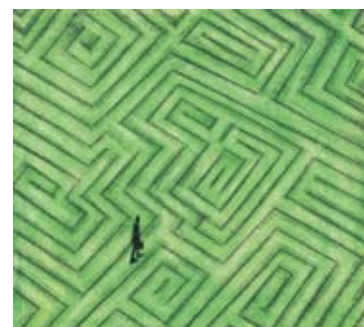


An Innovative Approach to Close Cycle Reduction

As filing deadlines are accelerated and regulatory requirements become more stringent, companies are discovering that their financial close process does not always produce accurate results within the required timelines. The MorganFranklin Accounting Operations Playbook provides organizations with a tool to manage the financial close process, to ensure the completion of important internal controls and to gain insight into the process in order to improve close cycle performance.

INTRODUCTION

Does your accounting organization spend an inordinate amount of time closing the books and reporting financial results? As soon as financial results are determined for one period, does the next closing period begin? In many organizations, the financial close, the accounting procedure that includes closing the books and preparing financial reports at the end of the accounting period, is based upon manually intensive, non-standard processes that have to be completed under tremendous time pressure. In this environment, few organizations have the time to examine the drivers of efficiency in order to improve their situation. Accounting managers and staff typically spend the majority of their time executing manual financial close processes that are time consuming and error prone. Many feel like they are trapped in a “constant close” cycle that does not allow accounting departments to effectively analyze financial data in order to ensure accuracy or to identify or implement improvements to the close process.



The stress on timely and accurate financial data produced by the close process is not new, but accelerated SEC reporting deadlines are increasing pressures on finance departments to find ways to address the “constant close” trap. Many businesses scramble to comply with these new regulations because they have not adapted their close process to meet the changing requirements. A common solution to the accelerated deadline is simply to compress the close calendar without driving any true process improvement. In response to the shorter SEC deadlines, one of our clients simply compressed a twenty-day close cycle with ten-hour days into a ten-day close cycle with twenty-hour days. The resulting time crunch on accounting staff forced accountants to make independent decisions about the degree of completion of close tasks and activities. In this situation, we typically see staff focusing on what they view as the “must haves” for close, which are transaction processing activities. This is a direct result of the focus of the traditional staff accountant – they tend to be transactional in nature and gravitate toward their comfort zone when pressured. As a result, decision support and control activities are often overlooked or completed in a less than thorough manner.

While the passage of the Sarbanes-Oxley (SOX) Act has increased scrutiny over financial controls, which has improved investor confi-

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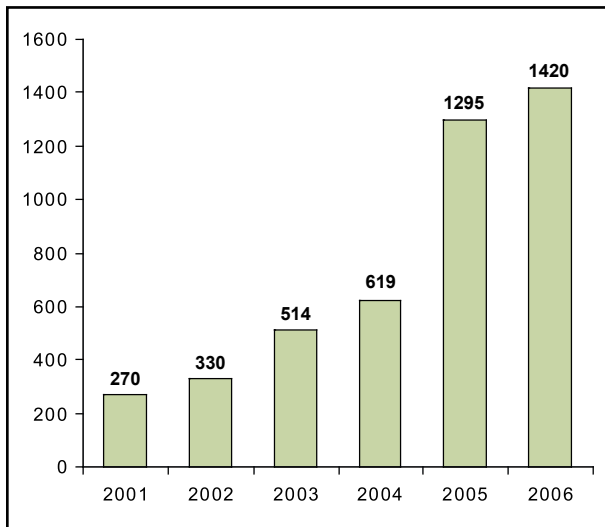
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dence, it has not resulted in a decrease in earnings restatements. In fact, restatements increased by 426 percent from 2001 to 2006 (see figure 1 below) and continue to increase. This has also added to the pressure finance organizations face to find new and improved ways to manage the financial close and reporting process.

Figure 1. SEC Earnings Restatements by Year



¹Rapoport, Michael. "Report Finds Restatement Trends Show Sarbanes-Oxley Works." SmartPros. Retrieved August 8, 2007 from <http://accounting.smartpros.com>; and, "Compliance News: 2005 was a record year for earnings restatements." IT Compliance Institute. Retrieved August 8, 2007 from <http://www.itcinstitute.com>.

In response to these challenges, MorganFranklin has created the Accounting Operations Playbook (the Playbook). The Playbook is a low cost workflow and document management tool that facilitates, tracks and documents the financial close process. The Playbook also serves as a flexible institutional knowledge repository that captures procedures for account activities and streamlines the transition of individuals in and out of roles.

The Playbook employs commonly used technology and can adapt to the requirements of each client's financial close process. The Playbook is easily integrated with operations – seamlessly blending in with financial close processes and systems. Furthermore, closing process historical data stored in the Playbook allows managers to identify bottlenecks and inefficiencies in order to launch performance improvement initiatives that address data quality issues and improve the efficiency of the close cycle.

Specifically, the Playbook:

- Integrates easily into any accounting environment;
- Documents account definitions, purposes, closing steps and related controls in order to standardize account management activities;
- Provides business process management (BPM) and workflow capabilities to improve controls and efficiency of the close process;
- Allows managers and accountants to track real time individual and overall progress throughout the closing cycle;
- Produces a valuable audit trail by maintaining a detailed history of all closing activities performed on each account;

- Maintains a record of the execution of all key SOX controls which may lead to lower SOX requirements testing costs;
- Maintains and organizes all close related documentation for easy access and future reference; and,
- Acts as an institutional knowledge repository that maintains valuable account information and reduces training time for new employees.

THE BUSINESS CHALLENGE: AVOIDING THE "CONSTANT CLOSE" TRAP

Most organizations trapped in the "constant close" cycle have developed or inherited complex and inefficient financial close processes that can have several negative effects on the finance organization, including increased work hours and employee turnover, error-laden reconciliations and potentially material weaknesses. When addressing the close process, we find that organizations usually target a set of standard objectives:

- Shorten the length of the close cycle while improving quality and efficiency;
- Increase standardization of account management activities;
- Solidify and enforce internal controls;
- Develop the ability to monitor close process in real time;
- Retain and transfer institutional account knowledge; and,
- Develop a culture of continuous improvement.

When analyzing the processes, people and technology that create an organization's close environment, typically we find that improvement opportunities are based on a mix of short-term process and system solutions as well as longer term strategic change recommendations that address the upstream processes impacting the finance organization. The short-term solutions are typically related to one or more of the following areas:

- 1 Shifting work outside of the close period;
- 2 Developing ways to eliminate non-value adding tasks;
- 3 Performing required tasks more efficiently; and,
- 4 Using technology as a point solution to enhance capabilities while maintaining the core system infrastructure.

An area of opportunity that illustrates the final three points above is the traditional close meeting. Our experience has shown that many companies rely on close meetings as the primary source of integration, workflow management and knowledge sharing across accounting operations. Close meetings are typically held for the following reasons:

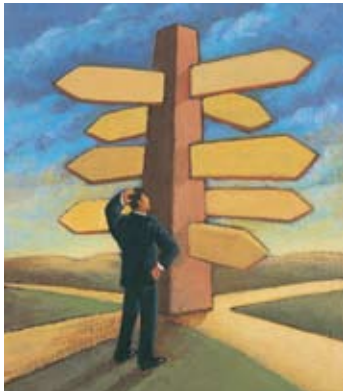
- To communicate changes in timing or updates to the process;
- To ascertain the degree of completion of key tasks;
- To address and resolve issues; and,
- To identify and evaluate dependencies across groups.

One of our clients who had a 28 day close cycle held close meetings every day for the last ten days of the close. While the meetings had valuable objectives, they placed a heavy drain on resources considering only 10-15% of attendees were engaged in the meeting at any point in time. In this example, these close meetings cost our

client between 200 and 400 man-hours each close cycle. The status information and details on close tasks available in real time through the Playbook would have allowed this client to reduce close meetings to once a week and save hundreds of man-hours a month. When striving to accomplish the close cycle improvement objectives articulated above, business leaders must balance the drivers of efficiency with their control objectives. We have found that this balance can best be achieved by organizing and addressing the root causes of financial close issues across three categories – process, people and technology. The MorganFranklin Playbook is an innovative and cost effective solution that can help companies address these root cause issues.

Process

When the close cycle starts to exceed fifteen working days, the accounting operation is engaged in a “constant close” – as soon as one period is closed, the next closing cycle begins. When operating in this environment, finance and accounting staff typically do not have the time or perspective required to develop improvements to the process. Staff lack the ability and time to evaluate the process holistically and do not have the appropriate tools to drive standardization and enable easy measurement of process efficacy.



The Playbook provides important BPM information that can assist an organization in gaining awareness of process performance and insight into process steps that do not add value or are the constant source of errors. Successful BPM efforts begin with real-time monitoring of actual process execution in order to capture process information as events occur and to help leaders analyze why business objectives are not being met². The Playbook will not only provide management with this insight into close process efficiency, but will also validate the completion of key tasks and controls.

Examples of activities that drive close process inefficiencies include manual data entry and non-standard account management activities. Many companies still rely on manual data entry to complete their reconciliation and closing processes. The likelihood of human error becomes a significant risk as staff must transfer volumes of data between systems and documents. The Playbook will help determine the manual processes that have the greatest negative impact on the outcomes of the close process in order to pinpoint and appropriately prioritize improvement and automation initiatives. Automating the standard recurring components of account reconciliations is an area that offers significant savings to many organizations. The Playbook can be enhanced to automate source system data

²Pasma, Tony (2006). “Optimizing BPM to Ensure Competitive Edge.” KM World. Retrieved Jul 17, 2007 from <http://www.kmworld.com/Articles>.

extract, data manipulation, standard calculations and business logic driven identification of transactions for further review. By automating these non-value adding activities, staff can focus on analysis as well as true understanding of reconciliations and “unusual” items identified through automated business logic review.

The lack of standardization of account management activities and controls is another factor driving inefficiencies in the closing process. Although many organizations have a clearly defined chart of accounts, few have documented the purpose and standard activities that should be performed for each account. The combination of manual data entry and the lack of standardization increases the likelihood of errors and results in inefficiencies related to rework. Without standardization, temporal differences in the approach to account management may lead to inconsistent accounting treatments and errors across periods. Non-standard approaches also decrease consistency across accounts and result in less efficient review procedures. The Playbook addresses this issue by documenting account information and management activities. This will help ensure that activities and controls are performed the same way and in the same order every time, which will generate a reliable audit trail and reduce the time required for account reviews.

People

People and process inefficiencies are closely linked. As previously stated, accounting operations with complex, lengthy close cycles and ambiguous processes – organizations that are engaged in a “constant close” – are highly susceptible to employee turnover. A high rate of attrition combined with manual, non-standard processes often leads to insufficient knowledge transfer as people move in and out of positions. Because processes have not been adequately defined, employees handling new responsibilities are often left to “figure it out on their own” – a practice that is directly opposed to the goals of increasing consistency and standardization.

The principles of Knowledge Management (KM) urge organizations to develop frameworks that not only store institutional knowledge but also allow users to update and contribute new knowledge during their natural workflow. The Playbook documents and stores information about account management processes and allows organizations to efficiently retain and transfer institutional knowledge as well as to increase standardization throughout the entire financial close cycle.

Technology

Many organizations make the mistake of assuming that technology alone will solve their problems in the financial close. However, without a sound process and a competent workforce, new technology has the potential of producing more negative effects than positive. Many accounting operations have complex technological environments characterized by disparate system architectures that cannot provide a holistic view of closing processes or effectively control the workflow associated with close. Given the timelines required to change the underlying systems architecture, most accounting operations feel that significant improvement to the close system

environment is beyond their viewable horizon, which is typically consumed by the next monthly close looming around the corner.

However, we have found that many companies benefit from the creation of a separate workspace for accountants that manages workflow, establishes controls and provides insight into the actual closing process and status. The Playbook fills these requirements and provides managers and accountants with increased control over account activities, real time workflow information, easy access to all account related documentation and historical data to examine error-prone or inefficient portions of the process.

THE MORGANFRANKLIN ACCOUNTING OPERATIONS PLAYBOOK

The MorganFranklin Accounting Operations Playbook provides a low cost solution to many of the people, process and technology issues discussed above. Although Playbook does not replace sound financial close processes, it does provide organizations with a tool that maintains important account information, manages and monitors the financial close process and serves as an institutional knowledge repository. For an organization trying to improve their close process and move away from the “constant close,” analysis of the workflow information that the Playbook gathers can also assist in the identification of process inefficiencies and the launch of process improvement initiatives. The sections below describe the commitment required from the organization in order to successfully implement the Playbook as well as the Playbook’s actual features and benefits.

Organizational Readiness

Organizational readiness is an essential component of a successful Playbook implementation. To obtain maximum the benefit leaders must be ready and willing to dedicate time and effort. We recognize even those who are not in “constant close” have significant time pressures. As such, the MorganFranklin approach leverages the knowledge we have gained from supporting clients with needs such as SOX compliance and procedures development. MorganFranklin will work closely with members of your organization in order to understand the organization-specific challenges associated with implementation, address stakeholder concerns and build organizational commitment and support. Based on MorganFranklin experience, the most important aspects of organizational readiness are:

- Management alignment and support – Management should be aligned with the project, provide visible support and participate as needed during implementation.
- Communication – Frequent and consistent communication is essential in order to ensure awareness and understanding of the Playbook throughout the organization.
- Training – As the technology is commonly used, there are minimal training requirements, but the training provides key skills necessary to fully utilize the Playbook functionality.
- Stakeholder commitment – Management support, communication and training will help garner support from stakeholders throughout the organization.

Accounting Operations Playbook Features and Benefits

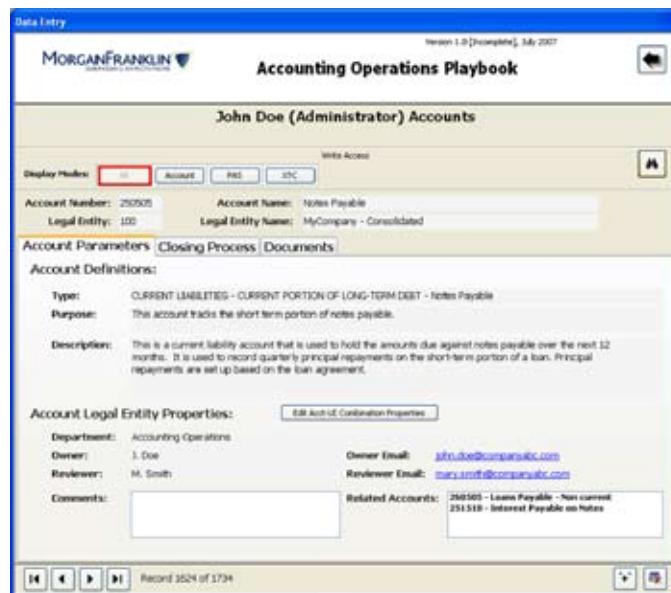
The Accounting Operations Playbook is a separate workspace from which accountants perform closing process activities and managers can monitor the closing process as a whole. The Playbook is easily integrated with current operations and is designed so that it does not produce extra work for accountants or managers. Instead, the Playbook provides a tool that allows accountants and managers to track individual and overall progress against close objectives.

Account Information

Figure 2 depicts the basic structure of the Playbook. The information in the Playbook is organized into three tabs: Account Parameters, Closing Process and Documents. The Account Parameters tab details the account number and name, legal entities, purpose, description, related accounts as well as contact information for the account owner and reviewer.

In the Account Parameters tab, a detailed definition and purpose are provided for each account. Clear documentation of the purpose and processes for each account greatly decreases the likelihood of errors and incorrect entries because accounting personnel will be able to reference the Playbook to determine exactly what kind of activity should be entered into the account.

Figure 2. The MorganFranklin Accounting Operations Playbook – Account Parameters

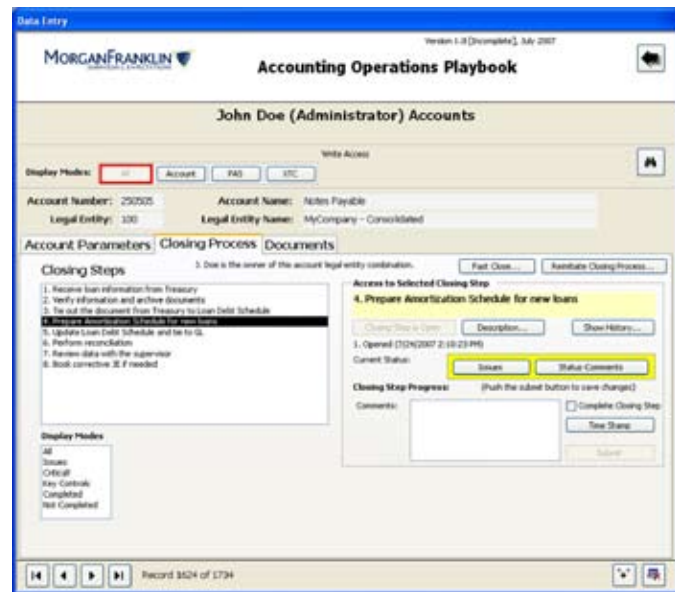


Closing Process Workflow

The next tab, Closing Process, houses the workflow component of the Playbook (see figure 3). It stores high level and detailed closing steps and provides the interface for accountants to execute closing steps. In this tab, account owners can insert status comments, review the closing history of the account and send the account to the reviewer for approval.

The workflow component of the Playbook facilitates the standardization of accounting practices and internal controls, which not only helps organizations comply with various regulations but also reduces the number of errors that result from inconsistent or unclear account processes. Accountants will use the Playbook workflow functionality to record completion of or progress against the closing steps for each account, creating a valuable record of all closing related activities performed on the account in that cycle. The Playbook workflow functionality also allows users to comment on issues encountered and communicate with the account reviewer if issues cannot be resolved. Furthermore, key SOX controls are built into the closing steps in order to maintain a record of control execution. Reports can be easily created to verify the completion of key controls.

Figure 3. The MorganFranklin Accounting Operations Playbook – Closing Process



After the account owner has completed all of the closing steps for an account, the Playbook notifies the account reviewer that the account is ready to be reviewed. The reviewer then utilizes the Playbook to review all the closing activities performed on the account and the associated documentation. The reviewer can approve the account or request further action on the part of the account owner. The Playbook workflow functionality records all of these activities and provides the notifications required to ensure the process moves along efficiently. This not only standardizes the closing process for each account and enforces internal controls during the close cycle, but also creates a valuable audit trail that can be used by internal or external auditors.

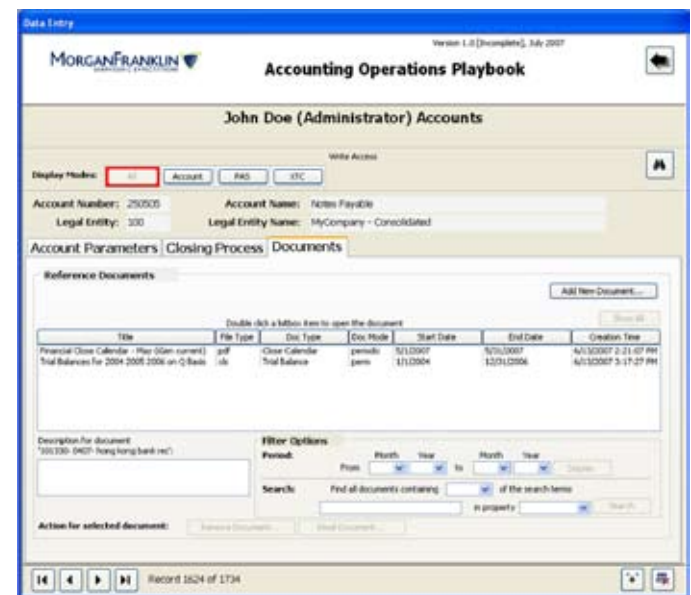
Document Management

The third tab, Documents, provides document management capabilities for Playbook users. It allows users to access, control versions and upload all documents related to the account (see figure 4). This allows organizations to move from hard copy close binders to electronic reconciliation packages that include clear audit trails and electronic signatures. If fully embraced, companies can move toward a “paperless” close process. The Playbook also provides

extensive document search features including filters by account, by document purpose, and even free text searching.

The documentation feature promotes efficiency in the account review process because documentation from the current close period and all previous closing cycles is readily available to the reviewer. This eliminates the need to search disorganized network drives or folders for supporting documentation. Some of our clients claim that network drives can adequately meet their needs if they can only muster the discipline to use them appropriately. Given the high turnover of accounting staff, this discipline is difficult for any organization to achieve. As such, the Playbook eliminates the need for staff accountants to think about what network drive folder is appropriate. The discipline and structure is built into the functionality of the Playbook.

Figure 4. The MorganFranklin Accounting Operations Playbook – Documents



Business Process Insight

Perhaps the most important feature of the Playbook is the insight that it provides into the closing process. The Playbook offers customized reports as well as a closing process dashboard. Because accountants and managers use the Playbook as a workflow tool, the Playbook contains real-time information regarding the exact status of the closing process. Managers no longer have to rely on anecdotal evidence from employees regarding the status of accounts; they can simply use the Playbook to determine accounts for which the closing process is completed, in progress or not initiated. The Playbook also houses a dashboard populated with customized key performance indicators (KPI) that is continuously available without running a separate report. These KPIs provide management a view into the status, efficiency and quality of the close cycle. The Playbook can also support a tiered approach to dashboard reporting so that KPI's are appropriately aligned to management level. The Playbook also provides detailed workflow information by account for each closing cycle. This data will assist in pinpointing bottlenecks and other process inefficiencies in order

to launch process improvement initiatives. Over time, the close cycle data and KPIs will help the organization measure the realization of process improvement initiatives.

Institutional Knowledge Repository

The Playbook is a flexible institutional knowledge repository that stores important account and closing process information. As the organization and its processes evolve, users with the appropriate access can amend account information and closing steps to reflect the changes. Furthermore, as individuals transition in or out of accounting roles, the Playbook facilitates the transfer of valuable institutional knowledge that might otherwise be lost. Because the Playbook retains a complete history of each closing cycle, new employees can review histories to gain a deeper understanding of the account history.

CONCLUSIONS

The MorganFranklin Accounting Operations Playbook provides businesses with the tools to shorten the length and improve the efficiency of their financial close. After implementation, accountants will be able to shift their attention toward the more important tasks of analyzing financial data and ensuring its accuracy and away from the completion of non-standard, manual steps that were typical of the pre-Playbook close cycle. Furthermore, as a result of the business process insight gained from the historical close data captured by the Playbook, leadership will be able to dedicate more time to evaluating and adjusting the processes, people and technology currently in place in order to optimize the return on investment of all three components.

ABOUT THE AUTHORS

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Mrs. Irene Didinsky is a Senior Consultant in the Consulting practice of MorganFranklin Corporation. She has three years of experience in consulting industry solving complex business problems, developing and implementing financial and strategic solutions for senior management of large corporations. She also has 10 years of experience in the area of corporate finance. Her assignments center on the development and implementation of changes to the financial processes. Her client experience spreads across a wide range of industries, including manufacturing, energy and real estate.

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