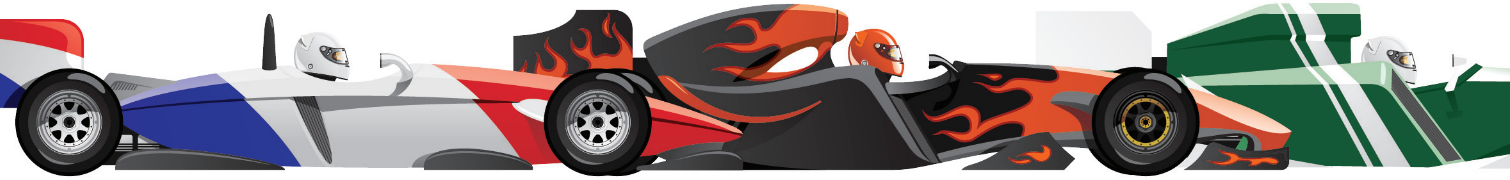
HOW TO SAFELY RACE to an OPTIMIZED FINANCIAL CLOSE

By Gabriel Zubizarreta



What would an optimized financial close look like after a year's worth of effort?

Most finance professionals have never asked this question and even fewer have answered it. It's hard to hit a target you cannot describe. To achieve goals, one must define them, break them down, plan to achieve them and work toward realizing them.

In the case of the accounting close, the characteristics of an optimal process are similar to those of a successful race car team. It requires the right systems and processes, quality control, precision, teamwork, mid-race adjustments and an ability to overcome adversity in a time-sensitive, regulated environment.

First, there must be increased visibility because an optimized close is transparent. Details about activities, the status of processes, compliance controls and contents are all highly visible by all team members. Visibility also helps to identify obstacles, limitations, anomalies and errors. Poor visibility limits efficiency. Think bright headlights and a clean windshield.

Managers should have the ability to adjust activities, workload and review depending on issues that arise during the process to increase manageability. Visibility gives warning, but manageability provides the option to navigate, adjust and overcome obstacles. Think of the car's steering wheel.

Additionally, evidence of process compliance, supporting documentation and controls verification should be embedded in each close activity. Quality and compliance are not add-ons or after-thoughts. Compliance is exponentially more challenging in a dynamic environment, like the accounting close, where issues can arise from anywhere and changes are the norm. Quality can only be attained through continuous improvement and adaptation. Think of racing teams designed to deliver high performance by being adaptable to track conditions.

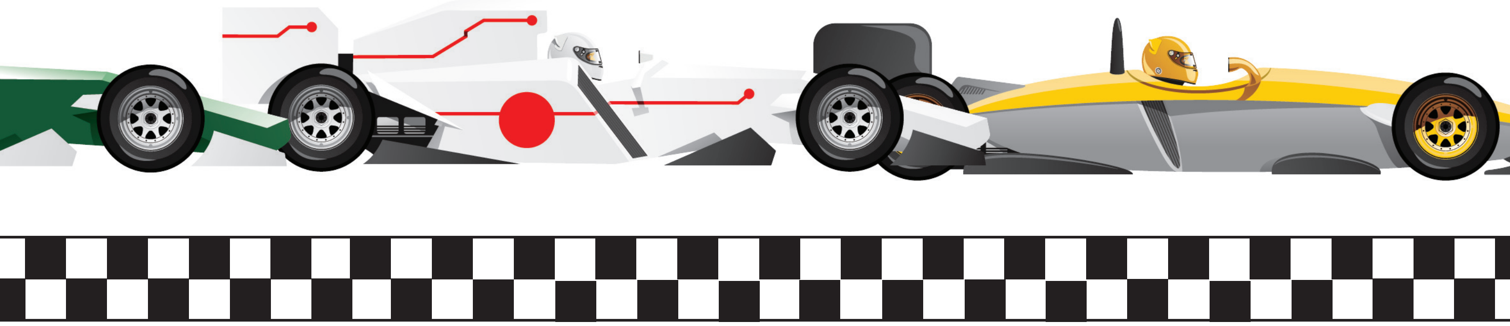
Analysis should also be a normal part of the close, and quality control should be performed as early and as often in the process as possible. Think about how race teams monitor the quality of the fuel they use, test fuel gauges, calculate fuel consumption and continually review the process, refueling just enough to win the race without extra fuel weight.

During the close, there are several types of communication required to track information, obtain the status of various close processes and communicate needed changes.

The characteristics of an optimal accounting close process are similar to those of a successful race car team. It requires the right systems and processes, quality control, precision, teamwork, mid-race adjustments and an ability to overcome adversity in a time-sensitive, regulated environment.

Most of the communications require interrupting the participants in the close. To minimize disruptions and speed results, companies should use various forms of push and pull notifications to ensure that relevant information is made available at the appropriate times. Using the race car analogy, think interactive dashboards that allow ad-hoc queries of information useful to the driver.

A optimized financial close also includes teamwork, with process and policies that are designed to support workload balancing and cross-training of personnel involved in the close. Teams are more effective than individuals. Team performance



can be increased by improving knowledge management, visibility, manageability, communication and training.

In a dynamic close environment, unanticipated issues and change are constants. Each represents an opportunity to learn and improve. The close process should be designed to meet current needs but also to adapt rapidly as conditions require it. As with a race team, the goal is continuous improvement.

Poor results attributed to random events are often the result of the failure to plan, to analyze and to accept complete responsibility. A well-designed close process combines processes, controls, communication, teamwork, monitoring and manageability to create predictability in an uncertain environment.

In almost every professional automobile race a significant group of cars cross the finish line after hundreds of miles of racing. A majority of the randomness inherent in auto racing is converted into predictability through the acceptance of responsibility, planning, analysis and reasoned reaction.

When it comes to the financial close, speed is a double-edged sword and can be correlated to process risk; a faster close can be the result of more efficient processes or increased recklessness. If speed is ascribed to better process quality, it will lower process risk. If it is attributable to recklessness brought on by inappropriate pressure to perform, it can increase process risk and eventually increase costs. Good speed, which reduces the accounting close elapsed time, effectively results from continuous process improvement keeping things in balance and controlled, avoiding a major crash.

Finally, the greatest attribute of a close is its accuracy. Accuracy is a result of everything discussed thus far — increased visibility and manageability, improved compliance, better analysis and communications, teamwork and a focus on continuous process improvement and predictability. Having all these things in place ensures that the team not only finishes the race, but operates at a championship level.

Getting Started

Now that the elements of an optimized financial close are known, where to start in the direction?

The financial close represents a significant consumption of valuable human resources, many very manual components — which are not very well documented or cross-trained — and it has some of the least sophisticated processes in the department. This list could go on, but ends with the promise that "it is one of the most cost effective process efficiency improvements available."

For more than 50 years, close process improvement challenges have proven to be complex, resistant, elusive and frustrating. There are many reasons why departments can't decisively address close process improvements; however, many just don't know where to start.

Here are the first five steps to understand to get started with significant improvements to your close processes.

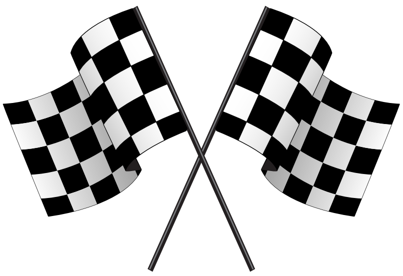
1) **Understand the Payoff.** Many people do not really understand the multiple benefits that come from tackling this issue. There is increased time for other high-value activities, reduced stress, continuous improvement, increased teamwork, improved communication, reduced turnover, increased analysis and much more.

A strong close process improvement will lead the way to department transformation from historical reporting to more value-added activities. It is a huge net cost savings and it is repeatable into other manual processes.

Additionally, it permanently lowers compliance costs. Finally, when performed correctly, it does not require significant investment of time or funds. If companies really understood the attainable benefits of a structured approach, many more would embark on the efforts.

2) **Learn About Close Process Improvement.** Most accounting personnel spend a sizable investment of time preparing, doing, reviewing, adjusting and report-

REASONS TO AVOID IMPROVING THE FINANCIAL CLOSE



Many finance professionals would like to improve their company's accounting close, but never seem to get around to doing it. There are six bad reasons for avoiding an accounting close improvement initiative:

WE ARE TOO BUSY.

The accounting close is one of the finance organization's biggest consumers of time, money and effort. The unpredictability of the close is one reason finance is too busy at its busiest times. Improving the close will free up valuable resources and the accounting department will actually become less busy. Management should never be too busy to consider prioritizing an initiative that can yield significant positive returns on time invested. It's too easy to be too busy — and it rarely gets better on its own.

WE DO NOT HAVE THE BUDGET.

Improving the close process saves money, time and compliance efforts. An American Productivity and Quality Center (APQC) study shows that more efficient and faster closes become less expensive by two to three times the cost of improving them. Lack of a budget is not as big of an obstacle as a lack of understanding and a lack of leadership.

WE HAVE OTHER PROJECT PRIORITIES.

If a company reduces its close process by just two days, it increases the resources available to other high-priority projects by 24 days per year. This can reduce outside consultant hours, build internal expertise and improve the focus on other projects. It is hard to generate world-class results from new projects when the company is limited by less-than-world-class processes in the accounting close.

ing the close in various capacities and roles. Few managers however invest any significant time studying about potential resolutions to the root cause issues surrounding the close. How do visibility, manageability, process accountability, quality control timing and communication inter-play in close process optimization?

Most departments should invest at least a day or two learning about the core cause issues and successful case studies of various ways to improve the close. This should be qualified education by experienced corporate accountants, not a sales pitch.

3) **Perform an Assessment.** Each company has a unique close with its unique challenges. No silver bullets exist that will solve all the significant close issues. Financial executives need to perform an assessment of the more significant close issues affecting their close. The close is a single process that also includes the most manual ending parts of many other processes originating outside the accounting department.

Many companies find that the more challenging issues exist in the process cracks between departments and some of those issues represent root causes that need to be addressed. Experience shows that most companies perform on average 40 to 60 manual activities per person substantially involved in the close.

Activities are defined as assignable tasks (often included on an Excel checklist), which, if omitted, would impact the quality or completeness of the close. These activities can include reports, completeness checks, reconciliations, analysis, adjustments, journal entries, allocations, meetings, analytical reviews and internal controls.

The company should get a least a general understanding of the multiple dimensions, such as variability, documentation, delay impact assessment, bottleneck review, redundancy and priority in a simple, yet comprehensive analysis. The primary result of an assessment should be the identification and understanding of issues and benefits.

4) **Make a Plan.** There are too many disparate possibilities that qualify as candidates for improvement. Typically each person has his or her own idea as to what is needed to improve the close process, which leads to an uncoordinated improvement effort. A coordinated approach with prioritized sub–projects can yield the best results. Often it is the difficulty of choosing between multiple good alternatives that slows the process improvements.

Someone needs to want to own this project and make the tough choices, which is often difficult to find. Skilled leadership in change management with solid accounting skills and political skills are a requirement.

5) **Take Action and Build Momentum.** It is important to both start a quick-win, methodical continuous improvement project and build momentum with the next follow-on steps. It is critical to build success with the first win and even more critical to consistently increase momentum.

The third priority is to be adaptive to the changing environment and priorities. Rebuilding momentum is very difficult and takes more than twice the effort as increasing existing momentum; therefore, always plan three steps ahead of the current step.

Well planned close process improvement projects can be a very rewarding team building exercise, which lays the groundwork for financial process excellence throughout the department, saves money, reduces compliance efforts and increases morale.

Let's get started now with a practical approach to solve a significant challenge, because it's absolutely guaranteed not to solve itself.

Gabriel Zubizarreta, (gabez@svacpa.com) is CEO of Silicon Valley Accountants, a San Jose, Calif. based accounting and consulting firm dedicated to helping companies improve their accounting and financial reporting processes, increase efficiency and lower compliance costs.

WE HAVE LIMITED IT RESOURCES AND TOO MANY OTHER IT PROJECTS.

Great, because improving the close is less about improvements in information technology (IT) systems and much more about improvements in the way people use existing systems. Most companies already have significant IT systems in place, but they tend to be underutilized.

Significant benefits to the close can be realized by allowing people to leverage existing systems, not replacing them, and thus improving the return on investment (ROI) on the systems the company already owns.

OUR CLOSE IS GOOD; WE CLOSE ON DAY X.

Good, as compared to what? You may be closed on Day X, but you probably do not know if that is a good performance or if the process is well-managed. Most companies do not have efficiency metrics surrounding their close processes, nor benchmarks from comparable companies.

Frankly, the cost of the close process is rarely known or even estimated. This has to change. As management guru Peter Drucker reminded followers many years ago, to be well-managed, a process must be able to be seen, measured and monitored before improvement can begin.

WE REALLY DON'T UNDERSTAND WHAT 'CLOSE PROCESS IMPROVEMENT' IS OR HOW THE COMPANY WOULD BENEFIT.

Some finance departments earn the nickname "Department of No." That's not always a bad thing; the department's initial screening process is efficient for weeding out obviously bad ideas. But it reinforces the unfortunate notion that finance executives and accountants are resistant to change.

Companies considering whether they can improve the accounting close must evaluate the idea based on merit and facts, and determine whether to proceed based on a consideration of the costs and benefits.