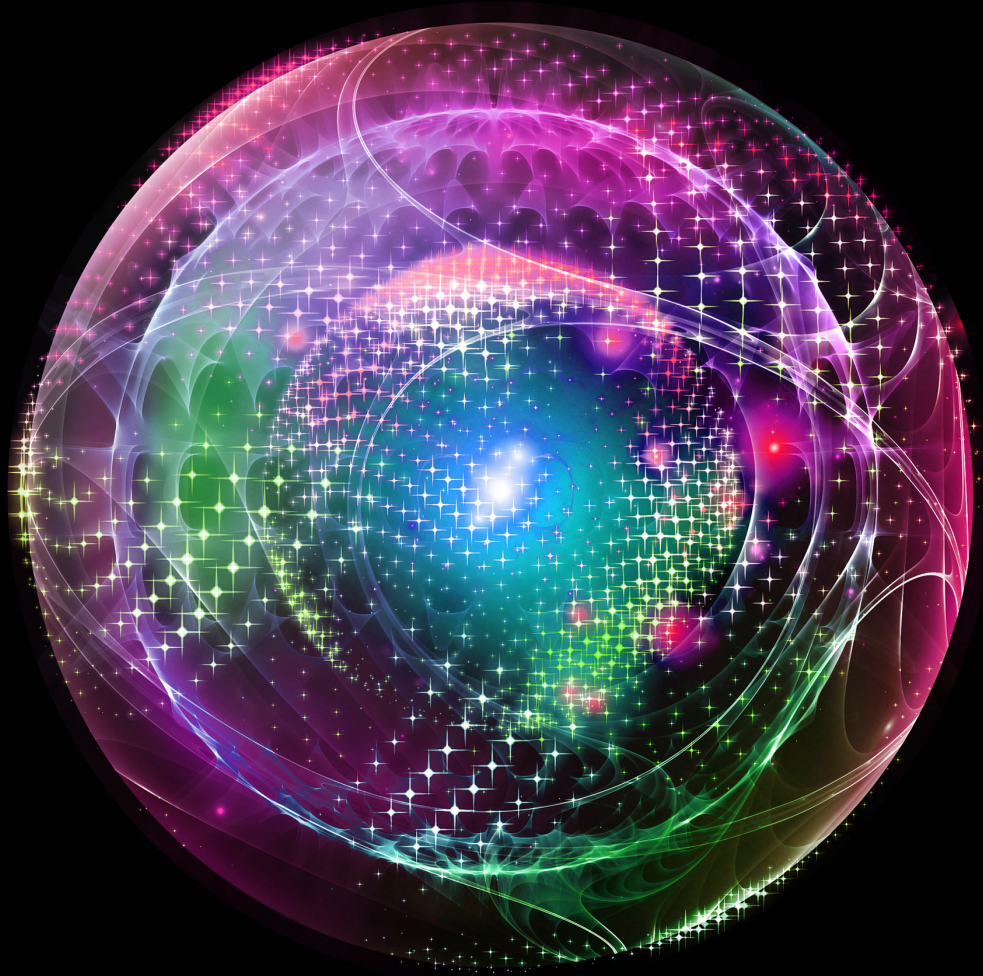


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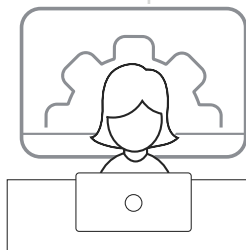
Optimizing your chart
of accounts and why
it matters

Picture this: A CoA failure



The filing deadline was fast approaching when the CFO raised concerns to the board that there were still some outstanding questions holding up his signoff on this year's financial statements. The concern revolved around findings brought to him relating to intercompany transactions between a US-domiciled subsidiary and a foreign-domiciled subsidiary. When compiling the annual reporting package, the director of financial reporting, Wendy, discovered what she believed could be errors in the recording of foreign exchange revaluation and translation.

The current method of accounting for intercompany transactions is highly manual, requiring monthly reconciliations between legal entities. This problem is not isolated; rather, it is a recurring issue, given that the manual adjustments must occur and be tracked outside of the ERP.



Tasked with understanding the issue, Wendy carries out a week-long investigation. Upon conclusion of her investigation, the CFO's fears appear realized, as the transactions look to be inappropriate. As this may be a pervasive issue, there is a need to quantify the total potential impact of intercompany transactions such as those identified as errors. However, as Wendy tries to further understand the breadth of the problem, her ability to determine the population is complicated by inconsistent use of intercompany-specific accounts across the organization. Coupled with the fact that there is no data element identifier of intercompany transactions, Wendy is unable to accurately assess the potential impact across a subset of intercompany transactions. The resulting extrapolated error calculated is material.



The failure of the company's chart of accounts (CoA) structure and ERP to convey the necessary meaning in a timely manner to the CFO and the board resulted in the company missing its filing deadline and the issuance of a material weakness. Compounding these issues, the organization has been under public scrutiny for years due to the perception that foreign entities have been used to evade taxes. The media seizes on the missed deadline and material weakness as proof of their suspicions and levels accusations of misconduct at the company.

What is a chart of accounts?

The CoA helps define a data model that is well-structured, governed, and robust, thus enabling the creation of reports, both for financial and operational reporting required levels of detail. Depending on the ERP you are interacting with, the chart of accounts has many names: common information model (CIM), finance data model (FDM), accounting segments, accounting dimensions, etc. The CoA represents the common data definitions or dimensions used to record, report, and measure performance across the enterprise and should align to the way the organization wishes to manage and report, both now and in the future, while providing flexibility and scalability.

Establishing common definitions for data elements enables organizations to:

- Develop a common language for enterprise data to be used across the enterprise and its subsidiaries;
- Drive the enterprise toward a consistent level of data consistency, granularity, and integration across the system landscape; and
- Enable more effective consolidations and create confidence in the uniformity and visibility of financial data.

CoA is a key component of a finance data model and requires thoughtful consideration for companies that operate globally due to differences that surface with statutory, local legal, or management reporting requirements. The CoA sets the foundation for finance and accounting transactional processing and is instrumental to supporting accurate and timely external financial reporting, management reporting, and global consolidation.

At clients, we often see management and statutory reporting performed in silos, making combined financial and managerial reporting a challenge. Companies tend to expand their CoA over time by defining accounts that represent product, region, location, and other managerial dimensions, resulting in an unwieldy CoA structure. Within the past decade, companies have trended toward streamlining their large CoAs to a minimal account set, which results in increased flexibility, reduced processing times, and eased burden of reporting.

The goal of the CoA can be summarized by three objectives:

1. Support financial reporting to meet statutory and governance requirements
2. Support management reporting and the ability to perform financial planning and analysis necessary to set company strategy and measure operating performance
3. Consolidate individual entity results through an efficient “rollup” to a single global view of company performance

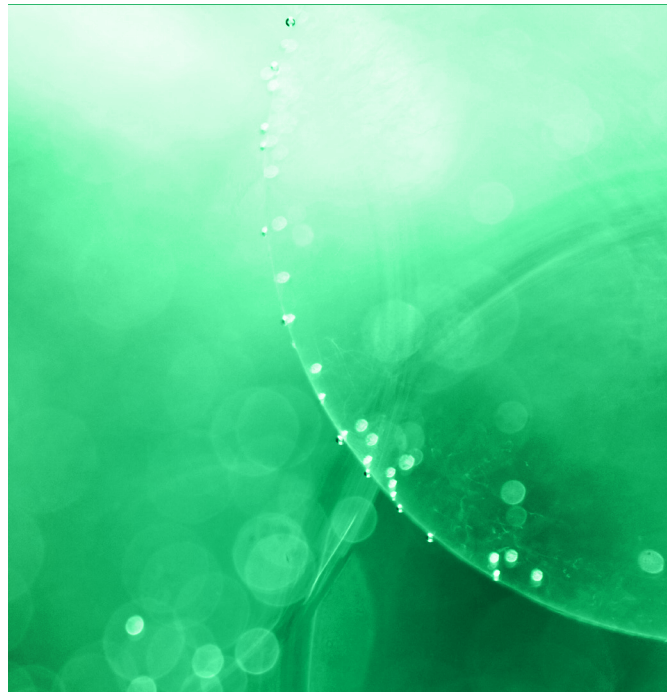
This paper outlines the use of the CIM while optimizing a CoA, highlighting design considerations and guiding principles that should serve to underpin a successful optimization effort.

How CoA effects an ERP transformation

Implementing the principles mentioned can lead to the creation of a sound data model structure and common data definitions across an organization. As organizations look to leverage technology breakthroughs and position themselves to be data-driven, many are embarking on digital transformation programs with a focus on increasing ERP enablement.

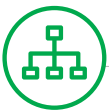
The foundation of any ERP implementation is developing a thoughtful CIM design, representing data definitions used across the enterprise. Once designed and implemented, a change in CoA structure might deliver benefits comparable to a complete reimplementaion of the ERP application. Capturing data, financial and management reporting needs, and consolidation necessitates the right CoA design to get full value out of an ERP implementation. In cases of reimplementaion or data migration from legacy systems, the CoA design also needs to consider the level of detail at which data will be made available from its source systems.

With myriad trade-offs between various design considerations and dilemmas associated with finalizing the complete design of a CoA structure, a comprehensively designed CoA is key for the long-term stability of an ERP implementation.



Guiding principles for CoA design

When designing an effective management structure, organizations have a multitude of factors to consider, including:



Organizational structure

Local versus global

- Address whether a single CoA or multiple CoAs are needed, depending on how the business is run. Whereas a global CoA might mean streamlined consolidation and consistency in reporting, a local CoA may mean fulfilling local statutory requirements through general ledger (GL) only, “local” user productivity, etc.

Organizational operations

- Analyze the trade-off between flexibility and complexity. Depending on the situation, a flexible global CoA could create unwanted segments for the entity, whereas different CoAs for every legal entity may increase complexity during consolidation.
- The CoA design should reflect the organizational structure (i.e., how the business is run). This will increase decision-making capabilities; provide a single source of financial data for financial, operational, and management reporting; and enable increased automation.



Reporting requirements

Statutory, management, and operational reporting

- The ledger should be designed to accumulate data in a way that supports your reporting requirements. Understand the final output that is required from this design, including statutory or external reporting and internal management reporting requirements. The design should support legal, business unit, management, and statutory reporting needs.
- Think through local requirements during global design iterations to address statutory and regulatory reporting considerations which affect country-specific CoAs (e.g., what US jurisdictions need to be reported on a national, state, and local tax reporting basis? Are there other industry-specific regulations to be considered? Based on local legal requirements, do we need to use alternate CoAs or country-specific ledgers?)

Thick versus thin GL

- A thick GL caters not only to financial reporting needs, but also to the management and operational reporting needs of an organization; a thin GL is used only to capture data for financial reporting. Thus, a thick GL requires a larger CoA.
- Optimize GL segments through streamlining and standardization. Enhance the use of other available master data components to reduce the “noise” in the GL and enable a “thin” ledger. If the value of a segment can be derived from another, then it should not be a unique segment.



Data-driven design

Designing the CoA

- Consider the CoA’s ability to enable the organization to make data-driven decisions; provide a single source of financial data for financial, operational, and management reporting; and increase opportunities for automation.

Ease of access and data security

- The structure should not be so large it demotivates users to enter values. The values should be coded to allow users to identify their meaning. Design values such that it is possible to impose access to certain financial reports or balances.

Presence of legacy systems and data conversion

- Every system has its own way of capturing data and generating reports. If legacy systems are not phased out during the ERP implementation, you need to consider data conversion efforts, such as if conversion strategy will be able to provide data at the detail required by the ERP if the legacy system captures it at a summary or more detailed level.



Uniqueness

All values related to a specific segment should be uniformly defined and considered to be like-type. Specifically, when designing GL account values and natural account segments, consider:

- How can we design account values to align with financial statements and disclosure requirements?
- What are the appropriate account naming and numbering conventions to support the buildout of financial hierarchies for reporting? How many digits should each value be?
- What types of values should comprise our data objects (i.e., alphanumeric versus numeric)?
- Are account values common across the entire chart or specific to a line of business, country, or other technical requirement?
- Should we create specific account values to capture US GAAP, local GAAP, and IFRS® requirements?



Flexibility and agility

- CoA design should be scalable to meet the existing and future needs of all entities and countries. For example, segments should contain enough digits for future value list growth, and the design should be flexible to accommodate reorganizations, acquisitions, and other business changes.
- Consider alignment with longer-term IT strategy.



Other design considerations

Hierarchy and rollup

- The grouping and structure of a CoA should be aligned to the business model to enable statutory and reporting requirements. Use number ranges for GL accounts to identify multilevel account hierarchy. CoA values may be arranged into hierarchical, rollup, or parent relationships. This means that values can be summarized and totaled together based on grouping. For example, “total revenue” may be a parent value that summarizes all the values that capture more granular types of revenues.

Budgeting

- If the ERP will be used as a system to impose budget constraints on transactions, budgeting requirements must be captured during CoA design (i.e., if you budget for expenses for every department for a year, and “department” is not a segment in the CoA, then you will not be able to impose budgets on transactions; you cannot budget at a lower level than your CoA).

Consolidation

- If there is a need for consolidation, depending on the CoA structure of various entities, you may require a different CoA for the consolidation books. If your reporting needs can be met using the existing CoA, the same CoA can be used; otherwise, there may be a need to create a new CoA for the consolidation book and perform mapping between two CoAs to derive accounting for the consolidation books and bring balances therein.

A measured approach to improvement

While there is a clear need and strong desire to realize near-term improvements, we recommend that an organization follow a measured approach based on the following four strategic efforts:

- 1** Confirming and communicating the CoA vision
- 2** Laying the foundation for CoA reengineering (five bubbles)
- 3** Reengineering the current CoA segment structure (CoA reengineering triangle)
- 4** Enhancing overall CoA governance and associated processes

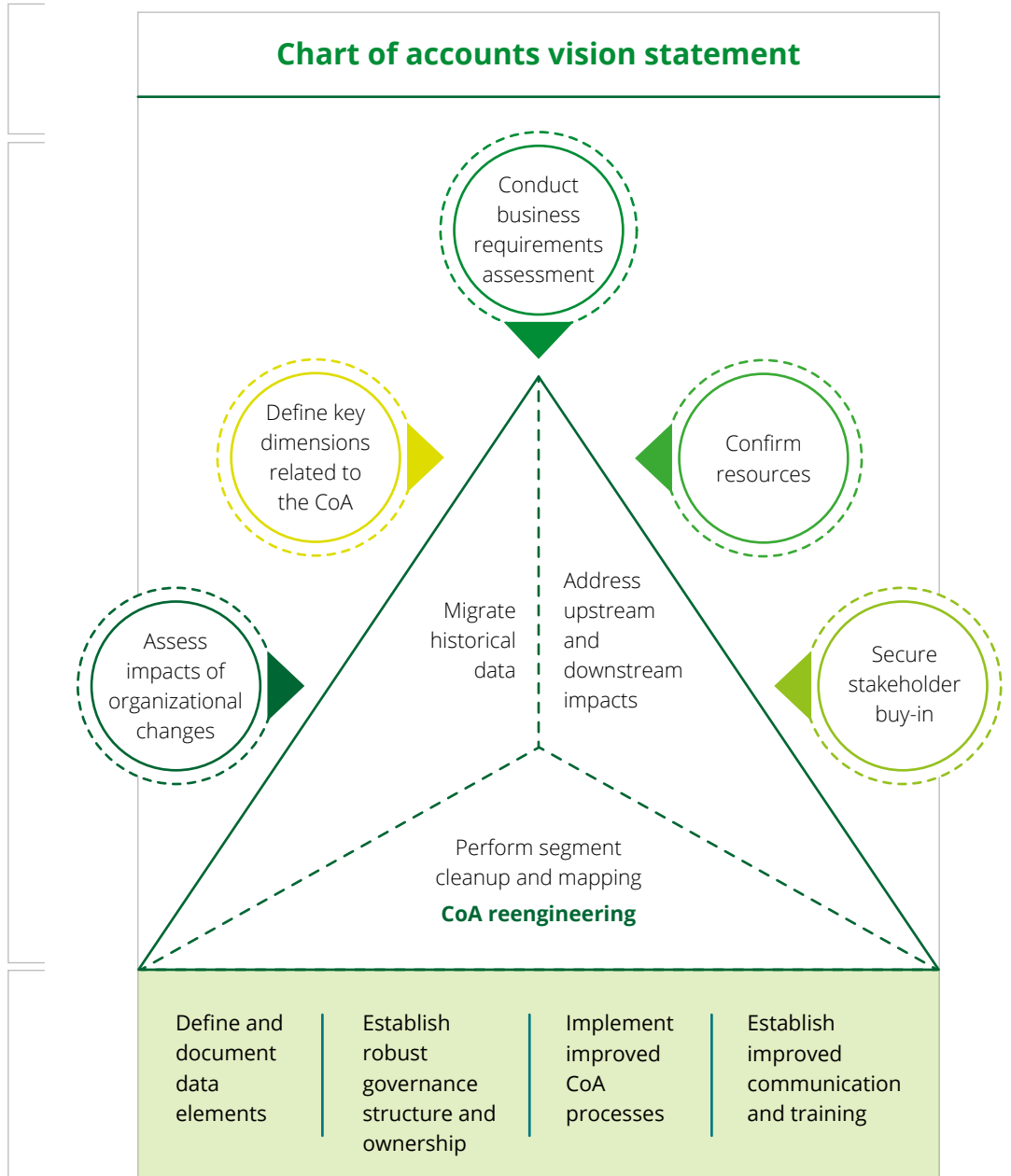


Chart of accounts and data objects

It is important to consider that every CoA design is unique and composed of different data dimensions (e.g., account, cost center, company code, or company). Across industries, companies have certain common elements, such as legal entity, account, etc., with the remaining elements being unique to the company itself. Leading practices guide organizations in optimizing CoA to the utmost possibility. During the initial design, stakeholders should think about the highest and best definition and use for each data object.

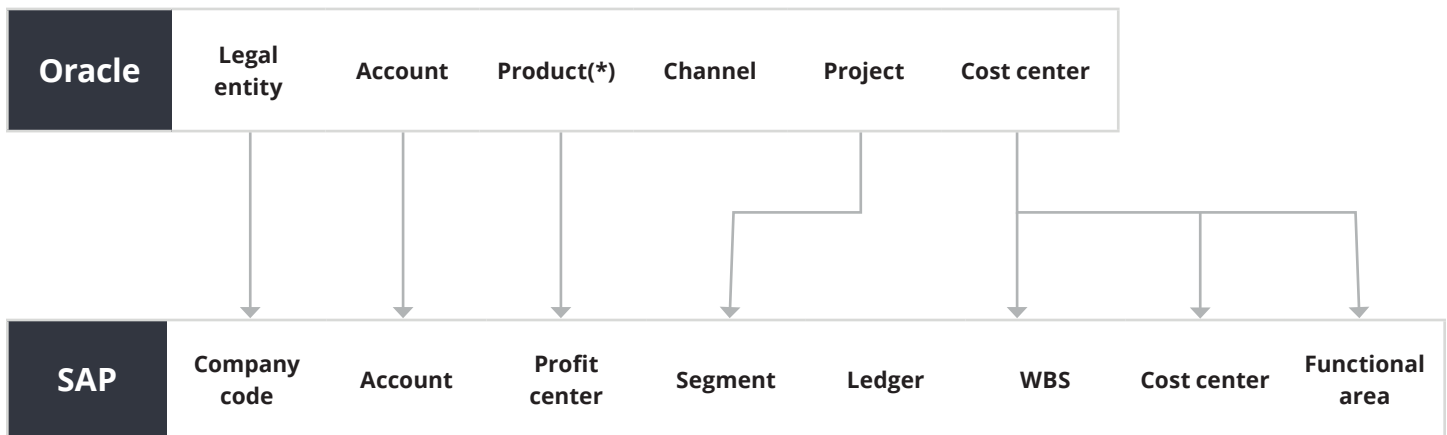
Depending upon the ERP, different objects need to be defined. Below is an illustration to show comparative mapping between Oracle and SAP.

Irrespective of the ERP, the CoA will center on “natural accounts,” as they provide the baseline for effective reporting and consolidation. As the idea of CoA is expanded, you should include other meaningful data elements, identification of which will fall into two broad categories: “system-defined” (elements that are required by the ERP) and “user-defined.”

System-defined elements will vary by ERP. For example, in Oracle, company, account, and cost center are system-defined and would need to be configured and considered. Similarly, for Infor, company, account, and project are system-defined elements. These elements tend to be more rigid in both their usage and definition, as they typically serve as the fundamental elements on top of which out-of-the box system functionality is performed.

Conditional or user-defined elements tend to be more flexible in their usage and definition, as these typically seek to achieve more nuanced, company-specific operation and reporting objectives and can be tailored as such. Examples of conditional user-defined elements might be customer or business partner, location, and, depending on the system, cost center (system-defined for Oracle). When designing, defining, and structuring your data model, it is important to consider the nature of required system-defined elements and conditional user-defined elements. Doing so will increase the potential for out-of-the box system functionality to serve the businesses needs and a clean data model that allows for elements to be both single-use and intuitive.

Figure 1. Illustrative and comparative mapping of data objects



(*) Illustrative mapping between Oracle CoA and SAP S/4HANA®

Final, but important, thoughts

Cost of inaction

An important consideration in the decision-making process should be to understand the impact of not optimizing your CoA as a part of your ERP transformation.

Organizations often face several recurring issues caused by a CoA that is not designed to meet the needs of both finance and nonfinance stakeholders:

- **Inconsistent data:** Having multiple technology platforms with inconsistent definitions and rules results in inconsistent data. A lack of data governance structure and understanding of data has an impact across the organization. Inconsistent data can also result in difficulties during transaction-related activities, such as mergers, acquisitions, and divestitures.
- **Outdated structure:** A CoA can become outdated due to acquisitions and changes to an organization and its business operations.
- **Manual effort:** Manual spreadsheet processes remain due to information being maintained outside of source systems, which results in ungoverned data. Reconciliation issues between finance-controlled data and reporting and operational reporting are not controlled by Finance.
- **Suboptimal usage of ERP capabilities:** The full multidimensional capabilities of the ERP are not harnessed due to structural and value set limitations in the data model.

A suboptimal CoA is an operational concern for the organization that could affect the efficiency with which close activities are performed. Apart from creating inefficiency, data quality issues in CoA can also result in the inability to obtain accurate management reporting and lead to potential misstatements.

CoA maintenance and prevention against regression

A CoA design is only as good as an organization's capability to govern and maintain it over the long term. To leverage an optimally designed CoA to the fullest extent, it needs to be supported by a strong governance structure. Governance enables the maintenance and creation of accounting segments, policies, and processes. The governance body should include key stakeholder groups such as controllership, FP&A, tax, compliance, and business technology.

Maintenance of the CoA should be centralized to enable greater control over data integrity. As part of the governance process, the use of the flex-field segments in Oracle and data objects in SAP should be clearly defined and documented to prevent disparate meaning or incorrect use. For example, for operating accounts (US GAAP), identify a materiality threshold to reduce the number of accounts to be created.

A suboptimal governance process could result in regression and data quality issues.



Your next move

Whether your company has outgrown your current-state CoA; the chart has evolved into an unmanageable, inconsistent, and unrecognizable form; or you are simply taking a fresh look at the CoA as part of an ERP system implementation, a CoA optimization using the CIM approach can elevate your organization's existing system capabilities or establish a foundation for success for a new ERP, multiplying the potential benefits to be gained from any finance transformation. As you embark on your CoA transformation journey, think about your long-term reporting strategy and contemplate how you can further enhance your reporting and analytical capabilities.



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