FINANCE & MANAGEMENT FACULTY

Business reporting

A FINANCE & MANAGEMENT REPORT

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This report is one of a series produced for faculty members. In each report we give a review of a topic within finance and management, offering both analysis of the relevant theory and a review of the practical application of appropriate management techniques.

If you have any comments or suggestions for future topics, please contact robert.russell@icaew.com

The information contained in this and previous issues of this publication is available (to faculty members only) on the faculty website at icaew.com/fmfac

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FOREWORD

Business reporting

Business reporting comprises such a wide range of activity that it is perhaps not fair to include all of these in one special report. We decided, however, that, rather than produce several specialised publications, it would be more interesting to focus on common themes within the topic.

Many would argue that the words in reports carry as much weight as the figures, but those who take this line are less likely to have a finance background. Those who enjoy a good ability to digest numbers are fortunate that we can focus on these, but the financially illiterate will rely on the text that accompanies the data.

The words that we use in reports do provide assistance to the users, offering explanations to those outlying figures and summarising the position which the data reveals, even for the financially literate. I am sure that you will have an anecdote or two of reports with contradictory comment and data; I have seen a few extraordinary examples myself and hope that I was never the creator of such.

Examples of less good reporting can also include unclear and cluttered graphs, over-use of colour, different fonts and other presentational styles that detract rather than enhance the numbers. The report is less interested in the style of reporting rather than the speed and efficiency of them.

David Parmenter, a faculty regular, has written a comprehensive look at rapid month-end closing and we have also included articles on new rules for micro-entities as well as interviews with finance directors about the issues that they have faced with their reporting.

We hope that you enjoy reading this report – please email Robert.russell@icaew.com or Stephen.ibbotson@icaew.com if you have any thoughts or suggestions about this report or about the faculty itself.

Robert Russell

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The art of rapid month-end reporting

David Parmenter explains how you can delight the chief executive by completing your month-end reporting process inside three working days.

Is each month-end a disaster waiting to happen? Are the finance team working long hours reporting results so late that next month is already well on its way? Are the finance team performing each month-end just like the last one? Are some of the accounting team wedded to detail, believing that there is a precise number to get to?

If some or all of these things are happening, then you and your team need some therapy. Better practice is now to report to the CEO the final numbers within three working days of the previous period end and world best practice is to be able to give net profit at any time of any day (called virtual reporting).

The approach to break this cycle of late reporting is to go immediately to day three reporting. This is easier than you might think and can be achieved in the first of a three-stage process:

- Stage one – challenge all the givens of the past, abandon the broken processes and unnecessary reporting, and streamline the processes using a technique called Post-it re-engineering. The stage needs to occur this month.
- Stage two – the time saving you generate can immediately be applied to start tackling the longer-term changes that will reap many benefits.
- Stage three - you will now be completing reporting with much less time and resources and you are now able to invest time in some new technologies that will open up the possibilities of virtual reporting. This third stage may take upwards of 18 months due to the time it takes to appraise technologies, get approval, and finally implement them successfully.

In this article I want to address stage one. The changes you need to make to get this month-end down to inside three working days.

Embracing Peter Drucker's abandonment mantra

Finance teams need to embrace advice from the management guru Peter Drucker. I consider Drucker to be the Leonardo da Vinci of management, and he frequently used the word 'abandonment'. I think it is one of the top ten gifts Drucker gave us all. He said: 'Don't tell me what you're doing, tell me what you've stopped doing.'

Abandonment is the key to a lean month-end. The act of abandonment gives a tremendous sense of relief to a team for it stops the past from haunting the future.

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' The act of abandonment gives a tremendous sense of relief to a team, for it stops the past from haunting the future '

Knowing when to abandon and having the courage to do so are important in the adoption of lean month-end processes.

The finance team need to set up an abandonment workshop where they have an initial go at the common abandonments including:

- Processes and reports that do not add value. In one council the finance team were allocating head office costs each month to business units and yet unit managers only focused on the numbers they could control. Allocations were abandoned and only done for the year-end annual report.
- The reconciling to supplier statements. Leading finance teams do not reconcile to an often inferior supplier accounting system. They trust their own system.
- Spring cleaning at month-end. This tidy up is now done in the quiet time during a month, well away from month-end.
- Large spreadsheets (over 100 rows) that not only are error prone but often require much time and stress.
- Excessive P/L account codes. Anything coded for under 1% of total annual expenditure surely does not warrant a separate account code.
- Accruals under a certain amount. Leading finance teams set minimum limits for accruals meaning that about half the business units are too small to do accruals.
- Variance reporting at account code level, this is now done at a higher category level.

Embracing Kaizen (getting all staff to see innovation as being a daily activity)

One thing that sets Toyota apart from nearly all organisations is Toyota's focus on continuous improvement. All employees are expected to ask themselves each day 'What could I do better tomorrow?' and come up with at least one innovation per month, no matter how small. The Toyota average, internationally, is 10 innovations per employee per year.

Far too often finance teams will perpetuate and support systems and processes that have been broken for some time. Tasks are undertaken because we did them last month. Now everything we do should, systematically, be questioned.

‘ There is often a pause here as staff look bewildered as they will be asking why they would be doing something that was not required ’

All the great paradigm shifters such as Peter Drucker, Jim Collins, Peters and Waterman have preached the need to innovate and not spend too much time trying to second guess whether an innovation will work or not. Join Motorola and see innovation very much like a growing tree; you let it branch out but you are also constantly pruning.

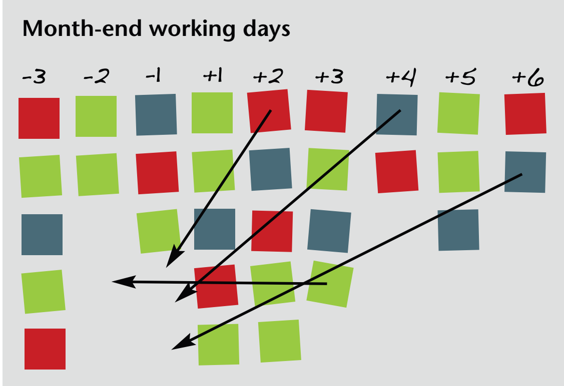
Re-engineering month-end processes using Post-it stickers

Re-engineering processes can be a complex and expensive task or a relatively easy one: the choice is yours. Many organisations start off by bringing in consultants to process map the existing procedures. This is a futile exercise as why spend a lot of money documenting a process you are about to radically alter and when it is done only the consultants will be bothered to look at the resulting data-flow diagrams!

The Post-it sticker process (see Figure 1, above right) is explained in my *Winning CFO* book and I will send you the extract if you send me an email. Basically the process involves four steps:

- Step one – the documentation of all tasks, reports, spreadsheets on coloured Post-it stickers, a different colour per team.
- Step two – you gather everybody involved in month-end and put the Post-it on a time line, getting agreement that every step is accounted for.
- Step three – locate processes that can be abandoned. Ask: ‘What processes do we not need to do anymore and therefore should be abandoned?’ There is often a pause here as staff look bewildered as they will be asking why they would be doing something that was not required. I recommend that you buy a dozen movie vouchers before the workshop so you can give one to every attendee who points out a process that can be removed as it is not necessary – each procedure that is removed is like finding gold because it means less work and fewer steps. After the first movie ticket handout you will notice a greater focus from the attendees! I often spend up to two hours on abandonments to ensure all the superfluous processes are removed.
- Step four – Reorganise the key processes and bottlenecks based on better practice. I start off by pulling off the accounts payable close-off sticker and ask: ‘When will we finish this exercise if we were to adopt best practice?’ The answer I am looking for is ‘Noon on the last working day’ which is discussed later in this article.

Figure 1 – The Post-it process



With each rescheduling of a process it is important to seek consensus. Invariably some members of the team will believe the world will end if the cut-off is moved earlier. I simply question the logic and allow a dissenting group to have their objections noted. ‘If you are proved correct, next month, we owe you a morning tea. If, however, you are proved wrong you owe all of us a morning tea.’ With that statement I move the sticker to where the majority have agreed.

Get the CEO’s support

For any change to occur we need to get the CEO to ‘go in to bat for us’. The CEO needs to make it career-limiting not to conform to month-end processes rather than being seen as a badge of honour. To get the CEO motivated, do a brief calculation on the costs of month-end reporting, then approach the CEO with a 10-year costing. Start off by mentioning: ‘We have just done some calculations that estimate we will spend between £_m and £_m over the next 10 years reporting results after the horse has bolted. I want to undertake a project to speed up month-end reporting, giving you access to numbers much

> ‘ It is better practice to have weekly or daily direct credit payment runs with none happening within two days of month-end ’

quicker and saving over £_m in the next 10 years. Can I count on your support?’ There is not a CEO on the planet who will not respond with ‘How can I help?’

Ask the CEO to phone those responsible for major breaches of procedures and issue a ‘one-minute manager’ reprimand making it clear that full cooperation is expected in future and noncompliance will be career limiting.

On a weekly basis report all breaches to the CEO such as: invoices over £10,000 with no raised order; lack of receipting in the system for large transactions say over £10,000; the names of budget-holders with over three months of outstanding expense claims, etc.

Set rules for the finance team so all members will sing from the same song sheet

Accountants are all artists: we sculpt a month-end result and there is no such thing as a ‘right’ number, only a ‘true and fair ‘number. The finance team need to realise that there is no perfect number. They should only do enough to arrive at a ‘true and fair’ view. To assist them with therapy you need to establish some new rules including:

- we will not delay for detail, we will make phone calls so a reliable estimate can be made when third party paper work is late;
- no spring cleaning at month-end;
- hunting for the perfect number is now agreed as unacceptable;
- variances will only be reported on major revenue and cost categories (say at least 10% of total revenue or expenditure);
- materiality is to be set at a group level and not at a business level;
- there will be no processing of adjustments into the G/L after 5pm last working day. All adjustments over say £10,000 are to be recorded in a spreadsheet; and
- all finance reports will have a two-person read through and be checked for internal consistency. This quality assurance step will never be compromised.

Ban spring cleaning and catch adjustments in a spreadsheet

Month-end reporting is not the time for spring cleaning, no matter how tempting it may be. This discipline requires a re-education within the finance team and with budget holders.

One of the most important practices is to catch all material adjustments in an ‘overs and unders’ spreadsheet that traps major adjustments – say, over £5,000, £20,000 or £50,000, depending on the size of the organisation. The accountants enter all adjustments on the spreadsheet, which resides on a shared drive on the local area network. In many months you will not need to process any adjustments as the net impact is

Figure 2 – Spreadsheet for major adjustments

Source	Raised by	ADJ#	Adjustment	P/L impact		B/S impact	
				Dr	Cr	Dr	Cr
xxxxx	Pat	1	Dr xx xx	125			
			Cr xx xxxx		125		
xxxxx	John	2	Dr xx x x	110			
			Cr x xx x		110		
xxxxx	Jean	3	Dr xx x x	225			
			Cr x xx x				225
xxxxx	Dave	4	Dr xx xx x			165	
			Cr x xxx x		165		
		etc					
				460	400		
				-400			
			Net impact on P/L	**60**			

immaterial on the P/L (see Figure 2, above). These adjustments can be processed in the quiet time the following month, to tidy up the year-to-date numbers.

Avoid late inter-company warfare at month-end

Clever organisations ban all inter-company adjustments at month-end except for major internal profit adjustments. Larger groups have inter-company software where the transaction is posted simultaneously in both general ledgers.

Where inter-company differences abound, lay down a rule that the accounts payable (AP) or accounts receivable (AR) ledger is always right, and adjust accordingly, leaving the inter-company parties to sort it out the following month. This change will require a CEO directive to all subsidiaries.

Avoid high processing of accounts payable (AP) invoices at month-end

The last thing the AP team needs is to receive a tsunami of invoices on the last day of cut-off. It is important to push processing back from the end of the month by avoiding a payment run at month-end. It is better practice to have weekly or daily direct credit payment runs with none happening within two days of month-end.

The finance team will need to visit all major budget holders and explain to them that all invoices which they have in their top drawer should be handed over now. You will also inform them that in future all AP invoices will be received by the AP team, and a scanned copy

emailed to them for immediate action if there is a missing order or receipting. You will explain that they can expect a phone call from the CEO when unrecorded liabilities over £_ are unearthed – a career-limiting activity.

Early closing of the AP ledger and accruals

If the AP is held open after month-end, you will find it difficult to complete prompt month-end reporting. What is the benefit of holding open AP for one or two days? We could hold the accounts payable open for six months after month-end and still not get the plumber's invoice that arrives when they are doing their year-end and realise they have forgotten to invoice for work done.

Better practice is to cut off AP at noon on the last working day or earlier. For a tight cut-off, budget holders will need to have cleared all outstanding issues regarding purchase invoices a day earlier (day –2) to give the AP team time to meet the cut-off deadline.

One CFO pointed out to me that once budget holders have cleared their desks of invoices to AP, you can ask them to do their accruals before AP is closed. You simply give the budget holders a guarantee that all invoices sent to AP, within the deadline, will be processed prior to the AP cut-off, or accrued directly by the AP team. You explain to the budget holders that we are only interested in major accruals. Set the accrual level at say, over £5,000, £20,000 or £50,000 for the total credit a unit must have, and also ensure each individual debit is greater than say, £2,000, £8,000 or £20,000 respectively. The latter stops an accrual for £65.55 being sneaked in with a larger one.

Accruals should be raised and processed by the budget holder. One CFO opened up the general ledger for that afternoon so BHs could post their accruals directly. Why bottleneck such a simple process in the finance team?

Early closing-off of accounts receivable (AR)

Many games are played with revenue, e.g. pinching the first two days of next month's sales so one can achieve target. You need to point out to the CEO that pinching revenue from the next month is a zero sum game. Far better to take the pain this month and then future months will be sorted.

Immediately close off AR on the last working day or, better still, noon on the last working day, with sales in the afternoon carried forward to the first day of the new month. Closing off earlier may be required for an organisation where the sales representatives make a lot of sales on the last working day of the month, e.g. car dealers. You simply tell them: 'All sales made on the last day of the month will now be recorded in the following month.' This will start their game a little earlier.

Close off capital expenditure and run depreciation calculation before month-end

Why perform depreciation calculations at month-end when clever organisations do so much earlier? They close off capital projects at least one week before month-end.

Any equipment arriving in the last week is therefore treated as if it arrives next month. It can still be unwrapped, driven or plugged in. The depreciation is calculated and posted by day –3. In my workshops I have found accountants who work in organisations where depreciation is not significant. They use the depreciation calculations from the annual plan and correct to actual at month six, 11 and 12.

Early inventory cut-off

If the last day of the month's production is delaying your month-end, make the inventory cut-off at the close of business on day –2 with all production on the last day being carried forward to the next month. This gives one day to check the valuation and records.

> ‘ Never attempt a flash report until the AP, AR and accrual cut-offs have been successfully moved back to the last working day of the month ’

Always avoid a month-end stock count. These should be done on a rolling basis and be held no nearer to month-end than the third week of the month. A jewellery chain I know counts watches one month and gold chains the next at a quiet time during the month.

The first 24 hours

At 5pm on the last working day, with all the cut-offs done, we can print off the first cut of the numbers. The management accountants should take a copy home and look for areas where they think the numbers could be wrong. At 9am the following day, all the accountants meet to assign the areas needing further rework in order that the numbers are true and fair. At 3pm to 4pm they meet again to discuss the net impact of all the adjustments; with luck, many will have netted each other off. Process only the few material adjustments that are needed to restate the numbers to ‘true and fair’.

Deliver a flash result to the CEO at 5pm of the first working day

Issue a flash result on the profit and loss statement (P/L) bottom-line to the CEO by the close of the first working day, stating a level of accuracy (e.g., +/–5%, +/–10%). Five to seven lines is normally enough for a flash report. Never attempt a flash report until the AP, AR and accrual cut-offs have been successfully moved back to the last working day of the month. The flash result will largely satisfy the CEO’s appetite for month-end information. This creates a great opportunity to reduce the final month-end report to the CEO to one A3 page.

Ban all late changes

Once the reporting pack is prepared, allow no adjustments unless they are very material. There is nothing worse for the finance team than to submit a finance report to the CEO that is internally inconsistent. This is frequently caused by a late change not being processed properly through the report. As night follows day, the CEO will be sure to find it. It is far better to hold back on processing minor adjustments as the net result reported in the P/L is still true and fair. If the CEO spots, say, a shortfall in revenue, point out that you have held back some adjustments as the net impact is immaterial. Most CEOs will agree with your judgement call and move on to another issue.

Check the report for internal consistency

For every number that appears elsewhere in the report – either in the text, a table or a graph – write the page reference where it appears again and initial to indicate you have checked the number in the subsequent page. Readers who have been in an audit team will most likely have used this quality assurance process.

The two-person read-back

Ask another person, who has not worked on the report, to read it aloud to you (the writer). By hearing the words read to you, you will be able to improve the grammar and make it an easier read. If the reader has difficulties understanding any of it, I can assure you the CEO will as well.

You can also use a ‘text-to-voice’ facility which is available in many applications such as Microsoft Word. A member of the IT team will show you how to set this up on your PC.

Look for the two gremlins

In every piece of work there are always at least two gremlins that manage to sneak through. If I find them and they are of minor importance, then I leave them and release the report. If you do not find them, then look again – or someone else will spot them.

Next steps

1. Sell the change to the CEO.
2. Get all the finance team to sign up to your new rules – I will send you a draft copy of a suggested set of month-end rules if you email me at (parmenter@waymark.co.nz).
3. Set up and operate an ‘overs and unders’ schedule this month-end.
4. Post-it re-engineer month-end processes.
5. Move all cut-offs to 5pm last working day or earlier (AP cut-off is best at noon on the last working day).
6. Deliver a flash report by close of play on the first working day to the CEO.
7. Embed the quality assurance procedures on the final report this month-end.