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Balance Sheet Integrity
The Utopian Close: Creating a low risk, highly effective financial close

Executive Summary

Accountants are seeking a solution for the last mile of finance – closing the books to provide the maximum insight into the numbers and at the same time enhancing the use of scarce resources.

New technology has emerged that automates various elements of the close, including areas such as management of reconciliations, close process scheduling, journal entry control, variance analysis, and intercompany accounting. Accounting departments are starting to realize the panacea by coupling this technology with improvements in process, close governance, and the talent model.

This paper outlines a path to improve the value from the close and addresses the following questions:

- How are leading organizations reducing their cost of finance to a new benchmark of 0.6% while bottom performers average 2.3% (calculated as cost of finance as a percentage of revenue)?
- How will these improvements provide better insights into the company's financial position and reduce risk of error in the financial statements?

Improvement efforts should prioritize historically manual processes that consume considerable time and effort. Such processes lend themselves to automation, and typically offer significant rewards in terms of efficiency and internal control. Balance sheet reconciliations and intercompany accounting have thus become two popular starting points when working toward a "Utopian Close". These areas provide a bedrock for other financial improvements and allow staff to be released to provide better use of their talents.

Chief financial officers (CFOs) and controllers should consider taking the following actions:

- Compare your cost of the last mile of finance to your industry peers
- Review your financial close process, technology and talent footprint
- Increase knowledge of evolving technologies and leading practices for the close.

Imagine a Utopian Close.

You are just about to make your quarterly conference call. As you listen to the hold music you are feeling confident and relaxed. You know that all of your accountants around the world have completed the tasks assigned to them. You have a firm handle on your variances and you feel extremely prepared for questions the analysts may ask.

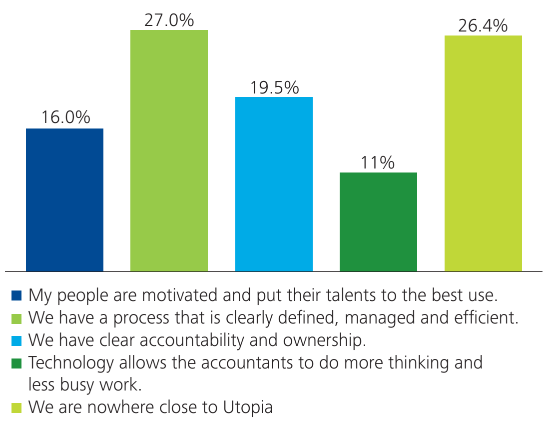
Not only do you have a good handle on the numbers, but you are also the first in your industry group to file your financial statements. You know that your cost of finance is the gold standard for your industry. Your competitors admire your accounting efficiency.

And then there's your team. Your staff describes the close as "clockwork, low stress, interesting, and invigorating." You are even hearing comments from your accountants that they feel motivated, as they are spending more time driving the business forward and less time looking back at the finances.

This is the "Utopian Close", where risk is effectively managed. A close that is both effective and efficient. Can this Utopia become reality?

We asked this question on a Deloitte Dbriefs webcast[1] where 1,700 participants compared their accounting function to this picture of Utopia. Over a quarter of viewers replied that their close is nowhere near Utopia. Only 11% stated that technology was being properly used to allow accountants to do more thinking and less busy work. There is clearly much to do on this journey to Utopia.

When asked which element of the close was closest to Utopia, 1458 Deloitte Dbriefs listeners had the following response:



How does Utopia compare to your close today?

Think back to the last time you signed a balance sheet. What was your reaction as you put pen to paper? Typically it is one of two thoughts: either how much risk is there in these numbers or, how much did we spend getting to the final answer?

According to a recent Gartner report citing the APQC Open Standards Benchmarking Assessments, "CFOs have been diligent in reducing the cost of finance during the past several years and top finance performers have reduced the cost of finance to 0.63% of revenue, while bottom performers average 2.31%."[2]

Gartner discussed the financial impact by stating: "The last mile of finance is ripe for cost reduction and efficiencies. While costs and resource consumption can be reduced by automating these processes, the bigger financial impact is in preventing the fallout from penalties, fines, lawsuits and valuation that result from inaccurate filing of financial statements."[3]

How do companies move the needle and achieve both risk reduction and efficiency in the controller's group? In the past, there has been a presumption that risk and efficiency are counterpoints to each other in the close. There is an assumption that achieving a set of accounts that have low risk of error requires substantive investment in people, process and technology. Contrarily, there is often a presumption that organizations that have a quick, lean, and efficient process may have left risk on the balance sheet.

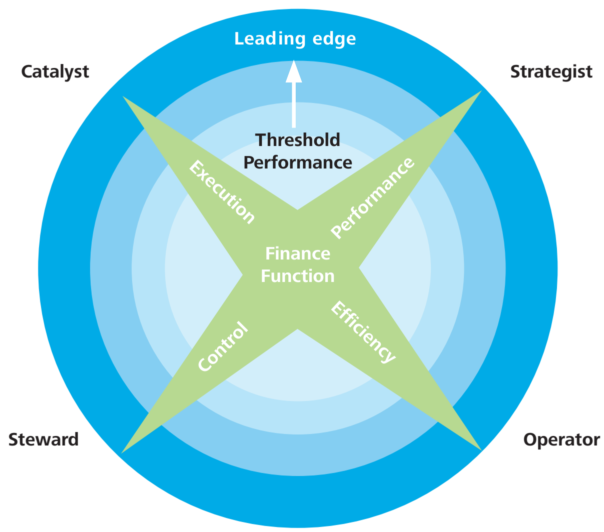
[1] Deloitte Dbriefs – Balance Sheet Integrity in the Last Mile of Finance, October 3, 2012

[2] CFO Advisory: Last Mile of Finance; Finance and Economics" Gartner, Inc., April 17, 2012 (Source: APQC Open Standards Benchmarking Assessments, June 2011).

[3] CFO Advisory: Last Mile of Finance; Finance and Economics" Gartner, Inc., April 17, 2012.

The value of an effective close to the CFO

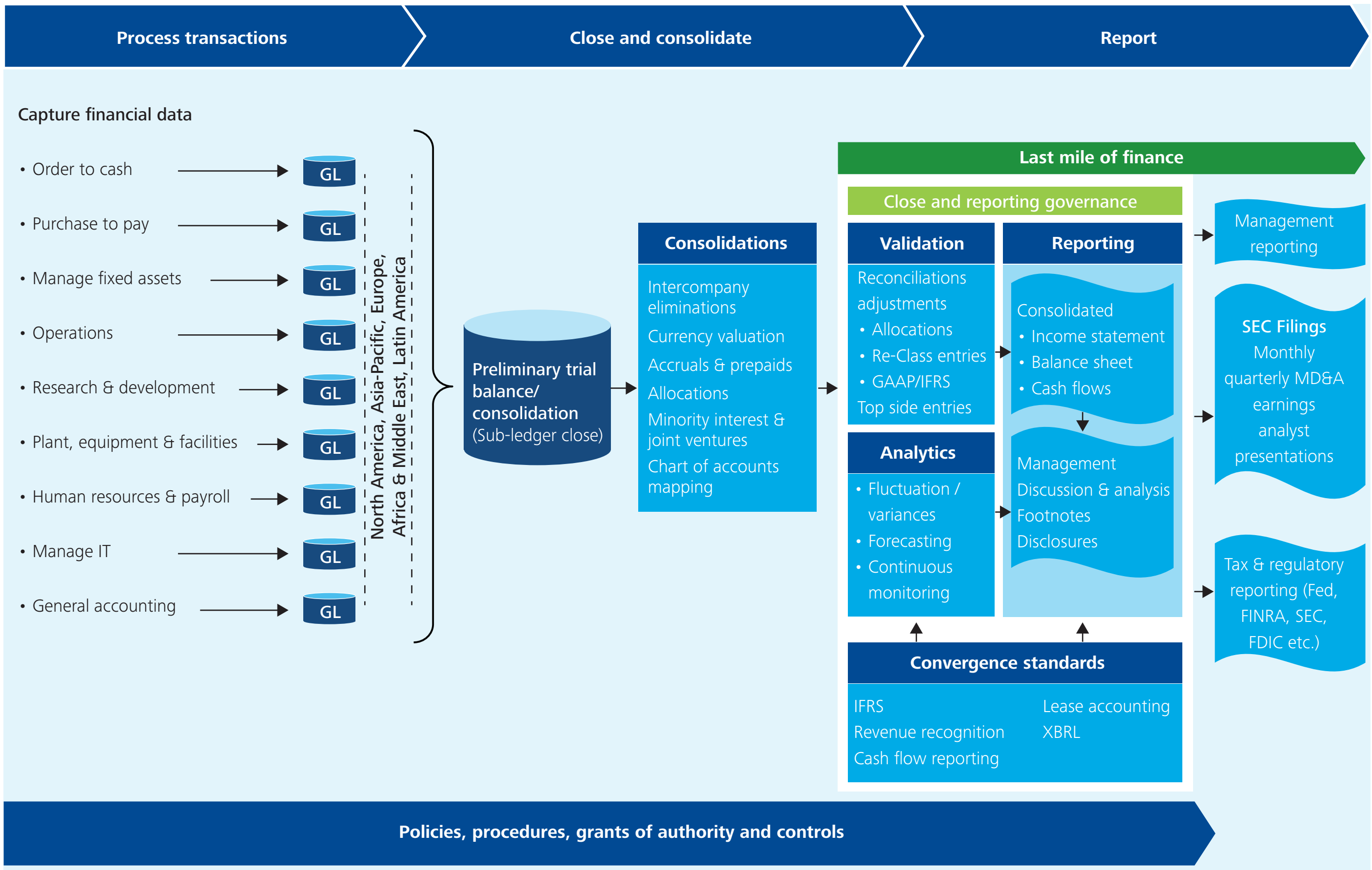
Preparation of a set of financial statements is a foundational responsibility for the CFO, fulfilling the basic responsibilities of steward and company operator. It is essential for the CFO to first provide the responsibility of effective accounting before using their role to provide higher tactical and strategic value. The CFO's tenure is dependent on the ability to produce sound financial statements through a quick and efficient process. Thus, safeguarding and reporting the corporate assets should be the first responsibility.



Value can be gained from improvements in the last mile of finance. Gartner's report also stated "Tools that help coordinate financial statement, regulatory reporting and investor report production can reduce process costs by up to 30%." [4]

[4] CFO Advisory: Last Mile of Finance; Finance and Economics" Gartner, Inc., April 17, 2012.

Risk reduction and efficiency in the last mile of finance



The last mile of finance refers to the activities and processes that result in the corporate books being closed and financials being published. This Includes:

- Validation that balances are appropriately stated
- Gaining understanding of balances and changes through analytical procedures
- Consolidation of local books and records
- Processing of adjusting journal entries
- Preparing financial statements
- Translating to a different version of GAAP (e.g., US GAAP to IFRS)
- Gathering financial data and narratives for disclosures

In the last decade, companies have invested heavily in the front-end of a financial process, promoting efficient and effective transaction processing through unified policies, procedures, and systems. In the past, this same focus has not been given to the last mile of finance resulting in manual and error-prone processes. Often more time is focused on the mechanics than understanding the numbers.

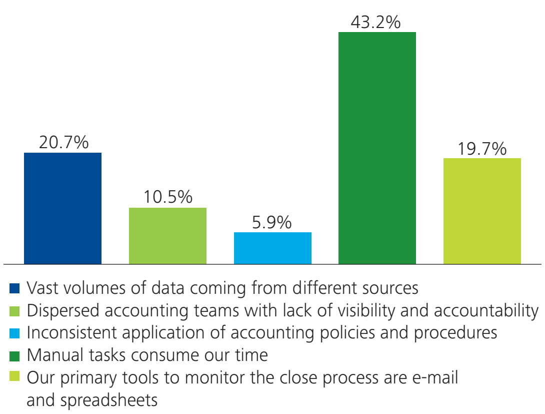
Today, there is more focus on balance sheet integrity in the last mile of finance. Through the catalyst of technology change, coupled with improved process, governance, and organization, companies are finding that investments may yield the panacea of both risk reduction and efficiency.

What's driving risk in the last mile of finance? Why is it so hard to close the books?

Typically, the key drivers include:

- Vast volumes of data
- Lack of visibility into the details of the accounting of geographical disperse or autonomous divisions
- Inconsistent application of group accounting policies and corporate GAAP
- A manual close process. Accountants are engrossed in busy work, rather than leveraging their skills and experience to provide insight
- Use of spreadsheets. Companies are often challenged to detect errors in these and govern a relevant review processes

When asked where the challenges reside in the close process, 1559 Deloitte Dbriefs listeners had the following response:



In addition to these challenges, a risk-based approach is typically not being applied. Resources are not being allocated to the areas that pose greater risk of error to the company's financial statements.

Attributes of the Utopian Close

The Utopian Close displays the following attributes:

Risk-based: Efficient allocation of resources is based on the risk of misstatement of the underlying balance.

Automated: Technology is leveraged to allow full automation of elements of the close and to accelerate other dependencies such as data collection.

Transparent: Dashboard reporting provides management with visibility into the status of the close while highlighting areas of potential error.

Consistent: Accounting procedures are applied in a uniform manner, across divisions and locations.

Segregated: There is a clear chain of command to allow effective review and oversight.

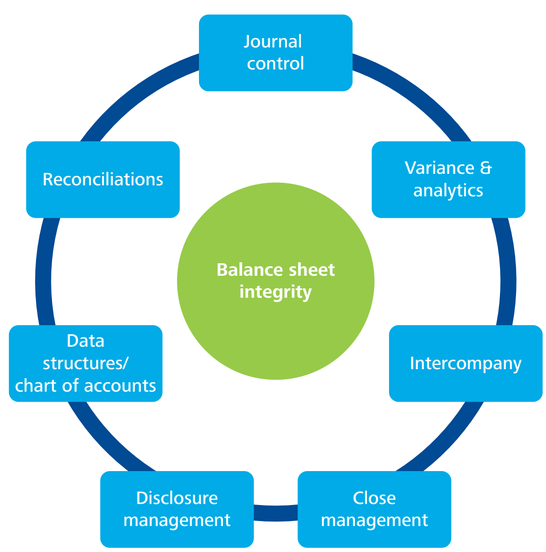
Auditable: Results of the close may be audited by external and internal auditors in a highly effective manner.

Platform agnostic: Data can be pulled from various systems in different formats.

Timely and efficient: Results are published in a timely manner, with a low cost.

Reconciliations: The heart of de-risking and driving efficiency in the close

The figure below depicts the various activities that occur during the close. Organizations may have a different risk profiles depending on their history, industry, systems, people, and other factors. While there may be different risk profiles, there is one constant.

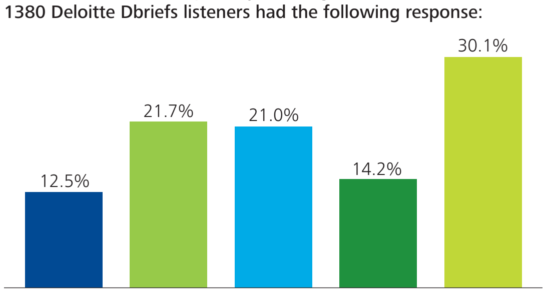


Reconciliation management lies at the heart of the close. Reconciliations are foundational to the integrity of the accounts. By comparing an account to an external data source, confidence may be gained that the balance is properly stated.

"Reconciliations were a logical launch point for our program. Firming up the balance sheet allowed us to have confidence when making other improvements in the close."
Controller, Global Financial Institution.

Consistent, effective reconciliations are a bedrock to allow accounting departments to produce effective variance analysis, prepare judgements, and post accurate journals. Without effective reconciliations, performance of these activities may be hindered by a lack of trust in the underlying numbers.

When asked about the primary challenge with reconciliations, 1380 Deloitte Dbriefs listeners had the following response:



An effective reconciliation program?

Reconciliations are a key control over the quality of financial reporting. Many companies recognize this and declare reconciliations as a foundational element of their Sarbanes-Oxley controls.

However, as business complexity increases, the volume of reconciliations has experienced an exponential jump. Add to this global operations, language, and multiple ERPs, reconciliation management may be difficult.

Many technology solutions have emerged to support efficient and effective reconciliation management processes. Depending on the nature of the implementation, these tools may automate the completion of the reconciliation within a defined and uniform workflow. In addition, reporting capabilities may provide management with dashboards and exception analysis that improves governance. While the technology is critical to establishing enforcable policy and procedures, it is only one part of the solution. For value to be properly generated, goverance, process and talent should also be included in a reconciliation initiative.

When building a global reconciliation platform, start with the end in mind. Consider the benefits that may be yielded from your program:

People
- More effective use of your people's talents
- Focus on analytics and resolving issues rather than the reconciliation mechanics and volume
- Avoid the tyrany of the volume and concentrate on what is important
- Increased transparency to the activities each accountant is performing
- Reduced staff burn out from high stress and long hours
- Lower efficient cost of finance

Process
- Higher consistency of process creates efficiency and removes errors
- Risk based reconciliation workflow focuses effort in the right places
- Improvements in reconciliations allow focus to be placed on understanding variances and exceptions
- More attention can be placed on gaining insight into the numbers and resolving issues

Technology
- Automated and consistent process flow and document management repository
- Automatic "certification" of high volume / lower risk accounts reduces user time
- Automated dashboard and reporting capabilities to provide transparency throughout the close

Governance
- Technology enforced segregation between preparers and reviewers of reconciliations
- Drill down of reconciliations and clear oversight

Realizing the Utopian Close: A call to action

First steps to achieving the Utopian Close:

- Compare your cost of accounting to your peer group. Consider whether your cost and speed to report are in line with your industry and the expectations of your stakeholders.
- Gain an understanding where risk may reside in your last mile. Receive input from those external to your group (internal audit, external audit, general counsel, compliance) and those within your accounting group who have intimate knowledge of the process.
- As reconciliations are often an effective place to improve quickly, obtain an understanding of the volume, frequency and process for reconciliations. Look for ways to rationalize the number of reconciliations while leveraging lower cost shared service centers for low risk reconciliations.
- Obtain an understanding of the evolving technology tools that support reconciliations and consider how it could be applied to your company.

Once these steps have been undertaken executives should start to build a business case for improvement investment in the people, process, technology, and governance.

There is tangible value to be gained by investing in improving the last mile of finance. The intangible benefit of preserving shareholder value by reducing the negative financial impacts of misstatements and restatements may yield even higher value as CFOs sign balance sheet with more confidence.

There is also tangible value to be gained from improvements in last mile of finance through efficiency. The intangible benefits, even though difficult to measure, may be even higher: confidence in the numbers, better decision making, more motivated accountants.

And the next time you have that earnings call, how close might you be to Utopia?

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