A Strategic and Practical Approach to Optimizing Financial Reporting in an Increasingly Dynamic World
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Executive Summary

Improving the effectiveness of the financial close process is an ongoing challenge for businesses of all sizes, as companies seek to balance increased accuracy and compliance with greater efficiency. Over the past several decades, companies responded to this challenge by making significant investments in ERP systems. The result of this investment has been to significantly improve the efficiency of transactional accounting.

Today, greater than 99% of transactions typically flow through the ERP system quickly and efficiently. However, even the most fully deployed ERP systems do not address 100% of the activities needed to complete a close. It is these remaining activities that typically require manual adjustments and applied judgment that are currently the last items completed in the close process. Therefore, the most effective way to improve the overall performance of the financial close process is to address these “outside of the ERP” activities.

In this paper we will discuss the ways and means by which companies can use proven methodologies to optimize the entire financial reporting process, achieve significant gains in accuracy and compliance, and as a result, increase the speed and reduce the related costs.

Topics covered include:

(1) An overview of events over the last two decades that have triggered the trend towards an optimized financial close
(2) Important benefits of an optimized financial close, especially the significance to your bottom line
(3) Typical obstacles to an optimized financial close
(4) Steps a business can take to prime itself for achieving the optimized financial close
(5) Key elements to achieving the optimized financial close

This whitepaper provides our blueprint for transforming the financial close into an optimized process. It distinctly demonstrates how a focused effort that uses the Lean Six Sigma methodology of continuous improvement, combined with key best practices and the right technology, can provide your organization with immediate positive impacts. Demonstrable benefits include improved accuracy and regulatory compliance, better investor perception and internal controls, noticeable cost reductions, and higher employee morale.
In the 1990s, newly available computing power enabled the widespread deployment of Enterprise Resource Planning (ERP) systems in businesses of all sizes. The new technology allowed accounting departments to become significantly more efficient in almost all areas of transactional accounting, data accumulation and analysis. Unprecedented automation helped standardize most processes and supported increased growth and complexity, even as accounting staff was reduced.

Unfortunately, even the most fully deployed ERP systems will not address 100% of the transactions a company must include in the close. Many close activities involve manual adjustments, analysis and applied judgment. Examples of some “outside of the ERP” transactions include tax provisions, fair market valuation, and equity adjustments. Other transactions include combining information processed by specialized best of breed systems, and are typically performed manually in the close. It is these manual activities that represent the most likely source of error, are the least predictable, least manageable and slowest portions of the close process. And yet, few companies have invested in systems to manage these manual activities. For the vast majority of companies, these manual activities are managed using a simple spreadsheet-based checklist.

The result of this?

The return on the huge investment in ERP and other accounting systems is limited by the extensive manual closing processes.

At the same time, regulators and the financial community—convinced that delivering financial information to markets faster protects investors and improves the efficiency of capital markets—have been pressuring companies to report results in an accelerated time frame. The financial scandals at the beginning of the 21st century brought an unprecedented level of stringency to regulatory oversight, putting greater pressure on the processes that comprise the financial close. The Sarbanes-Oxley Act (SOX) 404 of 2002, for example, extends scrutiny beyond reporting controls to quality of information, with special emphasis on accuracy, accountability, and segregation of duties. Public companies are forced to spend vast amounts of time and money documenting and testing their financial reporting processes and controls, which increases the complexity of the financial close and affects its overall efficiency.

Even as companies struggled to meet new reporting requirements, rapid globalization and the two global economic recessions of the past decade compelled them to focus on increasing efficiencies. Not surprisingly, general administrative expenses were the first to feel the economic squeeze. Faced simultaneously with diminished resources and increased reporting requirements, most finance departments responded by increasing the burden of manual tasks on their accounting staff. Today, businesses of any significant size or complexity are compelled to:

- Complete the financial close within a market-acceptable timeframe
- Comply with constantly evolving regulations and standards
- Provide a clearly verifiable trail of supporting documentation while operating under stringent budgets, and with austere resources

Faced with this reality, companies have to take a strategic view of the financial close process. Merely increasing technical resources and the number of staff assigned to the close is an insufficient response. While “throwing more people and systems” at the close often does increase the speed, this approach will also increase the cost and complexity of the process, and does little to improve the accuracy.

Current research shows that leading companies known for their best practices strongly favor solutions that can help them optimize the financial close. Optimizing makes the close process more efficient and effective without adding to its cost. These companies are also more likely to employ a strategy that uses technology to support a culture of continuous improvement.

### Top Priorities for Improvement in the Financial Close Process

- Continuously improve the close process
- Develop and monitor close performance metrics
- Establish clear accountability for closing tasks within a closing schedule
- Enforce deadlines

Why Optimization is Essential and Desirable

The benefits of a truly optimized financial close process, as enumerated below, extend beyond meeting regulatory guidelines and being able to report financial results early. They include:

(i) Greater accuracy of reported numbers because of timely reviews, consistent communication, and active management of items and issues.

(ii) Significant cost savings through emphasis on streamlined manageable and repeatable processes.

(iii) Increased investor confidence created by consistently meeting or exceeding industry and regulatory reporting expectations. This also creates an environment of reporting excellence that is well perceived.

(iv) Earlier access to critical information, such as monthly financial reports needed for building and prioritizing business strategies or reacting to changes in the business environment.

(v) More opportunities for accounting resources to perform value-added analysis and introduce improvements throughout the business as a result of a shorter close period.

(vi) Improved compliance through automated controls such as system-generated tracking of approvals, documents, policies and exceptions, resulting in reduced compliance overhead and verification costs.

(vii) Access to monthly financial reports that are based on an increased use and deeper understanding of historical and projected financial information more relevant to the company’s operations.

The Sarbanes-Oxley Act (SOX) of 2002 extends scrutiny beyond reporting controls to quality of information, with special emphasis on accuracy and accountability.
Obstacles to Achieving an Optimized Financial Close

If an optimized close is so advantageous, why are companies not implementing changes right away? There are two overriding reasons: (1) a lack of time (real or perceived); and (2) an ingrained belief that the close is as good as it is going to get, given its nature.

Further analysis reveals the many legitimate concerns underlying the reasons why businesses are reluctant to tamper with the close as it exists. They are as follows:

(i) **The close is a moving target.** The nature of the close itself is one of constant change and evolution. As a company grows and undergoes events such as restructuring, reorganizing and acquisitions, the requirements of the close change. And because many times, the perception is that process improvement must be “all or nothing,” nothing wins. Process improvement initiatives that focus on reengineering the entire process and locking down a set of best practices are almost always ineffective for a dynamic process such as the financial close.

(ii) **The close process lacks clarity and metrics.** The typical close process is opaque, and few companies collect metrics on the performance of the close process itself. This lack of visibility makes it difficult to know where changes should be made and if these changes have had the desired effect on the close.

(iii) **No bandwidth to plan process improvements.** Most accounting departments are caught in a cycle of continuous activity that goes from the ending of one close, to catching up on the backlog that piled up during the previous close, to beginning the next close period. In this environment, the accounting team simply does not have the bandwidth to analyze the current processes for possible efficiency gains, let alone implement new ones.

(iv) **The close is far too complex.** Accounting environments at many large companies operate with multiple systems deployed across multiple time zones, currencies, regulatory compliance requirements and corporate cultures. The idea of tinkering with such a multi-faceted process while working to an unforgiving deadline is viewed as intimidating. Not surprisingly, automation is seen as the best (and only) way to make efficiency gains.

(v) **Financial reporting happens on time.** Most companies achieve their financial close within an acceptable timeframe and fulfill reporting requirements in accordance with regulations. The tendency is to “get it done” by “dropping new requirements into old methodologies” rather than trying to overhaul a system in the midst of a critically time-sensitive activity.

(vi) **The nature of the close is unchangeable.** Accounting and finance departments have traditionally functioned in a very event-based manner around the close, with each group maintaining its own spreadsheet of priorities and checklists, everyone focused on their own individual tasks, and communications routinely channeled through one or two people. So, the concept of open communication, 360 degree visibility, and workload balancing “on the fly” in this environment is largely unimaginable.

(vii) **Imbalance between investment in systems to manage data and systems to manage people and processes.** Huge investments have been made in ERP, Business Intelligence (BI), and other systems designed to move and manage data. These systems typically work efficiently. At the same time, scant investments have been made in systems to manage and improve the process of the close. Yet, it is by improving these processes that companies can gain the greatest productivity improvement and unlock the ROI on the money they have already spent on automation.

All of these reasons, taken individually or collectively, go a long way toward explaining why companies maintain their status quo on the close.

The idea of tinkering with such a multi-faceted process while working to an unforgiving deadline can be intimidating.
Key Elements to Achieving an Optimized Financial Close

The optimized financial close is ultimately achieved through a comprehensive approach that encompasses:

- A continuous improvement methodology
- Best practices adjusted to suit your company
- Applied technology
- A set of focused resources and strategies to start and sustain the change effort

Continuous Improvement Methodology. Successful process improvement is built on the foundation of a proven methodology, which can provide direction, save time, reduce risk and increase productivity. While no single methodology chosen for process improvement can guarantee success, there are several proven methodologies that provide a solid foundation for your project. More significantly, by leveraging knowledge accumulated over several decades and the experience of others, you can create a sound strategy for your optimization project.

Some of the more widely used process improvement methodologies include: Theory of Constraints, Six Sigma®, The Trilliam Model, Twelve Leverage Points, and Lean Thinking. All of these methodologies are data-driven and make heavy use of statistical analysis.

Timing Reviews for Best Overall Results

The most effective time to review a close task is as soon as possible after the task has been completed. When tasks are reviewed in the most timely manner, the impact of discrepancies can be mitigated. However, in most companies the focus is on completing tasks quickly, and reviews are often delayed. This often results in mistakes or omissions that go undetected for several days and propagate through many close activities. In many cases the result is a series of steps that need to be redone, all because of a single error that was committed early and not detected.

Our choice for a close optimization process improvement methodology is Lean Six Sigma, which combines elements of Six Sigma (pioneered by Motorola® for manufacturing) and Lean Thinking (pioneered by Toyota® for manufacturing), with a focus on reducing waste to improve business processes.

Best Practices. Over the last 20 years, accounting departments have developed a set of best practices for accelerating the close. Some of these practices focus on the timing of activities, such as moving reconciliations out of the “crunch time” and eliminating or postponing non-critical reports; others on accounting practices, such as unifying charts of accounts and using recurring journal entries. Some best practices result from a combination of improved communication and timing. (See inset on timing of reviews)

Process improvement—such as assigning responsibility and deadlines for each close task, improving communications and developing close performance metrics—is also a common practice. In order to make the application of best practices both meaningful and successful, they must be customized for a specific environment, and their outcomes must be closely monitored using established metrics to validate the production of the desired result. A combination of a process improvement methodology (Lean Six Sigma) and the application of best practices are necessary to drive the success of the close optimization efforts.
What is Lean Six Sigma?

It is a process improvement methodology that combines elements of Six Sigma and Lean Thinking to help companies establish disciplined working environments focused on customer needs, detailed data analysis, and facts, not theories. The results of Lean Six Sigma process improvement projects—with its emphasis on reducing waste, making many small changes, and measuring the outcome of each change—have been nothing short of remarkable.

The key elements of the Lean Six Sigma methodology can be summed up in the acronym DMAIC illustrated below:

- **Define** the problem.
- **Measure** key aspects of the current process and collect relevant data.
- **Analyze** the data to investigate and verify cause-and-effect relationships.
- **Improve** or optimize the current process based upon data analysis.
- **Control** systems and continuously monitor the process.
Evolving to an Optimized Financial Close

Companies that can redirect resources currently devoted to the close towards more value-generating activities can gain a significant competitive advantage. With a more efficient close, finance departments can move away from their traditional “scorekeeper” role into a forward-looking, strategic, business intelligence function. The best way to give finance departments the bandwidth to take on this new function is by optimizing the close, making that process significantly more efficient.

We have identified below the preliminary steps that a company should take to prime itself for achieving the optimized financial close. They include:

(1) Bring senior management on board with the plan. Implementing a comprehensive solution that involves continuous improvement and adaptability requires some major overhauling. This can be difficult to achieve without the firm commitment of senior management.

(2) Create a strategic plan with active project management. A critical factor in a successful optimization strategy is an overall plan with stated long-term goals for managers in financial reporting. This should include achievable benchmarks for measuring progress on a regular basis. Additionally, having dedicated project management resources ensures a smooth implementation and lowers the risk of failure due to incompletion or neglect.

(3) The changing nature of the close makes detailed long-term planning problematic. In our experience, most companies will have at best a limited idea of what their optimized close process will look like, and few have started gathering meaningful metrics. Even so, there are critical aspects of the project that must be planned in advance such as:

- Which groups and which individuals will be initially involved in the project? It is usually best to begin with small groups and then expand the project.
- How much time is available for the project? Remember that close optimization efforts need to take place during times that will not disrupt the close.

(4) Determine which metrics need to be gathered. One thing we have found is that the metrics you will use to evaluate the close will change over the course of the project. In the case of one of our customers who had a 12 day close when we started, a key metric was the number of week one tasks vs. week two tasks. When they brought their close down to five days, this metric was no longer meaningful. Starting metrics we have found useful include:

- Number of post close adjustments
- Number of audit adjustments
- Number of financial control exceptions and remediation efforts

As the project progresses, new metrics become available and useful. Some more advanced metrics include:

- Percentage of late tasks
- Actual time required for each task
- Wait time between tasks or steps of a task

(5) Evaluate existing technology. Conduct a comprehensive analysis of all currently available options for managing the accounting close and financial reporting process—from spreadsheets to information management platforms. Then carefully choose your solution based on the vendor, the underlying technology, and your future needs.

(6) Make the most of your investment in technology. Fully leveraging your technological investments requires dedicated resources to install, configure, and implement software. This should be considered an integrated part of a comprehensive effort, especially considering the critical and time-sensitive nature of the close.

(7) Identify and adopt best practices. Best practices, by definition, are those that help a company meet or exceed its current reporting obligations and are also adaptable to the needs of the future. A comprehensive analysis of current practices should identify, develop and modify those that can be adopted as best practices.

(8) Prioritize change management. Managing expectations and responses to change is crucial to successfully deploying the benefits of any change efforts. In the close, as elsewhere, optimized results only occur when people embrace the changes that can improve current conditions.

(9) Adopt a culture of continuous improvement. Given the nature of the financial close process, any lasting optimization efforts must include a continuous improvement component. The Lean Six Sigma process improvement methodology is a proven methodology that provides a solid foundation and common framework for everybody to understand.

(10) Deploy focused resources for a short period. Most overworked and understaffed accounting and finance departments are likely to resist change simply because of the high-pressure, time-critical nature of the close process. To succeed at optimization, a company must be willing to deploy sufficient additional resources with relevant experience and training for the duration of the learning change period. Support of focused resources ensures that the finance department can implement changes with a minimum risk of failure.
The financial close is a crucial process that is often overlooked and proven resistant to process improvement efforts. The unique and constantly changing nature of the financial close requires a “total solution” approach to process improvement that must be ongoing.

To achieve a truly optimized close, companies need a combination of:

- Sound methodology (such as Lean Six Sigma)
- Best practices
- Effective technology
- Focused strategy and resources

Companies that invest in a continuous improvement effort for their financial close will gain significant benefits while achieving strategic competitive advantages.
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