

Mastering the Financial Close

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INTRODUCTION

The 'Financial Close' is a curious concept for it has no fixed definition and its boundaries are constantly blurring as regulation and enabling technologies bring new challenges and opportunities. But in broad terms it is commonly accepted to mean the process which culminates in the production of group consolidated accounts. But where does the process start and finish and why is a fixed definition so illusive?

Clearly a group consolidation, whether for statutory or management purposes, is reliant on a financial close process in reporting entities, subsidiaries, joint ventures and minority interests. For the sake of simplicity this local activity for individual reporting entities is called the 'Period Close'.

The end-to-end process from period close through financial close and ultimately the production of the annual report and accounts, Board pack and statutory filings (XBRL or otherwise) is the 'Reporting Supply Chain' or RSC.

The use of the term 'chain' is very apt since later tasks are inextricably linked to earlier tasks and the whole RSC can only proceed at the pace of the slowest activity.

Speed and accuracy are vital. The ability to close the books, consolidate group results and publish statutory accounts in ever decreasing timescales has become something of a corporate obsession for the last two decades – encouraged in part by regulatory pressure to accelerate statutory filings and increase the frequency of reporting. Announcing results to the stock market quickly after the year end is widely regarded by the capital markets as a proxy for good corporate governance, a 'tight ship' and a competent management team, whilst providing the Corporation exclusive 'air time' during the busy filing season which can lead to stock appreciation.

But change is in the air. The overriding concern with reporting velocity is giving way to a much more sober assessment of priorities. The 2009 financial crisis has been game-changing, forcing organisations to confront risk in a way that has no precedent in financial reporting. CFOs need to know that the results and disclosures are absolutely dependable before signing off the balance sheet and disclosures. As a result, risk management, compliance and financial reporting are coalescing into a single unified environment in which financial results can be linked to underlying tasks and controls across the entire RSC.

However, there are other pressures driving change in the Financial Close. Increasing complexity, for example, around IFRS and more novel environmental disclosures coupled with the move to digital reporting is placing the finance function under more strain. With the tough economy limiting the scope to add headcount, finance departments are seeking efficiency gains that will allow them to absorb change, provide greater visibility of risk and position the finance department as a whole for sustainable growth. With the advent of modern enabling technologies the Financial Close process is ripe for change.

THE CHALLENGES OF THE FINANCIAL CLOSE

- **ERP Not Meeting the Need**

Theoretically, ERP systems should support a much more streamlined and effective close process. But the vision of ERP has not always lived up to its promise. Few organisations manage to implement wall-to-wall ERP and even when they are standardised on a single ERP vendor many struggle to implement one instance of the software.

Also, the number of physical layers to a group consolidation can have a profound effect on the efficiency of the financial close process. For example, fractured infrastructure caused by different instances of ERP systems across geographic regions creates institutional delay and prevents complete visibility of the status of close tasks across the finance function. Without real-time knowledge of which entities have opened, started or completed their close tasks, or the issues they are facing, group finance cannot anticipate its workload at the centre or knowledgeably reallocate resources where necessary.

Although a common transaction platform simplifies the process of data capture it does not necessarily follow that the ERP system can be used for group consolidation and reporting. Whilst such an arrangement provides notable efficiencies around the process of data capture, for example, because of the use of common charts of accounts, validated transactions and shared database environments, there is often a trade off between ERP systems optimised for transaction processing and those designed principally for task management, controls and reporting.

Furthermore limitations such as these are difficult to remedy as ERP systems are notoriously inflexible to change requiring time consuming and expensive commitment to services and upgrades in order to bring about rudimentary change.

The Financial Close is an orchestration of many tasks and activities that are supposed to be performed based on the common organizational culture defined by policies and procedures, however the focus of ERP systems is at odds with what is required during the close process.

The motivation behind ERP systems is principally to drive down the cost of transaction processing not to marshal the delivery of financial results at a higher level of granularity. While ERP systems have undoubtedly contributed to lowering transaction costs they have had little impact on the more intricate task of collecting and consolidating balance level information across the enterprise. The cost of an error in a high volume transaction environment is unlikely to be material but the erroneous reporting of balance level information can have serious consequences. The emphasis of ERP is on straight-through-processing; i.e. correctly clearing as many transactions as possible first time. By contrast, financial reporting adds the heavy burden of data quality in an environment made up of hundreds of sub-processes and complex interrelationships (mappings) between local charts of accounts and the group reporting pack.

In this environment ERP systems have nothing to add. They simply do not have the functionality to exert sufficient control over the delivery of balances or to provide any assurance of the quality of the information captured at a Group level. Due to these limitations surrounding the financial close, organizations have lost agility and can only progress at the pace of the slowest moving period close. This leads to a sub-optimized Financial Close Process with longer than necessary cycle times, high opportunity cost from time spent on tasks closing books rather than analysing for future success, and most importantly a loss of control in the C-Suite leading to potential risks in regulatory compliance and loss of stakeholder confidence.

- **Complexity of Requirements**

Newer information requirements such as IFRS and environmental reporting have not only added to the complexity of financial reporting but also the number and types of the tasks needed to manage the process. The rising importance of non-financial performance measures as well as new disclosure requirements, such as 'Cap and Trade'

schemes around the world has widened the number of data sources underpinning the close process that need to be managed and reviewed on a timely basis.

Varied organisational hierarchies add to this picture of complexity. IFRS has ushered in a new era of segmental reporting which may be at odds with traditional statutory and management views of financial results - exacerbated by multi-GAAP reporting. It follows that businesses need to view the progress of close tasks in multiple dimensions as well, whilst embracing collaboration with business units and geographical locations.

- **Time Zones, Language and Culture**

The delays inherent in an incomplete and unreliable communications architecture are magnified by operations in different time zones. Close tasks such as reconciliations, say, in Excel files waiting in someone's 'Inbox' whilst they are absent or unavailable do not contribute to an efficient close process, whereas a system that is automatically updated overnight can trigger a business rule, routing or task that launches the next sequence of processing steps in the work flow.

Language, culture and the varied competence of resources in a global finance function can also have an impact on the smooth running of the close process. But without visibility of the status of tasks and collaborative technology across the entire organization it is not possible to readily overcome bottlenecks as they arise.

- **Over-Reliance on the IT Function**

Complex infrastructures, dated legacy systems, multiple vendors and a variety of ad-hoc software solutions all contribute to an over-reliance on the IT function. As a result, the finance function is disconnected from one of its key processes and even basic changes to group reporting requirements, mapping tables and interfaces has to be ceded to IT professionals. Regardless, the IT tasks are only a subset of the overall Financial Close, with many Finance-centric tasks having to occur prior to IT engaging. These tasks can be in the thousands, and unless these tasks are not completed, the IT Task will prove meaningless and ineffective performing interfaces and batch data transfers that are incomplete.

SO WHAT IS THE IDEAL ARCHITECTURE?

Over the last two decades the Financial Close process has relied heavily on a hotchpotch of technical solutions based principally on consolidation software, ERP systems and spreadsheets. Inevitably, the concept of a continuous workflow through the RSC is completely lost in this loose assembly of fractured applications. Yet it is workflow and collaboration that is the foundation of an effective financial close process. The question is what sort of architecture can cost-effectively provide this level of management control and visibility?

The ideal architecture is characterised by several factors;

- The ability to 'superimpose' a complete suite of governance, risk management and compliance applications on a miscellany of operational systems with the minimum of disruption.
- The ability to seamlessly connect period close, financial close, external filings and controls in a single over-arching environment.

- The ability to merge 'quantitative' information in the form of financial results with 'qualitative' information about workflow status, tasks, issues and controls to create a complete picture of financial reporting readiness.
- The ability to implement on a global or enterprise-wide basis over the web to smooth out the differences in time zones and connect disparate reporting entities to give complete end-to-end visibility of the financial reporting and controls environment.
- The ability to integrate with specialist applications, such as detailed high volume reconciliations and GL reconciliations that fill the void left by ERP systems in the close process
- The provision of specialist functionality that allows tracking and reporting of tasks, issues and controls throughout the financial close process.
- Tight integration with consolidation applications and a variety of other data sources so that financial outcomes are inextricably linked with underlying controls (through reporting and dashboards) to prove that reported financial results are dependable.

In recent years a new breed of GRC solutions has emerged that are readily capable of supporting the financial close process and being integrated with underlying consolidation and ERP systems in the manner described above. As a result they offer significant opportunities for process improvement and a step change in effectiveness and control.

WHAT ARE THE ORGANISATIONAL IMPLICATIONS?

- **The Need for Collaboration**

For many organisations the group reporting process is a mechanical and unthinking process in which the finance organisation is effectively confined to operational silos where each reporting unit in the same organisation is cut off from the other and the key processes in which they are stakeholders. The 'disconnect' between the finance organisation and the process makes it impracticable to share best practice and to respond efficiently to change. This in turn has implications for the effectiveness of the financial close since change, whether externally imposed or internally induced is a constant feature of the group reporting cycle.

The key objective of collaboration is to remove organisational and geographic barriers in the financial close process so that structured and unstructured information can flow unimpeded along the entire length of the RSC and that authorised users have visibility of information and the supporting process. For example, a change to a chart of account line, accounting policy, or an updated account definition or submission deadline should be instantly broadcast to everyone in the finance function that needs to know. Similarly, difficulty implementing a new group instruction, a performance measure or perhaps a query over the interpretation of an accounting standard or group policy should be widely available to assist knowledge exchange and the propagation of best practice.

But collaboration is not merely confined to the communication of quantitative and unstructured qualitative information – important as this is. Collaboration also extends to the management of the process itself, such as the prior approval of a change to the chart of accounts, the digital signature on a compliance statement or the rejection of a management commentary and explanation of variances.

Recognising, the importance of human interaction is crucially important. Unlike factory processes which are often linear and predictable, or even transaction processes which can be routed across business functions with a fair degree of certainty, information processes can have a variety of outcomes. So process automation has to accommodate human decision making, management review and appraisal as well as collaborative working and control. Informality around these vital close tasks frequently reduces the dependability and speed of the financial close process.

Research shows that information workers spend around 25 percent of their day simply looking for the basic information needed to do their job. Furthermore the cost of correcting an error is around 80 percent higher than processing an item correctly the first time. Collaborative technologies allow the finance function to quickly resolve issues arising during the close, especially in a multinational setting involving distributed finance functions operating in different time zones.

Workflow technology offers the dual benefits of communicating information bi-directionally within the same environment, as well as promoting an efficient and standardised process. It is one of the key transformational technologies capable of accelerating the financial close and encouraging the development of a repeatable and dependable process, cutting significant re-work and iterations of the process; resulting in hard savings and recovery of valuable time for review.

With the advent of more onerous filing requirements such as XBRL, collaborative technologies provide a rich capability for liberating time from close processes and eliminating informal communications such as conference calls, ad-hoc meetings and walking the corridors. The ability to harness collaborative technologies enables finance organisations to regain control of the process, connect users more intimately to the reporting supply chain and to absorb new requirements such as XBRL without necessarily adding to headcount.

- **Involving Other Functional Areas**

Now that financial reporting, controls and compliance are coalescing there is a pressing need for the finance function to collaborate with other functional areas of the organisation, such as internal audit and investor relations as well as other stakeholders such as the external auditors. Traditionally these other functions have used their own technical solutions and methodologies but there are now compelling reasons to bring them together in the same shared environment. Collaborative technologies, such as workflow provide the ideal conditions to share information and overcome the limitations of traditional communications via email, telephone calls and meetings.

- **Reducing Reliance on IT**

The latest round of technology has put the finance function in the driving seat, rather than having to rely on the IT department for every change. User configurable applications are allowing the finance function to define how the applications will be deployed and to make changes to processes 'on the fly'.

But one of the most noticeable organisational impacts is the ability to more clearly define and support specific roles in the process and the changed emphasis that a more proactive approach to problem resolution allows. For example, workflow support for inter-company eliminations allows discrepancies to be identified and resolved earlier in the process, reducing pressure on personnel. This makes the process more effective and more fulfilling for the personnel involved with it, improving the entire user experience.

VENDOR TO WATCH: TRINTECH

The changing face of the RSC, especially the financial close which is at its core, is familiar territory to Trintech, a specialist provider of financial governance, risk and compliance solutions. Its Unity Financial GRC Suite is at the forefront of supporting and extending the traditional group financial reporting process with specialist applications for reconciliation, financial close and electronic filing, taking the management of the financial close to new heights and well beyond the capability of most ERP and consolidation systems.

Fig 1.1 Unity Financial GRC Suite provides end-to-end visibility of the financial close providing the vital link between quantitative financial information and qualitative supporting, tasks, issues, controls and disclosures.



In common with the ideal architectures described earlier, Trintech’s capability stretches across the entire RSC, with, for example, its high volume reconciliation capability “ReconNET” through to its specialist financial close functionality, encapsulating GL Reconciliation, Certification and Balance Sheet Review, and its embedded support for XBRL in the final stages of the Reporting Supply Chain.

Meanwhile, the controls capabilities in “Unity Compliance” and “Unity Enterprise Risk Manager” underpin these specialist applications, ensuring that financial reporting across the entire enterprise is swathed in a comprehensive controls environment.

Although the scope of the modular solution suite is far-reaching it can be implemented with relative ease since all of the technology is designed to be superimposed on operational ERP systems and to complement popular consolidation systems. For example, trial balances of all shapes and sizes are readily ‘lifted’ from general ledger systems in reporting entities, ready to be incorporated and available to the Financial Close application.

But where Trintech excels is in the ability to re-connect the global finance function with the core process in its charge. It brings close tasks, controls, issues and disclosures together in a single environment alongside strict financial information, highlighting the key dependencies between them. As such it represents a complete end to end reporting supply chain solution that would be difficult to match.

Roles based dashboards, configured individually for different classes of users provide instant visibility of the process and their responsibilities within it, such as the completion of a task, the confirmation of the correct working of a control or the drafting of a disclosure.

Fig 1.2 Trintech's Financial Close Application allows task status, issues and controls to be viewed in every reporting dimension.



In Trintech's solution, email capability is an integral part of workflow so that users can be notified automatically of close tasks requiring their attention rather than waiting for them to log onto their roles-based desktop view. It means that finance personnel on the move can receive relevant emails on a PDA, laptop or other mobile device and action the next stage of the process. But email can also be used as a part of an authorisation process, for example the approval of close tasks such as the validation of a group reporting pack before it is submitted to the centre for consolidation.

Users can also leverage reference material, templates and other guidance which ensure a consistent approach to the completion or regular tasks. Issues arising can be escalated by leveraging the workflow and tightly integrated email capability that threads its way through the entire close process.

Typically, individuals involved in the process can display all of the tasks in the process or single out tasks assigned to them or tasks they have assigned to others. Authorised users can view the status of tasks which need to be completed before they commence their activities, for example, whether they have been started, completed or whether they are overdue. Colour coding and icons are used to emphasise progress (green for complete) or the lack of activity (red for overdue).

But it is Trintech's quantification of the 'softer' issues that is transformational. The ability to see the percentage of issues outstanding, the number of incomplete disclosures and the controls that remain outstanding brings a level of science and certainty to a process that was previously out of reach. Furthermore, these quantified snapshots of progress can be viewed at any level of granularity in the organisational hierarchy and in different reporting dimensions. So the impact of a delay in any aspect of the process can be assessed in relation to different reporting demands.

Trintech supports both a qualitative and quantitative assessment of status. For example the delay in agreeing an intercompany balance can be viewed in terms of its impact on the critical path for the whole process, or bottlenecks further up the line. But the failure to agree a material number can also shed light on the dependability of, say, loans in the balance sheet. It is the fusion of quantitative and qualitative information presented in a highly visual and intuitive way that makes the Trintech solution so valuable.

“Overtime was the norm and is now no longer paid (each person worked at least 4 hours of overtime per month). CME no longer incurs any overtime costs associated with the period-end.”

-- John Verburgt, Director, Compliance & Controls, CME

SUMMARY

The 2009 financial crisis has brought about a reassessment of the priorities around the financial close. Whilst speed and accuracy remain supremely important there is a growing appreciation of the need to simultaneously manage risk and controls if reported results are to be regarded as reliable.

There is also a pressing need to improve the efficiency of the financial close process in order to absorb constantly growing regulatory reporting demands without adding to headcount.

Neither traditional ERP systems nor consolidation applications provide the systems architecture or breadth of functionality needed to track issues, close tasks and controls in a single unified environment. But recent advances in technology, coupled with specialist GRC applications means that it is feasible to superimpose superior management of the financial close process over a variety of operational and ERP systems without causing major business disruption.

Advanced solutions from solutions vendors such as Trintech provide rich functionality for managing close tasks, issues, disclosures and controls across the enterprise, monitoring their status at every step of the way and in every reporting dimension. With deeply embedded workflow and email capability, Trintech’s financial close application provides a platform for collaboration and constant process improvement helping to accelerate the close process without compromising data quality and control.

Crucially, the Trintech financial close solution marries quantitative financial results with ‘softer’ qualitative issue to provide complete visibility of the status of tasks and controls at the point that the CFO prepares to ‘sign off’ the balance sheet. As such it provides vital assurance that the organisation has faithfully completed all of its tasks and controls in line with group policy and that the financial results and associated disclosures are dependable.

Best of Breed Close Management and GRC Solutions, such as Trintech’s, focus on encapsulating production in a controlled, easy to use platform, leading to optimised cycle time, embedded process controls, resource management and real-time oversight and control of the process. This leads to hard savings and the inherent quality and timely data capture which Executives can rely upon in addressing organizational stakeholders.

About FSN

FSN Publishing Limited is an independent research, news and publishing organisation catering for the needs of the finance function. The report is written by Gary Simon, Group Publisher of FSN and Managing Editor of FSN Newswire. He is a graduate of London University, a Chartered Accountant and a Fellow of the British Computer Society with more than 23 years experience of implementing management and financial reporting systems. Formerly a partner in Deloitte for more than 16 years, he has led some of the most complex information management assignments for global enterprises in the private and public sector. His bestselling book, "Fast Close to the MAX" was published in 2008.

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