a business process in order to meet accounting requirements.

Mark Crowley, a director at Deloitte LLP, warns that the principles-based nature of the standard calls for a change in mindset for corporate accountants accustomed to prescriptive, rules-based standards.

“The standard eliminates a lot of specific rules and requires companies to use a lot more judgment,” Crowley says. “There will be extensive disclosure requirements, including a requirement to describe judgments used in determining the manner in which revenue is recognized. It will require companies to document their conclusions and judgments not only to comply with their normal internal controls and policies but also to avoid being second-guessed on their judgments later.”

Boards Dealing with Implementation Issues

FASB and IASB recognize the inevitability of questions and problems as organizations learn to apply a single standard to their various industry finances. As a result, both boards are forming the Revenue Recognition Transition Resource Group that will help companies implement the standard consistently. It will solicit and assess issues from corporate and stakeholder perspectives, provide a forum for discussion of problems and help the boards determine what action may be necessary to minimize any diversity of implementation.

The group will include 10 to 15 specialists representing financial statement preparers, auditors, regulators, stakeholders and representatives from both FASB and IASB.

“We recognize that U.S. firms will need sufficient time to implement the changes into their financial reporting structures, and we are committed to supporting their smooth transition to the new standard,” FASB’s Siegel says. “The Revenue Recognition Transition Resource Group will
address implementation issues as they arise, and the FASB will engage in other outreach with U.S. stakeholders to make sure they’re ready by the Jan. 1, 2017 effective date.”

Guidelines for submitting issues will be posted on the boards’ websites.

**Investors to Benefit from Rules**

Investors will be the big beneficiaries of financial statements prepared under the new rules. They will have significantly more information about revenue, which will be disaggregated into categories with a link made to the segment revenue disclosure. Statements will disclose significantly more data on contracts, including judgments and estimates, remaining performance obligations, contract assets and liabilities and contract costs.

Under current rules, which accommodate the different needs of dozens of industries, revenue is presented at an aggregate level, making it hard to discern growth patterns among different business lines within a given entity, which makes it difficult for investors to understand.

According to a KPMG Executive Accounting Update: Changes to Revenue Recognition, to generate all that data, companies will need to assess and often adjust processes throughout the organization. Existing contracts will need to be analyzed for performance obligations, and future contracts may be formulated to facilitate accounting. Accounting departments will need to perform gap analyses.

In addition, the changes in the timing and amounts of revenue recognition and capitalized costs are likely to have tax implications. Judgments on accounting treatments will need to be captured, sculpted, fine-tuned and approved by legal and financial departments. Systems will need to be upgraded to capture the new kinds of data needed for estimates, judgments and disclosures.

Management may want to help stakeholders understand the changes in revenue recognition and new information in financial statements. In that all these adjustments will be interlinked, companies may want to assign staff to an interdepartmental task force to coordinate the changes.

Private companies and not-for-profit organizations will have it a bit easier. FASB notes that besides having an extra year to implement the standard, private companies and non-profits will be exempt from most quantitative disclosure requirements. Not-for-profits will be exempt from the onerous performance obligation test for contracts that primarily serve charitable or social benefit purposes.

The implementation of this new standard will be a crucial test of how well principles-based guidance will work in American business. The success of this standard will be a test of not only FASB’s ability to write principles-based standards but U.S. companies’ ability to apply them judiciously.
The “last mile” of finance is finally getting the attention it deserves. That’s not because chief financial officers and controllers have run out of things to fix. They don’t have a choice – the close-to-disclose process, particularly the final stretch of financial statement preparation, is rife with inefficiency and complexity. Previous gains made in cycle-time compression are gone. Risks of financial error and internal control failures are on the rise. Experts in U.S. Securities and Exchange Commission (SEC) reporting predict things will get worse.

The close-to-disclose process involves all activities needed to close an organization’s books, perform all necessary inter-company accounting and reconciliation steps, finalize consolidated financial statements and release earnings and publish official statements with regulators such as the SEC. Global corporate expansions in recent years, along with a steady pace of acquisitions, have created accounting and systems problems at many large companies and have made financial statement preparation a high-wire act.

“Intercompany accounting and balance sheet reconciliations pose significant challenges to multinational companies today,” says Kyle Cheney, a partner at Deloitte & Touche LLP. “There is a pervasive lack of central/corporate visibility to these activities, which creates risk from a Sarbanes-Oxley and SEC reporting standpoint.”

These organizations, he adds, “need to improve core processes and technology solutions, thereby providing transparent ability to initiate, settle, clear and reconcile balances. Leading companies have structured initiatives to accomplish this on a global scale, and they are gaining efficiency by doing so.”

Cheney is not alone in calling for serious change. A growing crowd of experts say financial statement integrity is at stake.

**Disclosure Explosion**

“Yes, more people are taking a look at the close process because financial reporting timetables and disclosure requirements are getting more condensed and expansive simultaneously,” says William Curry, corporate controller and principal accounting officer at Waters Corp. “Over the past 10 years, the level of complexity and the amount of required disclosures have grown enormously.

“Two examples involve fair value and pension disclosures. It’s fair to say there hasn’t been anything like this since the ‘33 and ‘34 Acts came out [the birth of the SEC after the Wall Street Crash of 1929].” Curry also serves as an instructor at the SEC Institute Inc., a training firm that specializes in financial reporting.

Reed Wilson, who consults on technical accounting and SEC reporting and serves on Financial Executives International’s (FEI) Committee on Corporate Reporting (CCR), concurs: “There is widespread frustration among finance professionals in the preparer community with the ever-increasing SEC and FASB disclosure requirements. This is especially challenging for interim periods given the tight filing deadlines.

By Mary Driscoll
Financial Executive Magazine, November 2013
For additional information on FEI and FERFPROS, go to: www.financialexecutives.org and http://www.financialexecutives.org/KenticoCMS/CPE/CPE.aspx#axzz2r34WHSER

Repairing the last mile of finance has historically been accomplished by patching the potholes, but statement users are pressing for faster and more frequent information. Here are some best practices for making it a smoother, faster, better controlled and efficient ride.
“For multinationals, global charts of account and common systems solutions can help, but this is difficult and costly to achieve, especially where frequent acquisitions are involved.” Also, adds Wilson, “information is being requested that does not reside in the ledger.”

One new rule that really irks finance executives is the SEC’s disclosure requirement involving the possible presence of “conflict minerals” in global supply chains. The rule refers to natural resources such as diamonds that are leveraged by perpetrators of violence in central Africa. “How am I supposed to implement that?” asks one controller.

Another executive – one who tunes into current opinion from his post on the Institute of Management Accountants (IMA) Financial Reporting Committee – reports that “people are asking why FASB [the Financial Account Standards Board] wants information that senior management doesn’t use in decision-making. Apparently, somebody at FASB thinks it’s important.”

The irony is that fuzzy rules and confusing directions have prompted statement preparers to take the “kitchen sink” approach. That is, throw in everything but the sink. Terry Iannaconi, senior partner at KPMG and former SEC official, advises against it. “The area of risk factors is one area where people are getting very carried away in attempts to cover themselves. They are including generic risk factors such as: ‘Customers could stop preferring our products and buy elsewhere.’ This is not specific to just your company. And in the end, analysts and investors can’t tell which risk factors are relevant.”

Most companies have not yet taken steps to reduce disclosure complexity, she adds. “It requires an arduous effort to go through everything and decide which things are irrelevant and unnecessary. And I know it can be tough, because you’ve got to make judgment calls that may be difficult.” Still, Iannaconi believes strongly that preparers owe it to investors, particularly individuals, to get this process fixed. (For an in-depth report on this subject, which is coauthored by Iannaconi, see Disclosure Overload and Complexity: Hidden in Plain Sight, by KPMG and Financial Executives Research Foundation.)

Stay tuned for developments on the regulatory front. In a September 2012 webinar, the Financial Accounting Standards Board reviewed a recent Invitation to Comment. This involved a project to establish an overarching framework to improve the effectiveness of disclosures in notes to financial statements. (Relevant documents are on the FASB website.)

**Process Improvement: Coming Up**

In the first quarter of 2012, APQC conducted a survey on trends in financial management process improvement. Responses were gathered from 145 senior finance executives from large organizations in the United States and Europe and a small percentage came from Asia. One surprising finding: nearly 75 percent reported that the close-to-disclose process ranked among their top-two targets for financial management improvement over the next 18 months.

A skeptic would question if we’re in for a round of band-aid measures. Or, could it be that CFOs are planning an “open kimono” approach to process transformation? A clue, perhaps, is found in the survey, which indicates that 81 percent of large corporations are currently investing in at least one major program to improve financial management processes.

With the close-to-disclose process high on the target list, expect to see a sizeable chunk of companies in the Fortune 1,000 getting serious about fixing the most fundamental finance mission: stewardship of financial accounting and reporting.

Robert Kugel, senior vice president and research director at Ventana Research, provides this context: “The average company in 2012 takes about one-half day longer to complete the full close-to-report cycle than it did in 2007, which, in turn, was about the same as 2004. While there are companies that do a great job and can close in five business days or less, the majority of
companies have gone in reverse. The reason is either that they have a poorly designed process, or there’s far too much reliance on manual processing.”

In addition, Kugel notes, “Over the past three years, things have been exacerbated by staff cutbacks. And when you’ve got a bad process to begin with and fewer people, you’ve got a longer close.” He believes that CFOs and controllers have erred in ignoring this corner of the stewardship tableau.

“If it’s taking until the third week of the month following the end of the quarter to finish your consolidation, and then you have to get SEC documents done on top of XBRL [eXtensible Business Reporting Language] work, a lot of people on your staff are in a lot of pain,” adds Kugel.

To his way of thinking, allowing a heavy reliance on spreadsheets as the primary process-enabling tool is just asking for trouble. “We find about 40 percent using spreadsheets for governance, risk and compliance (GRC) work. But spreadsheets have been shown repeatedly to be prone to errors when used in collaborative processes at an enterprise level.”

The reluctance by CFOs to invest in better GRC tools is out of step with the bulk of Kugel’s recent research findings, which indicate a strong desire by companies to address operational risk.

The situation is particularly disturbing in the financial services sector, says Michael Flagliello, a partner with WeiserMazars, an advisory firm that works closely with insurance companies. “We see some very antiquated infrastructure. More than 20 percent of the firms we looked at recently take more than 40 days to close their books. In fact, 70 percent of CFOs in this sector struggle to close the gap between ideal and actual closing times.”

The culprit, he says, comes as no surprise: an extremely heavy reliance on manual processes and spreadsheets, followed by a lack of functionality in core data systems. “As a result, people are so caught up in manual close steps that they have no time to do meaningful analysis. Even worse, the risk of error is leading to more restatement risk. We know rating agencies are talking about this,” says Flagliello.

It’s impossible to quantify restatement risk in a meaningful way using classic benchmarking tools. But cycle speed and process costs can be benchmarked to gain a sense of relative performance gaps. From there, it’s reasonable to assume that CFOs who have invested in streamlining and automating the close-to-disclose process – those that go fastest and spend the least – have less risk of data entry errors, avoid missed checks on the reasonableness of sums that roll up from local reporting entities, prevent version control problems and so forth.

All those potential mishaps in a high-pressure work cycle add to restatement risk.

Cost is another important dimension, and CFOs will want to look closely at the potential return-on-investment from tools for automating the close-to-disclose process. But in this case, speed (or lack thereof) is very important because of the ripple effect.

Kugel puts it this way: “Automating the close-to-publish process provides members of the board of directors and other external parties with more time to review the documents before the mandated filing deadline. It also gives time back to the finance and legal departments that they can apply to more valuable efforts.”

Playing It Forward

There are signs that more CFOs and controllers are taking stock of the situation. “A few years back, when companies first started to address the SEC’s requirements to file financial statement using XBRL, the answer for some was a quick fix – throw a dedicated XBRL-tagging software solution at the problem or outsource the tagging work,” says James Fisher, vice president of marketing, analytics at business software provider SAP.

“But many of them are now coming around to the idea that you should take an end-to-end perspective with a strong eye on the future. That means fixing inefficiency across
the entire process, not just the tagging step. It seems that more people now are discussing the bigger picture because they want to take out more cost and at the same time improve the quality of the process,” adds Fisher.

Looking toward the future, experts say the close-to-disclose process will grow more burdensome and pressured. “Even if we do not have wholesale adoption of IFRS [International Financial Reporting Standards] here in the U.S., as we move closer to convergence, there will be more incremental disclosures,” says George Wilson, vice president at the SEC Institute.

“But every company has its own nuances for getting this work done. So it’s not going to be a matter of flipping a switch on a piece of software. The only way you can stay in front of this is to take a process-based approach and make a commitment to getting better and better as you go along, says Wilson.”
Controllers Panel Discussion:
Key Accounting and Auditing Issue

QUINLAN: Our cameras were on hand at the Financial Executives International’s Current Financial Reporting Issues Conference where controllers of major companies shared their perspectives on the key accounting and auditing issues they are dealing with in today’s complex and rapidly-changing environment.

Among the topics discussed by the controllers were revenue recognition, audit committees, the impact of the PCAOB on audits, conflict minerals, and disclosure simplification.

Many of your clients are probably grappling with these same issues. The panelists provided insights into what their companies are doing and answered questions from the audience of fellow conference attendees.

CANGIALOSI: We have an esteemed panel this year. We have Graeme Bottger, who’s from Alcoa, and Pascal Desroches from Time Warner, Jan Hauser from GE, Marsha Hunt from Cummins, and Diana Sands from Boeing, and I would encourage you all to, if you have questions for the panel, they’re always happy to answer, right, guys?

We’re going to make this informal. Please jump in when you have a comment. I’ll start off with some questions, and then we can go from there. We heard yesterday about revenue recognition and some of the difficulties in applying the new standard. Can you comment on what you’re doing to prepare for it? Pascal, do you want to start us off?

DESROCHES: Sure. Good morning, everybody. Like most people, I would imagine we’ve all familiarized ourselves with the standard, but candidly, it’s hard to do anything tangible and make significant investments before you actually have a final standard and see what it says, but there are a couple things that we’re doing.

We are forming a cross-functional team to make sure that we’re bringing all the subject-matter experts that may have relevant points of view that may be impacted by this.

For example, in addition to the obvious ones like the accountants and finance people across the organizations, obviously IT, because of system changes, needs to be involved.

Also, our tax folks, we’re making sure that they are involved to see whether or not the changes here will have any tax consequences.

Another area that you may want to keep an eye on is incentive compensation plans.

As this gets implemented, invariably, there will be open plans that were set in old GAAP. You have to make sure that you’re mindful of the impact on those plans. The other area that I would make sure that you’re all focused on, speaking from Time Warner’s standpoint, are changes that are at the margins, but I don’t anticipate there is going to be a significant difference in the timing of revenue recognition for us. Still, when you look at some of the disclosure requirements, they are not things that we’re currently capturing as part of our system, so you’re going to have
to change systems and processes at a minimum to be mindful of the
disclosure requirements.

HAUSER: Yeah, this has been a big focus for us. I feel very fortunate because on our
team, we’ve had Russell Hodge following the revenue recognition
standard very closely. We’ve been kind of in the mix in a lot of the
discussions that have been going on, so I think it has allowed us to think
through some of the issues we’re going to encounter.

We also had the opportunity to look at the guidance and share it with our
global business controllers, so we, with some of the pro forma wording,
we asked them, how are you going to operationalize this standard?

Tell us where you understand it or don’t understand it, or it’s going to
cause complexity, so while we haven’t given a dry run obviously, we have
been engaging with the businesses because we operate in so many
different sectors that whether it’s SAB 104 or long-term contracts or
service agreements, we touch pretty much everything, so we know we’ve
got a huge task in front of us.

Like Pascal, we have formed a cross-functional team that’s getting
underway and starting to chart a course.

The timeline looks long when you just look at it in the abstract, but when
you start to put project plans together and think about how you’re going
to roll it out and who you need to get involved and how you’re going to
have to have the processes, the controls, identifying what are performance
obligations, is one business unit looking at it the same way as another
business unit, it becomes a pretty daunting task, but we have started.

In addition to that, we did take the opportunity a few months ago to talk
to the audit committee about what they will be seeing, so we wanted to
inform them about the changes that are coming up about some of the
questions we’re going to have to ask ourselves in terms of, what does the
transition look like?

How are we going to apply it? Some of the key decisions, and we’re
going to have to try to come with that as early as possible. People are
going to want to be sizing what the change is, so we’ve tried to engage it
with our folks at all levels within the organization.

CANGIALOSI: Okay, great. Marsha, you have a comment on that?

HUNT: Two quick additions. You asked kind of what we can be doing now. At
Cummins, we’ve already spoken with our main IT vendors, so we’re
trying to understand their timeline of when we can expect to have some
modules.

We are primarily an Oracle shop, so our conversations have been with
Oracle. That’s helpful because it helps us think about how to integrate
other changes that we were thinking through on our Oracle platform so
that we’re efficient when make some of these changes, and that’s altered
our prioritization of some activity, number one.

Number two, we’re already thinking through the internal education effort
of our finance teams, especially in the operating unit. While many of us
are fortunate to have very talented professionals in our corporate team that
may already be thinking about this, we know that for many of our
operating folks in the line, especially international folks, we want to try to
streamline their education as it relates to this, so we’re starting to think
through what that would look like.
SANDS: This is going to be a lot of work for most of us. We’re one of the companies Russ mentioned yesterday that has long-term contracts, so we will see in our defense business a pretty substantial change in revenue recognition from milestone delivery based to cost to cost. We have been preparing.

Really, it’s hard to really work in earnest on this until we see the final standard, but we’re going to have to do everything from evaluate all of the transactions in our business against that standard to IT systems changes to process education to educating investors on our part. One cautionary or one concern we have is, as the standard has been pushed out in terms of its final issuance, and if the implementation date stays where it is right now, we do feel a little bit pressed for time right now, so I think we are going to be engaging some external help along the way as well.

HAUSER: As we go forward just thinking about that, as we get into it and all the questions that are going to arise, I think the implementation group is going to be very helpful, but I do think this is all going to continue to add to the timeline.

BOTTGER: I think I’m the lucky one on the panel, Loretta. I come from the manufacturing background, and we’ve got a fairly basic operation, very vanilla in flavor, and we make a product, we ship it to a customer, they take title and then we book the revenue, so I feel as though I’ve dodged the bullet on this one.

CANGIALOSI: Lucky you. Okay, so the takeaways for me on this one are, start now. Don’t wait. Form some sort of cross-functional team with the relevant people, and start thinking about the changes in controls, possibly different business units, the more diversity you have in your business, you may need to look more carefully at those comments and questions.

One of the things I was thinking about was that we have a number of shared service centers, and aside from that within the markets is trying to educate everybody around this standard. What training do you use in general, and specifically, maybe you can comment about what you might do with this standard?

HAUSER: We have a number of different trainings, but relative to revenue recognition, we have a comprehensive module that we use that is not just for the accounting folks; it’s for operations as well. Being able to access that, they have the foundation.

When it comes to certain contractual terms and the way in which the different business units look at that, we’re going to need to be very focused to make sure that the commercial teams that are out there, facing the customers and trying to determine whether or not they met all the criteria, know what they’re doing.

We’re going to be doing a refresh on our modules related to revenue recognition, getting that out early and working with the commercial teams. Then we’ll likely do regional and in person and have the business units do it as well. We want to really drive home for the particular business units, what their particular historical terms and conditions have been, how do they have to look at it, how do they apply the new guidance under 81-1 or the new module. We’re going to have several bites at the apple, and it’s not going to be just a singular way of approaching it.
CANGIALOSI:  I would imagine that it’s going to be difficult because any training you give them now, I’m not sure they’ll remember in 2017, so it’ll be an interesting time. Pascal, did you have a couple comments?

DESROCHES:  We’re doing and thinking about a lot of the same things as Jan at GE is. We’re going to have to identify a subset of people that are basically going to go around the world and begin to sensitize people to the new standard once it is issued, make sure that they understand what the requirements are. Then they can translate not only for accountants but also for people who are on the front lines, who are responsible for incentive compensation systems that drive performance, make sure that they understand and can operationalize it. Loretta brings up a good point in that while you’re familiarizing them in 2014, this is going to have to be an ongoing effort where, as you get closer and closer to the implementation date, you have to make sure that across the globe you have tangible plans that do reflect the substance of the standard, including all the various interpretations that invariably will come out between now and then.

CANGIALOSI:  Great. One of the things that we deal with all the time is our audit committees. What are your audit committees focused on these days? What are the questions that they’re asking of you, and maybe the tougher questions? Marsha?

HUNT:  I’ll start. Our audit committee has taken a look at their agenda, and at every in-person meeting, they are taking one of the top ten ERM or risk management items that the board has agreed on in the past year, and they’re asking for a deep dive.

I find that very interesting, but that also then means that sometimes the people attending the audit committee don’t quite fit in the conference room. We keep going to bigger and bigger conference rooms. They’re spending a lot of time on that.

I’m also starting to get more requests for education on certain business transactions we’ve had in the past. Some of that is because the audit committee members are getting ideas from the sessions they’re attending about the questions they should be asking; they’re trying to understand the commercial business organization.

We spend less time talking about the internal audit plan compared to what we were doing ten years ago and more time really trying to tackle these topics.

SANDS:  Can I echo that? Two main focus areas similar to yours, Marsha. One focus is clearly, risk areas. Risk and compliance, they want to hear that.

But the business side is also very important, and we actually now schedule in each of our face-to-face meetings at least one business topic, and we always tie that topic back to the accounting, if you will, but it starts with just understanding that aspect of the business better, and they’re really looking to do that.

CANGIALOSI:  Leading into some of the audit requirements, let’s talk a little bit about auditors. Certainly the PCAOB has oversight over the auditors, but everything that they come up with has an impact on us. I’ve had quite a number of questions from the audience whether you’ve seen a change in the approach of the auditors, particularly around the recent inspections on internal controls over financial reporting. We seem to have the pendulum going more toward more work, more auditing. How are you, what are you
seeing and how are you coping with that? Pascal, you have any thoughts on that?

DESROCHES: Sure. I’m sure this will come as no surprise. We are clearly seeing an effect on that.

Our auditors are asking for a lot more documentation and the audit fee discussions are become a lot more intense in that every year. While we, as a company, have trouble even keeping our prices flat, auditors are looking for fairly significant increases because of their increased regulatory requirements. I used to be in that role, and I try to be fair, but at the same time, I believe that it can’t be that every single regulatory requirement has to be borne by my shareholders. So it’s trying to strike the right balance and say, “Look, some of this is going to have to hit your bottom line and not mine.”

You have increasing audit fees and a lot more time required of our people having to provide documentation about things that don’t matter just because they are concerned that somebody may ask a question as part of the review process. The other thing that I see is a lot more stress in the system. It used to be that the engagement partner felt fairly comfortable they could explain a transaction to their SEC reviewer. A certain approach was practical, even though it wasn’t by the letter of the law; it was in the appropriate judgment given the facts and circumstances. Now I’m hearing that those discussions are a lot more tense, and everybody’s looking to cover their own risks, so even within the firms, there’s a lot less pragmatism going on.

CANGIALOSI: Anybody else see any changes?

HUNT: We’ve started our negotiations for the 2014 audit, and our auditors delivered a very nice, sizeable number as Audit Quality Improvements in the discussion, so we’re continuing that push-back.

We’ve had a great conversation up to this point about the talent, the people we want in our organizations, and how we can build them as leaders. However, some of the initiatives in which the auditors are either asking management to document or we’re spending more time helping them get comfortable with exactly what our review controls are, are taking us away from some of the things we just said are important to be good business partners and to become leaders.

It’s going to be difficult, and every company’s going to be different as to what’s that right balance between what we can accept.

One of the discussions I recently had is around some old language, SAS 70 reports, and the reality is, management is signing an internal control opinion every quarter with every single 10Q filing. We’re comfortable with our general control environment, and at one point in time in that four-quarter cycle, if you get these reports on an annual basis, they’re going to be nine months old.

So we’re starting to get requests about what we need to do for those that aren’t exactly as of the year-end when the auditors are giving an opinion as if that quarter was different from every other quarter. We’re having discussions about the fact that year-end isn’t different from an internal control environment for us as management, because we’re taking that responsibility continually, so I think that some of these discussions are going to complicate our year-end audit, frankly.
HAUSER: Maybe I haven’t been around long enough, but the dialogue that I’m having with our auditors has been, you know, pretty, I’ll call it constructive.

Because they are dealing with a regulatory environment that is part of ours now, too. It’s ingrained in what we’re going to have to deal with going forward.

I am concerned about talent, too. I am concerned about talent within the audit firms in terms of what they have to deal with their regulators.

We see it for sure on the financial institution side of the equation because we have GE Capital, and if you want to talk regulation, just turn to that particular business, and it’s pretty much off the charts in terms of the regulatory impact.

So there’s a little bit of juxtaposition as I look at both elements. Yes, we are getting more requests for documentation. There’s a question about the value added, but some of it quite frankly has to deal a little bit with the reality, making sure we don’t overdo it, make sure we keep it in balance, and make sure that that conversation that we’re having with the auditors continues to be a productive one.

How can we do it, how can we do it as efficiently as possible, and because, at the end of the day, we want to have a clean PCAOB for our auditors.

CANGIALOSI: Yeah, and I would say we certainly have seen changes within the requests for more documentation. There are the review controls, where people want to sit in on the meeting to make sure you’re doing the control and the reviews so there’s some very weird kind of auditing going on now.

The sense I’m getting from a lot of the audit team is there is something of a fear, for lack of a better term, of the PCAOB and possibly having to answer for something that they haven’t done something right. We’re all interested in having a good audit.

Part of the PCAOB’s creation happened at a time when there was lower confidence in audits, and their responsibility was to build up that confidence.

I’m not sure that they were successful in that, but clearly we do see a lot more challenge as far as some of the judgments that are made. All of us have financial statements where we’re making lots of judgments, whether it’s how much work has been completed, whether it’s fair value Level 3’s, it’s just on and on, and it certainly has become much more of a focus for them. I suspect that if the new auditors’ report as proposed by the PCAOB goes through, it’ll continue to be a focus, and it’ll get much harder because those will be your critical audit matters that people will be looking to in how they get written up, so I don’t see a path away from this, unfortunately.

I think this is going to increase. On the quality improvements, they know not to come to me with that because every time they have, I’ve said, “Well, what do you mean? We haven’t had a quality audit?” Then they’ve backed away from that language. They’re looking for another acronym or another word to use besides “quality” because it doesn’t make any sense to me that they’re going to charge me for increased quality when it’s the same opinion. Any other comments on that?
DESROCHES: I do have concerns. Where does this stop because at a certain level, as much as I could say, I’m not going to pay this, you want to make sure that the firm has the appropriate resources to bring to bear to your audit. I clearly believe it is costing them more to do audits. There is no doubt in my mind, because they are spending a lot more time, they’re asking a lot more questions, which I think on balance is good.

But has it gone too far? I think it has, and I’ll give you an example of the sort of craziness that’s happening. We have, like many companies, lots of analysts that follow us, and the auditors read the analysts’ report, and they will see something in there that is inconsistent with what management is saying, and we have to get into the business of disproving what the analyst said.

This is crazy. You’re going to, this is a third party publishing their opinion. This is not management’s opinion, but this is the sort of level of discussion you get into because they are concerned that somebody’s going to second guess them, that perhaps they weren’t skeptical enough. We are reaching the point where the process is unhealthy, and long-term, it is going to drive good people out of the profession. I spent half of my career being an auditor. Some of my fondest memories are that, and it’s unfortunate that the profession’s going in this direction. Clearly some of it was necessary, but there is an over-rotation at this point.

CANGIALOSI: I concur, and unfortunately, I don’t see the pendulum moving the other way. It becomes more and more difficult; they’re requesting more and more information, and it’s partly driven by the inspection process, where it’s very easy for someone to come in and do the Monday morning quarterback, and say, “Well, why didn’t you think of this?” They spend a lot of their time thinking, “What should I be thinking of, and I should ask every question under the sun.” It does detract from the more important aspects and the riskier areas. I think everybody feels the same pain right now, we’re not sure what to do about it, but we’ll have to somehow muddle through and figure out the next steps.

I’ve got a question here on conflict minerals. To what extent is finance involved or are your groups involved? Do you plan to do implementation on it in advance of the requirement to make sure you’ve got the right process? Those of you who don’t have, don’t meet the requirements, are you going to disclose that fact that you don’t meet the requirement? Any comments on conflict minerals? Diana?

SANDS: Yeah, I can start. This is an effort for us that’s being led right now by our supplier management group, although we are very actively involved.

We are also engaging with some external consultants to help us to ensure we have the right process, but this is uncharted territory, obviously.

We are investing a lot of resources right now in making sure we have the right process in understanding what we have through our supply chain.

We are, but we are still somewhat early. We’re trying to go through this and meet the requirement in 2014 and go through the diligence that’s required, but very clearly some uncharted territory there.

BOTTGER: At this stage, we’re just basically finding out what conflict minerals we do have in the organization, where they’re sourced, and then working with suppliers to get certifications and doing the diligence behind that. Of course we in finance and legal are sitting behind the scenes behind that making sure that we’re collecting in procurement that will enable them to do the appropriate reporting, so that’s where we’re at.
DESROCHES: We’ve concluded that we don’t have anything that meets the definition of a conflict mineral, so we won’t have to have an audit performed. In terms of whether or not we plan to disclose that explicitly, we’re still in the process of evaluating that. Our current thinking is, we probably won’t even do that, but we have that question into counsel just to get their point of view.

CANGIALOSI: I guess there’d have to be some benefit to doing that. We have the same, we don’t believe we qualify, either, on the conflict minerals unless somebody would want to tell me there was a substantial benefit in making such a statement, I don’t know why I would, but more to come from counsel, they have the final say on that.

HUNT: Loretta, I’ll just add to this discussion that at Cummins, this process is being led by a lawyer, who’s in charge of our compliance efforts, and Procurement, but Finance is involved through our internal audit function. We’ve designed some internal audit work around reviewing the process, going back and verifying some numbers, and trying to do an operational audit of the process, not necessarily a financial reporting audit.

CANGIALOSI: Okay. Thanks, everybody. So yesterday there was a session on disclosure simplification, and we hear about it all the time. It’s the Holy Grail from what I can see. We’ve had probably four or five panels that have been convened over the year to talk about disclosure overload, disclosure simplification, etc., etc. Last year there was yet another report on Disclosure Simplification, and this year, we’re pretty much in the same boat where we still don’t have disclosure simplification.

Maybe you guys can comment a little bit on what you do to benchmark and what you look at to try to simplify things in your disclosures, or maybe you don’t. What are the challenges you might have with your auditors or others like lawyers who, when you try to simplify, would like to put things back. Comments on that? Diana?

SANDS: We actually have simplified. If you go back in our ‘04 filing versus our 2012 filing, our 10K has about 18 percent fewer pages than we did in ‘04. Our 10Qs have about 30 percent fewer pages.

The way we did that was by eliminating repetition, incorporating by reference where you can, really looking at what’s required, and most importantly, just looking at our language. Are we being succinct in our language?

Are we being as clear as possible in what we’re trying to say? But having said all that, we still have 119 pages in our 10K. Our pension footnote is about eight pages. Our risk factors are about eight pages. I think there are a lot of opportunities still to be had.

I think Legal is part of it. In many cases they do the first draft of our risk factors, and there are some challenge we can have or discussions on that. Our pension situation is a little bit different than that of Intel. Our pension expense last year was about two and a half billion, on about six billion of pre-tax earnings, but I think there is a lot more opportunity. I think it goes back to those foundational elements, though.

A lot of it is just looking at it and seeing if we’re making our filings as readable as possible to make them, as noted yesterday, documents to inform clearly as well as being compliance documents.
HAUSER: Yeah, we’re taking a look at it as well. I don’t know what my page count is exactly, and I don’t think it’s gone down, but we are starting to, as a result of some of the dialogue around simplification, tackle specific areas.

We may not have wholesale changes overnight, but we’re looking at some of our disclosures and saying, “Is all of this relevant and necessary? Did we overdo it at first blush?”

Where’s the balance within some footnotes where we have loads and loads of information, and it’s very dense, and it’s hard to get through, and then you look at another element of the financials, and it’s pretty slim, and you say, “It needs to be right sized.” Some of that is just growth over the years, something new comes up, and then you meet the challenge with gusto, and sometimes it’s not all that necessary.

We do benchmarking. We have a regular rhythm where we look at what others are doing, what our peer companies are doing relative to things that are on the horizon.

In addition, if we do have a unique transaction, we do benchmarking to think about how others have disclosed those transactions, so that’s kind of an ongoing operating rhythm for us.

I am heartened at the overall focus, looking at what the FASB’s been trying to do. If we can get that intersection between the parties to kind of work productively to get something done, even with the juxtaposition of some of the concerns that the SEC has raised regarding some of the MD&A disclosures, got to keep that in mind as well, it’s all a balance, but it would be great if we could have the financial reporting package be a bit more readable and streamlined.

CANGIALOSI: Okay. Well, our time is up, and I would echo that. Thanks to the panel. Great conversation, and look forward to another panel next year.

Thanks, everyone.