Are We Expecting Too Little?

Three Outdated Beliefs about Balance Sheet Account Reconciliations that May be Driving Low Management Expectations on Quality, Productivity and Cost.

"Among respondents who felt that compliance costs were decreasing, some of the reasons given for lower costs included automation of controls… and systems and productivity improvements."

Robert Half Management Resources & Financial Executives Research Foundation
Benchmarking the Finance Function 2011

In an effort to be leaner and more efficient, it is hard to believe that we may be unintentionally allowing low expectations to flourish. Interestingly, while senior management's process improvement agenda targets areas like budgeting and business intelligence within finance and accounting, the monthly account reconciliation process – a recurring and manually intensive key compliance activity for most publicly traded organizations – has been largely overlooked. In 2010, Gartner research found that "many firms' reconciliation processes are mainly manual (with no enterprise technology solution)" and cited several critical challenges that come with manual reconciliation management. And is there a link between finance automation and the bottom line? Very likely. In a 2011 survey[1] of finance executives of more than 200 public and private companies, over 70% of respondents felt that the cost of compliance has increased over time and only 9% of respondents felt those costs *decreasing* over time. Among this 9% minority group, however, "automation of controls… and system and productivity improvements" were cited as reasons for a lower cost structure.

Why is that, while other areas within Finance are scrutinized for targeted improvement, the often laborious balance sheet reconciliation process remains untouched in many organizations? Perhaps this phenomenon stems from traditional management expectations around general ledger account reconciliations and their long accepted limitations. In this paper, we will explore these common perceptions and beliefs.

Belief #1: The objective of the month-end reconciliation process is to ensure all reconciliations are completed.

Reliance on Completion Statistics Alone May Satisfy Sarbanes-Oxley Requirements but Can Provide Management with a False Sense of Security

The objective of the month-end reconciliation process is to *correct errors in the balance sheet and anticipate potential adjustments*, which may not necessarily correlate with the completion of all reconciliations. Because internal controls typically prescribe only *timely* completion of balance sheet reconciliations, organizations with hundreds, or even thousands, of balance sheet accounts and a tight timeframe to perform their reconciliations expend much of their resources during the monthly close on meeting the timeliness component. As a result, identification of write-offs and analysis of open items – the ultimate goal of performing reconciliations – do not enjoy adequate attention. Combined with the challenge that executive level insight, such as companywide balance sheet exposure and exception aging, is time-consuming to produce without a dedicated reconciliation management solution, finance functions are often ill-equipped to generate insight beyond the completion status.

> Emphasis on *completion* alone may overpower the true purpose of account reconciliations

Disproportionate Emphasis on Timely Completion May Compromise Reconciliation Quality

The quality of individual reconciliations is most often compromised when the staff prepares a roll forward in place of a true reconciliation, where general ledger balance is compared against an independent source. Transaction roll forwards are not effective reconciliation tools, because they simply replicate the general ledger activity and cannot surface reconciling items. Unfortunately, roll forwards are an expedient choice when, in addition to day-to-day operational activities, accountants must reconcile by hand hundreds or thousands of balance sheet accounts each month.

Belief #2: Spreadsheet, offline documents and email are dependable and cost effective tools for reconciling accounts and managing workflow.

Spreadsheets Have Inherent Risks That Are Not Well-Controlled

The spreadsheet is steadily gaining notoriety as one of the riskiest end-user applications used by today's business professionals. The enormous flexibility that allows for nearly any type of computation and manipulation places overwhelming ownership on the spreadsheet creator to build in system controls during spreadsheet design to prevent and detect user errors. But more likely than not, many financial spreadsheets in use today do not have adequate system controls since they are almost always created by individuals who lack formal instruction in systems design. U.S. regulators seem to agree. In 2009, the Public Company Accounting Oversight Board (PCAOB) urged external auditors to focus more of their testing on financially significant manual spreadsheets in its *Report on the First-Year Implementation of Auditing Standard No. 5*. And although finance departments today still employ Microsoft Excel® for key activities like account reconciliations, budgeting and long term planning, controls over spreadsheets remain week. A recent spreadsheet usage survey conducted by the University of Loyola Marymount showed that 88% of U.S. public companies surveyed still do not have a computing policy specific to spreadsheets.

Reliance on Disparate, Undedicated Systems Drains Productivity and Wastes Resource

Relying on email and offline document storage to manage preparer, reviewer and approver activity presents several issues. Policy and procedural information such as account materiality, key attributes and preparer instructions are often kept separately in a hardcopy binder or a company shared drive. Because off-line documentation cannot "follow" each balance sheet account and be available at the time of reconciliation preparation, their impact on controlling reconciliation consistency, however well-intentioned, is limited. Email and personal hard drives exacerbate version control and force managers to search for files and manage workflow, when their time would be better applied reviewing reconciliations and performing aging analysis. With scattered review notes and multiple drafts at various stages of finalization located in email inboxes or various hard drives, efficient coordination between reviewer and approver is difficult. Very often one or more of the following occurs, draining resources and adds little value to the process: Updates are made in different drafts, prompting the reviewer or preparer to retrace their steps; Offline discussions and meetings occur to clarify status and issues; or, the completed final reconciliation is not retained in the company shared drive but buried in personal email inboxes.

> Reliance on spreadsheets and undedicated systems is not only risky but contains hidden costs in the form of errors and lost productivity

Belief #3: Limited reporting on account reconciliations.

Management's Control over the Account Reconciliation Process Remains Largely Peripheral

Beyond rudimentary measurements that are gathered periodically by hand (e.g., Account Population, Not Started/In Progress/Completed statuses), management typically receives little or no real-time information for decision-making during the reconciliation process. In addition, critical insights such as balance sheet risk exposure by financial statement line item, impact of write-off adjustments and worker productivity assessments are nearly impossible to generate real-time in a manual environment. Absent better tools and more precise data, oversight activities must rely on basic after-the-fact data and spot checking of individual accounts. While these metrics glimpse at the reconciliation process at a point in time, they are poor substitutes for direct and immediate insight that management can use to make real-time assessments and decisions on the balance sheet.

Finance executives must have access to data that produces insight in order to manage the balance sheet and the accounting group

It's Time to Expect More

According to the Association of Certified Fraud Examiner's 2010 Report to the Nation, the account reconciliation ranks as a top five occupational fraud detection tool. Being one of management's best defenses against financial statement misstatement and fraud, ensuring reconciliation accuracy and integrity is vital to maintaining confidence in the financial statements. Traditionally, this process is costly to the Accounting function in the form of man hours, poor controls and missed insight. Reliance on manual effort and disparate systems not only produces a host of administrative "busy work," but also creates hidden costs in the forms of errors and rework. In addition, lack of meaningful metrics reduces the executive team ability to optimize the value of the monthly reconciliation activity, gauge work productivity and drive efficiency into the overall month end close.

"Understand your reconciliation management process, including the costs to maintain your most manual processes. Determine whether automated applications can provide value and cost reduction opportunities."

Gartner
Leveraging Technology to Improve Reconciliation Management in the Office of Finance

At the same time, this is an area with significant process improvement potential that finance executives can seize. Account reconciliation automation removes the challenges associated with traditional reconciliation management so that the finance team can remove administrative distractions and focus more on value added work that matters.

Resources

Gartner. *Leveraging Technology to Improve Reconciliation Management in the Office of Finance*. November 10, 2009.

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The Public Company Accounting Oversight Board. *Report on the First-Year Implementation of Auditing Standard No. 5*. September 24, 2009.

Nancy Costner et al. *Controls over Spreadsheets for Financial Reporting in Practice*. Loyola Marymount University, Los Angeles, California. 2011.

Association of Certified Fraud Examiners. *2010 Report to the Nation*. 2011

Footnotes

1. *This references the Robert Half Management Resources and Financial Executives Research Foundation study in the Resources section.*

About the Author

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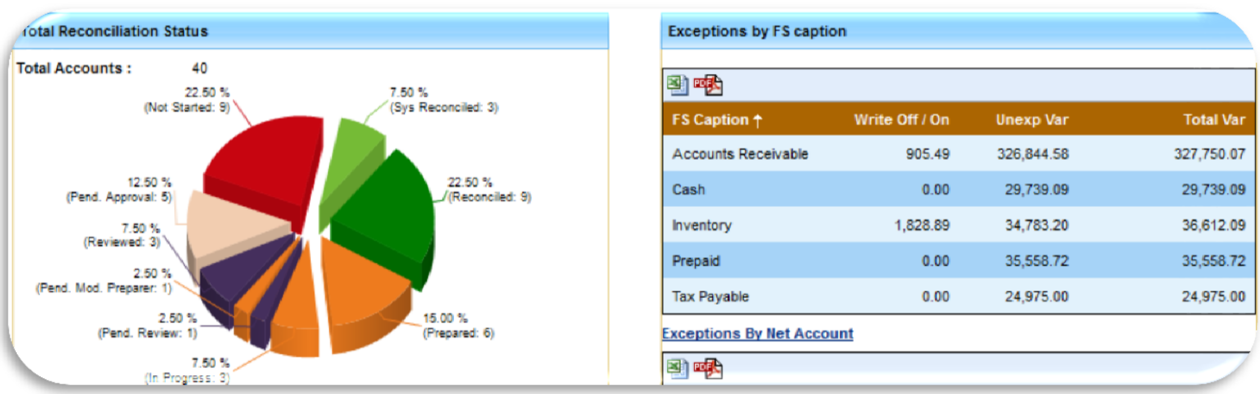
About SkyStem's ART

ART equips executives with striking insight into their balance sheet by transforming the account reconciliation process. Do away with spreadsheets, crazy emailing and manual distractions. Enjoy ART's powerful workflow management and reporting tools to automate account reconciliations and become more productive without ever installing software. Contact us (info@skystem.com) for a private demo and see how ART can help your group:

- ✓ Standardize the month end reconciliation process for consistency and repeatability, so you have full confidence in the balance sheet.
- ✓ Reconcile accounts with speed and accuracy so work gets done faster.
- ✓ Do away with spreadsheets and administrative activities so accountants accomplish more while doing less.
- ✓ Work remotely yet maintain total transparency and accountability.

ART is offered by SkyStem LLC, a New York based company.



Partial snapshot of ART's dashboard for reconciliation reviewers and preparers