What's Troubling Finance?

The office of finance is in the midst of a sea change. Our world has shifted dramatically, and a host of new challenges have emerged. Many of the attributes that made finance an attractive career choice are now hidden in a sea of compliance, disclosures, litigation and controls, and the rewards for this profession are getting increasingly difficult to realize. Fortune recently summed up the position of today's CFO by stating, "the chief financial officer post – once a finishing school for CEO's – has become the crummiest gig in the corporate suite." (Fortune, February 2007) Yet, this new world is here to stay, and the changes to the fabric of finance are permanent.

We have all been swept up in the effort to survive these changes, putting ourselves and our staffs on the defensive. It is time to get back in the driver's seat and find a way for us – not simply to survive – but to succeed in this new world. What will it take to create an environment for success?

How did we get here?

If you ask finance executives why they chose this career, they'll likely tell you it was because they wanted to create strategies and organizations that helped drive the profitable growth of a company – and, of course, do so legitimately. Today, they would tell you that their job has evolved into something very different – a job focused on risk. A steady stream of restatements, scandals, and court cases continually remind us of what is wrong in the world of finance. Let's take a step back to review how we got here.

Finance has become a relentlessly high pressure function – faced with heightened governance and tighter deadlines, we are required to report at ever increasing levels of precision and disclosure. Trends like the shortened windows for SEC filings, material weakness disclosures and the threat of restatements keep the pressure on 365 days a year.

We live under a microscope – as the events of the past decade have driven us to increased transparency in financial reporting - not just on the operations of the business, but also on the processes that we use to document them. Regulators, legislators, and shareholders demand more access, with heightened sensitivity to any missteps.

Stakes are higher – with the risks ranging from material weaknesses, to restatements, to criminal prosecution in some cases. Today, our mistakes are far more expensive, with costs that extend well beyond the corporate bank account. When we are held personally accountable for the accuracy of the financial reports and our personal liberty is at risk, it has profound implications on the way we run the function.

The probability of errors is higher – In explaining the underlying causes of material weaknesses in Securities and Exchange Commission (SEC) filings, public companies often cite the complexity and proliferation of accounting rules, which create additional risk for error due to oversight or misapplication of GAAP. This situation has been further compounded by the concern among independent auditors on maintaining their independence, placing more responsibility on finance teams to master the technical nuances of accounting standards.

On a broader scale, US markets have lost some of their luster – There has been much discussion about the decreasing competitiveness of US public markets, whose share of the total value of global IPOs dropped from 50% in 2000 to 5% in 2005. This is due, at least in part, to the increased regulatory burden that has driven businesses to capital markets outside of the US. Similarly, since 2001, the number of VC-backed acquisition exits has exceeded the number of IPO exits by more than ten to one (Interim Report of the Committee on Capital Markets and Regulations Nov 2006).

All this is taking a toll on the finance profession. For example, college graduates with degrees in accounting have only recently seen a modest rebound after a steady decline since 1991 (AICPA, The Supply Of Accounting Graduates

And the Demand For Public Accounting Recruits–2005). Requirements for success in finance are changing, and it is increasingly difficult to attract people with the required background, experience and interpersonal skills. At the executive level, CFOs are moving to other roles in the company, or simply leaving. A recent Liberum Research survey indicated a 40 percent increase in CFO turnover in the first nine months of 2006 – reflecting the pressures of SOX, stock option backdating, and the resulting scrutiny for public companies.

Despite the clamor for change, these trends show no sign of reversing. It is becoming increasingly clear that this new world is here to stay. Recent statements from the SEC and the Public Company Accounting Oversight Board (PCAOB) indicate that while there will be course corrections, there will be no fundamental changes to the spirit of our new regulatory environment. Over time, some regulations will relax, but others will inevitably be introduced. For example, new guidance proposed by the PCAOB in AS# 5 may lighten the burden of SOX but, at the same time, FIN #48 presents large, new compliance and disclosure challenges for public companies. The fabric of our control system will always be complex and dynamic and if we spend all our efforts merely trying to resist this changing landscape, we're missing the point.

How Do We Position Ourselves for Success?

The real challenge is this: What is it going to take to be successful in this new world? How do we get ahead of the game, instead of reacting to every new regulatory initiative that comes our way? What can we do to stop walking on eggshells, worrying about restatements, material weakness disclosures, and shareholder litigation?

1.Take Control of the Process

As enterprises have evolved, we have discovered tools to assemble the data, improve efficiencies and report with ease. In fact, tools for aggregating and consolidating the numbers – ERP, CPM and others – are quite good: the arithmetic is almost always right. However, the close and financial reporting process is still like baking a cake by instinct, with no recipe to lead us through the process and no assurance that we won't leave out an important step. Walk into any finance organization during the quarter end close, and you will see a team hard at work assembling the ingredients, mixing them just so, adjusting as necessary until they achieve financial statements ready for public disclosure. Just don't ask them to systematically describe the process. This informal approach worked when companies weren't held to today's levels of precision and transparency, and when we had the flexibility to use a fair amount of judgment in the process (without the requirement to maintain that same judgment for all similar situations going forward). In today's environment, this is no longer tenable.

For while we have made significant efforts to adapt and enhance our finance data, we have left off the process layer. Without integrated, streamlined operations, we are doomed to the same turmoil quarter after quarter, year after year. What's more, finance is one of the last places in the enterprise to implement comprehensive process automation. We have processes stored in our head, written in documents, or exchanged via emails. We have different operations for controls, consolidation, reconciliation, close tasks, reporting, internal audit, and external audit – each with discreet teams whose interaction is largely informal.

The problem and solution lies in stitching it all together in the Last Mile of FinanceSM - the final critical phase of financial management prior to public disclosure, where financial and operational information are aggregated, tested and converted to a set of financial statements. Material weaknesses and errors in disclosures occur within the Last Mile because it remains, in large part, an onerous, time consuming, and intensely manual process. In fact, according to a 2006 study of public companies by IDC, the financial close is cited as the number one financial process targeted for improvement. And while we have progressed along many dimensions, we have yet to step back and look at our entire finance operation as a single, integrated workflow.

2. Run Finance Operations as We Do Other Enterprise Processes

Every company, public or private, develops, manufactures and delivers a set of products and services. We need to view financial statements as a product delivered to customers – or investors in this case – who have a right to expect that a public company uses the same level of diligence in producing these statements as they do in delivering the other products and services that they sell. We need to take on the process as an end to end integration challenge – one that is managed centrally and one that can be improved and streamlined through automation.

Look to our colleagues on the manufacturing floor. In their quest to get from zero to Six Sigma® they were able to reduce costs, improve cycle times, increase customer satisfaction and produce higher quality products. Companies have embarked on similar initiatives for procurement, customer service, order processing, and even sales management.

Finance should be no different. We should require our finance operations to achieve the same process improvements that have been successful in other areas of the business. Why can't financial statements come off a production line with the same level of precision and quality as semiconductors, cars or bank statements?

3. Put Compliance in its Place

Part of the answer is to create an environment in which we are not constantly looking in the rear view mirror at compliance. Just as the enterprise does not exist merely to comply with rules and regulations, the office of finance is not simply about compliance. Despite recent experience, we must not devote so much of our time on defensive activities.

We have put significant effort over the past few years into building compliance infrastructures that can stand up to scrutiny. According to the University of Nebraska, public companies' accounting fees have doubled to comply with SOX. We have enhanced control structures, hired entire compliance staffs, and added new systems. Compliance will continue to be a priority – we clearly need to accomplish corporate objectives within established legal and regulatory frameworks. And we must be prepared to accommodate the future ebb and flow of new rules and regulations.

However, we are now several years into SOX, and it is time to put these efforts into perspective. To build and maintain a finance function focused solely on compliance not only de-motivates the entire team, but also keeps us from performing the job we signed up for – to be part of a management team that is looking ahead, making solid strategic decisions, acquiring and retaining customers, winning against competitors, and running a successful enterprise. Without this, all the compliance in the world won't help. As it was summarized in the Interim Report of the Committee on Capital Markets and Regulations, "A regulatory 'race to the bottom' will serve no useful competitive purpose."

At its core, SOX is less about regulations than about best practices. It is about having an efficient process as a public company to publish accurate, transparent results of your company's performance that will not be subject to restatement. If we can focus on this goal, we can move beyond compliance as an end in itself.

4. Hire the Right People and Influence Education of Accountants

We can no longer be content to hire anyone with an accounting degree and must, instead, begin to develop the next generation of finance leaders – those with the vision, energy and skills to be successful in this new world of finance. With finance no longer being just an accounting function, the quality and depth of people with which we staff the function will be a key success factor. Foundational skills will continue to be important including financial analysis, understanding business models, being up to date on GAAP and being able to communicate effectively. However, the people that make up world class finance teams are business minded, accounting savvy, and articulate. To find these people, finance executives need to work with universities to explain the real work of finance and help influence that training.
At the same time, we should be prepared to reduce reliance on public accounting firms to train our incoming finance professionals.

5. Build an Integrated Close

One of the key priorities from both the SEC and PCAOB is more integration – viewing the preparation and audit of financial statements and internal controls as a single process. For companies, this means that an integrated close is a critical process in the production of financial results that will not need to be restated. The integrated close focuses on the following key elements:

Start from the top – good, clean, and accurate financial statements. Focus on tasks that directly relate to financial statements and work your way back from there. Rather than attempting to wrestle with thousands of accounting controls, you automatically focus on the financial statement accounts that are material. Using financial statements as the foundation will ensure that your processes are integrated for the purpose of delivering a quality product, not just for SOX compliance, or reconciliation, or the close.

Scope your work activities on those elements most likely to cause problems. Implement a structured approach for rationalizing your control activities, and establish dynamic scoping rules that support a continuous, real-time process of control rationalization for evaluation of controls as "in" or "out of" scope. Dynamic scoping gives you the ability to adjust your activities as you learn more about what is important and material throughout the close process.

Integrate your financial statement and internal controls audit and testing activities. Ensure that auditors and management have the same basis of understanding of the process and materiality. This means establishing a single version of the truth that is used by both management and auditors that tightly links financial numbers with the controls, tests and tasks needed to guarantee that the financial results that are ultimately reported are not subject to restatement.

Leverage automation to perform the mundane tasks, reduce process overlap and free up your resources to focus on the more challenging elements of your close. Strive for the right balance between good technology and good process and leverage automation capabilities to assess and manage risk. While automation can never replace the skill, experience and judgment required of finance professionals on a day-to-day basis, automation can streamline the everyday, repetitive tasks such that we can focus our scarce finance resources on higher value-add analysis.

Progressive finance organizations have already embraced the concept of the integrated close. Brown and Brown, one of the largest and most respected independent insurance intermediaries in the nation, is one of these companies. Cory Walker, CFO of Brown and Brown, Inc. recently stated, "For mid-size companies (non-Fortune 1000 companies), the accounting and finance function will be more structured and better documented. In this new world order of high government regulations, there will be greater scrutiny to document and prove that all the decisions and accounting accumulation processes were performed in a consistent and complete manner. Attempting to document these decisions and processes in a non-automated method is a potentially corporate-life-threatening activity, given the aggressive regulatory environment…I think spreadsheets will be around a while. The CFO will benefit by having more time available for operational and strategic issues" (Financial Executive, December 2006).

With an integrated close that tightly links financial numbers with the relevant controls, reconciliations and close tasks, we can build predictability, flexibility and sustainability into our finance operations. We need to assess the way we implement our processes, what steps we need to take to integrate them, and how to raise the level of control and visibility in all stages of the process. The goal is to move forward based on what is best practice in our operations rather than waiting to respond incrementally on each change of regulations.

Let's Get Back to the Business of Finance

At the end of the day, the professional and corporate success of financial executives is based on the quality, accuracy and timeliness of our financial disclosures. It is about how we manage financial operations, and how well we manage that Last Mile of Finance rather than merely how well we comply with Sarbanes Oxley, or any other regulation.

It is time for us to break out of the defensive cycle, and take charge of creating a new environment for success. Building an integrated close will give us a new level of control over our processes. It will also ensure operational readiness across the entire finance function, and set us up for smooth sailing through that Last Mile. We must put compliance in its rightful place as an integral part of this infrastructure – one that can accommodate new rules and regulations instead of being driven by them.

And in creating a set of best practices, we can return our focus to the real job of finance – contributing to the success and growth of the company. Only then will this job become rewarding again.

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