

## How to achieve more timely, accurate and transparent reporting through a smarter close\*

Smart, efficient closing cycles create a foundation for evaluating performance and supporting business decisions.

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## Situation: Companies face increased pressure to provide higher quality information faster and more efficiently.

Finance departments are being pressed to improve the close and reporting process. Externally, market and regulatory bodies have accelerated reporting deadlines. However, simply speeding up the process is not enough as there is also greater demand for more reliable and transparent information. Sarbanes-Oxley requires it, and today's public markets often reward companies for providing transparency that goes beyond regulatory requirements.

Internally, executives and business leaders are looking to the finance department to play a larger role in supporting business and operational decision making. This larger role includes measuring and managing corporate performance against strategic objectives. Furthermore, cost and performance factors are also present as finance departments are trying to do more with the same, or fewer, resources. Combined, these pressures are forcing finance departments to look for opportunities to close faster and smarter.

### **External stakeholders and regulators want more transparent information in less time**

Demands that companies complete financial reporting faster and with more transparency are coming from every angle. Market and regulatory bodies require access to more reliable information within shorter periods of time. Most notably, the SEC accelerated its filing deadlines for 10Q and 10K reports. At the same time, revelations of corporate financial irregularities have prompted investors and analysts to scrutinize financial information more aggressively and penalize companies that delay or restate earnings. Approximately 20 percent of restatements made between 1997 and 2002 resulted in credit rating changes,<sup>1</sup> and numerous studies document the hit that stocks suffer after restatements.<sup>2</sup> In today's environment, even companies not regulated by the SEC must demonstrate greater transparency and accountability to banks, venture capital firms and other financing sources.

### **Internal executives and business leaders require fast, accurate information to support decision making**

Beyond regulatory and market demands, finance departments are playing an ever-increasing role in management reporting. Finance departments must also provide company leaders with timely and accurate performance information to enable corporate performance management (CPM). CPM represents an expanded scope of responsibilities for finance departments as it extends beyond the traditional components of corporate reporting and includes planning, budgeting and forecasting and business analytics. Providing the data is not enough; finance departments are now expected to deliver insight into how to interpret results to drive decision making and improved performance.

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1 Bryan, S. and Sinnett, W. 2005. "Undoing the Past: Implications of Earnings Restatements" Financial Executive 21: 42-44

2 Akhigbe, A., Kudla, R. and Madura, J. 2005. "Why are some corporate earnings restatements more damaging?" Applied Financial Economics 15: 327-336

A number of obstacles stand in the way of finance departments that want to provide decision support. Inefficient financial reporting ties up valuable time and resources, obscures transparency, increases the risk of errors, and causes organizations to base critical business decisions on incorrect or incomplete information. Finance departments must minimize data compilation time and effort to improve their ability to analyze results. This begins with the process of closing the books and makes timeliness and accuracy essential to the success of the process.

### **Companies must report faster with fewer resources while running out of “quick wins”**

A strong economy and increased global competition have forced companies to cut costs to maintain profit margins. Additionally, executive leadership wants better value for the money from finance functions. As a result, finance departments must do more with the same or fewer resources. Some organizations attempt to accelerate the close and reporting cycle by simply asking employees to work faster to meet external and internal demands. But at what cost? Companies find that they can realize only so much speed before accuracy and control are compromised. Overtime and high turnover are commonplace, and the consequences are compounded by fierce competition for experienced accounting resources. Additionally, the costs of replacing accounting resources are significant. According to recent TowerGroup estimates, it can cost as much as 65% of an employee’s annual salary to fill an open position when taking a realistic view of all direct and indirect costs as well as lost business and/or productivity during the transition.<sup>3</sup> However, the real costs of high turnover may be even greater as some experts hypothesize that turnover increases the risk of costly accounting errors.<sup>4</sup>

Pressed for resources, many companies have responded to the need to accelerate their close by “tweaking” their processes to save a few days. Few companies make significant holistic changes to their processes or maximize their use of technology to expedite the closing and reporting cycle. As a result, many companies have exhausted “quick wins,” which are easy changes that minimally reduce the process, at a point when they need to remove significant time and effort from the process.

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<sup>3</sup> TowerGroup. Research by Rodney Nelsestuen, Senior Analyst, Financial Services Strategies and IT Investments, TowerGroup.

<sup>4</sup> Linn, E. and Diehl, K. 2005. “Financial Restatements: Causes, Consequences, and Corrections.” *Strategic Finance* 87 (3): 34-39

## Our perspective: A smart, efficient closing cycle creates a foundation for evaluating performance and supporting business decisions.

With external, internal and cost pressures placing increased demands on finance departments, now is the time to establish a faster, smarter close and reporting cycle. Initially, finance executives must focus on discipline, control and accountability rather than speed. Timeliness, accuracy and transparency are critical, and unfortunately, there is no “silver bullet” that can transform the cycle overnight. It is through incremental wins that companies are able to create sustainable solutions. With an effective process, companies can explore ways to use data to manage performance more intelligently within finance and throughout the organization.

### **The smart close is controlled, standardized and efficient**

Across all industries, truly successful closing cycles share a number of characteristics. Perhaps most importantly, they focus on accuracy as opposed to speed and take advantage of opportunities to improve accountability and control throughout the cycle. Smart closes are also simplified and standardized to eliminate unnecessary complexity and inconsistencies. Additionally, they are streamlined and optimized by appropriately sequencing work steps and by eliminating bottlenecks, duplication of effort, and non-value added activities. Lastly, smart closes are process-focused and effectively leverage existing technology. Efficient cycles need not center around the latest and greatest technology. In most cases, current systems can be modified or enhanced to deliver the necessary data.

### **Are the books really closed?**

Best practice companies are able to produce consolidated reports within five business days.

All too often, companies with a five- to seven-day close cycle are not actually able to produce reports for several more weeks. In many cases, this accelerated cycle is followed by a series of post-close adjusting entries that continue up to the release of earnings. From our perspective, the books are not closed until the numbers stop moving. Continuous adjustments are one of the most prevalent problems facing companies today. There are a number of other indicators that suggest there are opportunities to improve the close and reporting cycle. These indicators are:

- **Lack of speed**—Companies that take more than five days to close and generate consolidated results, require more than 30 days to publicly release earnings, and provide limited support for business and operational decisions need to add speed to the close and reporting cycle.
- **Insufficient accuracy and/or control**—Companies that record significant adjustments or corrections after the books are closed, have difficulty balancing inter-company transactions, and create external financial reports that differ from internal management reports need to improve accuracy and enhance control.

- **Dependence on manual processes**—Companies that rely on manual recurring journal entries, account reconciliations and consolidations, off-line Excel spreadsheets, multiple charts of accounts, and disparate systems need to leverage technology more effectively.
- **Ineffective decision support**—Companies that have difficulty identifying potential financial surprises far enough in advance to correct them, capture excessive detail, and utilize complex reporting and legal entity structures need to align processes to provide timely, accurate and relevant information to the organization.

### Speed and accuracy will improve with a smarter close

Improving the closing and reporting cycle helps companies respond to the pressures of the current business environment and support compliance with reporting regulations. At the same time, it reduces the risk of financial surprises and enhances the organization's ability to support better decisions and use resources more efficiently. The measurable results of well-planned and thorough efforts can be quite striking. Companies that have worked with PwC have improved the timeliness of the close process by 40% and reduced error rates by 20%.

### A Win for the Company and the CFO

An improved close and reporting cycle benefits the entire organization, but success is especially rewarding for the finance department and its leader, the CFO. A smarter, faster close delivers:

- Greater confidence when certifying financial statements
- Lower compliance costs and less volatility in financial data
- Scalable processes and better information to enable decision support
- Enhanced credibility in the market and within the organization
- Opportunities to pursue other strategic objectives and value-added activities
- Improved staff skill, awareness and satisfaction along with lower turnover



## Impact: Improving the timeliness and accuracy of the closing and reporting cycle requires a holistic approach.

Within the close and reporting cycle, a number of underlying factors can hinder or accelerate the process. Often, the breadth of these factors is not considered when evaluating opportunities for improvement due to the limited scope of enhancement initiatives. This in turn limits the success of efforts to improve the closing and reporting cycle. A holistic approach that considers factors across all business dimensions, including strategy, structure, people, process, and technology, creates a close and reporting cycle that is highly sustainable and scalable.

### **Strategy—Determine the desired result, develop a plan, and monitor progress.**

**Align reporting objectives with the overall strategy of the organization.** An organization's strategy drives close and reporting activities through key performance indicators (KPIs). To measure performance and provide decision support, financial and operational KPIs are linked to the corporate strategy, market conditions, and competitive environment. Analysis and reporting activities that are not in line with the KPIs or corporate strategy do not add value and can be eliminated.

**Look for leaders, not silver bullets.** There is no easy way to achieve a faster, smarter close. It takes vocal and visible commitment on the part of top-level leaders—inside and outside the finance department. Success requires determination and attention to detail at all levels within the company. At the top of the organization, CEOs and CFOs must set the tone and make a smarter close a priority by ensuring the organization focuses on achieving closing and reporting objectives.

**Consider opportunities throughout the close and reporting cycle.** It is important to identify all enhancement opportunities by focusing on the three primary stages of the close and reporting cycle. The first stage is the inputs, or feeders, and it includes transaction processing and sub-ledger cut-offs. At this stage, focus on data quality and standardization as well as timely feeds of information to the general ledger. The second stage is the process itself, and it encompasses executing the close and consolidation process. Enhancement opportunities are likely to revolve around sequencing activities, distributing workload, and eliminating non value-added activities. The third stage is the output, and it consists of internal and external reports. In the third stage, look for opportunities to eliminate activities that do not support decision making or regulatory requirements.

**Do not be afraid to implement change.** Implementing new policies, procedures, automated controls, and systemic enhancements can be extremely difficult from both the technological and human perspectives. But do not hesitate to initiate change where change is needed. Efforts to simplify and standardize processes will benefit the entire organization. Once changes gain momentum, do not stop before achieving goals and objectives. When you implement change, remember that it is essential to train employees on the new policies and procedures to ensure they embrace the new processes.

**Expect to spend six to ten months transforming your closing process.** In our experience, you should plan to spend approximately two weeks strategizing goals and objectives and mobilizing resources. It then takes about two to three months to analyze and design solutions. The final rollout and testing period can usually be completed in three to six months. The most successful projects seize opportunities to make small, high-impact modifications early in the process. While it is important to focus on changes that significantly reduce the close cycle, implementing “quick win” changes can help process improvement projects gain momentum and inspire widespread support.

**Plan the work and work the plan.** Success requires effective project and change management. Develop an implementation plan with measurable milestones using a proven process improvement methodology to guide the effort. Focus on communication and proactive issue resolution. When difficulties arise, stick to the established plan and use the methodology to resolve the problem.

### **Structure—Align the finance function to enable the strategy of the organization.**

**Evaluate alternative operating models.** The degree of centralization (or decentralization) of the overall finance function is a critical factor in the close and reporting cycle. A centralized organization provides greater control and economies of scale while a decentralized model provides greater insight into business unit and operational matters. Both are viable structures if there is standardization and an environment of control and accountability, but this is much more difficult to achieve in a decentralized model.

**Align your structure to meet specific stakeholder needs.** Successful organizations structure themselves and their services to meet specific stakeholder needs. For the finance department, this may be achieved through a three-tier structure consisting of front, middle and back office groups. With a focus on creating value, the front office provides decision support and analysis, such as management reporting, budgeting and forecasting, and long-term planning. The middle office provides specialty services, such as tax, treasury, and SOX compliance in an effort to protect value. The back office delivers transaction processing services, such as billing, payables, and closing the books in an effort to realize value for the money.

## **People—Maximize the effectiveness of your resources.**

**Assign clear roles and responsibilities.** Different departments play supporting roles in closing and reporting processes. Make sure all involved understand the role they play in the process and how they can contribute to a more efficient close. From accounting, tax and treasury to legal, IT and investor relations, you must identify who is responsible for specific activities and assign clear due dates for completion and approval. If people do not fully understand their responsibilities or deadlines, the risk of wasted time and duplication of effort increases.

**Establish a calendar with defined milestones to support accountability.** Employees are far more likely to complete measured activities than those with vague parameters. It is essential to establish a calendar and hold people to it. Inventory all activities and confirm assigned responsibilities and due dates. If deadlines are missed, take immediate and firm corrective action.

**Optimize workload distribution and resource alignment.** Companies must strategically align resources with the appropriate skills and training throughout the close and reporting cycle. Effective workload distribution goes hand-in-hand with the proper sequencing of close and reporting steps. Uneven workload distribution results in overtime and bottlenecks that can lead to errors and high turnover. Furthermore, it brings into question the productivity of resources during non-peak times.

**Communicate effectively throughout the organization.** Improved communication significantly enhances finance leaders' ability to proactively manage issues and avoid surprises during the close and reporting cycle. Due to the number of dependent steps in the cycle, being able to share knowledge and status is essential throughout.

**Measure and reward performance.** A closing scorecard that measures performance across costs, quality and time can be a very effective way to evaluate progress over time. Accounting personnel should be measured against specific goals and targets. Incentives and performance measures beyond the finance department may also impact the close cycle and should be evaluated to ensure they are driving the right behavior.

## **Process—Streamline, simplify and standardize processes throughout the cycle.**

**Properly sequence activities and look for opportunities to move work away from the close.** The close and reporting process is a series of interdependent steps that, when appropriately sequenced, can be accelerated. Determine interdependent steps and the time needed to complete all activities. Conduct a critical path analysis and identify opportunities to improve sequencing. Many activities traditionally performed during the closing cycle may be moved before or after the close. Handling these tasks during off-peak periods allows resources to focus on critical steps.

**Use estimates and materiality thresholds intelligently.** Effective use of estimates and accruals can significantly accelerate the close cycle. Explore opportunities to cut off appropriate transaction processes earlier. Then develop sound estimating techniques to ensure accurate month-end numbers. Work with finance and operations leadership to plan the specifics of using estimates and develop a clear methodology for how they are produced. Leverage materiality thresholds in an effort to save time and focus effort. Finally, continually analyze actual results after the close and adjust accordingly.

**Proactively manage accounting issues and perform root cause analysis.** Unexpected accounting issues can result in significant rework and duplication of effort. Develop a formal issue escalation process and proactively manage issue resolution. Assign responsibilities and due dates and plan to resolve issues with finance and operations leadership in an orderly manner. Incorporate root cause analysis as part of the escalation and resolution process. Effective root-cause analysis can lead to upstream process enhancements that will help establish a culture of continuous improvement.

### **Technology—Optimize your ability to leverage current systems.**

**Identify opportunities to further leverage technology.** Systems are support mechanisms that help analyze and communicate data. Excessive reliance upon Excel spreadsheets, too many manual journal entries, manual account and bank reconciliations, decentralized document storage and version control, and hard copy report distribution are key indicators that a company is not fully leveraging available technology. Work with finance and IT leadership to validate, prioritize and pursue opportunities to use technology more effectively.

**Use existing IT systems where possible.** Effective use of technology is essential to gaining timely, accurate and transparent data. However, buying new applications is not the answer for most companies. In fact, some companies already have too many applications with overlapping capabilities, which can create redundancies that interfere with achieving success. Companies must ensure they leverage existing technologies that reach—or can be optimized to reach—across all areas of the organization to generate financial and operational results.

## How PwC helped a major energy company meet a significant new reporting deadline

### The client's challenge

A major energy company recognized that it needed to improve its closing processes to ensure the accuracy of results and to accelerate quarterly earnings releases. Steps to improve the timeliness and accuracy of the close, consolidation and reporting cycle included:

- Automating manual processes and reports, including the preparation of cash flow statements and data requests to support external reporting
- Establishing standard policies and procedures to support calendar deadlines and minimize post-close adjustment entries
- Facilitating the coordination of close activities, including calendar planning and the communication of status and issues across the organization
- Implementing a Close Management Tool (CMT) to monitor and maintain the status of all close activities, facilitate communication and planning across the organization, and provide centralized document storage and version control

### The impact on the client's business

The company accelerated its quarterly earnings release by two weeks while realizing significant improvements to internal controls and the quality of financial results. With the CMT, due dates are automatically calculated for all closing activities; notifications alert users when tasks are past due; support material is centrally stored and tied to each activity; management reports are distributed electronically with automated alerts when changes are made; security controls access to sensitive information; and reports provide management with real-time status throughout the cycle. Moreover, while increasing control, speed and accountability, the company established a foundation for further acceleration and process improvement.

Train your employees to get the most out of current systems. Training empowers people to succeed in new environments. To achieve a smarter close, you must ensure employees understand the capabilities in the systems they use and expose them to potentially valuable tools that other departments may be using.

Automate manual activities and create templates. Review all manual tasks that contribute to your closing process and identify opportunities for automation. At the same time, create 10Q and 10K templates that can be easily populated with relevant data after you close. Every word in those documents cannot be known in advance, but many can.

Capture data appropriately to meet your reporting needs. For the close and reporting cycle, data capture begins with an effective and efficient chart of accounts structure that is consistent with the company's needs. An overly complex structure, or one that is not standardized, increases risk and limits a company's ability to meet reporting requirements without significant manual intervention.

Leverage tools for real-time status tracking. In addition to core financial systems, companies can leverage workflow and collaboration tools to manage the close and reporting process. These tools can be customized to improve internal controls and promote accountability; to provide real-time status and increase visibility for management; to enhance communication and automate distribution of results; to support document storage and version control; and to further accelerate the closing cycle.



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