

How to improve account reconciliation activities*

Many common account reconciliation problems are preventable.

Effective management of account reconciliation activities greatly increases executives' ability to proactively identify and resolve issues that could result in misstatements in financial accounting and reporting records and lead to substantial write-offs. This article explores common, recurring problems with account reconciliations and the practices¹ that can improve their effectiveness and efficiency.

Many common account reconciliation problems are preventable. By creating and putting in place appropriate reconciliation and information management processes, and improving organization, training, and automation, companies can gain assurance over their general ledger balances.

Improving the process

From a process standpoint, many problems stem from a failure to deploy a consistent methodology and terminology. In many cases, an account owner may consider transactions reconciled if the differences have been quantified but not resolved. In other instances, account reconciliations are merely a roll forward of activity that posted to the account, without a validation of appropriateness. Timing is also frequently an issue: account reconciliations that are in arrears more than one month risk misstatement of the financial results.

Another major source of risk arises when action is not taken to resolve open issues or confirm appropriate treatment. At some companies, unreconciled amounts within reconciliations remain on an open list for an indefinite period. At others, failure to investigate and resolve recurring problems leads to their continued recurrence in future periods. Problems can also arise when companies identify reconciling amounts properly but fail to investigate the reasonableness of their accounting treatment in the financial statements.

Establish risk-based criteria to guide the timing of account reconciliations.

Here is what you can do to improve processes:

Rationalize the number of accounts—The number of accounts in a company's books often increases significantly over the years as a result of new processes, new entities being formed or acquired, new transactions, and new people being added throughout the process. This often results in a larger volume of accounts than would otherwise be necessary. Since more accounts equals a larger workload, management should perform an annual account rationalization exercise to identify accounts that are no longer required or could be merged with other accounts, thereby reducing the number of account reconciliations required.

¹ Based on research from PricewaterhouseCoopers' Global Best Practices team and our experience.

Establish a standard definition of “reconciled” and use it across the company—Account reconciliations should be more than a roll forward of activity or isolation of differences. An account should only be considered reconciled when differences have been investigated, proper accounting treatment ascertained, and correcting journal entries (if any) posted to the general ledger or sub-ledger. The account reconciliation should begin by comparing the ending balance in the general ledger with the ending balance in the sub-ledger or supporting detail, and it should finish with a matching adjusted balance for each. Reconciling items should adjust the general ledger balance or the sub-ledger as appropriate.

Perform a separate reconciliation for each balance sheet account—Prepare a separate reconciliation for each general ledger account, including financial reporting and statutory reporting accounts. Accounts (such as retained earnings) that are simply flow-through from other activities should have a separate reconciliation prepared only if differences exist between the ledger and sub-ledger. Discourage the practice of linking multiple bank accounts or multiple intercompany transaction activities to a single general ledger account, as is often done with cash accounts. Instead, maintain separate accounts for separate transaction flows—i.e., receivables and payables without netting balances; separate cash accounts for each bank account; separate bank accounts for each process, such as a payroll account, payables account, and receivables account.

Establish risk-based criteria for the timing of account reconciliations—Stagger the timing of account reconciliations based on potential for fraud or misstatement, turnover, account history, materiality, volume of transactions, significant judgment, need for regular manual posting of adjustments (as for revenue accruals and deferred costs), and so forth. Depending on the level of risk, perform reconciliations daily, weekly, monthly, or quarterly. Risk levels and associated reconciliation frequency requirements should be reconfirmed at least annually.

Facilitate faster identification of errors through timely reconciliations—Good practices include the following:

- Reconcile those routine accounts that summarize daily sub-ledger information each time the sub-system posts summary details to the general ledger. Daily posting and reconciliations help provide more timely identification of errors in problematic accounts.
- Complete account reconciliations in the account period being reported for finance reporting purposes. In certain cases, account reconciliations may be extended beyond the reporting cycle, but should not exceed 30 days.
- Establish a process to identify significant or material reconciling items during the close. This process should define both the threshold used for reporting material items that require correction in the current month and the procedure for adjustment, to help insure that they are properly reflected in the financial statements included in regulatory filings.
- Investigate all large or unusual items and conclude in the body of the reconciliation as to the appropriateness of their accounting treatment. In cases that require that adjustments be posted, make reference to the journal entry to record the adjustment.

Managing information

Information management issues range from preparation of reconciliation in spreadsheets (which rarely have supporting documentation and proper controls over versions) to lack of visibility into the current status of account reconciliations. In many companies, internal audit reviews and Sarbanes-Oxley 404 tests are the only formal source of information available to evaluate the potential impact of unreconciled financial accounts on financial statements.

Reports must enable controllers to evaluate the impact of unreconciled accounts on financial statements.

Here is what you can do to improve information management:

Use a standard account reconciliation form—Use the same format and content for documenting account reconciliations across all locations within the business units and at the corporate level. Key elements of a standardized reconciliation form should include the following:

- **Header:** Identifies the business unit location along with any reference numbers that identify the location to the company's financial statement (e.g., entity number used in general ledgers or consolidation systems).
- **Account ownership:** Provides a listing of the people responsible for the account, including ownership of the balances and the performance of the reconciliation. The listing should include e-mail addresses and telephone numbers for all parties.
- **Account description:** Includes the name of the account (this should match the convention used in the general ledger and be representative of the types of transactions flowing through the account), account type (as classified in the financial statements), and account number. The account description should also identify (a) if the account includes tax-sensitive information, and (b) any corresponding general ledger accounts linked to the account (e.g., an offset account for the debits or credits).
- **Account purpose:** Describes the types of transactions that flow through the account and the account's purpose in recording the transaction activities. For example, a cash account for a company's lockbox should describe the types of transactions (e.g., customer remittances, employee loan payments, etc.) that pass information to the account. The account purpose should also describe supporting trial balance details, interface details (i.e., automated or manual), and whether sources are from a single system or multiple systems.
- **Types of journal entries:** Provides a brief description of the journal source, journal category, journal type (i.e., debit or credit), and nature of activity for every transaction that posts to the account.
- **Normal account balance and range:** Identifies whether the account is typically a debit or credit balance and notes its normal range of activity and ending balance. This information should also briefly describe the types of transactions that offset the account.
- **Account reconciliation details:** Includes any references to standard operating procedures, potential reconciling items, and important details to aid in understanding the account reconciliation. Identifies differences in terms of root causes (such as timing, permanent, recurring, or correction of an error). Identifies the accounting treatment for any reconciling items noted during the process and verifies to the corresponding general ledger account as part of the reconciliation process. Lists all posted journal entries to correct the accounts and include their corresponding figures.
- **Account conclusion:** Includes language that certifies that all appropriate journal entries to correct the account records have been posted as noted in the account reconciliation, with supporting detail.

Require that supporting documentation be attached to account reconciliation forms— This is particularly important with respect to electronic files. In cases where various versions of reconciliations are prepared, a printout of prior versions should be attached to the latest version of the analysis and strict file-naming conventions should be followed to prevent replacing an older version of a file. File versions should follow the company’s document-retention policy for these types of materials.

Establish action plans for all reconciling items—A proper reconciliation identifies the reconciling item and the actions that are going to be taken to clear the reconciling item. Such action plans include who is responsible for clearing the reconciling item, when it will be cleared, and what other actions will be taken (i.e., to prevent that type of reconciling item from being generated again). All reconciling items should be aged, and as a general rule no reconciling item should exist for more than 60 days. If the item has not cleared within 60 days, it is unlikely that it will clear subsequently.

Document approval for all account reconciliations—All account reconciliations should be reviewed in conjunction with supporting documentation and approved for completeness and propriety by someone other than the person who performed the reconciliation. This role is usually filled by a supervisor. Approvals by a subordinate are not recommended.

Report to management regularly on account reconciliation status—Measure account reconciliation status and report your findings to management on a regular basis, typically monthly. Measurements should include details on the number of accounts not reconciled, the age of unreconciled items, and the total dollar amounts of the differences without right of offset (i.e., no netting of debits and credits). Quality measures and related criteria should be established to measure the effectiveness of the reconciliation based on successful completion of the standard form, the timeliness of completion, a review of the account reconciliation, etc.

Require action plans on delinquent reconciliations—Require the account owner of delinquent reconciliations (i.e., those that exceed 60 days) to prepare a 90-day action plan to remediate the deficiencies. Report progress on the action plan as part of the regular reporting of account reconciliation status.

Organization and training

Account reconciliations often suffer from their reliance on overburdened accounting personnel who must respond to constantly changing priorities. Additionally, turnover, staffing issues, and acquisition of other entities (along with their account reconciliation issues) all mean that organizations frequently lack institutional knowledge regarding proper process for reconciling accounts. Business unit priorities can also hinder timely action, since accounting staff rely on knowledge from the business unit regarding the process, types of transactions, responsible individuals, and other operational information. Further difficulties arise when field personnel who are responsible for recording activities in the transaction records fail to do so accurately or on a timely basis. This is frequently the case with inventory and fixed asset accounts.

All significant balance sheet accounts should be visible to operational management and receive sufficient attention in the company's analytical reviews.

Here is what you can do to improve organization and training issues that arise:

Establish clear ownership and accountability for each account

reconciliation—A lack of business unit focus on the balance sheet can undermine account reconciliation priorities. For this reason, all significant balance sheet accounts should be visible to operational management and receive sufficient attention in the company's analytical reviews. Measure front-office operations performance in generating reconciling items and hold personnel accountable for accurate, timely, and complete initial processing of transactions.

Implement regular training programs—Establish an online, web-based training course supplemented by live instruction for account reconciliation protocols. Require staff to participate in an introductory program and attend supplemental refresher courses.

Perform peer reviews of account reconciliation techniques—On a quarterly basis, subject a sample of account reconciliations to peer reviews outside of internal audit reviews. Such reviews should look for proper application of internal controls, examine conclusions reached on the reconciliation, and verify that the proper resulting accounting treatments were used.

Establish a quality control team—Establish a team responsible for developing quality measures, and periodically select a sample of account reconciliations to assess compliance with policy and procedures. The team should identify improvements based on quality feedback and changes in business operations or organizational structure. In some companies, this team is responsible for reconciliation management reporting and developing training for policy and procedural changes. The team should include reconciliation experts who can be called upon to troubleshoot when problems are identified.

Using technology

Business processes evolve as a business changes its product and service offerings and volumes, its customers, its vendors, and its people. Regulatory changes, accounting changes, and other outside influences can also impact a business's reporting and processing environment, as can changes to systems that were purchased or designed based on the original business process and expected volumes. Such changes often result in system stress, system workarounds, manual interventions, and other back-end adjustments that are aimed at achieving the desired results but often create an increase in reconciling items that must be addressed and corrected at the end of the process. In addition, enterprise resource planning (ERP) systems rely on account tables that map transaction activities to the general ledger. Too often, transactions are mapped to post activity to the wrong account (e.g., intercompany transactions post to third-party accounts, cash sweeps post to improper cash accounts, etc.), requiring subsequent reclassifications in the accounting records.

Some companies also underutilize automated capabilities that can make certain reconciliation activities more accurate and efficient. Processes to match transactions and capture reconciling transactions, age unreconciled amounts, maintain history, and continuously track and report progress to resolve exceptions can all be automated to great advantage.

Automated tools reduce manual effort and reliance on spreadsheets, and enhance the integrity of and internal controls over account reconciliation.

Here is what you can do to address technology issues and opportunities:

Simplify and streamline financial systems—Management should continuously evaluate system capabilities and, when systems no longer support the complexity of the business, consider changes to the systems to simplify and automate the process and better handle the increased complexities.

Maintain ERP transaction tables and account linkages—This may be a big job to start, but after tables and linkages are updated once, they can be maintained routinely.

Automate activity—Deploy online, web-based tools that enable reconciliations to be performed in a systematic manner, with interfaces between the general ledger and sub-systems where appropriate, and to generate effective management reporting. Such tools should support a history of reconciliations in the current and prior periods to enable trend analysis for recurring items. Appropriate controls should be embedded to ensure that an audit trail is appropriately maintained throughout the reconciliation process. Commercial software is available to support the following activities:

- Reconciliation process management
- Creation of a systematic, updateable list of accounts subject to the reconciliation process
- Assignment of reconciliation and review responsibility to each account on the list
- Configuration for company-specific policies and procedures
- Summary and analysis of reported exceptions
- Automated identification and follow-up with delinquent reconcilers or reviewers
- Monthly status reports suitable for the company controller, CFO, and internal audit

- Notifications to reconcilers and reviewers about changes in policies and procedures, and feedback on the reconciliation process
- Periodic quality-assurance reviews and annual internal controls audit
- Analysis of accounts to be used for quality assurance sampling and internal controls audit
- Access to reconciliation documentation to support review and audit
- Performance of reviews or audits and summary of their results
- Status reporting for controller/CFO
- Sarbanes-Oxley attestation
- Report package for the CFO to evidence effectiveness of the reconciliation program, as required by Sarbanes-Oxley

In closing

In general, account reconciliations are an activity that should be:

- Performed with regularity to provide assurance over the general ledger balances, preventing where possible the introduction of reconciling items
- Automated where manual
- Monitored continuously to prevent misstatements in the financial accounting and reporting records

Account reconciliations are typically identified as a key internal control activity for Sarbanes-Oxley compliance, and many larger companies have even identified reconciliation as a significant transaction activity in itself. As companies consider changes to account reconciliation activities, it is important to embed appropriate internal controls in the process in a consistent and standardized way.

For more information on simplifying finance processes, please visit:
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