Closing the Loop on Closing the Books

ILLUSTRATION: ROB COLVIN/ARTVILLE

By Jeff Adler, CPA

IN 1494, LUCA PACIOLI, a Franciscan monk, documented the double-entry bookkeeping process that we follow today. Over the past four decades, as an auditor for six years and a financial manager and consultant for more than 30, I've seen a lot of changes in the accounting world. Full keyboard adding machines became 10-key adding machines, which became mainframe computers with remote terminals, which became desktop computers, which became laptop computers. Now we have portable smartphones and tablet devices. But despite these changes, the debits are still on the left, and the credits are still on the right.

Now in the 21st Century, we have automated tools for general bookkeeping, detailed transaction processing, and financial reporting. These include sophisticated enterprise resource planning (ERP) systems, consolidation applications, industry-specific procurement and billing software, specialized human resource and payroll systems, inventory control, cash management, and budgeting and forecasting—just to name a few of these specialized areas.

But what's available to help us become better and faster at closing the books so we have accurate, easily accessible financial statements and reports to help us manage our businesses? Yes, this is the basic blocking and tackling of accounting and bookkeeping, but if we don't pay attention to these basic steps of closing the books efficiently and accurately, the rest of the process is worthless. The financial statements won't be timely or accurate.

There's a need for software that's focused around making sure the right things get done the right way and at the right time. We need to document these actions to provide evidence that key controls exist. After all, a key control isn't just something we do—it's something we do at the right time—and in this world of Sarbanes-Oxley Act (SOX) compliance, key controls are also activities that we have documented to provide evidence that they are working as planned.

In order to know the financial statements are correct, we must have assurance that the underlying general ledger account balances are correct. As a wise consultant once told me, "You can have the most perfect font, the most beautiful chart or graph with the most amazing colors and hues, but if the underlying information is wrong, all the beauty of the presentation is worthless."

In this article I'll address ways electronic applications can improve efficiency, reliability, and, most important, accuracy. I'll cover three main processes: task checklists, account reconciliations, and variance analysis.

Common elements of all three processes include:

- Documentation of directions and instructions,
- Assignment of responsibilities,
- Capturing and storing appropriate evidence and supporting documents,
- Ability to monitor workflow, and
- Evidence that everything was done in a timely manner.

Is Everything Done? The Checklist

When month-end comes, everyone has a to-do list that expands for quarter- and year-end accounting periods. When we combine those individual to-do lists, we create our companywide checklist. We need to document what must be done, when it should be done, how it's done, and when the step is in fact completed, including who did it and when. Then we have to document the approval and review process, showing evidence that all steps have not only been completed, but have been completed on time. Completion of these tasks sometimes includes creating or circulating various reports. These need to be retained as evidence of completion of the task as well.

Tasks that are often controlled with checklists might include:

Journal Entries—Make sure all standard journal entries have been completed.

Closing Subledger Systems—Document that all appropriate processes have been completed before these systems post total activity to the general ledger.

Contracts and Agreements—Make sure copies of all new significant agreements have been forwarded to the auditors.

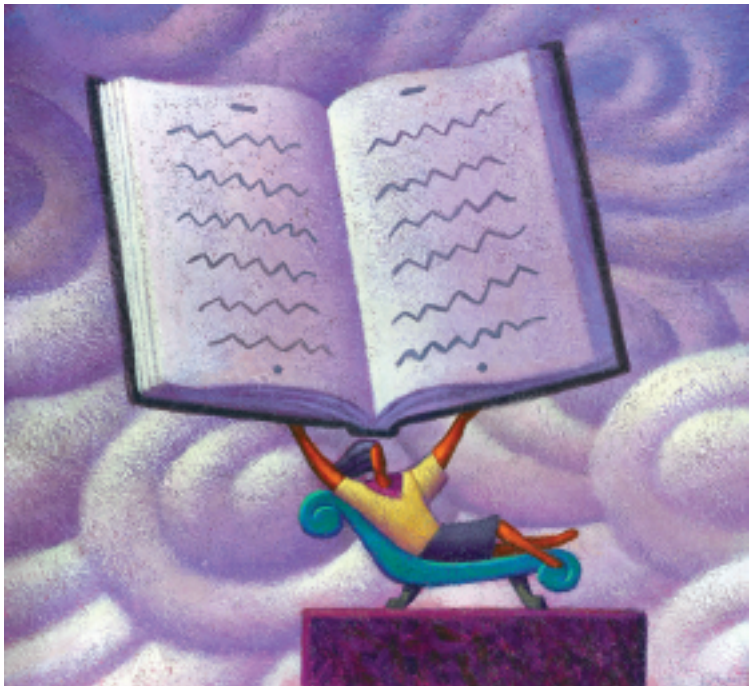
Account Reconciliations—Sign off that they are all completed.

Print and Distribute Reports—List all the period-end reports and their related distribution lists.

Most companies formalize this process by using Excel workbooks. They may store the workbooks in centrally accessible areas, such as a shared drive on the computer network, or the workbooks might be prepared individually and then forwarded to a coordinator to combine information into a consolidated overview.

Are the Balances Correct? The Account Reconciliation

During our routine accounting cycles, we have many elements of control, including various approval levels, systematized processes, and review procedures. But as we close our general ledger and prepare our financial state-



ments, we perform one last critical control step—preparing the account reconciliation. If any of our control processes failed to work properly, or we simply had an error performing our month-end close activity, the account reconciliation, when done properly, will identify these problems.

Similar to the checklist process, we need to define what should be done, who should do it, and how to do it. We also need to define and explain that the balances in the account comply with company policy. Supporting documents are critical in this process to show that the balances are correct. They must not only be readily accessible, but they must be retained in a secure environment where they can't be altered or lost.

When the reconciliations are complete, we often identify errors that require adjustments. Those items must also be summarized to evaluate whether the cumulative effect of those errors would materially distort our financial results and require an immediate adjustment. Excel is clearly the preferred tool of accounting professionals for this process.

Explaining the Business Forces Affecting Our Results

Once we've succeeded in making sure the books have been closed (the checklist) and the balances in our general ledger are correct (the account reconciliation), we need to explain what's happening in our business. A critical tool in helping us provide those explanations is the variance analysis.

The variance analysis doesn't just explain what the balance is but why it may be different from a predefined target amount, such as a previous period balance or a budgeted or forecasted amount. The explanation must include not just what changed, but also the underlying business reasons for the change.

We must define parameters to identify what's a significant enough change to require an explanation (there isn't enough time to explain every detail), and a summary of the detailed results must be complete and accurate to provide the overall explanation of how business conditions are affecting the results of operations.

For most of us, these control processes use the same key software application we rely on for checklists and account reconciliations—Excel. Let's now talk about what's good about Excel, what some risks might be in our current processes, and how we can look to other software applications to help us improve our efficiency and accuracy.

Pros of Using Excel

There are three main advantages of using Excel: availability, familiarity, and flexibility.

Availability—Virtually everyone has access to an Excel program in some form. If not to the actual Microsoft application itself, we certainly have access to software like Google Docs or OpenOffice, which have a similar look and feel and comparable functionality.

Familiarity—As accountants, we use Excel almost every day to perform a variety of tasks, so there's a great deal of comfort that comes from dealing with the familiar. Excel-like work environments make us feel good, and we know how to use the software.

Flexibility—We can define our checklists, reconciliations, or analysis documents any way we like. It's also easy to adjust and improve them when appropriate. If we need to address specific elements, we can easily add them to our workbooks without going through a series of requests, approvals, and formal design processes with our IT department or programming staff. We just simply "do it."

Cons of Using Excel

Security, supporting documents, development, and consolidation of results pose challenges.

Security—We must take extra care to make sure the workbooks are in a secure environment to maintain an enterprise level of integrity. Once they have been com-

pleted for a given accounting period, these documents must not be alterable.

Supporting Documents—While it's easy to insert comments and explanations, documents can't be attached to an Excel workbook to serve as evidence that something was completed, so they must be stored in another location and be readily retrievable. What often happens, however, is that stacks of paper and piles of binders are stored offsite in disparate and hard-to-get-to warehouses.

Development—With the flexibility of Excel comes the responsibility for development. We have to create our own forms, edit them for propriety, protect them from erroneous data entry, and clearly document any calculations. We also have to ensure the forms are performing the correct calculations. If we're using macros, we should document these forms thoroughly to provide an audit trail that allows validation reviews and testing of the process.

Consolidation of Results—The consolidation of individual workbooks is often a manual process that leads to risk of human error. Because this is most often a manual process, the consolidated report isn't available real-time. Therefore, a significant amount of time may be spent reaching out to gather information, making sure all information has been received, and—only after all that time and effort—preparing the final consolidated report. The consolidated results need to show not just the status—i.e., done or not done—but also the exceptions, which is another step of manual gathering and collection. Manual steps translate into wasted time and possible errors.

If we have created macros to perform these steps of consolidating information, it's important to have that process clearly documented in case changes in the overall process require changes in the final consolidation process. Otherwise, we lose integrity of the process and risk errors of missing information and improper calculations.

Workflow Alerts—Workflow may be defined with the specific assignment of responsibility, but there's usually no automated formal notification process such as sending e-mail alerts on a real-time basis.

Benefits of an Integrated, Automated Application

To help address these challenges of operating in an Excel environment, there are now integrated, automated applications that provide several benefits in controlling all three processes: checklists, account reconciliations, and variance analysis.

Consistency—Standard formats ensure complete and consistent documentation of instruction and requirements. The information is readily available to all users to ensure consistent completion of the specific task/reconciliation/analysis, and review of information is much faster because effort is spent understanding content rather than trying to understand the specific form developed by the person performing the activity.

Supporting Documents—These applications provide the ability to attach supporting documents and comments as evidence the activities were completed as appropriate. They are stored in secure environments that provide for backup, redundancy, and, most important, for efficiency—immediate accessibility and availability. No more digging around storage warehouses when the auditors ask for a copy.

Security—Software housed on your servers or in a software-as-a-service (SaaS) environment usually has much better data security and backup processes than what might be located on individual computers. These secure areas also are protected from intrusion and manipulation of the documents that are being stored.

Automated Efficiency—Information can be imported into these applications to greatly minimize the chance of manual error and provide rules-based processes that can significantly reduce manual effort and increase accuracy. For example, an account reconciliation application can use specially designed auto-certification rules, which could include certifying an account if the GL balance agrees with the subledger balance or certifying a zero-balance account that has no activity. These two processes alone could free up significant time for an accountant to spend on more important analytical processes.

Workflow—To help manage the close, e-mail alerts and predefined reports (both summary and detail) clearly define responsibility and workflow and keep everyone informed about the progress of the process.

Real-time Monitoring—Having visibility into the closing process and readily available reports created with a few mouse clicks helps manage the process. This can be done at any time with the most current information available—no one has to wait for the collection-of-information process to be completed and summarized. Reports, dashboards, and interactive grids provide this type of information.

Best Practices—Specialized software targets specific areas of operations and expertise because it takes the best ideas and processes from many clients and incorporates them into one application.

Obstacles to an Integrated, Automated Application

There are a few hurdles to overcome before implementing an integrated, automated application.

Cost—Excel is already available to us, so there isn't any additional cost for the software. With a new application there is obviously new cost, but we can minimize it by selecting a solution that's offered in the SaaS environment. SaaS software is usually offered on a monthly license or subscription basis with minimal upfront installation costs, which makes it affordable and scalable.

Change—We all have to overcome our nature to want to stick with the familiar. Using a new tool means learning a new tool. Most SaaS companies have extensive training materials available, including live webinars and e-learning tools.

Integration with Other Applications—With one more piece of software, we're often concerned about possible errors occurring when we move information from one application to another. In fact, using Excel is often a manual process. But because these new automated applications are designed to interface with many different financial software applications, we're able to reduce our chance of manual errors by creating dynamic interfaces. Again, with an SaaS offering there's typically no new hardware or software to install or maintain.

The Solution That's Right for You

In the past few years, several vendors have entered the field of providing software to assist with these critical control processes. The solutions vary depending on the vendor. SaaS applications provide fast implementation with pay-as-you-go pricing. ERP add-ons work well for organizations that have standardized on one common platform. Traditional purchase software options also are available.

Some of the software providers branched out from existing analytical applications. Starting with software designed several years ago to assist with high-volume transaction matching, such as bank account activity, they created additional functionality surrounding the process of monitoring the close.

New companies in the market designed software specifically from the accountant's perspective as a control tool and then added technical refinements and design to integrate with more specialized enhancements, such as automated transaction matching, rules-based variance analysis, and multicurrency consolidation.

As evidence that this is an area of future growth and importance, major ERP providers have been enhancing their own functionality in areas of transaction matching and process-management control.

Big Dividends

Analyst reports are readily available to show return on investment (ROI) of well over 100%, with one report even stating an ROI of more than 600%. This is a great investment, especially when you consider there was no "value" given to the improved controls in calculating the ROI. One company determined it recovered its total investment just in the cost of paper savings the first year. In addition, suggested time savings for preparers using a more efficient process is estimated at anywhere from 20% to 40%. Supervisor and manager time savings can be as much as 50% because of the very visible workflow and consistency that standardization provides.

While auditor savings don't seem to be readily identified, there appears to be a common understanding and agreement by users of these closing control applications that the auditors are spending time on more important issues rather than testing the account reconciliation and close-control processes ad infinitum.

Also, these applications can be set up and running in just a few months. Believe it or not, some companies have done this in just a few weeks. The process becomes more of an incremental growth process where you start with some basic features or controls and then grow into maturity. This isn't like making a change in your billing or GL system where you have to do a massive, well-planned cutover. Start with some critical areas, such as just your key account reconciliations, and then add more functions and controls as you learn about the application and how it best capitalizes on your existing staffing and strengths.

You'll gain efficiency (that means cost savings) and improved reporting accuracy (that means better decision making and less risk of reporting errors). And the benefits start almost immediately.

Closing the Loop

The debits are still on the left and the credits are still on the right, but now we have the ability to have consistency, reliability, and oversight seamlessly included in the process of closing the books with the use of new software tools. **SF**

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