Process Scalability: Practical Approaches to Reducing Manual Effort and Risk in the Close, Consolidate and Reporting Cycle

Introduction
With the demands of today’s economy, most companies are being pressed to drive greater efficiency into their operational processes. While there are many opinions regarding the timing of the recovery, most industries envision medium- to long-term improvement in their markets. Accordingly, many are focusing on efforts that drive increased efficiency and scalability into existing operations. Finance and accounting leadership often is tasked with both identifying opportunities and driving these changes due to a number of factors:

- Their historic ownership over key components of recurring general and administrative costs
- Their linkage to multiple functions through the ownership of both financial reporting and planning and forecasting
- A growing awareness that there can be significant opportunities for optimizing core financial processes by leveraging technology to minimize manual effort

While many organizations have renewed their interest in outsourcing, others are realizing significant improvement by taking time to standardize finance processes. Specifically, they are integrating acquisitions made in prior years and better leveraging existing technologies. Both of these approaches help to create a scalable organization that can grow without a dollar-for-dollar increase in the cost base.

The Circle of Distrust in Financial Reporting
This focus on scalability and optimization has been particularly pronounced in the financial close, consolidate and reporting cycle. Many organizations are finding that a significant amount of hours are spent every month in a group of interrelated activities that can be called the “circle of distrust.” Among other activities, these include balance sheet reconciliations, accruals, manual journal entries and intercompany reconciliations (see Figure 1).

Conducting these four steps typically is a critical aspect of validating the periodic financial statements. We refer to these steps as the “circle of distrust,” as concerns over the accuracy of the information, as well as the potential for multiple versions of the truth, can cause this activity cycle to repeat itself within a given period, resulting in excessive handoffs and delays.

These issues often are left unresolved, at which point companies can find themselves locked in this circle of distrust, jeopardizing the timeliness and accuracy of financial data that drives both key business decisions and investor confidence. Essentially, this continuing cycle often represents numerous re-validation and re-review steps that are based on concern (lack of trust) regarding the accuracy of the financial statements.
The activities in these four areas of the cycle typically are manual, supported by large numbers of specialists and spreadsheets. Ultimately, this set of dependent tasks is a critical obstacle to scalability, whether that scalability comes from outsourcing or standardization and integration.

Given these issues and the associated time and costs they create, organizations can benefit from developing a better understanding of their circle of distrust and challenging whether the underlying level of effort represents incremental value to their financial reporting cycles.

**Risk and Cost to the Organization**

It is well-understood that manual processes inherently increase risk. The circle of distrust model can be used to help organizations better understand the drivers of manual effort in their financial close, consolidation and reporting cycle.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Material Weakness Internal Control Issue</th>
<th>Year 4 Totals</th>
<th>#</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Accounting Documentation, Policy and/or Procedure</td>
<td>1,126</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Accounting Personnel Resources, Competency/Training</td>
<td>836</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Material and/or Numerous Auditor/YE Adjustments</td>
<td>469</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Untimely or Inadequate Account Reconciliations</td>
<td>167</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Journal Entry Control Issues</td>
<td>95</td>
<td></td>
</tr>
</tbody>
</table>

In addition to the question about incremental value-add, these five areas can represent significant risk to the accuracy and completeness of financial reporting.


At the strategic level, the risks associated with manual processes typically are apparent, but the depth of the challenge is often 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 ([www.coda.com](http://www.coda.com)). Research shows that errors are found in 94 percent of all spreadsheets and in 5.2 percent of formulas audited.¹

  Keep in mind that the four elements of the circle of distrust typically are supported through a series of supporting stand-alone worksheets, highlighting the risk that errors will be passed on undetected between each related activity.

- **“Hard dollar” cost** – Along with the potential to erode investor confidence in the accuracy of financial reporting, spreadsheets rotating within the circle of distrust have at least one person pushing them. In global organizations, there tend to be regular handoffs of files and processes, often resulting in duplication of effort. Ultimately, in many organizations there are significant resources dedicated to supporting the mass of manual activity in this area.

- **Low morale** – At the staff level, it is well known that the overly manual nature of activities within the circle of distrust requires a substantial amount of time and effort to complete, yet management is often unaware of the depth of the problem. Continuing pressures to provide information more quickly often raises the level of stress among staff. This eventually can lead to lower performance, inability to focus, burnout and high turnover.

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¹ “Sarbanes-Oxley: What About All the Spreadsheets?,” Raymond R. Panko and Nicholas Ordway, University of Hawaii, presented at EuSpRIG 2005.
Key Indicators of Need
The inefficiencies associated with manual efforts intensify during the most critical periods of the financial close, consolidation and reporting cycle. Below are some of the symptoms that 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
- More than 250 monthly financial statement reconciliations
- Relatively high volume of manual journal entries (organizations with more than 200 per month warrant consideration)
- Continual issues with post-close adjustments (e.g., “surprises,” issues that recur as post-close adjustments each period, large dollar amount adjustments, etc.)
- A history of being highly acquisitive combined with close processes of acquired entities not being integrated effectively into the corporate consolidations process
- Heavy reliance on spreadsheets and “off-line” sub-ledgers
- Numerous manual handoffs for tasks such as reconciliations and journal entries (preparation and review are manual and require manual sign-off)
- Remote international finance operations where financials are prepared in spreadsheets and manually consolidated into overall corporate financials

Benefits that Leading Organizations are Realizing
Many companies are addressing these issues actively and have been able to achieve substantial reductions in the level of manual effort (and the associated risk) in their financial close, consolidation and reporting process through focused investment. Specific benefits can include:

- Reduction in recurrence of post-close “surprises” by establishing a consistent, repeatable approach for analyzing and preparing accruals
- Reduction of up to 25 percent in the number of close activities by eliminating duplicative and nonvalue-adding tasks
- Reduction of nearly one day of an assistant controller’s workload during the critical eight days of the organization’s close simply by delegating down lower-risk, lower-complexity tasks
- Reduction of 18 percent of the annual close process workload by aligning the frequency of reconciliations with the risk of each account
- Automating more than 200 manual journal entries by leveraging existing ERP capabilities
- Reducing reconciliation workload more than 25 percent by replacing spreadsheets with a reconciliation application
- Eliminating more than five days of delay in preparing the intercompany reconciliation by replacing the control spreadsheet with a reconciliation application
- Cycle time improvements of up to 15 percent achieved by implementing and managing against a detailed close checklist and dashboard, without significant investment in process/systems change

Approaching the Challenge
To improve the financial close, consolidation and reporting cycle, the devil truly is in the details. Organizations must first become fully aware of the detailed set of activities underlying the problem.
This approach typically results in eye-opening data. However, identifying the problem and developing the case for change is the easy part. Embedding improvements that are sustainable over the long term requires sponsorship, focused project management, and involvement of the appropriate process owners and specialists.

**Conclusion**

There is little question that the recent economic climate has caused many companies to delay or forego a broad array of initiatives across their organizations. However, leading companies are continuing to invest in projects that will provide both quick wins and strategic benefits. One such project is improving the organization’s financial close, consolidation and reporting cycle.

- **Taking advantage of down time to focus on process scalability and reduction in recurring G&A** – As your organization moves forward with the economic recovery, existing manual processes are likely to be rolled out to new business units. Over time, overly manual processes could easily become unmanageable, and the lack of scalability could require additional staff just to manage and control the process. Leading organizations are taking advantage of the low levels of organic growth and M&A activity by focusing their best resources on operational modifications and redesign that will provide both tangible short-term quick wins and long-term scalability.

- **Opportunity cost** – The finance organization has long struggled with the imbalance of time between data collection and analysis. Current economic conditions have intensified the importance of a strong analytical team in finance that spends the majority of its time looking forward. Leading organizations are taking the time to ferret out the drivers of overly manual effort in finance and replacing inefficient processes with simplified, automated solutions. This makes more time available for the finance organization to understand the drivers of the business, enabling it to focus on analysis that matters.

Change is inevitable, and the strongest companies will be able to respond more quickly to the economic recovery by making necessary, and sometimes dramatic, improvements to key business processes. Now is the time to strategically position your organization for growth by identifying opportunities for process scalability, implementing leading practices, and leveraging technology to improve efficiency, effectiveness and your overall process risk profile.
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- M&A Services
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