Benchmarking and Accounting – a field study

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ABSTRACT: Many studies in the field of empirical accounting research reveal that although companies should follow the approach of telling their specific investment story (Stanton and Stanton, 2002) to the outside investors corporate disclosures tend to assimilate and converge to their peers group disclosures and form clusters or bundles (Beerbaum, 2015, Wagenhofer, 2008, Cadbury, 1999, Markarian et al., 2007) following the theory of path dependency (Bebchuk and Roe, 1999). To discern the wood from the trees and grasp the nettle of complexity in the increasing overloaded annual report, corporate annual reports have inevitable been playing the adding value role due to technology: application of sophisticated clustering software using content analysis, processing of structured data by Extensible Business Reporting Language (XBRL) and using artificial intelligence to help to navigate the reader and identify decision useful information. Little research is however done on the understanding if company themselves pro-actively support convergence by applying management accounting technique of Benchmarking and Best-practice analysis. The paper applies a mixed-method approach to improve understanding. In an exploratory setting first interviews demonstrate in fact that Benchmarking and Best-practice analysis are widely-used tool among Financial Management and are not restricted to Management Accounting. This development also underpins the convergence between Management and Financial Accounting. In a followed quantitative study the hypothesis can be confirmed that through the application of Benchmarking disclosures among peers tend to convergence and standardize over time, whereas the degree of convergence increase the longer the Accounting Standard is applicable. The study specifically focus on Related Party disclosures and recommend to extend the scope for future research.

KEYWORDS: Benchmarking, Related Party Disclosures, Best Practice analysis, Corporate Disclosures

**This working paper is in an early draft stage and will be discussed on different academic conferences.*

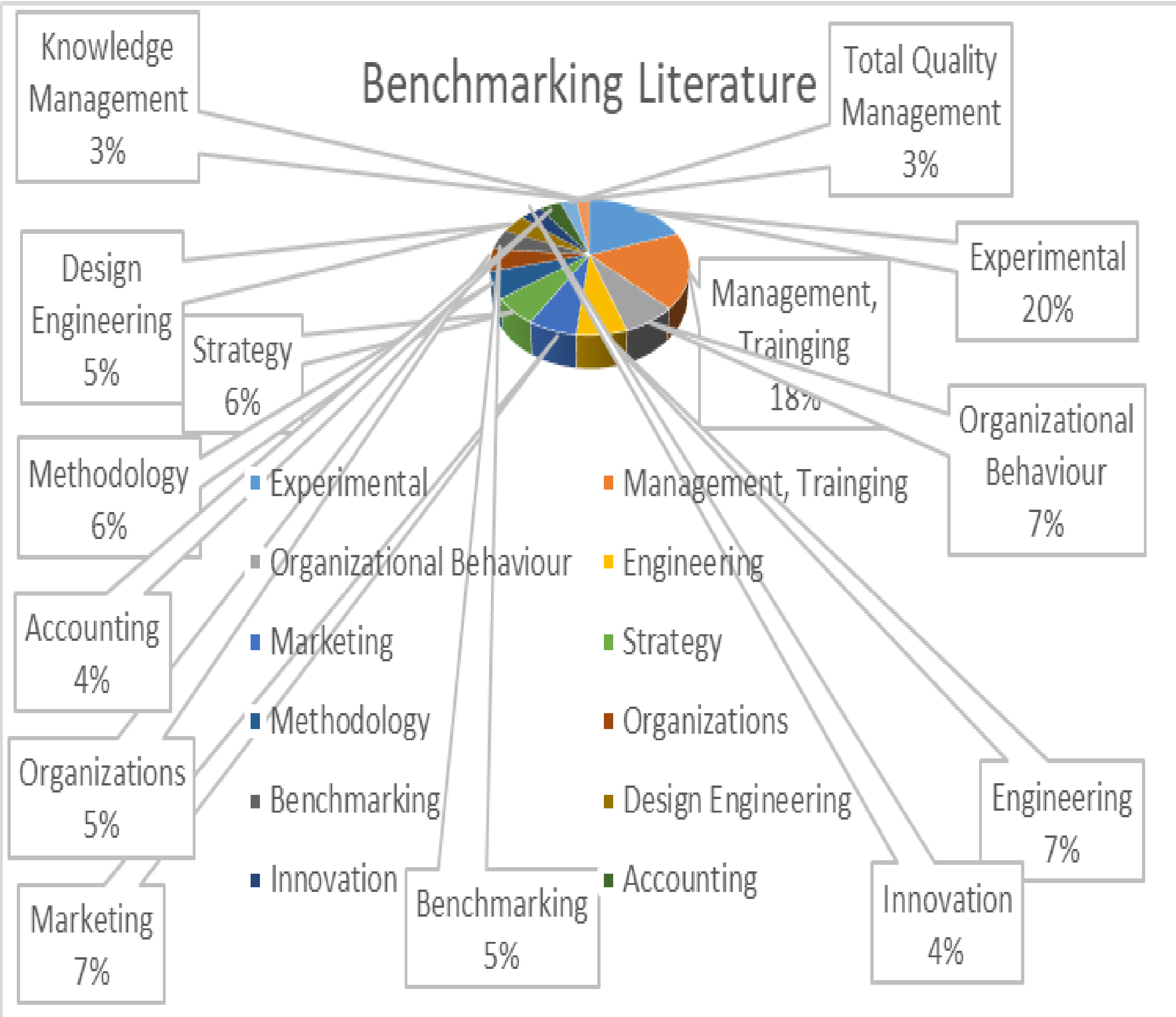
1. Introduction

Benchmarking could be summarized as learning from the best. According to Bhutta and Huq (1999) “The essence of benchmarking is the process of identifying the highest standards of excellence for products, services, or processes, and then making the improvements necessary to reach those standards - commonly called ``best practices''”. It implies the comparison and quality validation of one's business processes and performance metrics to those which are assessed to be the best in the industry and best practices from other companies. Dimensions typically measured are quality, time and cost (Bogan and English, 1994). In the process of best practice benchmarking, management identifies the best firms in their industry, or in another industry where similar processes exist, and compares the results and processes of those studied (the "targets") to one's own results and processes.

In this way, they learn how well the targets perform and, more importantly, the business processes that explain why these firms are successful. Very often it is mentioned in the international literature about Benchmarking that “best practice" can not simply be picked-up and “surgically” be implemented in one's own organization (Boxwell, 1994). One has to look at the way things are being done, the culture prevailing, the human resource employed to do the job before one can adapt a process. This forms a main challenge of the benchmarking methodology, i.e. to adapt the process from the leading companies to one's own organization (Bhutta and Huq, 1999). The question arise if this also applies for accounting. Does play benchmarking a role in Financial Accounting. If yes, how it is applied or for which purpose?

2. Literature Review

Benchmarking is a management technique or a tool which aims at learning from the best companies. 70% of the Fortune 500 companies follow Benchmarking on a regular basis (Bhutta and Huq, 1999). A lot is written about Benchmarking for processes, products and services, however little is knwn abou the application of Benchmarking in other disciplines Accounting. A systematic literature review with the search terms "Benchmarking" and "Accounting" reveals that the concept of benchmarking is only documented in a few cases in the academic literature in the context of Accounting.



Source. Aalto University "Learning centre" word search "Benchmarking", "Accounting", "Peer reviewed" and "Management"

General topics are that companies follow benchmarking technique in identification if their key disclosures are in line with peers. Benchmarking looks into the quantity and quality of disclosures and follows different techniques: scoring, index, factor analysis. To identify best-practice disclosures.

The following literature sources can be identified, which are the most relevant in the context of this paper.

Author	Source	Summary of results
Mccarthy (2010)	AICPA National conference	Benchmarking is widely applied in Accounting. Depending on the industry different disclosures need to be compared to each other.
Holland (2005)	Accounting and Business Research	The case companies made use of a value creation story and of subjective benchmarks as key disclosure means, and these incorporated a high responsiveness to user demands, market changes and fashions.
Ray and Das (2009)	Decision	Annual reports for automobile giants-Tata Motors and AB Volvo are compared through qualitative analyses as per the proposed framework and challenges for implementing Corporate Reporting Framework are discussed.
Faulkender and Yang (2012)	The Review of Financial Studies	Evidence shows that benchmarking manipulation became more severe after enhanced mandatory disclosure, particularly at firms with substantial shareholder complaints about compensation practices, low institutional and director ownership, busy Boards, and large Boards. The effect is the strongest at firms with new CEOs. These findings call into question whether mere disclosure can remedy potential executive compensation abuses.

3. Related party Disclosures

Many of the most well-known corporate scandals were associated to related party transactions such as Enron, Worldcom or Parmalat. Enron set up partnerships to remove assets and debt off of their books, which was inadequately disclosed and explained in its annual report.

However, according to the Financial Accounting Standards Board (FASB) Statement No. 57 financial statements have to include disclosures of material related-party transactions. WorldCom granted the CEO a large related party loan without no apparent schedule for repayment (Rittenberg et al., 2011). Parmalat created special purpose entities to carry out illicit related party transactions (Caprio, 2012).

A related party transaction is defined by International Accounting Standard (IAS) 24 as follows: “a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged”, and two or more parties are considered to be related if one of them has the ability to control, joint control or to exercise significant influence over the other one in making operational or financial decisions. A relevant example for opportunistic purposes is when transactions are carried out at a different price than the market one and the profits are then shifted among group members, while the consolidated earnings remain generally unaffected.

There exist according to IAS 24 general two kinds of being related, by a person (a) or by an entity (b). When the person (a) gains control over a company by holding a major stock of votes for exam-ple, all other companies related to (a) are related to another due to the same interest shown by (a). The same happens when (a) has a significant influence over a company, so it can directly or indirectly influence the operational decisions, but cannot completely control them. This happens in cases of investments in an entity, when (a) holds a significant part of shares. If (a) is a member of the key personal management, so has “authority and responsibility for planning, directing and controlling the activities of an entity” (IFRS-Foundation, 2017), all entities which are controlled or significant influenced by (a) must ensure to disclose transactions between each other.

According to IAS 24 the purpose of the Related Party Reporting is “To ensure that an entity’s financial statement contains the disclosure necessary to draw attention to the possibility that its fi-nancial positions and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties”.

Table 2.1 Summary of studies on related party transactions

Year/ Author	Summary
(Beasley et al., 1999)	In one of the first studies about 12 cases were reported, in which related party transactions were not disclosed properly. It could be proven by the authors that although the auditors possessed the necessary knowledge about the missing related party disclosures due to their documentation, they did not challenge the company’s disclosure and did not demand to extend the company’s disclosure.
(Kohlbeck and Mayhew, 2004)	In this study related party (RP) transactions are analysed for incentive and monitoring determinants. The sample consists of 1,261 firms included in the S&P 1500. According to the study the most frequently disclosed RP transactions are loans. According to the authors director and officer ownership are not directly associated with RP transactions. Overall this study concludes that an associations between director and officer compensation, corporate governance and related party transactions exists.
(Gordon et al., 2007)	This study examines 83 SEC enforcement actions which consists of both fraud and related party transactions. The author cluster the different types of related party transactions which might potentially be applied to misstate financial reports. Generally, the existence of related party transactions is not always associated with fraud, and their presence need not necessarily indicate fraudulent financial reporting.
Cheung et al. (2009)	According to this study a sample of 254 related party and arms’ length acquisitions and sales of assets in Hong Kong during 1998-2000 are examined. The analysis shows that publicly listed firms enter deals with related parties at unfavourable prices compared to similar arms’ length deals. Firms acquire assets from related parties by paying a higher price compared to similar arms’ length deals.
Lo et al. (2010)	This study examines whether good governance structures help limit management's opportunistic behaviors. The data is based on a sample of 266 companies listed on the Shanghai stock exchange that disclose gross profit ratios on related-party transactions. Overall, the research findings reveal that the quality of corporate governance is important in deterring the use of manipulated transfer prices in related-party sales transactions.
Jian and Wong (2010)	Based on a sample of Chinese listed firms from 1998 through 2002, this paper documents that listed firms manipulate earnings by using abnormal related sales to their controlling owners. Such related sales propping is more prevalent among state-owned firms and in regions with weaker economic institutions. Since these abnormal related sales can be cash-based, there is significant cash transfer via related lending from listed firms back to controlling owners after the propping. However, no cash transfer via related lending is found to be associated with accruals earnings management.

To sum up, in the academic literature on the related party transactions topic, two theories can be in general identified (a) conflict of interests: as a consequence these transactions imply an harmful impact although initiated by the executives and leading to expropriation of wealth related to share-holders based on Jian and Wong (2010) (b) efficient transaction: related party transactions are considered profitable economic deals based on Gordon et al. (2007).

4. Benchmarking for disclosures

4.1 Disclosure Checklists

The first step is to define some minimum requirements based on disclosure checklists issued by “Big Four” audit companies.

*	Section of the Disclosure checklist				Disclosure Requirements	Applicable (Y) or Not Applicable (NA)
IAS 24.12	**Special topics**	4.6	Related party disclosures	General	Disclose related party relationships between parent and subsidiaries irrespective of whether transactions have taken place between those related parties.	Y
IAS 24.12	**Special topics**	4.6	Related party disclosures	General	Disclose the name of the parent and the ultimate controlling party, if different.	NA
IAS 1.138(c)	**Special topics**	4.6	Related party disclosures	General	Disclose the name of the ultimate parent of the group, if not disclosed elsewhere in information published within the financial statements.	NA
IAS 24.12	**Special topics**	4.6	Related party disclosures	General	If neither the entity’s parent nor the ultimate controlling party produces financial statements available for public use, then disclose the name of the next most senior parent that does so.	NA
IAS 24.22	**Special topics**	4.6	Related party disclosures	General	Disclose items of similar nature in aggregate except when separate disclosure is necessary to understand the effects of related party transactions on the financial statements.	Y
IAS 24.21	**Special topics**	4.6	Related party disclosures	General	Disclose that related party transactions were made on terms equivalent to those that prevail in arm’s length transactions only if such terms can be substantiated.	Y

Source: KPMG Disclosure Checklist, www.kpmg.com

The disclosure checklists derive disclosure requirements using mainly a deductive method. Considering the requirements set out in IAS 24 defines the mandatory disclosure requirements. Additionally, voluntary or non-mandatory disclosures are defined in the disclosure checklist. Those are disclosures, the auditor or the auditing community expects as peer industry benchmark disclosures.

4.2 Definition of scoring scale

In a next step peers are identified for a benchmark analysis. Under a benchmarking approach the best companies are identified. In this case study approach due to limited available company data the sample number of companies is identified. A scoring is defined by receiving the maximum amount of points, if all requirements are fulfilled by the company.

4.3 Scoring

Based on KPMG altogether 67 reporting elements for Related Party Disclosures are derived. The maximum score provides the highest possible score.

Paragraph	Sub-category	Max. Score
IAS 24.21	General	1
IAS 24.20	General	1
IAS 24.17	Transactions with associates	
IAS 24.17	Transactions with associates	1
IAS 24.17	Transactions with associates	1
IAS 24.17	Transactions with associates	
IAS 24.17(a)	Transactions with associates	1
IAS 24.17(b)	Transactions with associates	1
IAS 24.17(b)(i)	Transactions with associates	0,5
IAS 24.17(b)(ii)	Transactions with associates	1
IAS 24.17(c)	Transactions with associates	0,5
IAS 24.17(d)	Transactions with associates	0,5
IAS 24.18(e)	Transactions with joint ventures in which the entity is a venturer	
IAS 24.17	Transactions with joint ventures in which the entity is a venturer	
IAS 24.17	Transactions with joint ventures in which the entity is a venturer	1
IAS 24.17	Transactions with joint ventures in which the entity is a venturer	1
IAS 24.17	Transactions with joint ventures in which the entity is a venturer	
IAS 24.17(a)	Transactions with joint ventures in which the entity is a venturer	1
IAS 24.17(b)	Transactions with joint ventures in which the entity is a venturer	1
IAS 24.17(b)(i)	Transactions with joint ventures in which the entity is a venturer	0,5
IAS 24.17(b)(ii)	Transactions with joint ventures in which the entity is a venturer	1
IAS 24.17(c)	Transactions with joint ventures in which the entity is a venturer	0,5
IAS 24.17(d)	Transactions with joint ventures in which the entity is a venturer	0,5
IAS 24.18(f)	Transactions with key management personnel of the entity or its parent	
IAS 24.17	Transactions with key management personnel of the entity or its parent	
IAS 24.17	Transactions with key management personnel of the entity or its parent	1
IAS 24.17	Transactions with key management personnel of the entity or its parent	1
IAS 24.17	Transactions with key management personnel of the entity or its parent	
IAS 24.17(a)	Transactions with key management personnel of the entity or its parent	1
IAS 24.17(b)	Transactions with key management personnel of the entity or its parent	1
IAS 24.17(b)(i)	Transactions with key management personnel of the entity or its parent	0,5
IAS 24.17(b)(ii)	Transactions with key management personnel of the entity or its parent	1
IAS 24.17(c)	Transactions with key management personnel of the entity or its parent	0,5
IAS 24.17(d)	Transactions with key management personnel of the entity or its parent	0,5
IAS 24.16	Transactions with key management personnel of the entity or its parent	
IAS 24.16(a), 19,23	Transactions with key management personnel of the entity or its parent	1
IAS 24.16(b), 19.47, 124(b)	Transactions with key management personnel of the entity or its parent	1
IAS 24.16(c), 19,131	Transactions with key management personnel of the entity or its parent	1
IAS 24.16(d), 19,143	Transactions with key management personnel of the entity or its parent	1
IAS 24.16(e)	Transactions with key management personnel of the entity or its parent	1
IAS 19.124	Transactions with post-employment benefit plans	
IAS 24.17	Transactions with post-employment benefit plans	
IAS 24.17(a)	Transactions with post-employment benefit plans	1
IAS 24.17(b)	Transactions with post-employment benefit plans	1
IAS 24.17(c)	Transactions with post-employment benefit plans	1
IAS 24.17	Transactions with post-employment benefit plans	
IAS 24.17(a)	Transactions with post-employment benefit plans	1
IAS 24.17(b)	Transactions with post-employment benefit plans	1
IAS 24.17(b)(i)	Transactions with post-employment benefit plans	1
IAS 24.17(b)(ii)	Transactions with post-employment benefit plans	1
IAS 24.17(c)	Transactions with post-employment benefit plans	1
IAS 24.17(d)	Transactions with post-employment benefit plans	1
IAS 24.18(g)	Transactions with other related parties	
IAS 24.17	Transactions with other related parties	
IAS 24.17	Transactions with other related parties	1
IAS 24.17	Transactions with other related parties	1
IAS 24.17	Transactions with other related parties	
IAS 24.17(a)	Transactions with other related parties	1
IAS 24.17(b)	Transactions with other related parties	1
IAS 24.17(b)(i)	Transactions with other related parties	1
IAS 24.17(b)(ii)	Transactions with other related parties	1
IAS 24.17(c)	Transactions with other related parties	1
IAS 24.17(d)	Transactions with other related parties	1

4.4 Scoring comparison

Scoring Table Disclosure Practice

Paragraph	Sub-cate	lax. Scor	Requirement	Barclays	BMW	Commerzbank	HSBC	Postbank	SAP		
		32,5		18,75	5	17,5	22,25	15,75	5		25,75
			Auditor	PWC	KPMG	PWC	KPMG	PWC	KPMG		KPMG
			Total score:	18,75	5	17,5	22,25	15,75	5		25,75
			Ranking:	3	6	4	2	5	6		1
			Category:	upper quartile	bottom quartile	upper quartile	upper quartile	lower quartile	bottom quartile		best practise

Valuation scale:
16-20: best practice
11-15: upper quartile
6-10: lower quartile
0 - 5: bottom quartile

Conclusion

Many studies in the field of empirical accounting research reveal that corporate disclosures tend to assimilate and converge to their peers group disclosures and form clusters or bundles (Beerbaum, 2015, Wagenhofer, 2008, Cadbury, 1999, Markarian et al., 2007) following the theory of path dependency (Bebchuk and Roe, 1999). This study reveals that benchmarking as a methodology is widely spread and also used in the context of Financial Accounting. Annual Reports nowadays represent a key product within a company investor relation and external publication and therefore intends to reach the optimum in terms of investor transparency and investor perception.

To discern the wood from the trees and grasp the nettle of complexity in the increasing overloaded annual report, corporate annual reports have inevitable been playing the adding value role due to technology: application of sophisticated clustering software using content analysis, processing of structured data by Extensible Business Reporting Language (XBRL) and using artificial intelligence to help to navigate the reader and identify decision useful information. Those benchmark studies therefore are much more efficient than previous non-tech paper-based comparison studies.

This research provides guidance how company themselves pro-actively support convergence by applying management accounting technique of Benchmarking and Best-practice analysis. The paper applies a mixed-method approach to improve understanding. In an exploratory setting first interviews demonstrate in fact that Benchmarking and Best-practice analysis are widely-used tool among Financial Management and are not restricted to Management Accounting. This development also underpins the convergence between Management and Financial Accounting (Taipaleenmäki and Ikäheimo, 2013). In a followed quantitative study the hypothesis can be confirmed that through the application of Benchmarking disclosures among peers tend to convergence and standardize over time, whereas the degree of convergence increase the longer the Accounting Standard is applicable. The study specifically focus on Related Party disclosures and recommend to extend the scope for future research.

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