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The Checklist Mentality: Problem or Solution?

Although concerns have arisen over accounting professionals' reliance on checklists, the proper use of checklists can improve the quality of financial reporting.

Accounting professionals often use checklists in performing their work. Yet the use of checklists in financial reporting routinely raises concerns among regulators, standards setters, educators, and accounting professionals themselves. In this month's column, I'll address common concerns regarding the use of checklists in financial reporting. I'll also explain why the appropriate use of checklists is likely to improve rather than degrade financial reporting.

Checklists in Financial Reporting

Checklists are used in many kinds of business processes. In some cases, the checklist serves as a set of readiness or "gate" criteria, indicating whether or not a process should proceed. In other cases, it describes specific process tasks that a person should perform, usually in a certain sequence. In still other cases, it enumerates particular qualities that the output of a process must exhibit in order to "pass inspection."

In financial reporting processes, checklists are used in all of these ways and more. One example is the *financial-close checklist* for tasks that must be done each month (or other accounting period) to "close the books," that is, finalize an entity's financial accounting records. Another example is the *disclosure checklist*, which financial statement preparers and auditors use to verify that all of the disclosures required by applicable financial reporting standards have been included in a particular financial report before it's issued.

Is It Bad to Have a "Checklist Mentality"?

The widespread use of checklists in financial reporting has attracted significant criticism. Three frequently expressed concerns can be paraphrased as follows:

- "True professionals don't use checklists."
- "Checklists can't substitute for experience and professional judgment."
- "Checklists encourage compliance in form rather than in substance."

As earnest as these concerns are, they don't hold up well against the realities of financial reporting today. For example, it's true that accounting professionals are less likely to need checklists if they work in a simple, uniform, and stable business environment. But while such an environment was the norm in decades past, today's professionals are likely to be overwhelmed by complexity, diversity, and continuous change. And those realities alter what constitutes "professional" practice to the point where checklists and other practice aids play an increasingly necessary role.

Even so, checklists have never been—and still aren't—a substitute for experience and professional judgment. Anyone who would attempt to make such a substitution is simply misguided. But that isn't to say that checklists can't *enhance* the exercise of professional judgment. In fact, checklists can actually improve professional judgment by reducing the amount of time and mental capacity a professional must devote to low-judgment tasks, freeing up time and mental capacity for high-judgment tasks. As a result, professionals can better comprehend the consequences of different alternatives and bring their experience to bear on the decisions that they must make.

The last of the three concerns is often expressed by observers in the face of ever-growing disclosure requirements that financial statement preparers are forced to address. There certainly is a risk that preparers will compose disclosures that superficially satisfy a requirement without actually providing any new, useful information. And it's possible that the use of a checklist might contribute to that risk. But it's also possible for a checklist to reduce the risk—and some checklists are much better at doing so than others. The difference is in the degree to which a checklist includes *evaluative* tasks—tasks for assessing the quality of a process's output, such as a financial statement disclosure. Better still, checklists that also incorporate *corrective* tasks clearly place the responsibility on the person following the checklist to do something to fix or improve the quality of the output if it would otherwise be deficient.

The Benefits of Checklists

Rather than being a source of concern, checklists hold many benefits for an organization's financial reporting function when they are used under appropriate circumstances with appropriate expectations. The benefits include better:

◆ **Effectiveness.** If there's a particular approach to doing financial reporting tasks that increases the likelihood of them being done correctly, then a checklist is an excellent tool to use to document that approach. In short, *checklists help prevent preventable mistakes.*

◆ **Completeness.** When the quantity of tasks or attributes involved is large, it's virtually certain that one or more of them will be overlooked without a practice aid that helps ensure completeness. *Checklists help ensure that nothing important is forgotten.*

◆ **Efficiency.** While the days of "efficiency experts" studying the movements of employees performing physical work are largely behind us, employees can still benefit from organizational lessons about the most efficient ways to perform knowledge work. *Checklists help organizations document and disseminate lessons in efficiency.*

◆ **Consistency.** In financial reporting, it's usually important for tasks to be done the same way, regardless of who does the tasks or when the tasks are done. *Checklists support consistency across people and time.*

They also deliver benefits from a talent-management perspective. For example, a manager can use checklists to enhance staff accountability as a result of clear documentation regarding who is supposed to do what, when. Checklists also aid in staff training by reducing the amount of time it takes for a new staff member to learn what he or she is expected to do. And they can also contribute to staff development because, when shared and discussed among staff members, they can help each individual understand how his/her work figures into the attainment of departmental and corporate goals, which the individual will need to know in order to succeed and advance in the organization.

When Are Checklists Appropriate?

Although checklists offer numerous benefits for financial reporting, they tend to add more value under some circumstances than others. Indicators that it's appropriate to use checklists include:

◆ **The goals and attributes of success for a process and/or its outputs are well defined.** A checklist can't overcome ambiguities in the underlying process. It can, however, highlight areas where the process needs to be better defined and will achieve its potential only after the process is better defined.

◆ **Mistakes are costly but avoidable.** The consequences of reporting financial information that is incorrect, incomplete, or otherwise deficient are often adverse and significant. For example, financial reports may have to be submitted to regulators by certain deadlines, and there may be substantial penalties if the reports are late and/or wrong. Yet in almost every case, such failures are avoidable. Financial accounting and reporting can be done effectively and efficiently—and checklists increase the likelihood that they will be done effectively and efficiently.

◆ **Tasks can be grouped so as to minimize the number of interactions, dependencies, and handoffs among individuals.** Ideally, each checklist should aid one person in performing the tasks associated with producing one meaningful result. For example, an accounting department might benefit from having a checklist for preparing a depreciation schedule, but it probably should avoid having one checklist for preparing the entire balance sheet. More-sophisticated practice aids are needed when the quantity, complexity, and dependencies of tasks extend beyond one person; in such situations, process flowcharts and workflow-support software are

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likely to be more appropriate than checklists.

◆ **The quantity and/or complexity of tasks are high.** The more ways there are to make mistakes in a process, the more mistakes are likely to be made. In a world where everyone suffers "information overload," the less the success of a process hinges on people remembering things accurately and completely, the better.

Tips for Developing and Using Checklists

I've spent several decades using checklists for financial accounting and reporting purposes. Here are some tips I'd like to share:

◆ **If you want high-quality results from following a checklist, incorporate evaluative and corrective tasks into the checklist.** The person following the checklist needs to know what constitutes quality and how to bring it about.

◆ **Handing someone a checklist isn't the same as teaching him/her to do the tasks on the checklist well.** Training is still a key differentiator between getting a job done and doing it well.

◆ **When developing a checklist, be prepared for the development process to reveal complexity and flaws in the process that underlies the checklist.** Use that experience to fix/improve/simplify the process.

◆ **View checklists as works in progress.** Encourage your subordinates and colleagues to suggest improvements to the checklist and to the process that underlies it. Be ready to adapt the checklist to changing goals, requirements, resources, and circumstances.

You can use these tips as a "checklist for checklists"—which means, of course, that you should feel free to add to and modify the tips as you see fit. **SF**

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