

# Concepts in Enterprise Resource Planning

*Fourth Edition*

*Chapter Five*  
*Accounting in ERP Systems*

# Objectives

After completing this chapter, you will be able to:

- Describe the differences between financial and managerial accounting
- Identify and describe problems associated with accounting and financial reporting in unintegrated information systems
- Describe how ERP systems can help solve accounting and financial reporting problems in an unintegrated system

# Objectives (cont'd.)

- Describe how the Enron scandal and the Sarbanes-Oxley Act have affected accounting information systems
- Explain accounting and management-reporting benefits that accrue from having an ERP system
- Explain the importance of Extensible Business Reporting Language (XBRL) in financial reporting

# Introduction

- In this chapter, you will learn about the activities in the Accounting functional area
- Accounting is tightly integrated with all other functional areas
- Accounting activities are necessary for decision making

# Accounting Activities

- Areas of accounting:
  - Financial accounting
  - Managerial accounting
- **Financial accounting**
  - Documenting all transactions of a company that have an impact on the financial state of the firm
  - Using documented transactions to create reports for external parties and agencies
  - Reports, or financial statements, must follow prescribed rules and guidelines of various agencies

# Accounting Activities (cont'd.)

- Common financial statements: balance sheets and income statements
- **Balance sheet**
  - Statement that shows account balances such as:
    - Cash held
    - Amounts owed to company by customers
    - Cost of raw materials and finished-goods inventory
    - Long-term assets such as buildings
    - Amounts owed to vendors, banks, and other creditors
    - Amounts owners have invested in company

<b>Fitter Snacker Balance Sheet</b> <b>December 31, 2011</b> <b>(in thousands of dollars)</b>		
<b><u>Assets</u></b>		
Cash		\$5,003
Accounts receivable		\$4,715
Inventories		\$9,025
Plant and equipment		\$6,231
Land		\$1,142
Total assets		\$26,116
<b><u>Liabilities</u></b>		
Accounts payable	\$6,400	
Notes payable	\$10,000	
Total liabilities		\$16,400
<b><u>Stockholders' Equity</u></b>		
Contributed capital	\$2,000	
Retained earnings	\$7,716	
Total stockholders' equity		\$9,716
Total liabilities and stockholders' equity		\$26,116

Figure 5-1 Fitter Snacker sample balance sheet

# Accounting Activities (cont'd.)

- **Income statement**
  - **Profit and loss (P&L) statement**
  - Shows company's sales, cost of sales, and profit or loss for a period of time (typically a quarter or year)
- Integrated information system simplifies the process of closing the books and preparing financial statements
- **Managerial accounting:** determining costs and profitability of company's activities



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Figure 5-2 Fitter Snacker sample income statement

# Accounting Activities (cont'd.)

- Quarterly financial statement
  - Close books
  - Closing entries to nominal accounts
  - Nominal accounts – zero balance to start next cycle
  - Ensure accounts accurate and up-to-date
  - “Adjusting” entries
- Integrated information system advantage
  - Simplifies process of closing books and preparing financial statements

System Help

**Financial Statements**

**Fitter Snacker**

FS 10 Ledger  
 USD Currency type Company code currency  
 2011.01 -2011.16 Reporting periods  
 2010.01 -2010.16 Comparison periods

F.S. item/account	Tot.rpt.pr	tot.cmp.pr	Abs. diff.
Assets	26,116,815.00	25,533,531.00	583,284.00
Cash & Cash Equivalents	5,003,182.00	4,982,485.00	20,697.00
Inventories	9,025,081.00	8,761,907.00	263,174.00
Accounts Receivable	4,715,394.00	4,374,098.00	341,296.00
Property, Plant & Equipment	7,373,158.00	7,415,041.00	41,883.00
Liabilities/Equity	26,116,815.00-	25,533,531.00-	583,284.00-
Current Liabilities	6,400,158.00-	5,984,730.00-	415,428.00-
Long-term Liabilities	10,000,782.00-	11,289,379.00-	1,288,597.00-
Equity	9,715,875.00-	8,259,422.00-	1,456,453.00-
Profit & Loss Statement	3,433,353.00	2,983,945.00	449,408.00
Net Income After Taxes	3,433,353.00	2,983,945.00	449,408.00
Income Before Taxes	4,577,589.00	4,011,598.00	565,991.00
Corporate Tax	1,144,236.00-	1,027,653.00-	116,583.00-

Balance Sheet

P&L statement

Comparison of current year to previous year

SAP AB1 (2) 905 ab1 INS

Figure 5-3 Balance sheet and income statement for Fitter Snacker in SAP ERP system

# Accounting Activities (cont'd.)

- Managerial accounting
  - Determine costs and profitability of company's activities
  - Provide managers with detailed information
    - Informed decisions
    - Create budgets
    - Determine profitability
  - Information that managers use to control day-to-day activities, develop long-term plans

# Using ERP for Accounting Information

- Problems associated with unintegrated systems
  - Data sharing usually did not occur in real time
    - Accounting's data were often out of date
  - Accounting personnel had to do significant research
- ERP system, with its centralized database, avoids these problems
- In traditional accounting, company's accounts are kept in a record called a **general ledger**

# Using ERP for Accounting Information (cont'd.)

- In the SAP ERP system, input to general ledger occurs simultaneously with business transactions
- Many SAP ERP modules cause transaction data to be entered into general ledger, including:
  - Sales and Distribution (SD)
  - Materials Management (MM)
  - Financial Accounting (FI)
  - Controlling (CO)
  - Human Resources (HR)
  - Asset Management (AM)

# Operational Decision-Making Problem: Credit Management

- Unintegrated information system
  - Out-of-date or inaccurate accounting data can cause problems when a company is making operational decisions
- Industrial credit management
- Fitter Snacker's credit management procedures
- Credit management in SAP ERP

# Industrial Credit Management

- Credit management requires a good balance between:
  - Granting sufficient credit to support sales *and*
  - Making sure that the company does not lose too much money
- Setting a limit on how much money a customer can owe at any one time
  - Monitoring that limit as orders come in and payments are received



# Industrial Credit Management (cont'd.)

- Sales representative needs to be able to review an up-to-date accounts receivable balance when an order comes in
- Problems arise if Marketing and Accounting have unintegrated information systems
  - Less than full cooperation on updates
- Problems should not arise with an integrated information system
  - Accounts receivable is immediately updated

# Fitter Snacker's Credit Management Procedures

- FS sales clerk refers to a weekly printout of a customer's current balance and credit limit to see if credit should be granted
- Sales data are transferred to Accounting by disk three times a week
- Accounting clerk can use sales input to prepare a customer invoice
- Accounting must make any adjustments for partial shipments before preparing the invoice
- Accounting clerks process customer payments

# Credit Management in SAP ERP

- SAP ERP would allow FS to set a credit limit for each customer
- Company can configure any number of credit-check options in SAP ERP system
- Advantages of using SAP ERP to manage credit
  - Process is automated
  - Data are available in real time

Table View Edit Goto Selection Utilities System Help

**Change View "View for Maintenance of Automatic Credit Control": Detail**

New Entries

OCA RxC CG Credit control Curr. Update  
 FS Z00 01 Standard Credit Check USD 000012

Document controlling Released documents are still unchecked  
 No credit check ☐ Deviation in % ☐  
☐ Item check Number of days ☐

Credit limit seasonal factor Checks in financial accounting/old A/R summary  
 % ☐ Minus From To ☐ Payer  
 Permitted days ☐ Permitted hours ☐

Checks

	Reaction	Status/Block		
<input type="checkbox"/> Static	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/> Open orders	<input type="checkbox"/> Open deliveries
<input checked="" type="checkbox"/> Dynamic	<input checked="" type="checkbox"/> C	<input checked="" type="checkbox"/>	Horizon	2 M
<input type="checkbox"/> Document value	<input type="checkbox"/>	<input type="checkbox"/>	Max.doc.value	
<input type="checkbox"/> Critical fields	<input type="checkbox"/>	<input type="checkbox"/>	Number of days	<input type="checkbox"/>
<input type="checkbox"/> NextReview date	<input type="checkbox"/>	<input type="checkbox"/>	Max.open.item %	NoDays openI <input type="checkbox"/>
<input type="checkbox"/> Open items	<input type="checkbox"/>	<input type="checkbox"/>	Days oldestItem	<input type="checkbox"/>
<input type="checkbox"/> OldestOpenItem	<input type="checkbox"/>	<input type="checkbox"/>	High.dunn.level	<input type="checkbox"/>
<input type="checkbox"/> High.dunn.level	<input type="checkbox"/>	<input type="checkbox"/>		
<input type="checkbox"/> User 1	<input type="checkbox"/>	<input type="checkbox"/>		
<input type="checkbox"/> User 2	<input type="checkbox"/>	<input type="checkbox"/>		
<input type="checkbox"/> User 3	<input type="checkbox"/>	<input type="checkbox"/>		

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Dynamic credit check with Reaction C selected

Two-month credit check horizon

Figure 5-5 Credit management configuration

# Product Profitability Analysis

- Business managers use accounting data to perform profitability analyses of a company and its products
- When data are inaccurate or incomplete, the analyses are flawed
- Main reasons for inaccurate or incomplete data
  - Inconsistent recordkeeping
  - Inaccurate inventory costing systems
  - Problems consolidating data from subsidiaries

Credit management   Edit   Goto   Extras   Environment   System   Help

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**Customer Credit Management Change: Overview**

Administrative data

Customer: 201   Health Express  
 Credit control area: FS   FS Credit Control Area  
 Currency: USD

Status		Dunning data	
Credit limit	1,000.00	Dunning Area	<input type="checkbox"/>
Credit exposure	590.00	Last dunned	<input type="text"/>
Cred.lim.used	59.00 %	Leg.dunn.proc.	<input type="text"/>
Horizon	03/01/2012	Dunning level	0

Payment history/arrears		Control	
With cash disc.	0.00   0	Risk category	Z00
W/o cash disc.	0.00   0	Last int.review	<input type="text"/>
		<input type="checkbox"/> Blocked	
		Cred.rep.grp	<input type="text"/>
		Payment index	<input type="text"/>
		Rating	<input type="text"/>
		Last ext.review	<input type="text"/>
		Monitoring	<input type="text"/>

Payment data	
DSO	0
Clearing amount	0.00
Author.deduct.	0.00
Unauthor.deduc.	0.00

Credit limit

Amount of credit used

Figure 5-6 Credit management for Health Express

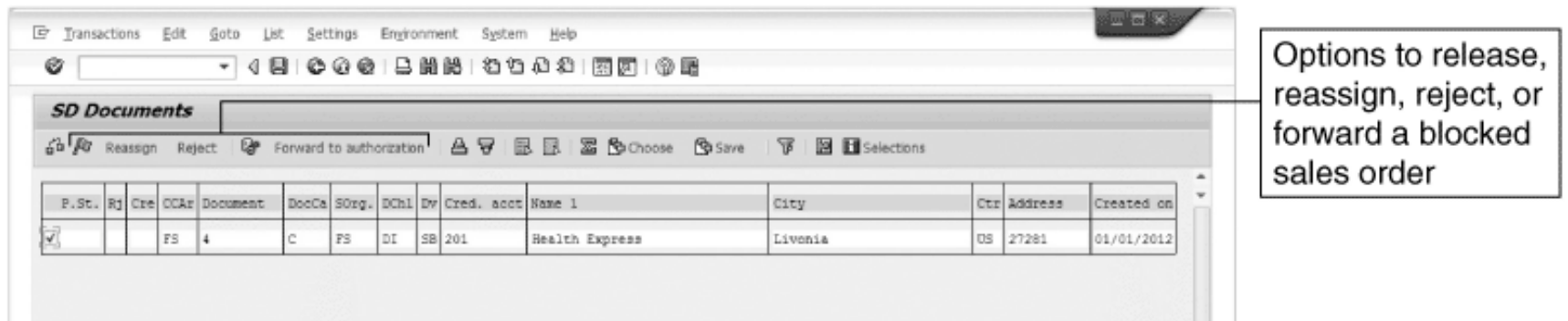


Figure 5-7 Blocked sales order

# Inconsistent Recordkeeping

- Each of FS's marketing divisions maintains its own records and keeps track of sales data differently
- Paper records might be inaccurate or missing, making validity of the final report questionable
- Without integrated information systems, accounting and reporting to management requires:
  - Working around limitations of information systems to produce useful output
- ERP system minimizes or eliminates these problems



# Inaccurate Inventory Costing Systems

- Correctly calculating inventory costs
  - One of the most important and challenging accounting tasks in any manufacturing company
- Inventory cost accounting background
  - Manufactured item's cost has three elements:
    - Cost of raw materials
    - Cost of labor employed directly in production of item
    - **Overhead:** all other costs

# Inaccurate Inventory Costing Systems (cont'd.)

- Inventory cost accounting background (cont'd.)
  - **Direct costs:** materials and labor
    - Can be estimated fairly accurately
  - **Indirect costs:** overhead items
    - Difficult to associate with specific product(s)
  - **Standard costs** for a product are established by:
    - Studying historical direct and indirect cost patterns
    - Taking into account the effects of current manufacturing changes
  - **Cost variances:** differences between actual costs and standard costs

# Inaccurate Inventory Costing Systems (cont'd.)

- ERP and inventory cost accounting
  - Many companies with unintegrated accounting systems analyze their cost variances infrequently
    - Often, they do not know how much it actually costs to produce a unit of a product
  - If FS had an ERP system, employees throughout the company would have recorded costs in a company-wide database as they occurred
  - ERP system configurations allow analysts to track costs using many bases

# Inaccurate Inventory Costing Systems (cont'd.)

- Product costing example
  - Suppose Fitter Snacker wishes to update standard costs for NRG-A bars
  - Product cost analysis for NRG-A bar
- Product cost analysis in SAP ERP
  - **Product cost variant:** method for developing a product cost in an ERP system

NRG-A Bar Product Cost Analysis (7 cases)				
Ingredient	Unit of measure	NRG-A	Cost per unit of measure	Direct material cost
Oats	lb	300	\$0.20	\$60.00
Wheat germ	lb	50	\$0.30	\$15.00
Cinnamon	lb	5	\$3.00	\$15.00
Nutmeg	lb	2	\$4.50	\$9.00
Cloves	lb	1	\$5.50	\$5.50
Honey	gal	10	\$6.40	\$64.00
Canola	gal	7	\$1.70	\$11.90
Vit./min. powder	lb	5	\$18.45	\$92.25
Carob chips	lb	50	\$2.10	\$105.00
Raisins	lb	50	\$3.20	\$160.00
Total direct material cost				\$537.65
Production overhead cost (100% of Total direct material)				\$537.65
Direct labor				54.50
Cost of goods manufactured (COGM)				1,129.80
Sales and administrative costs (30% of COGM)				338.94
Cost of goods sold (COGS)				1,468.74
COGM per case				\$161.40
COGS per case				\$209.82

Figure 5-8 Product cost analysis for NRG-A bar

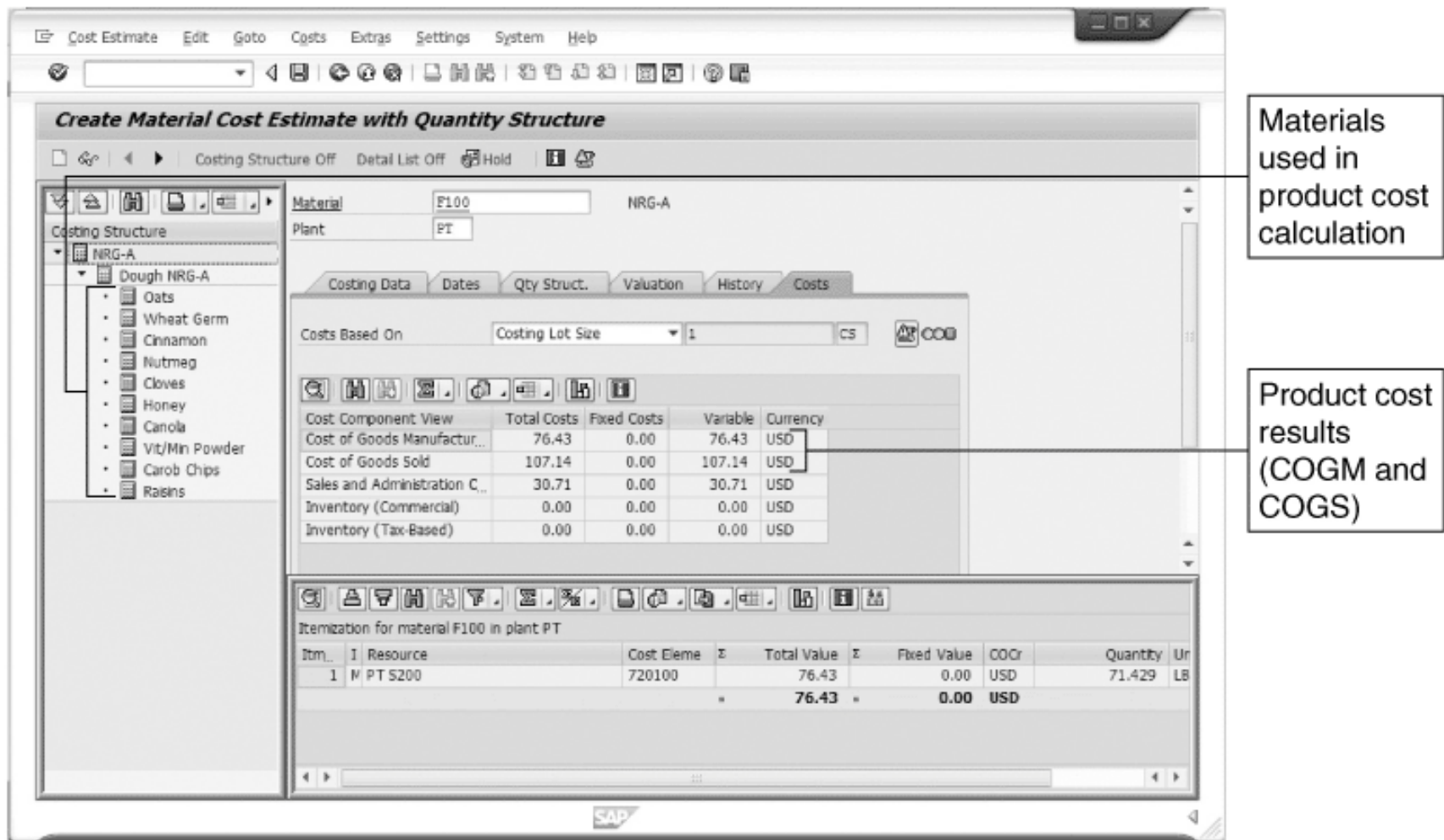


Figure 5-9 Product cost analysis result in SAP ERP

# Inaccurate Inventory Costing Systems (cont'd.)

- Activity-based costing and ERP
  - **Activity-based costing (ABC)**
    - Accountants identify activities associated with overhead cost generation and then keep records on costs *and* on activities
  - ABC requires more bookkeeping than traditional costing methods

# Companies with Subsidiaries

- Account balances for each entity must be compiled and forwarded to the home office
- Consolidated statement for the company as a whole must be created
- Currency translation
  - Problems when **currency translation** is needed for a subsidiary's accounts
- Intercompany transactions
  - Transactions that occur between companies and their subsidiaries



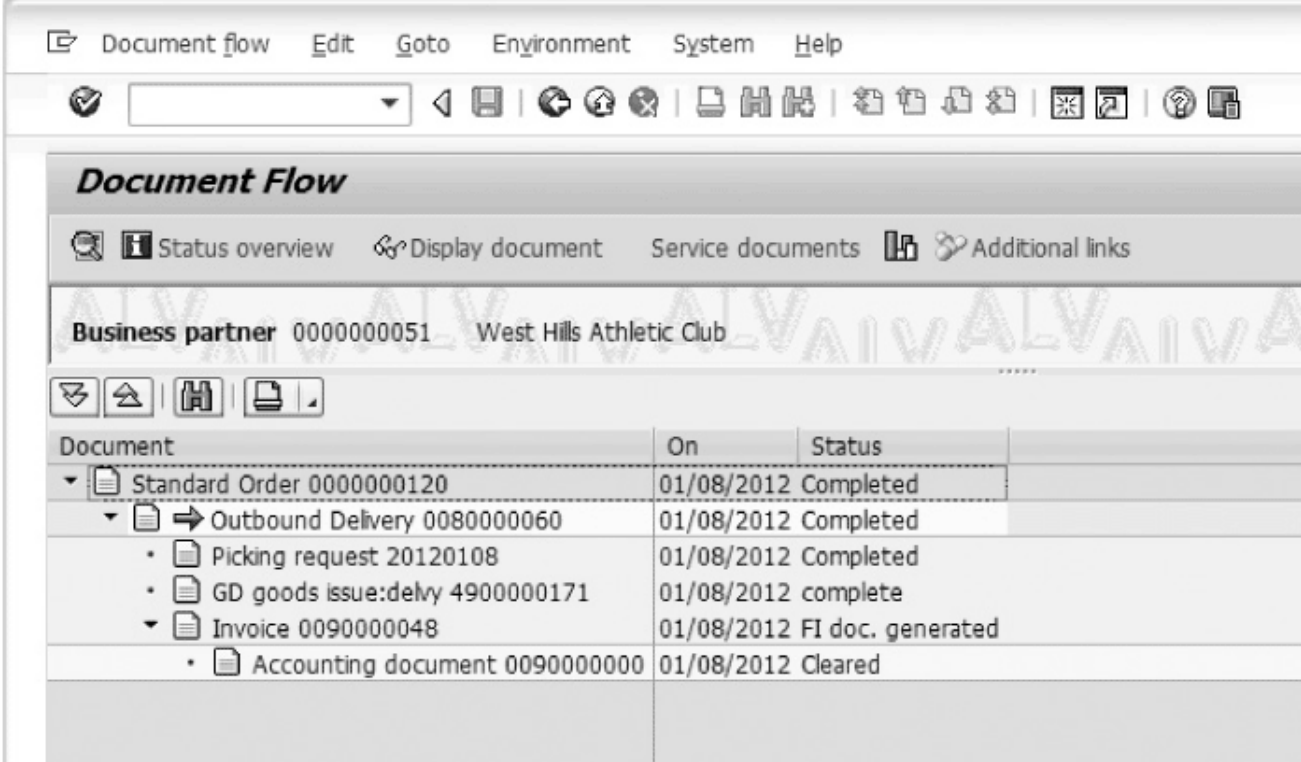
# Management Reporting with ERP Systems

- Generating the right reports for the right situation is often challenging
- Without an ERP system, the job of tracking all the numbers that need to go into a report is a monumental undertaking
- With ERP system, vast amount of information is available for reporting purposes

# Document Flow for Customer Service

- With an ERP system, all transactions in all areas of a company get posted in a centralized database
- Each transaction posted in SAP ERP gets its own unique document number
  - Allows quick access to the data
- In SAP ERP, document numbers for related transactions are associated in the database
  - Provides an electronic audit trail

# Document Flow for Customer Service (cont'd.)



The screenshot displays the SAP ERP Document Flow interface. At the top, there is a menu bar with options: Document flow, Edit, Goto, Environment, System, and Help. Below the menu is a toolbar with various icons. The main header area shows the title "Document Flow" and navigation links: Status overview, Display document, Service documents, and Additional links. The business partner information is displayed as "Business partner 0000000051 West Hills Athletic Club". Below this, there is a table showing the document flow hierarchy. The table has three columns: Document, On, and Status. The hierarchy starts with a Standard Order (0000000120) which is completed on 01/08/2012. This order has an Outbound Delivery (0080000060) which is also completed on 01/08/2012. The Outbound Delivery has three associated documents: a Picking request (20120108) completed on 01/08/2012, a GD goods issue (4900000171) completed on 01/08/2012, and an Invoice (0090000048) generated on 01/08/2012. The Invoice has an associated Accounting document (0090000000) which is cleared on 01/08/2012.

Document	On	Status
Standard Order 0000000120	01/08/2012	Completed
Outbound Delivery 0080000060	01/08/2012	Completed
Picking request 20120108	01/08/2012	Completed
GD goods issue:delvy 4900000171	01/08/2012	complete
Invoice 0090000048	01/08/2012	FI doc. generated
Accounting document 0090000000	01/08/2012	Cleared

Figure 5-10 Document flow of a transaction in SAP ERP

# Built-In Management-Reporting and Analysis Tools

- Accounting records maintained in the common database
- Advantage of using a database is the ability to query the records to:
  - Produce standard reports
  - Answer ad hoc questions
- SAP provides a **data warehouse** within each major module
  - Data warehouse: repository for data from various sources

# The Enron Collapse

- October 16, 2001: Enron was one of the world's largest electricity and natural gas traders
  - Reported a \$618 million third-quarter loss and disclosed a \$1.2 billion reduction in shareholder equity
- U.S. Securities and Exchange Commission (SEC) inquiry into possible conflict of interest related to company's dealings with partnerships run by CFO Fastow

# The Enron Collapse (cont'd.)

- Volume of financial contracts was far greater than volume of contracts to actually deliver commodities
- Some partnerships were faked to mask billions of dollars in debt
- Enron's financial statements had been audited by Arthur Andersen, a highly regarded accounting firm
- Andersen employees on the Enron engagement team were instructed to destroy documentation relating to Enron

# Outcome of the Enron Scandal

- Shareholders lost an estimated \$40 billion dollars
- Thousands of workers lost their jobs
- 31 individuals were either charged or pled guilty to criminal charges
- Jurors convicted accounting firm Arthur Andersen for obstructing justice by destroying Enron documents
- U.S. Congress passed Sarbanes-Oxley Act of 2002
  - Act was designed to prevent the kind of fraud and abuse that led to the Enron downfall

# Key Features of the Sarbanes-Oxley Act

- Designed to encourage top management accountability in firms that are publicly traded in the United States
- Title IX
  - Financial statements filed with the Securities and Exchange Commission must include a statement signed by the chief executive officer and chief financial officer, certifying that the financial statement complies with SEC rules



# Key Features of the Sarbanes-Oxley Act (cont'd.)

- Title II
  - Auditor independence
    - Limits non-audit services that an auditor can provide
- Title IV
  - More stringent requirements for financial reporting

# Implications of the Sarbanes-Oxley Act for ERP Systems

- To meet the internal control report requirement, a company must:
  - Document the controls that are in place
  - Verify that the controls are not subject to error or manipulation
- Companies with ERP systems in place will have an easier time complying with the Sarbanes-Oxley Act than will companies without ERP

# Archiving

- SAP ERP software offers very few ways to delete items
- Data are removed from SAP ERP system only after they have been recorded to media (tape backup, DVD-R) for permanent storage
- **Archive:** permanent storage
- SAP ERP systems keep track of when data are created or changed
  - Change Record

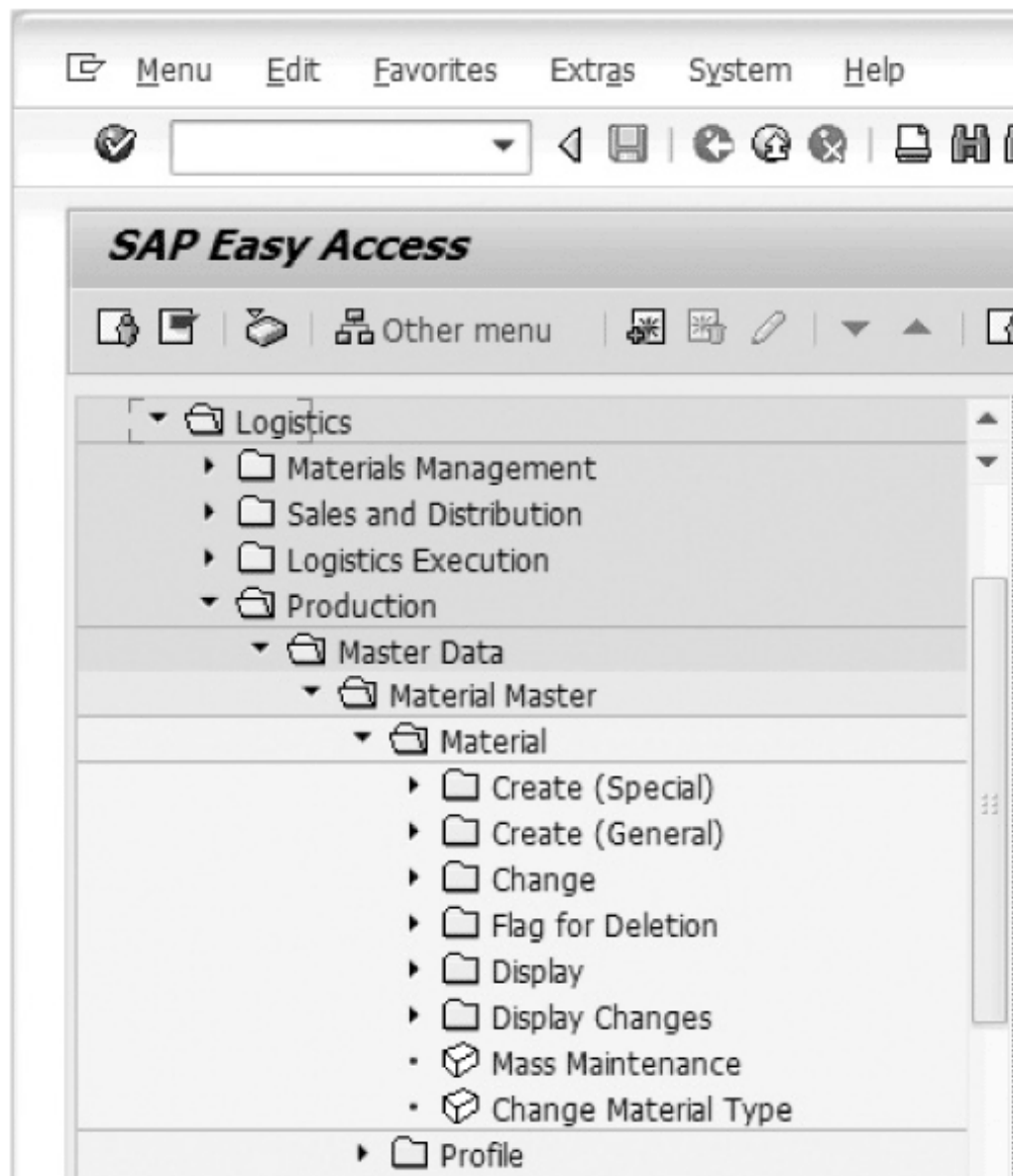


Figure 5-11 Transaction options for material master data

# Archiving (cont'd.)

Change Material 00R380 (Basic Data 1, Raw materials)

Material R380 Oats  
Industry sector 1 Retail  
Material type ROH Raw materials  
Low-level code 002  
Created by BRET on 07/12/04  
Last changed by AUDREY on 02/01/12

Status information:

No deletion flags or locks exist

Client level:

Status description	Created On	Created by	Last Chg.	Changed by
Purchasing	07/12/2004	CHARLES	01/08/2008	CHARLES
Basic data	07/14/2004	CINDY	04/28/2010	CINDY
Storage	08/11/2004	AUDREY	02/01/2012	AUDREY

✓ [icon] [icon] [icon] [icon] [icon]

Figure 5-12 Change Record for material master

# User Authorizations

- SAP ERP has sophisticated user administration tools that allow different levels of authorization management
  - Ensure that employees can perform only the transactions required for their jobs
- Profile Generator
  - Provides a simple method for selecting functions that a user should be allowed to perform

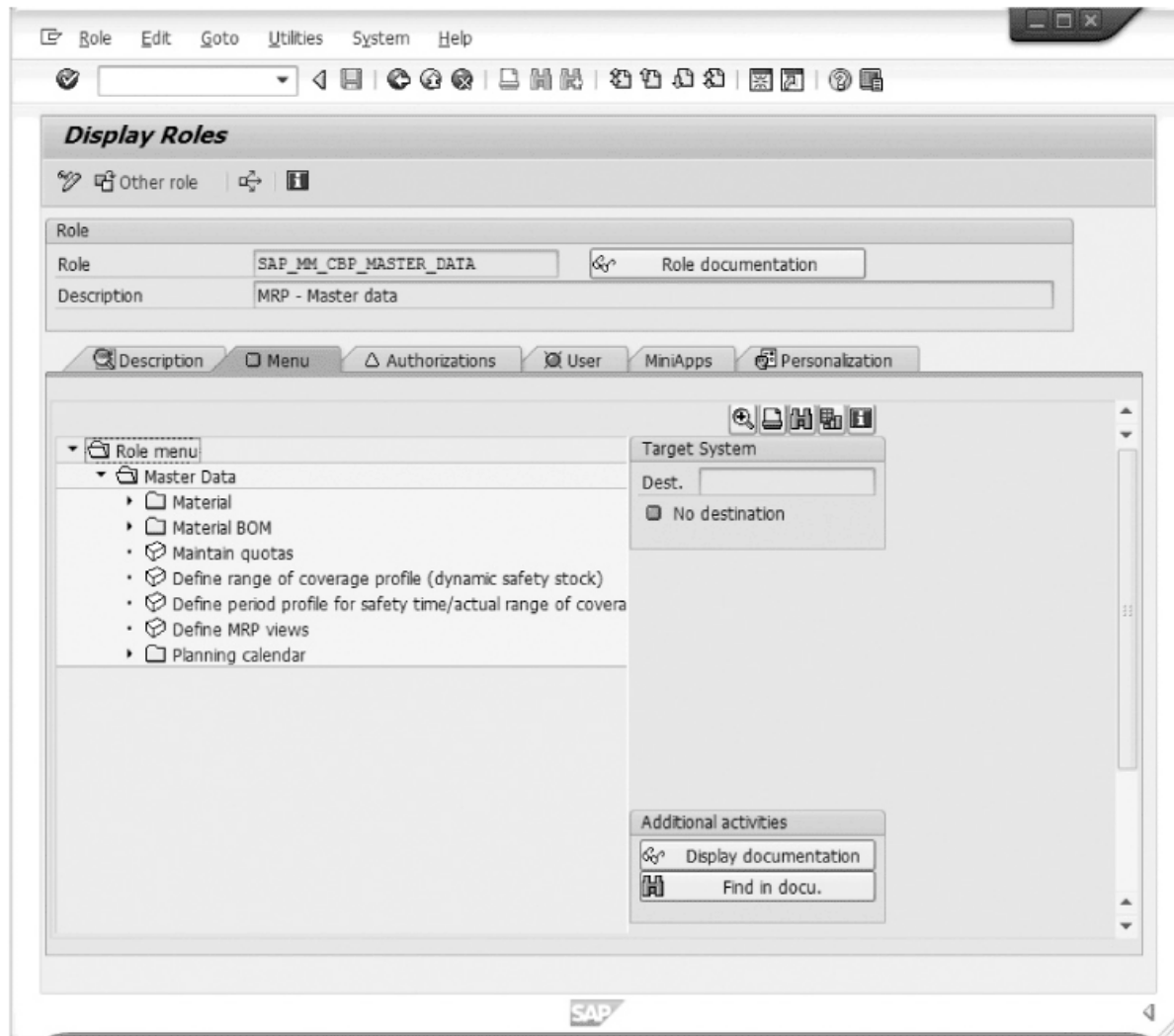


Figure 5-13 Display Roles screen in SAP

# Tolerance Groups

- Setting limits on the size of transaction an employee can process
  - In an SAP ERP system, this is done using tolerance groups
- Tolerance groups
  - Preset limits on an employee's ability to post transactions
  - Set limits on the dollar value for a single item in a document as well as the total value of document



Table View Edit Goto Selection Utilities System Help

Change View "FI Tolerance Groups For Users": Details

New Entries

Group

Company code FS Fitter Snacker Kalamazoo

Currency USD

Upper limits for posting procedures

Amount per document

Amount per open item account item

Cash discount per line item

Permitted payment differences

	Amount	Percent	Cash discnt adj.to
Revenue	<input type="text" value="10.00"/>	<input type="text" value="1.0 %"/>	<input type="text" value="10.00"/>
Expense	<input type="text" value="10.00"/>	<input type="text" value="1.0 %"/>	<input type="text" value="10.00"/>

No group specified, so this is the default tolerance

Default setting allows posting of documents for \$1,000 or less

Payments can differ by \$10 or 1%

Figure 5-14 Default tolerance group

# Financial Transparency

- ERP systems provide the ability to drill down from a report to the source documents (transactions) that created it
  - Makes it easier for auditors to confirm the integrity of reports
- With a properly configured and managed ERP system, there are direct links between the company's financial statements and individual transactions that make up the statements
  - Fraud and abuse can be detected more easily

Report Edit Goto Navigate Extras Settings System Help

Execute G/L Account - Balances: Overview

Navigation

Segment

Profit Center

Business Area

Functional Area

Currency Type Document currency

Currency US Dollar

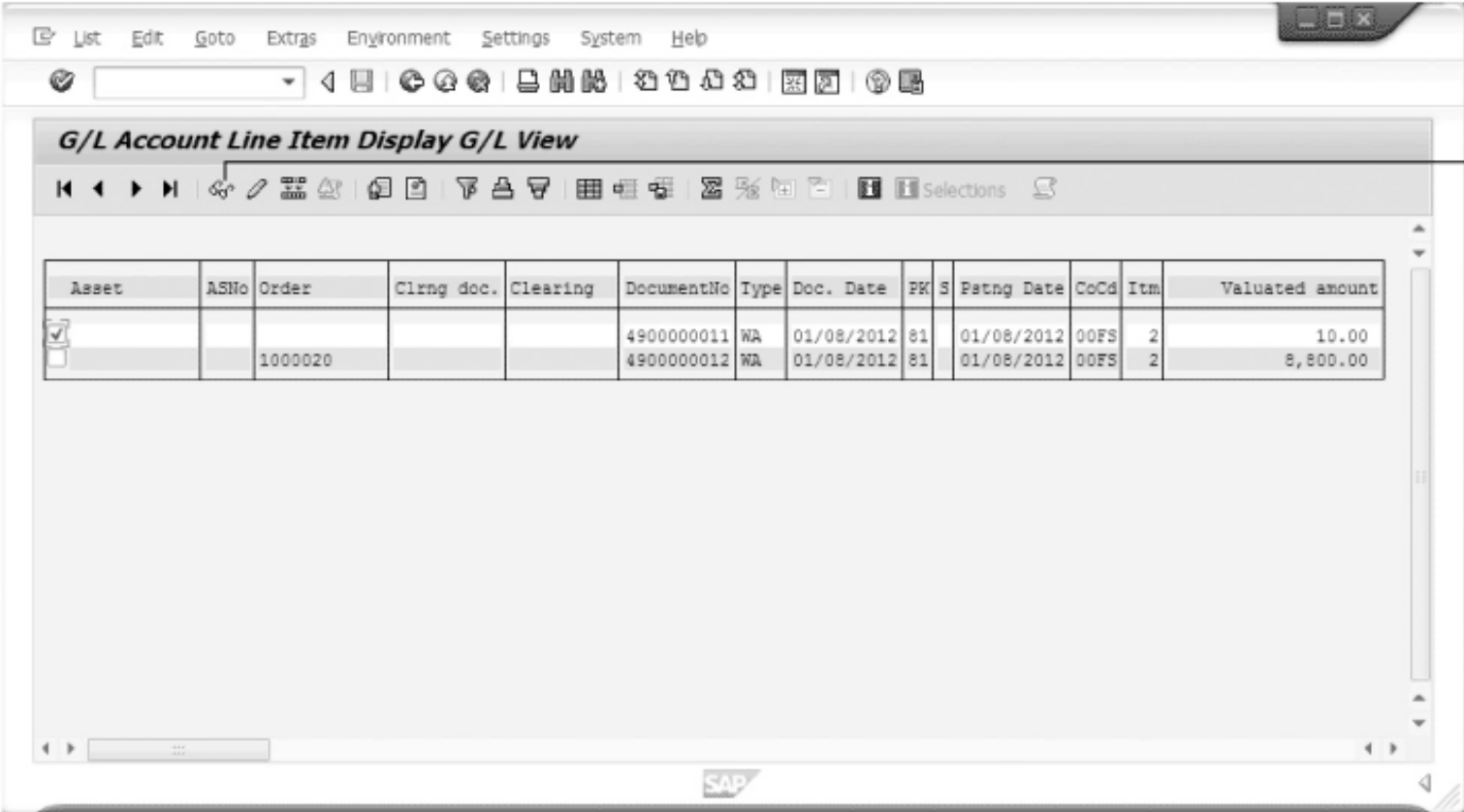
Current data (01/08/2012 16:38:10)

Account	Balance Car	Balance previous pe	Cumulated B Previous Pe	Debit Total Per. 1- 12	Credit Total Per. 1-	Cumulated Debit Bala	Cumulated Credit Bal	Accumulated Balance
Raw Material Consumption Expense	0.00	0.00	0.00	8,810.00	0.00	8,810.00	0.00	8,810.00
Result	0.00	0.00	0.00	8,810.00	0.00	8,810.00	0.00	8,810.00

SAP

Figure 5-15 G/L (general ledger) account balance for raw material consumption

# Financial Transparency (cont'd.)



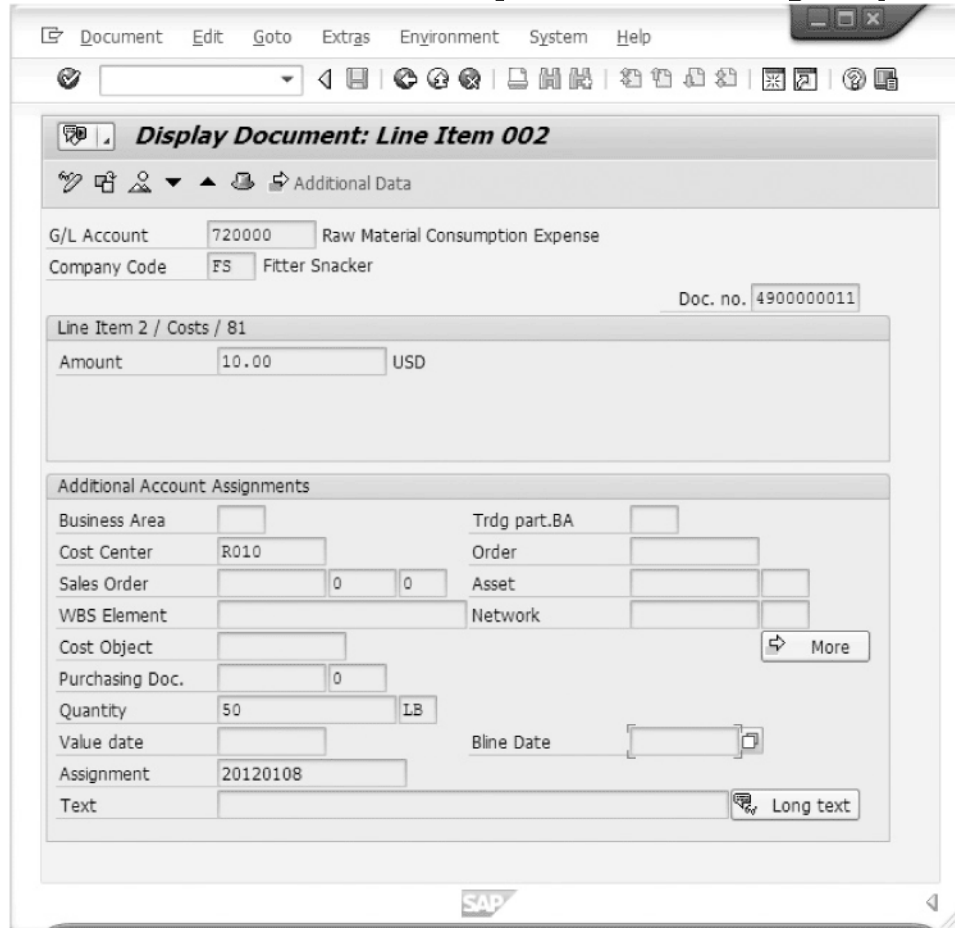
**G/L Account Line Item Display G/L View**

Detail button

Asset	ASNo	Order	Clrng doc.	Clearing	DocumentNo	Type	Doc. Date	PK	S	Prtnng Date	CoCd	Itm	Valuated amount
<input checked="" type="checkbox"/>		10000020			4900000011	WA	01/08/2012	81		01/08/2012	00FS	2	10.00
					4900000012	WA	01/08/2012	81		01/08/2012	00FS	2	8,800.00

Figure 5-16 Documents that make up G/L account balance for raw material consumption

# Financial Transparency (cont'd.)



The screenshot shows the SAP 'Display Document: Line Item 002' window. The menu bar includes Document, Edit, Goto, Extrgs, Environment, System, and Help. The toolbar contains various icons for document navigation and editing. The main content area is divided into several sections:

- Document Header:** G/L Account: 720000, Raw Material Consumption Expense; Company Code: FS, Fitter Snacker; Doc. no.: 4900000011.
- Line Item Details:** Line Item 2 / Costs / 81; Amount: 10.00, USD.
- Additional Account Assignments:** A grid of fields for Business Area, Cost Center, Sales Order, WBS Element, Cost Object, Purchasing Doc., Quantity, Value date, Assignment, Trdg part.BA, Order, Asset, and Network. The Quantity field is set to 50, and the Assignment field is set to 20120108.
- Text Field:** A 'Long text' button is located at the bottom right of the assignment section.

The SAP logo is visible in the bottom right corner of the window.

Figure 5-17 Details on \$10.00 line item in G/L account for raw material consumption

# Trends in Financial Reporting (XBRL)

- Extensible Business Reporting Language (XBRL)
  - Standards based language
  - Extensible Markup Language (XML) coded data directly from web page into database
  - Reports processed faster and validated easier
  - ERP systems accept data in XML and XBRL

# Summary

- Companies need accounting systems to record transactions and generate financial statements
- Unintegrated information systems
  - Accounting data might not be current
    - Can cause problems for sales representatives trying to make operational decisions
  - Data can be inaccurate
    - Can affect decision making and therefore profitability

# Summary (cont'd.)

- Closing the books at the end of an accounting period can be difficult with an unintegrated IS, but is relatively easy with an integrated IS
  - Closing the books means zeroing out temporary accounts
- Using an integrated IS and a common database to record accounting data has important inventory cost-accounting benefits
  - Can lead to more accurate product cost calculations
  - Can help managers determine which products are profitable and which are not



# Summary (cont'd.)

- Use of an integrated system and a common database to record accounting data has important management-reporting benefits
  - Built-in drill-down and query tools available
- Sarbanes-Oxley Act, 2002 U.S. federal regulation
  - Written and passed in the wake of Enron collapse
  - Promoted management accountability by requiring extra financial approval and reporting
  - ERP systems can help companies meet the requirements of this legislation

# Summary (cont'd.)

- Trends in financial reporting
  - XBRL
  - XML
  - ERP systems accept data in XML and XBRL into database