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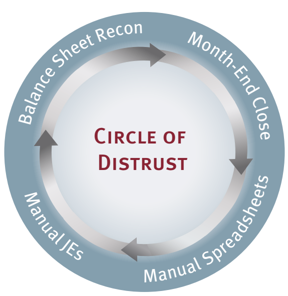
How to Break the "Circle of Distrust" – Tactical Solutions to Reduce Manual Effort for Financial Close

Issue

Pre-IPO organizations continually strive to develop greater efficiency in business processes in order to adapt to the changing regulatory climate and meet evolving customer needs. Many of these companies forecast medium to long term sales growth and strive for increased scalability in existing operations. Finance and accounting leadership is often tasked with identifying these opportunities and thus driving this change.

Issues pertaining to manual efforts often stem from rapid organic growth, experienced by many pre-IPO companies, and the resulting complex business structures.

Consider a group of activities referred to as the "circle of distrust." In this circle, an organization may encounter one or all of the following:



1) A growing population of manual spreadsheets used for intercompany accruals and other transactions, which result in
2) An increasing number of manual journal entries (MJEs), which in turn leads to
3) A lengthy (and costly) process of period-end reconciliations.

As the process repeats from period to period, companies often find themselves stuck in this "circle of distrust," jeopardizing the timeliness and accuracy of financial data that drives key business decisions and is reported in the financial statements.

It is time for management teams to develop a better understanding of their "circle of distrust" and start challenging whether the underlying level of effort represents incremental value to their financial reporting cycle.

Risks

Some of the risks associated with manual processes are apparent, but others may be overlooked.

- **Data Integrity** – Despite the broad use of integrated financial transaction and reporting solutions, it is estimated that 95 percent of companies utilize spreadsheets for financial reporting. Use of spreadsheets for record keeping and accounting is understandably even more prevalent with pre-IPO companies. Research shows that errors are found in 94 percent of all spreadsheets and **in 5 percent of the formulas audited.**
- **"Hard Dollar" Cost** – Excessive time spent on manual close efforts, such as accruals, MJEs and reconciliations, reduces the time available for strategic business analysis. For fast-growing companies with resource constraints, the more relief finance teams get from digging through the data, the more time they have to focus on value-add information for management.
- **Internal Controls** – Control deficiencies related to reconciliations, adjustments and MJEs are among the top 10 material weaknesses reported by companies in their internal controls reports. Even though pre-IPO companies are not required to report their management internal control evaluation, companies gearing towards a public offering in the foreseeable future should have the mind-set of maintaining good internal controls for financial reporting.
- **Scalability** – As companies and their finance functions expand, the obstacles produced by manual effort will generally intensify if new business units and systems are not properly integrated.
- **Low Morale** – At the staff level, it is well known that the overly manual nature of "circle of distrust" activities require a substantial amount of time and effort to complete, yet management is often unaware of the depth of the problem. The continuing pressure to provide timely information often raises the level of stress among staff, and eventually can lead to lower performance and high turnover.

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Our Point of View

1. Watch for Key Indicators of Need

The inefficiencies associated with manual effort intensify during the most critical periods of the financial close, consolidation and reporting cycle. The following symptoms could indicate a need to evaluate existing processes before the issues become unmanageable:

- Limited visibility into the status of the close process and/or minimal lead time for finance to perform analysis, and for senior management and board review
- An extensive close process, with bottlenecks at various stages and multiple handoffs between departments
- Heavy reliance on spreadsheets and "off line" sub-ledgers
- Continual issues with post-close adjustments (e.g., "surprises," issues that recur as post-close adjustments each period, large dollar amount adjustments)
- Frequent and high volume of overtime by accounting personnel in order to meet tightening deadlines

2. Adopt Leading Practices

Through addressing policy and procedural deficiencies, strengthening internal controls and optimizing available technology, leading organizations have been able to substantially reduce the manual effort within the financial close and reporting process in a sustainable and scalable manner.

3. Develop an Approach

By developing a systematic approach, process optimization is achieved through various project phases, ultimately resulting in process improvements that are sustainable over the long term.

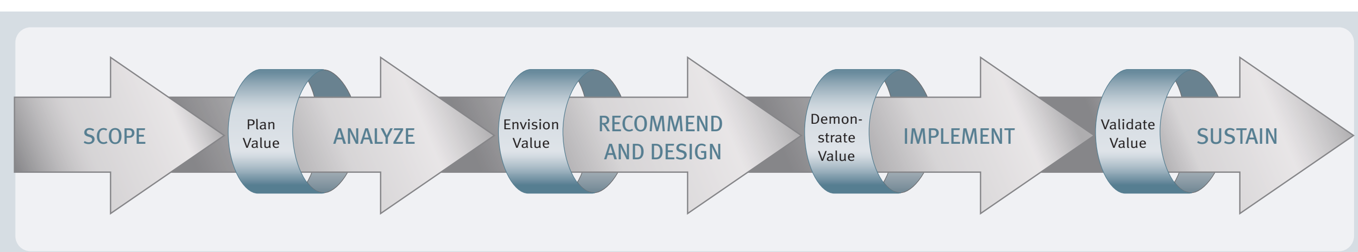
We suggest applying a phased approach as shown below:

- **Scope** – Identify the population of manual tasks performed during the financial close and reporting process for applicable functions and business units. Collect the necessary data for each task to support analytical procedures.
- **Analyze** – Perform "deep dive" analytical procedures to identify process bottlenecks, workload imbalances and opportunities for automation. Focus on isolating the root cause of issues encountered.
- **Recommend and Design** – Identify and design the appropriate solution for critical issues by providing recommendations that are specific to each organization's unique circumstances.
- **Implement** – Develop and execute the implementation strategy to ensure new or reengineered processes are consistently applied and thoroughly tested, and that effective training is provided prior to rollout.
- **Sustain** – Conduct periodic monitoring to assess the success of the new solution in meeting management's expectations and ensuring that the implemented solution remains effective and scalable.

4. Utilize Enabling Technologies

Advanced software can substantially increase the quality and efficiency of the financial close and reporting process by automating many of the most common manual tasks, providing workflow capabilities and streamlined reporting. Some of the tools are quite scalable to fit the needs of smaller but fast-growing companies.

- **Integration to a Single ERP** – The goal is to reduce the reliance on isolated systems where manual input and reconciliations are required. Data flow and consolidation efforts should be streamlined across business units and reporting entities.



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- **Workflow Management Tools** – Powerful and versatile software is available to provide capabilities for efficiently managing close processes, including account reconciliations, close and financial reporting tasks, transaction matching, journal entry workflow, consolidation integrity management and variance analysis.
- **Spreadsheet Tools** – Diagnostic software is available to help identify the total population, map the hierarchy and evaluate the risk associated with linkages, formulas and version control within spreadsheets.

Conclusion

The current economic climate has caused many pre-IPO companies to delay initiatives to address issues within the financial close and reporting process. However, it may also provide a unique opportunity for change:

- **Timing and Cost** – As your organization grows, so, too, will existing manual processes. Over time, the processes could become unmanageable due to added complexity, inconsistencies in systems and procedures, and turnover of key personnel. The current low levels of organic growth have provided a slower operating environment that is prime for operational modifications and redesign.

- **The Case for Change** – Under the current market conditions, change is inevitable. The strongest companies entering the economic recovery will have made necessary, and sometimes dramatic, improvements to key business processes. Now is the time to best position your organization through implementing leading practices and leveraging technology.

Contacts

Steve Hobbs
Managing Director
Leader, Public Company
Transformation Practice
+1.415.402.6913
steve.hobbs@protiviti.com

Brad Rachmiel
Managing Director
+1.312.476.6425
brad.rachmiel@protiviti.com

Charles Soranno
Managing Director
+1.732.275.2792
charles.soranno@protiviti.com

Ken Conway
Director
+1.602.683.4134
ken.conway@protiviti.com

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