

Prerequisites for Financial Information in Real Time

Ignacio Urrutia
e-business Center PwC&IESE
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The current system of producing quarterly financial reports is obsolete. This is the opinion of the market's four top auditing firms—Deloitte, Ernst & Young, PricewaterhouseCoopers and KPMG—and two of their smaller rivals, Grant Thornton and BDO. The consulting firms have prepared a document in which they call for an overhaul of the financial reporting standard existing in current American legislation, known as the Sarbanes-Oxley law. Among the reforms, the group proposes the inclusion of corporate information that goes beyond the numbers, and especially the preparation of financial reports updated in real time. The consulting firms say that this would help investors to better forecast a company's future performance.

Without a doubt, financial information in real time has its positive aspects. If started, this practice would allow investors to see a company's daily progress and would make it tougher to disguise the results. In short, it would lead to greater transparency of the information companies provide to their investors, something which theoretically would reduce the chances of a financial scandal repeating, such as those of Enron and Parmalat, who hid their abysmal financial results from investors, many of whom found themselves broke when these companies went bankrupt.

The financial community reacted to these and other scandals by preparing a set of measures fostering policies of corporate transparency, an essential virtue for the progress of both markets and companies. To hide and mask important financial information confuses investors and disrupts the market, while transparency policies allow for understanding of the real situation of a company and help avoid uncertainties. That said, one must also consider the disadvantages of constantly publishing updated information. First off, it is not clear whether this actually contributes to companies always making better decisions; in some circumstances it could lead to situations that are worse than those aimed to be avoided.

Highlights

1 The report Global Capital Markets and the Global Economy underlines the wave of corporate scandals at the start of the decade—including Enron, Parmalat and others—which undermined investors' confidence in auditing firms. In the opinion of these auditors, the measures established by regulators are not enough to guarantee the financial transparency required of companies.

2 Publication of reports in real time faces a number of problems. Among these, the cost, which would be added to that which companies already had to take on in order to comply with the US legislation resulting from the passing of the Sarbanes-Oxley law; privacy, since the competition could benefit from privileged information acquired through this channel; complexity, which comes from instantly revising a daily flow of data, with the danger of having reports which are more updated but less reliable. Furthermore, it could reduce the room for maneuvering that managers have for making long-term decisions.

3 If the proposal is able to guarantee that these obstacles be overcome, it will lead to the development of transparency policies and restore investors' trust as well as strengthen the market.

In fact, the current quarterly financial reports already put enormous pressure on executives. Having investors keep daily tabs on their work could require managers to make decisions that do not compromise the company's daily operation but which lack strategic vision. Or even jeopardize the company's future.

Secondly, having more information does not necessarily mean that it can all be absorbed, as occurs with the so-called "analysis paralysis," which affects investors and analysts who are subjected to an avalanche of data that is impossible to digest and often replaces quality for quantity of information. There is yet another drawback, in this case cost-related. If the information obtained from reports in real time is to be a new service from auditors, companies will resist adopting it, as it will add a new administrative cost to the one they had to assume with the implementation of the Sarbanes-Oxley law.

To summarize, in order for this new initiative to gain acceptance, it will first have to demonstrate that companies are capable of providing a larger and better dose of relevant information and that analysts and investors are prepared to process it adequately. There also must be a guarantee of mechanisms so as to avoid a steady decrease in the room for maneuvering needed by executives when making strategy decisions, along with the other side of the coin, being that companies must be able to handle the costs. If these conditions are met, meaning that if the change is not detrimental to companies but instead helps them give more security to their investors, the new practice called for by the consulting firms could reinforce transparency and thus, the market.