

# The Last Mile of Finance

*If you navigate it properly, you can have a smooth financial close, a good set of internal controls, and an accurate set of financial statements.*

BY ERIC KELLER

**A**s I speak with today's CFOs and other senior finance executives and compare the challenges they face with the ones I tackled during my years as a public company CFO, it's apparent that the job has become increasingly difficult. In the last 25 years, an abundance of new accounting rules have been introduced at the same time that reporting deadlines have been compressed, requiring a more rapid close process. Sarbanes-Oxley (SOX) compliance has further added to these challenges, dramatically increasing the time and cost to ensure that financial statements are accurate, complete, and timely. Finally, increased regulatory scrutiny has resulted in lower materiality thresholds so that even relatively small errors in financial statements can result in material weakness disclosures or financial restatements.

Here are some tangible examples of these trends:

- ◆ During the past 10 years, a typical quarterly report (10-Q) to the Securities & Exchange Commission (SEC) has grown roughly fivefold—from 10 or 15 pages to 50 and 75 pages—reflecting an increase in both the number and complexity of disclosures that public companies are required to make.

- ◆ Filing deadlines for submissions to the SEC are accelerating significantly: Large-company quarterly filing deadlines have been reduced from 45 to 40 days and annual deadlines from 90 days to 75, with further reductions likely.

- ◆ The number of public companies issuing restatements has also grown dramatically from 100 in 1997 to an expected 1,200 in 2005 as estimated by Glass Lewis & Company, an investment research advisory firm. In addition, approximately 15% of public companies disclosed material weaknesses last year.

- ◆ Audit fees for public companies are also on the rise. A June 2005 study by Foley & Lardner found that audit fees for a sample of more than 700 public companies increased from an average of \$1.6 million in 2001 to more than \$4 million in 2004. Small and mid-cap companies saw their audit fees almost double in 2004 alone.

For public companies, these trends—coupled with pressures to reduce staffing levels in the finance organization—mean mounting pressure on financial professionals. A *CFO* magazine survey asking more than 200 finance executives how their work had changed in recent years found that two thirds felt that pressures on them were increasing and that work-related stress was taking a toll on their health. As a former CFO myself, I am no stranger to the grim statistics: Turnover in CFO positions in public companies is very high as many have decided that the benefits of their jobs just don't outweigh the stresses and risks.

## REGAINING CONTROL

Forward-looking finance executives aren't surrendering to these trends—they are looking for solutions that will help them produce accurate financial results in a shorter period of time while simultaneously sustaining SOX compliance and reducing costs.

The Public Company Accounting Oversight Board (PCAOB) recently recommended a number of steps to improve compliance and reduce inefficiencies associated with the initial year of SOX. First, the agency recommended that the audits of a company's financial statements and internal controls be integrated as a way to save time and reduce costs. This integrated approach allows

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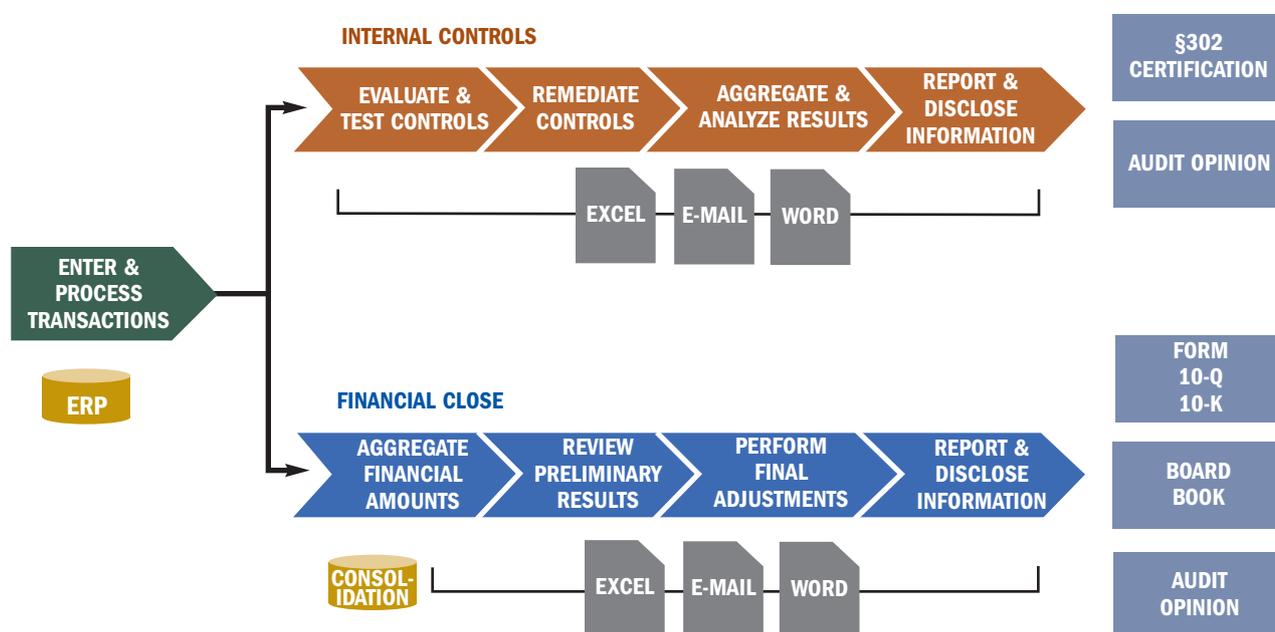
the objectives of both audits to be achieved simultaneously, saving time and money and identifying issues before the financial statements are issued. Today, most companies still run the preparation of their financial statements and the work to demonstrate an effective system of internal control over financial reporting as separate processes, thus increasing the risk of both material weakness disclosures and restatements.

Second, in addition to emphasizing the importance of an integrated audit of the financial statements and internal controls, the recent PCAOB guidance stressed the importance of the quarterly financial reporting process:

*“[T]he period-end financial reporting process is always a significant process because of its importance to the company's financial reporting. The period-end financial reporting process ordinarily consists of a combination of manual and automated functions, requires considerable judgment to evaluate, and presents numerous opportunities for misstatements to occur. Given the high degree of risk that misstatements could occur during the period-end financial reporting process, significant attention to this process is necessary in virtually all audits.”* (PCAOB Release 2005-023, November 30, 2005)

At most companies, this period-end financial reporting process is known as the “close.” It encompasses all accounting processes and journal entries created by the finance team to accurately recognize and report the financial results and position of the company, and it includes the reporting of the statements and disclosures in SEC-required financial statements. The quarterly financial close is also a time during which auditors, controllers, CFOs, and compliance officers operate under

Figure 1: “Last Mile” of Finance



enormous time pressures to detect exceptions and potential errors and produce financial statements that reflect the company’s financial results fairly and in accordance with generally accepted accounting principles (GAAP).

The dual objectives of the integrated audit and improving the close process have created the concept of an integrated financial close in which financial controls and close tasks are linked directly to a company’s financial statements, creating a system of record for both the financial close and financial compliance. Combining these activities reduces compliance costs, improves efficiency of finance teams and auditors, and enables everyone to focus their attention on exceptions, issues, and key risks.

John Verburt, associate director of compliance at the Chicago Mercantile Exchange (CME), thinks that the move to assimilate compliance into financial close processes is self-evident. “Compliance should not be viewed as a separate process,” he says. “Compliance is part of the way that we do business. Most of what is performed during a financial close is a control of ensuring our financial statements are accurate and reliable. What SOX has done is it has taught people a lot about their jobs and also doubled as a to-do checklist.”

Despite the goal of an integrated financial close, most public companies currently lack a unified framework that allows them to successfully merge the critical processes

associated with the quarterly financial close with their efforts around Sarbanes-Oxley compliance.

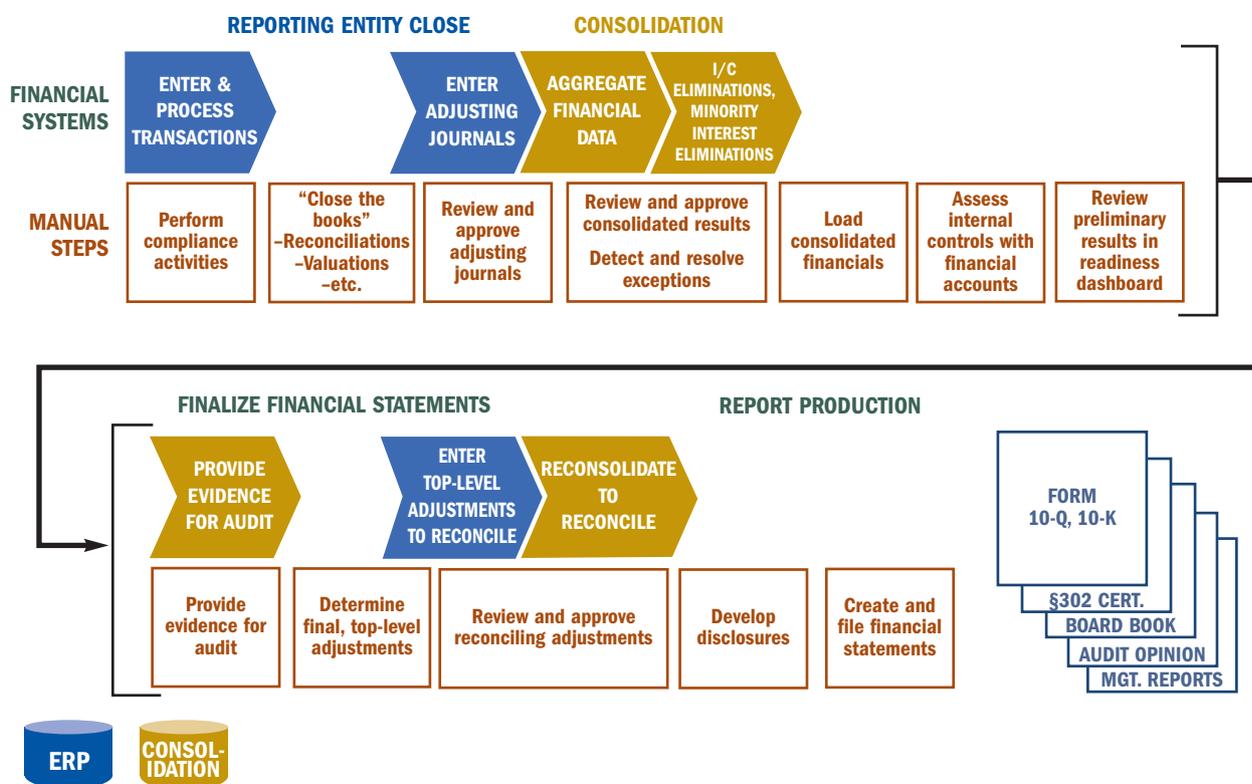
### WHERE EVERYTHING COMES TOGETHER

Many of today’s issues—from corporate governance to restatements and SEC filings—come to a head in what can be called the “last mile” of finance, the last critical phase of financial management prior to public disclosure where aggregated financial and operational information is turned into a set of financial statements.

The “last mile” of finance is the series of steps involved in the close from consolidation through the company’s public disclosure of its financial results, including filings with the SEC. As most financial professionals have experienced, the process of preparing financial statements is fraught with risks, costs, complexities, and inefficiencies. Yet it is the final opportunity for finance departments, auditors, and audit committees to identify and address the issues or errors that could later result in a restatement.

The financial close and the SOX-related internal control tasks that make up the “last mile” (see Figure 1) are composed of a wide variety of interdependent activities supported by different technologies. Existing applications such as enterprise resource planning (ERP) and consolidation systems manage financial data and standard trans-

Figure 2: No System of Record for “Last Mile” Manual Steps



action processes, recording adjusting entries and aggregating quantitative information. But during the “last mile,” many of the most critical tasks required to produce accurate financial statements are performed manually, are often dynamic and analytical in nature, and frequently occur outside any formal systems of record (see Figure 2 for some examples).

The finance organization relies heavily on spreadsheets and other documents that are created and stored on personal computers throughout the company, and it frequently uses e-mail to informally communicate priorities, issues, and results. “Most close processes include an exhaustive list of activities to complete,” Verburgt notes. “The toughest controls are the ones that are manually driven and where the most risk occurs.”

In addition to complexity, coordinating all these various activities and systems takes time, and, as noted earlier, filing deadlines are getting compressed. “In order to meet the new SEC filing schedules, U.S. companies must adopt strategic measures that will accelerate their financial reporting processes,” Pat Neeley, Global Service Line lead of Parson Consulting, a leading financial management consultancy, says. “An effective way for companies to do so is to improve close processes now in a methodi-

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cal way that is sustainable over time.”

The most effective way to address these challenges successfully is to zero in on the “last mile” and embark on an automated close by bringing together the financial and compliance results from across the company. Conducting an effective integrated close means identifying and automating manual processes, linking information from ERP and consolidation systems, controlling the use of manual spreadsheets, and synchronizing compliance management with financial results to create reliable, accurate financial statements.

### THE PATH TO AN OPTIMUM CLOSE

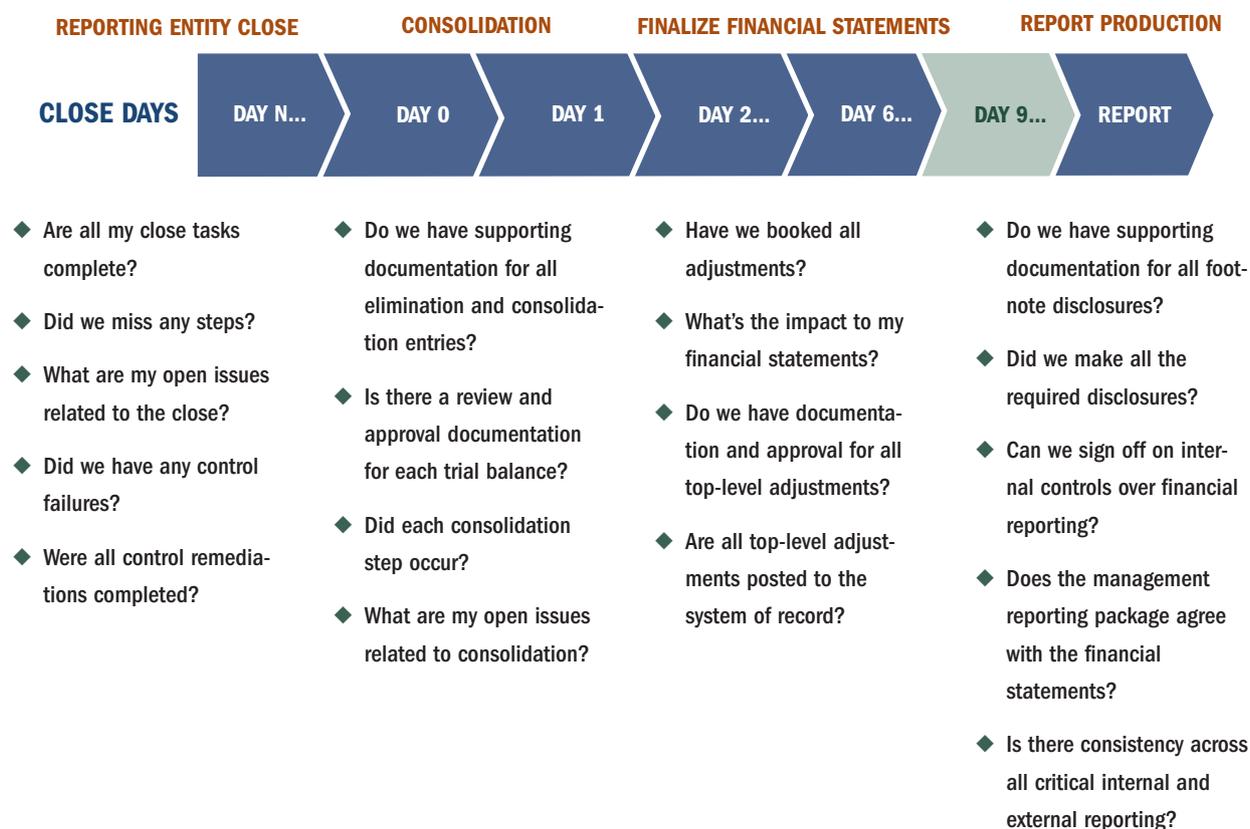
By implementing an automated, integrated close, a finance organization can combine the close for financial results and the assessment of internal controls with the

## Table 1: Material Weakness Examples

Problems in the “last mile” were frequently associated with material weakness disclosures during 2005, as demonstrated in the following excerpts from SEC filings.

<p><b>Inadequate documentation of close process</b></p>	<p>“The company does not have sufficient policies and procedures related to the preparation of accounting records and the financial close, consolidation, and financial reporting processes.” (eCollege.com, 10-K/A May 2005)</p>
<p><b>Misstated accruals and estimates made during close</b></p>	<p>“The company concluded that controls over the financial statement close process related to the determination of accrued liabilities and prepaid expenses were not operating effectively...resulting in numerous adjustments.” (The Princeton Review, Inc., 10K/A, May 2005)</p>
<p><b>Breakdowns in the close process in international locations</b></p>	<p>“[T]he company did not have adequate procedures and controls to ensure that accurate financial statements [in] Europe can be prepared and reviewed by management on a timely basis...” (Transkaryotic Therapies, Inc., 10K/A, May 2005)</p>
<p><b>Inadequate controls over nonroutine transactions</b></p>	<p>“[A material weakness in the] design and implementation of adequate controls over the financial reporting and close process, including controls over non-routine transactions.” (General Cable Corporation, 10-K/A, April 2005)</p>
<p><b>Error in intercompany eliminations</b></p>	<p>“[W]e discovered an error in a spreadsheet application, which was designed to eliminate intercompany balances. As a result of the error, amounts accumulated in the property account for one subsidiary were...inadvertently not eliminated in consolidation.” (Edge Petroleum Corporation, 10-Q/A, March 2005)</p>
<p><b>Reliance on manual processes</b></p>	<p>“[T]he company did not maintain effective controls over the communication among operating, functional, and accounting departments of financial and other business information that is important to the period-end financial reporting process, including the specifics of non-routine and non-systematic transactions. Contributing factors included the large number of manual processes utilized during the period-end financial reporting process and an insufficient number of accounting and finance personnel...” (Pride International, Inc., 10-K, March 2005)</p>

Figure 3: “Last Mile” Checklist



overall financial reporting process to improve employee and auditor productivity, increase accuracy, and reduce audit costs associated with financial reporting. By automating the close activities and the SOX compliance testing, it's possible to integrate the two related processes and benefit from a more effective means to identify issues and a more efficient way to perform close and control activities.

Without an integrated close, or *single close*, the “last mile” is prone to several points of failure that increase corporate risk and cost. Missed close tasks or errors in disconnected spreadsheet-based analyses can lead to filing inaccurate financial statements, increasing the risk of material weakness disclosures and financial restatements (see Table 1 for some material weakness examples). Without unified processes that highlight issues, finance spends time on unnecessary and inefficient processes rather than important analyses. And the lack of centralized, consistent documentation inflates audit costs. While other industries long ago turned to automation and efficiency, the work conducted by finance organizations in the “last mile” lags behind.

A single close is accomplished with an automated envi-

ronment where control management and close tasks can be standardized, managed, and documented. Manual activities and spreadsheets can be controlled, tracked, and documented. Control testing and close task processes can be analyzed and issues addressed immediately. This means formalizing close activities, managing approved close spreadsheets, assessing key controls, increasing visibility of internal activities, and accomplishing this through a system of record that manages all the numbers, analyses, comments, and issues. A single close means dramatically reducing both external and internal costs as well as the risks that ultimately manifest themselves in material weakness disclosures and restatements.

Here are the essential elements of a single close:

**Automate close tasks.** Rather than tracking the close manually, use workflow and automatic scheduling to guide close tasks to completion and issues to resolution. Advanced error-detection capabilities highlight problems and remove bottlenecks.

**Manage approved close spreadsheets.** Ensure that financial personnel use preapproved spreadsheets to perform critical calculations such as reserves, intercompany eliminations, and asset valuations. Unmanaged spread-

sheets frequently introduce inaccuracies and errors into financial results and often are the source of material weaknesses in controls.

**Assess key controls.** Determine the operating effectiveness of key controls for all high-risk financial statement accounts by evaluating controls that are explicitly mapped to specific financial statement accounts that in turn are mapped to disclosures and reports. This explicit mapping of controls provides confidence in the accuracy and precision of financial statement account balances and, ultimately, in disclosure documents.

**Increase transparency.** Whether the company performs a distributed or centralized close process, provide managers with a clear status for critical close tasks, including compliance activities, at any time during the close cycle to bring together the components creating a single close. Management consoles that provide a summary view of the close and drill down to details are indispensable.

**Deliver an online close binder.** Use a software application that automatically creates an online close binder for the single close for each period. Providing this to auditors significantly reduces the time and money spent preparing for and supporting them and decreases the amount of work they must perform.

It's also a good idea to have a checklist for the finance team to use to make sure they have followed all the appropriate steps and procedures during their "last mile" walk (see Figure 3 for a sample checklist).

## A RETURN TO GOOD FINANCE

Good financial practices don't make headlines. It's the mistakes, the missed earnings, the scandals, and shots of CEOs and CFOs in courtrooms that make the news. Wouldn't it be nice if a newspaper or magazine celebrated or, at the very least, acknowledged the hard work and effort that go into getting the numbers right? Not all mistakes are a scandal waiting to be found—some are just the result of too much complexity and too many moving parts.

Moreover, all the work on compliance hasn't been wasted. As CME's Verburgt emphasizes, "We learned a lot during year one of SOX—it was an extremely challenging time. And what we realized is that implementing controls in our financial close processes helps us prevent and detect errors and exceptions. By bringing the two processes together, we have minimized any additional effort for our auditors and financial managers for sustaining SOX compliance. Rather, we've made the process more streamlined and efficient."

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The role of finance is to help companies achieve their strategic goals and create value for shareholders, not to be merely a compliance enforcement organization. To do this, financial executives must be able to embrace their broader role in their respective companies—as trusted business advisors and strategic thinkers who contribute to the legitimate success of the enterprise. By integrating controls into standard financial close processes, the focus of time and resources can shift from primarily compliance and return to a more balanced approach that includes helping organizations grow profitability and successfully.

Addressing the inefficient, disorderly state of the financial close and the increased needs of disclosure means getting down to the bread and butter of a financial team—their ability to interpret, analyze, and smartly evaluate the numbers. Producing a streamlined and accurate financial statement that will be used by the public to judge their company's financials is a complicated task and means adapting to a modern world—where other aspects of business are already running at full throttle. So, what are we waiting for? It's time to bring finance up to speed by applying today's technology to implement a single close in your organization. ■

*Eric Keller is president and CEO of Movaris, Inc., a company that helps finance organizations transform their "last mile" into repeatable, auditable, and efficient processes. He has more than 20 years of experience as a financial executive in high-growth technology companies, and his business background encompasses corporate and international finance, public offerings, acquisitions, intellectual property licensing, and financial information systems. He also has extensive experience in corporate compliance with government agencies. You can reach Eric at (408) 213-3400 or [erick@movaris.com](mailto:erick@movaris.com).*