

Financial Close Optimization: Five Steps for Identifying and Resolving Systems and Process Inefficiencies

Introduction

A recent survey by the Institute of Management Accountants found that financial closing is one of the key challenges accounting and finance organizations face; more than half of respondents to that survey said streamlining the financial close process could help improve their team's productivity.¹

However, making improvements to the financial close isn't easy. The financial close cycle is not one process, but many interrelated and often interdependent processes, each with its own stages. One bottleneck occurring "upstream" in the financial close process can have a significant impact on the other processes that follow. In addition, both process inefficiencies and enterprise resource planning (ERP) system design flaws can cause constraints in the financial close process. Resolving these constraints requires identifying and addressing the root causes of issues, rather than only addressing the symptoms.

There is no quick-fix technological "cure" for financial close inefficiencies. Optimizing the financial close cycle requires that organizations make a concerted effort that involves making specific financial close-related improvements to their systems, people and processes in order to make the financial close more efficient. This white paper outlines five steps to help organizations with this effort. By following these five steps, organizations can assess the current state of their financial close process; categorize and resolve the root causes of issues; identify automation opportunities, especially where standard ERP functionality can be leveraged; and improve the efficiencies of financial close tasks by optimizing controls, sequences and dependencies and streamlining deliverables.

¹ *Rising to the Challenge: Productivity in Accounting and Finance Organizations*, Institute of Management Accountants, 2012: http://www.imanet.org/PDFs/Public/Research/NetSuite_Rising_Challenge.pdf.

Five Steps to Optimizing the Financial Close Process

The five steps to optimizing the financial close process are outlined in Figure 1, below, and discussed in the sections that follow.



Figure 1: Steps to improve the financial close process

Step 1: Assess Financial Close Inefficiencies

This first step to optimizing the financial close process involves conducting a detailed assessment of existing processes to identify the main inefficiencies.

Why this step is important: The assessment will help to uncover issues such as:

- Disjointed systems hosting various accounting transactions, resulting in cumbersome and time-consuming reconciliations
- Different systems and spreadsheets used to aggregate and post transactions in the general ledger without keeping the proper documentary evidence for traceability and auditability
- Multiple and redundant managerial reporting packages used at various stages of the close process and requiring extensive data manipulation in many separate spreadsheets
- Shortcomings of the close process in foreign subsidiaries, such as inaccurate intercompany transactions, inaccurate currency conversions, and inappropriate eliminations and consolidations of financial statements
- Lack of sufficient resources to perform the close activities efficiently

- Unrealistic period-end schedule that fails to consider the workload and availability of personnel

Identifying key inefficiencies can help organizations determine which items should be addressed immediately, which items are potential “quick wins” that can be addressed with minimal effort, and which issues likely will require more time or effort to correct.

Step 2: Align Systems, People and Processes

Creating the right alignment of systems, people and processes is the next important step in the financial close optimization process. To bring about this alignment, it is recommended that organizations do the following:

- Create awareness
- Define realistic goals
- Focus on the big picture
- Eliminate silos

Why this step is important: Alignment of systems, people and processes helps define the optimization scope and balance optimization resources and priorities. Here is how the four elements above support this alignment process:

- **Create awareness** – The financial close cycle consists of many stages, with different groups in charge of their respective areas of responsibility. These groups typically have a limited view of the entire financial close process and are not fully aware of the dependencies among the activities performed by them and by others. It is essential to create awareness among groups about all the stages of the financial close process, including the regional close, pre-tax reconciliation, general accounting, tax accounting, managerial reporting, and disclosure. This helps relevant teams understand the scope of the optimization program and be part of the solution as changes are implemented.
- **Define realistic goals** – The number of activities related to each of the various stages of the financial close process can be significant. From a practical standpoint, it is important to limit the initial optimization scope and focus on areas that could provide tangible results in the short term – the “low-hanging fruit.” For example, a common optimization initiative starting point is the pre-tax close and reconciliations stage. Optimizations in this stage can yield significant improvements, potentially reducing the duration of the closing cycle by almost two-thirds.
- **Focus on the big picture** – The financial close cycle, by its nature, involves almost all of the business processes necessary for the organization to conduct business operations. Business processes that have the most significant impact on the financial close process include risk to compliance, contract to cash, demand to supply, procure to pay, invest to divest, hire to retire, and record to report. The number and breadth of these processes demonstrate the sophisticated and complex nature of the financial close process. By focusing on the big picture, organizations can determine which business processes have the most impact on the financial close process and focus their efforts on enabling these processes. Organizations also need to look broadly at how the

processes are designed, how resources are allocated and how the ERP systems can be improved to achieve the desired financial close efficiencies.

- Eliminate silos** – A company may have dozens of employees whose activities create dependencies and impact the efficiency and duration of the financial close process. The main groups may include revenue, operations and services, finance and accounting, treasury and cash management, payroll, legal, and information technology (IT). When these groups perform their activities in silos, it is difficult to gain a clear picture of the dependencies and the way changes in one process sequence will affect other people, teams or processes. Removing the silos will help the different teams work together to identify where a change can be made that will affect other teams and the financial process positively – for example: Which parts of the closing process can be done earlier in the cycle so other teams do not have to wait until the actual close to get the numbers they need to perform accruals and other calculations?

Design a Holistic Architecture Beyond Your Primary ERP

The table below includes key business processes and related supporting systems that are typically considered when assessing financial process inefficiencies and designing optimizing steps:

Business Processes	Supporting Systems
Concept to Product	Costing
Contract to Cash	Customer relationship management (CRM), contract management system (CMS), inventory, order management, pricing, shipping, billing, accounts receivable, point-of-sale (POS) system
Demand to Supply	Sales forecasting, master planning, inventory planning
Procure to Pay	Vendor master, purchase requisition and order management, receiving, vendor invoicing, accounts payable
Record to Report	Budgeting, cost center accounting, profit center accounting, intercompany foreign exchange and re-evaluation, consolidation, tax accounting, treasury and cash, revenue recognition, financial close cycle monitoring, equity system, sales compensation
Invest to Divest	Capital assets and property accounting, capital assets and property reporting
Hire to Retire	Time and labor management system, employee expense management system, workforce management payroll system
Risk to Compliance	Governance, risk and compliance (GRC), security administration, continuous controls monitoring (CCM), compliance testing, exception management

Step 3: Determine Dependencies

When undertaking financial close process optimization, organizations typically will work to identify dependencies (activities that happen before financial close data collection, such as POS processing and rebate calculation) and events that can create upstream bottlenecks and lead to delays in downstream activities, which must wait for resolution of the upstream bottlenecks before they can be completed (e.g., reconciliations, accruals).

Why this step is important: Determining which key processes are dependent on each other helps organizations gain a more holistic view of why there are delays in the financial close process. Dependencies will vary by organization, which is why an assessment is needed. For example, for many companies, dependencies within the revenue cycle can create bottlenecks at data collection and POS processing, revenue recognition, rebate calculation, bonus calculation, inventory reconciliation, general ledger reconciliation, and report generation. The reasons for these bottlenecks in the revenue process may include:

- Manual processing of contracts with nonstandard terms and conditions
- Manual processing of sales orders using the Free on Board (FOB) shipping method
- Manual clearing of errors detected by the interface programs between the POS data and core ERP accounting modules
- Poor performance of the POS data processing program
- Processing of drop-ships and intangible transactions using multiple ERP systems, resulting in cumbersome reconciliation and control to ensure data accuracy
- Manual work to compute and allocate the fair value of the product shipment using disjointed reports and spreadsheets
- Cumbersome and manual reconciliation of large-volume revenue transactions related to balance sheet accounts

These inefficient processes in turn can cause a number of delays downstream, such as:

- Deferrals related to product new features that depend on final processing of POS data
- Delayed rebate computation due to dependency on transactions received from the POS system
- Revenue adjustment for direct shipments, as it depends on final completion of accounts receivable processing
- Slowdown of activities waiting for the arrival of inventory spreadsheets from contract manufacturers
- Long wait time for executive approval of bonus amounts, to account for unexpected changes

An analysis of dependencies helps companies expose the events causing upstream bottlenecks and identify the restrictions that exist around these events (what information is needed when, who needs to provide it, who will use it, etc.). Companies can then identify what tasks can be re-arranged for the process to be more efficient.

Focus on Future Processes

Focusing on future processes helps organizations see the big picture and allows them to address current inefficiencies with a long-term view. Optimized processes and systems should be redesigned to eliminate bottlenecks that affect close activities, resolve constraints, and determine the relevant ERP functions that can be automated.

For example, switching from an actual to a calculated accounting method allows preparatory close activities to shift to an earlier stage, starting several business days prior to the reconciliation stage. The calculated method uses anticipated sales, inventory and delivery transactions during the last four business days prior to the first day of the close calendar. A risk management approach may determine the appropriate materiality threshold to control potential variation and accuracy of the estimated versus actual transaction values.

Also, by using standard ERP functionality, the connection between the contract administration and revenue teams may be redesigned to provide up-to-date visibility into the latest statuses of new, renewed and changed contracts. The improved communication process enables revenue teams to predict the period-end workload related to new and existing contracts.

Step 4: Resolve Constraints Having the Greatest Impact

A number of restrictions could be causing bottlenecks and slowdowns in the financial close process – some with more downstream impact than others. Thus, it is important for organizations to determine the most affected processes, along with the root causes of the delays in these particular processes, in order to help define a constraint resolution plan with the greatest benefit to the financial close.

Why this step is important: Defining root causes allows organizations to determine what solutions to apply and where to apply them. For example, contract management inefficiencies may cause the revenue team to spend several business days during the period-end cycle identifying and investigating contracts that require different processing, revenue adjustments and deferrals. This situation may be the result of last-minute deals, late involvement of the legal department, and/or misalignment between the contract management system and the core accounting modules or systems. Thus, recommendations for optimizing the overall revenue cycle process in this case may include:

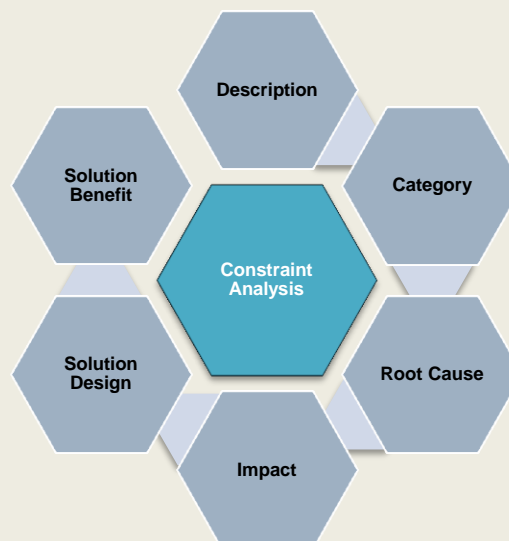
- Defining a hard cut-off date to accept and sign contracts
- Including in the next accounting period those contracts already in the system but not signed at the close deadline

- Notifying the revenue team about contracts that are under legal department review
- Limiting the review of contracts by the legal department to those above an established materiality threshold or requiring different processing
- Calculating sales achievements using bookings, without dependency on reviews by the legal department
- Adding a resource to process the large number of contracts during the last week of the close period
- Integrating the contract management and core accounting systems. (Note: Optimized design of an ERP system would allow efficient communication between the legal and revenue teams, ensuring a well-timed identification and processing of contracts having an impact on the financial close process.)
- Leveraging financial close solutions (e.g., SAP Financial Closing Cockpit, BlackLine, or Trintech) to enforce a formal contract cut-off date, enabling the revenue team to predict the workload necessary to prepare individual contracts, and reducing the duration of the close

Designing Solutions to Remove Constraints

When designing a solution to remove a constraint in the financial close process, be sure to utilize and/or consider the following:

- A clear and accurate description of the constraint
- The appropriate category (people, process, policy and procedure, or system)
- The root cause of the constraint
- The impact of the constraint on the close cycle
- The expected benefits of resolving the constraint



Step 5: Optimize Financial Close Process Administration

This last step to financial close optimization may include implementation of solutions to assist in streamlining the financial close process. There are several solutions that can provide support over financial close and reconciliations and can automate, monitor and control financial close activities and their dependencies. Examples are Oracle Hyperion Financial Close Suite, BlackLine Systems, Cadency® (Trintech) and SAP Financial Closing Cockpit.

Why this step is important: Implementing the right solution(s) can enable organizations to:

- Monitor a structured hierarchy corresponding to financial close activities
- Automate execution of recurring tasks and transactions
- View real-time information and status about close cycle activities
- Connect the groups involved in the financial close process, and their activities, using predefined workflows
- Control the activity sequence and dependencies, preventing errors resulting from executing tasks in the wrong order
- Record an execution log and related details for auditing purposes

Automation of administrative tasks and control of their dependencies can help reduce wasted time, decrease manual errors, and increase efficiencies. By moving away from the commonly used Excel task list, organizations can optimize the number of tasks and their assignment to different people involved in the close process.

Nine Tips for Financial Close Optimization Success

In addition to the five steps discussed above, the following tips can help organizations execute a successful analysis and optimization of their financial close processes:

1. **Obtain consensus.** The financial close process involves multiple stages and departments, and for each department, the tasks, scope and definition of the financial close process will be different. Obtaining consensus among departments on the scope and definition for each stage up-front can help avoid misunderstandings or misinterpretation of activities.
2. **Create momentum.** Focus on the most critical steps and the bottlenecks that cause slowdowns. Providing tangible results and resolving specific issues will create the momentum to extend the optimization initiative to a broader range of financial close activities.
3. **Apply “solution design.”** Leverage solutions, such as ERP functions, optimally and avoid workarounds such as spreadsheets and manual data processing.
4. **Use a holistic approach.** Adopt solutions that interrelate people, processes, and systems at all stages of the analysis.
5. **Avoid overengineering.** Do not waste time and energy overengineering ERP modules to resolve issues that result from broken processes or inefficient methods.

6. **Embrace automation.** Use solutions that provide support for financial close and reconciliation activities to automate close activity administration and monitoring.
7. **Address real root causes.** Identify and resolve the real reasons behind “technical” issues such as “data upload errors” and “missing data.” Do not assume these root causes are purely technical, and not caused by a process upstream.
8. **Work with experts.** Apply leading practices and tap the expertise of experienced teams with a proven track record of success with similar financial close optimization projects.
9. **Engage business leadership.** The management team from the business side, not IT, needs to own the financial close optimization process. The role of IT is to educate the business team about automating, monitoring and integrating capabilities of ERP system modules such as comprehensive usage of workflows, contract management, validation rules and task scheduling. The role of management is to ensure adequate flow, including input, process and dependencies, and to make sure controls are performed and information is timely and accurate.

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