Lean Practices to Transform Your Finance Team

June 2018

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1 Finance Role is Changing

Every high-performing finance team must be focused on helping their organisation get future ready. By future ready, we mean an organisation that is fast and light on its feet, able to react quickly to events as they unfold. We mean an organisation that is nimble through utilising world best practice, an advanced adopter of leading edge technologies and with modern people practices that abandon the broken, ill-conceived management practices of the past.

The issue, however, is that many finance teams are far from future ready. In truth, how many finance teams are satisfied that they have:

- Fully embraced all the lean best practices to be future ready
- An annual planning process that helps their organisation get future ready
- Successfully adopted the tried and tested leading edge technologies now available in the 21st century

1.1 Finance Teams Have a Burning Platform

Many finance teams spend long hours, frustrated, working with antiquated error prone systems and, to make it worse, follow procedures because they were carried out last month.

Yes, indeed the platform is on fire and we need to jump off right now. Many performance management processes that I used during my brief time with BP Oil, and helped support as a consultant for Ernst & Whinney are well and truly broken. I am talking about key performance indicators (KPIs), the annual planning process, forecasting, using outdated technology and, to round it off, month-end and year-end reporting.

These processes have not worked for years—and possibly never worked. The finance team has presided over an annual planning process where management and the board are told the lies they wanted to hear. The finance team have issued monthly reports that often end up in an executive's briefcase, which, on their third return journey back to the office, are deemed as read.

There are now significant performance gaps between what the CFO sees as important and their current proficiency in that area. In the 2015 IBM Global C-suite study,[1] the CFOs were saying that three most important areas for them were identify and tracking new revenue growth opportunities, developing talent in the finance organisation and measure and optimize planning, budgeting and forecasting, as shown in Exhibit 1.1.

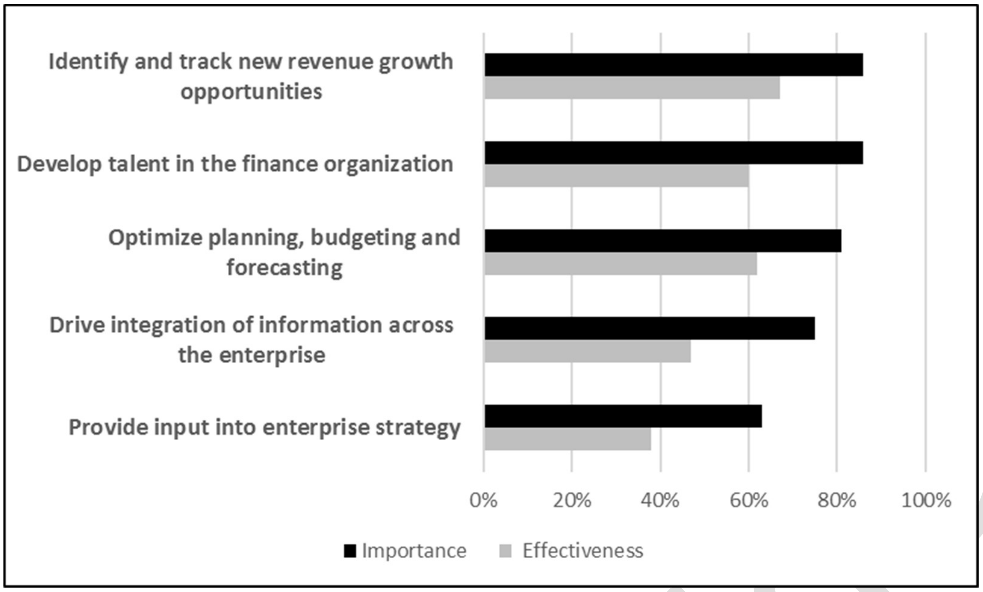


Exhibit 1.1 The Biggest Performance Gaps in Finance Teams

Source: IBM 2015 Global C-suite study based on 643 CFO interviews.

1.2 Finance Teams Are Locked in the Past

When Henry Ford said, "You can have any colour you like as long as it is black" the world of commerce was a simpler place. The Ford company only had to work out its production capacity in a year and it could then estimate sales, having backed out the expected movement in inventory.

Large production runs, lengthy month-end processes, were the order of the day. Charles Horngren's "Cost Accounting: A Managerial Emphasis" and books like it were locked into detail and a view into costing, budgeting, and allocation that is directly opposed to the lean movement.

When I was studying commerce at Liverpool University I was taught well to deliver services that Ford might have needed when building the model T Ford as illustrated in Exhibit 1.2.

Exhibit 1.2 The birth of Management Accounting

The accounting profession has learnt many bad habits:

Area	Bad habit
Direct labour costs are variable	Treating direct labour costs are variable, yet we cannot go back to the Victorian times and hire staff on a daily basis.
Transferring operating costs to the balance sheet	Absorbing as many fixed costs into WIP and closing stock as possible thereby transferring costs from the current period to subsequent periods.
Wedded to complexity	Installing one complex system after another e.g. timesheets, work orders, detailed inventory tracking systems and activity based costing.
Detail is good	Having a large chart of accounts with 200+ account codes for the P/L.
Slow month-ends	Overseeing a slow month-end reporting process as finance teams pursue the perfect number. Yet we are only required to get to a true and fair number, and the "right" month-end number does not exist.
Slow year-ends	Signing up with the auditors for a slow year-end accounts exercise with most of the finance team's time in the first quarter being spent endlessly adjusting the month 12 number. The final audited numbers often being within 5% of those reported at month 12. In other words, we have, in reality, come full circle.
Spreadsheet epidemic	A spreadsheet for everything that moved, and most certainly, multiple versions of the truth.
Maintaining an annual planning process	Managing the annual planning process, believing that it must be of some use. Each year, thinking that this time the annual planning process will be better, quicker, and easier than last year's disaster.
Generating unread reports	Generating reports that will not be read.

1.3 Maybe It Is Time for Therapy

Two hundred years ago, when the Napoleonic Wars were raging the English Navy had a device for retribution. It was called the cat o' nine tails. Why is it that if the English Navy gave this up a long, long time ago yet so many accountants pick the cat o' nine tails up and whip themselves time and time again?

If it is not the cat o' nine tails, it is shooting ourselves in the foot. This paper is about stopping this self-inflicted punishment and changing our ways.

1.4 Caught in a Revolving Door

I see many finance teams in this situation. The slow month-end reporting, the never ending annual planning process and the long, drawn-out annual reporting cycle trap us in a revolving door scenario. How do we get out of this Catch-22? The finance team needs to create time for change, to have more time to act. Where do we find this time? We find it by aiming for these lean finance team benchmarks:

Area	Lean finance team benchmarks
Month-end reporting	Fast month-end by day three or less (by next month-end) reporting by the close of the first working day within 12 to 18 months and be able to report net profit intra-month (virtual reporting) inside of three years.
Year-end accounts	Committing the auditors, your finance team, your board and executive to a 15-working-day signed set of annual accounts.
Annual planning	Produce the annual plan in less than two weeks from the rolling planning exercises. Eventually the annual plan will be dropped in favour of a quarterly rolling planning process.
Key performance indicators (KPIs)	Work with no more than 10 KPIs in the organisation. The other operational measures, which are not key to operational performance, to number less than 80 and be renamed see the 10/80/10 rule in my IBM KPI paper[1].
Excel ad hoc systems	All spreadsheets over 100 rows replaced with a robust solution using one of the modern planning and reporting tools now readily available.
Streamlining the chart of accounts	Having over 50 account codes for profit and loss (P/L) is unnecessary and leads to miscoding and is anti-lean.

2 The Lean Movement

The finance team needs to embrace the lean movement to slim down all of its processes so it can be more future focused. This change will have an impact on the workload of the team as shown in Exhibit 2.1, which compares an antiquated team and a lean finance team.

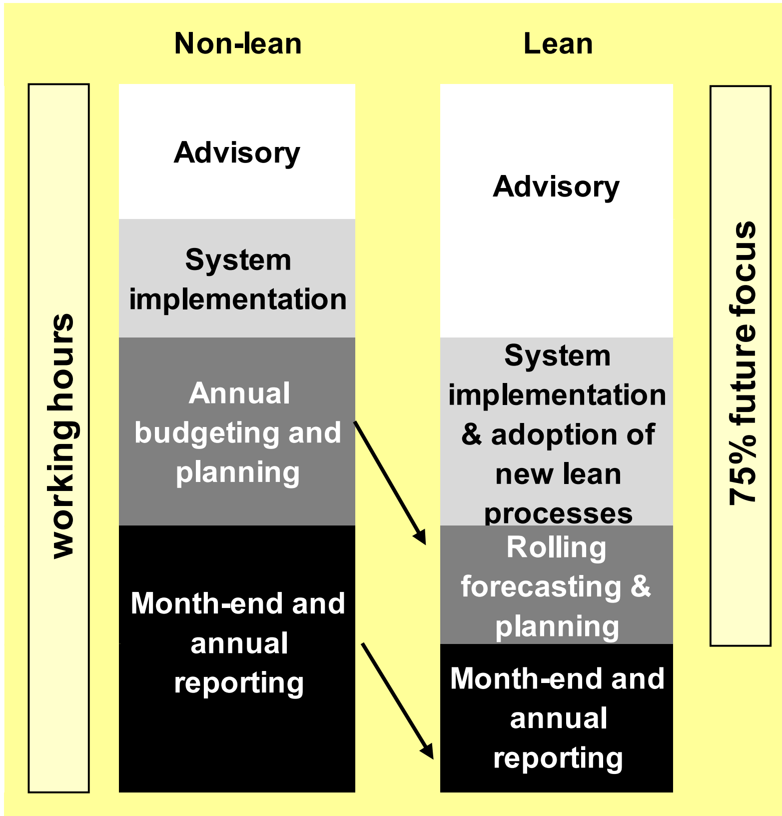


Exhibit 2.1 Non-lean versus lean a finance team

The significant increase in advisory time will lead to:

- Adding more value to the business units the finance team supports;
- Selling and leading change, in particularly with regards new systems
- Leading the battle against waste;
- Having time to adopt the profound lean practices such as Post-it re-engineering, Scrum, Kanban, action meetings.

The result will be participating in more rewarding work and a happy and more fulfilled finance team.

2.1 Background to the lean and its spread to the finance function

The lean movement is largely credited as a Japanese process that was responsible for the meteoric rise of the Japanese multinationals over the period 1960 to 2000. However, when you look at its origins you see the influence of American writers such as Edwards Deming. Over the years there have been many institutes and consultancy methodologies that make up the lean movement as we see it today.

Whilst the lean movement has been part of workshops for over twenty years – lean accounting has been a more recent phenomenon lead by a series of thinkers and dates back to roughly 2004. The key players include:

- Jeremy Hope[2]
- Frances Kennedy & Brian Maskell[3]
- Jean Cunningham[4]

Although most corporate accountants are aware of the revolution of lean and its positive impact on private, government and non-profit sectors, few have realised the profound impact it has on the accounting function. The pioneers of lean accounting have now blazed a pathway that all corporate accountants need to walk along.

Indeed the "lean accounting" movement has been gaining momentum around the world. Thus, it will not be long before CEOs start asking questions about this hot topic. It is imperative that corporate accountants, sooner rather than later, understand the concepts of lean accounting and its implications to their finance team and organisation.

In fact, the movement has progressed to such an extent that there is now an annual lean accounting summit which can be found easily on the Internet.

2.2 Lean is About Eliminating the Eight Wastes

In lean methodology, there are eight types of waste. These wastes are seen within the whole organisation and within the accounting function. I have outlined the eight wastes below in Exhibit 2.2

Exhibit 2.2: The Eight Wastes that Need Tackling

Eight types of waste	Within the accounting function
Over-production: Building batches of products larger than the customers' immediate need. Printing marketing brochures in advance.	Our reports are too large and go into too much detail
Waiting: Production operators waiting because a machine has gone down or a component is not available. Operators "minding" machines.	The processing of batches of AP or AR transactions where these batches wait for hours or days before processing. Also, the month-end, year-end, annual planning processes have much waiting time.
Transportation: Moving materials around the factory. Buying raw materials and components from distant suppliers.	The finance team is always shuffling information around team members.
Extra processing: Processes that appear productive but are unimportant to the customer. Painting and finishing components that are not seen. Designing additional features into a product that the customers do not use e.g. many features in Excel.	The chart of accounts, the month-end, year-end, annual planning processes all have extra processing within them.

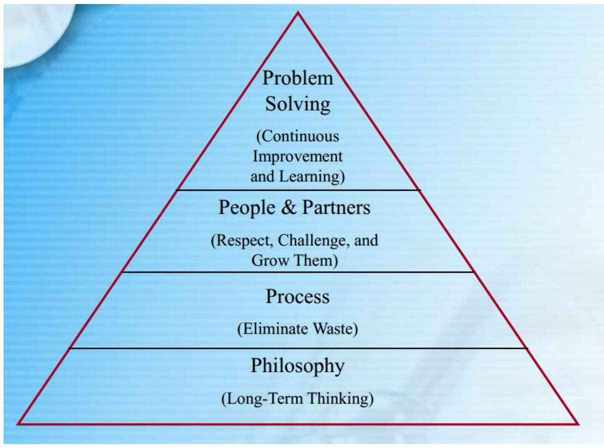
Excess inventory: Having materials, components, work-in-process, and finished goods levels above the immediate need.	The way we have transferred this period's sunk costs into next period production costs has created a blow – out in inventory.
Waste of motion: Having to search for tools, parts, or forms.	We all need to know where everything is filed and be disciplined in maintaining this.
Defects, scrap and rework in production: Complex inspection steps to overcome poor processes or poor design.	Accounting function generates many spread sheets that have a dubious function. They are completed because they were completed last month.
Unused employee creativity: Employee ideas having to hurdle many obstacles before adoption.	Based on Toyota, we would need to have 10 innovations implemented per team member per year within the finance function.

"Most business process are 90% waste and 10% value-added work." Dr Jeffrey Liker

Boeing reduced over a trillion of internal transactions through adopting lean.

2.3 Toyota's 14 Lean Management Principles and Their Relevance

I believe Toyota to be possibly the greatest company in the world. It has 14 lean management principles which are the backbone to its culture and Toyota can embed these principles in all countries it operates within. Its Kentucky plant in the USA exceeded all Toyota expectations with its acceptance of the Toyota way. To understand the Toyota principles, one needs to read Jeffrey Liker's book[5] *The Toyota Way*. He has broken them down into four categories as set out in Exhibit 2.3.



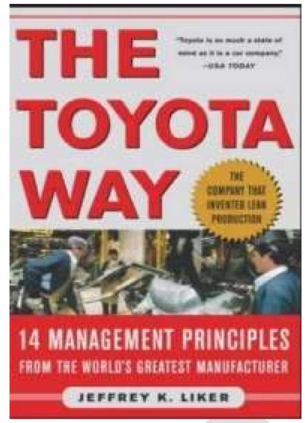
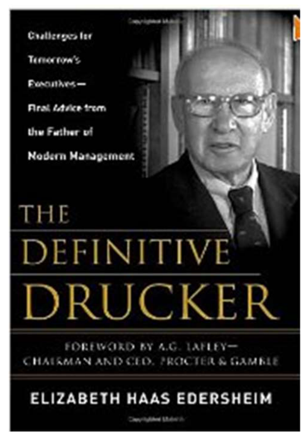


Exhibit 2.3 Jeffrey Liker's Analysis of Toyota's 14 Principles

I believe that Toyota's 14 principles should be embedded in all private, government and non-profit agencies as best they can. They would make a profound impact on the organisations, benefitting the staff, management, board and customers. **The 14 principles are set out in the attached electronic media.**

2.4 Importance of Abandonment



From the time we were at kindergarten we have had a fear of ever omitting we were wrong. If I was to go into a reader's garage what would I find? Maybe an exercise machine that started off life in great excitement as we envisaged a leaner me. After a couple of weeks in the lounge it started its inexorable journey to the garage. There to rest under the dust cover for a day in the future when we would use it again, so we could say "I told you so."

In the world of commerce this trait is equally damaging. We will hold on to systems, keep going with projects, keep writing that report that nobody reads because to remove it would mean a loss of face. Let's get over it.

Management guru Peter Drucker who I consider to be the Leonardo de Vinci of management, frequently used the word 'abandonment'. I think it is one of the top 10 gifts Drucker gave us all. He said, "Don't tell me what you're doing, tell me what you've stopped doing." He frequently said that abandonment is the key to innovation. He left some rather telling statements.

"If leaders are unable to abandon yesterday, they simply will not be able to create tomorrow"

"Without systematic and purposeful abandonment, an organization will be overtaken by events. It will squander its best resources on things it should never have been doing or should no longer do. As a result, it will lack the resources needed to exploit the opportunities that arise"

In finance, many processes are followed, year-in and year-out, because "it's the way things have always been done." When staff question, "Why do we do this?" the CFO or financial controller will often answer, "There must be a reason; so please do it. In order for the better practices in this book to work, there must be an adoption of:

- An abandonment of processes and procedures that are broken
- Letting go of the past
- A commitment to challenge the rules of the past

An organisation that embraced Peter Drucker's abandonment earmarked the first Monday of every month for "abandonment meetings at every management level." Each session targets a different area so that over the course of a year everything is given the once-over. This process would work well in the finance team except we should meet once a week to discuss at least two abandonments.

The act of abandonment gives a tremendous sense of relief to the finance team for it stops the past from haunting the future. It takes courage and conviction from the CFO. Knowing when to abandon and having the courage to do so are important leadership attributes.

I have included in the electronic media a book review of Elizabeth Haas Edersheim's *The Definitive Drucker*[6]. Read the book for more on abandonment and other great advice. I consider this book one of the top 10 management books I have read. I hope, like me, you will be become a follower of the great Peter Drucker.

2.5 The Importance of Challenging The Status Quo

Far too often, we have accepted antiquated and anti-lean practices within the corporate accounting repertoire as the status quo. If the medical profession used our approach, it would probably still be using leeches. (Well, actually, I understand that leeches are still used in special cases.) The medical profession has breakthrough conferences on a regular basis, and all the practising surgeons, in that field attend and adopt the new procedure. This should be the corporate finance model. The problem with corporate finance is that the "surgeon," the CFO, is often too busy to attend, caught in the aforementioned revolving door.

In an interview, called "The Lost Interview", Steve Jobs, was asked, "As a 22-year-old worth $10m, and a 25-year-old worth $100m, how did you get your business acumen?" He said that over time he realized that most business was pretty straight forward. He talked about when Apple had its first computerized manufacturing plant for the Apple II and the accountant sent Steve Jobs his first standard costing report. Jobs asked, "Why do we have a standard cost and not an actual cost?" The response was "That is the way it's done". He soon realized that the reason was the accounting system could not record an actual cost quick enough. When that was fixed, standard costing reports vanished.

In business Jobs believed that few in management thought deeply about why things were done. He came up with this quote which I want to share with you. I believe it should be on every wall and in front of every work station in the finance team work area.

"Your time is limited, so don't waste it living someone else's life. Don't be trapped into living with the results of other people's thinking. Don't let the noise of other's opinions drown your own inner voice." Steve Jobs

I believe this quote should be on every wall and in front of every work station in the finance team work area.

3 Selling and Leading Change

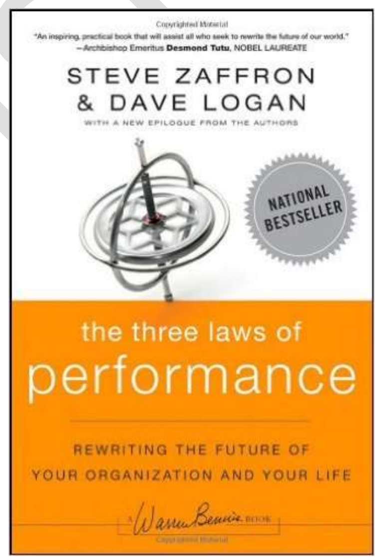
Before we venture on to the process of implementation we need first to address selling the change within our organisation. Finance teams around the world have wanted to embrace lean practices but are weary because many initiatives both inside the finance team and in other teams fail far too often.

As we will know from past experiences this sales process is not easy and can be prone to failure. I would argue that more than half the initiatives that are declined, at the concept stage, were under sold. In other words, given the right approach the initiative would have gone ahead.

If you are not prepared to learn the skills to cover the common deficiencies in a selling change process I would argue that you are resigning yourself to providing the same service level for years to come. Selling change requires a special set of skills and we all can, and should, get better at it.

Three books have opened up the way for us to rethink change and to apply techniques that will get change over the line.

3.1 Steve Zaffron and Dave Logan



Steve Zaffron and Dave Logan have written a compelling book "The Three Laws of Performance" that explains why so many of these initiatives have failed. The first law is "How people perform correlates to how situations occur to them." The writers point out that the organisation's "default future" which, we as individuals just know in our bones, will happen – will be made to happen. Thus, in an organisation with a systemic problem, the organisation's staff will be driven to make initiatives fail, so that the default future prevails.

They went on to say that is why the more you change the more you stay the same. The key to change is to recreate, in the organisation's staff minds, a new vision of the future, let's call it an "invented future".

Zaffron and Logan signal the importance of language (the second law), without language we would not have a past or a future. It is the ability to use language that enables us to categorize thoughts as either the past or the future. Without language we would be like the cat on the mat, sunning itself for yet another afternoon, thinking about our next meal but without the ability to process complex thought.

The next point they raised was that in order to make change we need to use a future-based language (the third law). It is interesting, if you listen to the outstanding orators of the past like Sir Winston Churchill, you will hear future based language at work. These great speakers knew, intuitively, about the power of future-based language.

"We shall fight on the beaches, we shall fight on the landing grounds, we shall fight in the fields and in the streets, we shall fight in the hills; we shall never surrender." Winston Churchill

4 The First Step – Speed up Month-end

Many large organizations have made massive inroads into fast and accurate month-end reporting. I say to them, "Celebrate your achievement!" but still read this section as you may be able to get even quicker. However, the vast majority of finance teams around the world have month-end processes that are career limiting. This section is an extract from my white paper, "Reporting rapidly, informatively and error free."[8]

When I was a corporate accountant, each month - end had a life of its own. You never knew when and where the next problem was going to come from. Two or three days away, we always appeared to have it under control, and yet each month we were faxing (email was not on the scene then) the result five minutes before the deadline. Our fingers were crossed as a series of late adjustments had meant that the quality assurance work we had done was invalid and we did not have the luxury of doing it again. Does this sound familiar?

4.1 Background

CEOs need to demand a complete and radical change if they are to free management and accountants from the shackles of a zero - sum process — reporting last month's results halfway through the following month. Here are the facts.

- Leading finance teams are now providing commentary and numbers by the first working day.
- Organisations are migrating to closing the month on the same day each month (i.e., months are either four or five weeks).
- In leading organisations, the senior management team (SMT) is letting go of report writing — SMT members are no longer rewriting reports. They have informed the board that they concur with the writer's findings but it is a delegated report.

See the attached electronic media for a checklist of implementation steps to reduce month - end reporting time frames and for the common bottlenecks in month-end reporting with techniques to get around them.

<u>Rating Scale for Month - End Reporting</u>

The following rating scale, see Exhibit 4.1, shows the time frames of month - end reporting across the 4,000 corporate accountants I have presented to in the past 20 years.

Exhibit 4.1 Speed of Month-End Reporting Ranking

Exceptional	Outstanding	Above average	Average
One working day	Two to three working days	Four working days	Five working days

<u>Benefits of Quick Month - End Reporting</u>

As a CFO of a tertiary institution said, "Every day spent producing reports is a day less spent on analysis and projects." There are a larger number of benefits to management and the finance team of quick reporting, and these are set out in Exhibit 4.2

Exhibit 4.2 Table of Benefits of Quick Reporting

Benefits to management	Benefits to the finance team
Reporting plays a bigger part in the decision - making process.	Staff are more productive as efficiencies are locked in and bottlenecks are tackled.
Reduction in detail and length of reports.	Many month - end traditional processes are out of date and inefficient, and these are removed.
Reduced cost to organisation of month - end reporting.	Happier staff with higher morale and increased job satisfaction.
More time spent analyzing trends.	Finance staff focus is now on being a business partner to the budget holder, helping them to shape the future.
More time spent on achieving results.	The team has time to be involved in more rewarding activities, such as quarterly rolling forecasts, project work, and so forth.
Greater budget holder ownership (accruals, variance analysis, coding, corrections during month, better understanding, etc.).	More professionally qualified finance staff.
Less senior management time invested in month - end.	Less senior finance team time invested in month – end the change also leads to a very quick year - end.

Impact of a Quick Month - End on the Finance Team Workload

It is important to cost out to management and the board the month - end reporting process. When doing this exercise, remember that senior management barely has 32 weeks of productive time when you remove holidays, sick leave, travel time, and routine management meetings. Thus a cost of $1,000 per day is not unrealistic. Based on an organisation with 40 budget holders, with around 500 full time staff, I have estimated that the cost estimate is between $0.9m to $1.5m.

Such an analysis can be easily performed by your accounting team in 30 minutes, and will be valuable in the sale process of changing month - end reporting time frames.

I have included a costing template in the reader download as a guide to this exercise.

4.2 Establish Reporting Rules within the Finance Team

Members of the finance team have to realize that they are sculptors; not scientists. There needs to be recognition that the monthly accounts are not precise documents. Assessments need to be made, and the monthly accounts will never be right; they can only be a true and fair view. We could hold the accounts payable open for six months after month - end and still not have the plumber's invoice that arrives when the plumber's company is doing its year - end and realize that it has forgotten to invoice for work done.

We therefore need some rules about the month - end reporting process which need to be signed off by all the accountants. The month - end financial report should:

- Not be delayed for detail.
- Be consistent — between months, judgment calls, and format.
- Be a true and fair view and error free.
- Be concise — less than ten pages (include the major business units' one - page reports but exclude minor unit reports. These are shown as a consolidated number in the consolidated P/L).
- Be a merging of numbers, graphs, and comments on one page.
- Not be changed for adjustments that are likely to be set off by others yet to be found – instead all adjustments are to be offset against each other on an "overs and unders" schedule
- Be based on an agreed, corporate view of materiality. Materiality will not be set at a different level for each budget holder. If materiality is set at $20,000 for a P/L item consolidated result, then the overs and unders might be set at $10,000 so that two adjustments going the same way would be over the minimum amount for an adjustment.

I have included a draft set of rules for the finance team in the reader download.

4.3 Catch All Adjustments in an 'Overs and Unders' Schedule

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

All miscoding, unless resulting in a material misstatement of the P/L, are processed during the following month. Budget holders are educated to review their cost centre numbers via on-line access to the G/L during the month and are requested to highlight any discrepancies immediately with the finance team.

We want to have a regime where we catch all material adjustments and see the net result of them before any decision is made to adjust e.g. only a material month-end misstatement will result in processing an adjustment. The first time you do this set up two 'overs and unders' spreadsheets, see Exhibit 4.3, at the close of the last working day.

One spreadsheet is to trap major adjustments. If materiality is set at $40,000 for a P/L adjustment, I would recommend setting the threshold for the "over and unders" schedule at around 40-50%. In this case it would be between $16,000 and $20000, so I would go for $20,000. The other "over and unders" schedule is to trap minor adjustments between $5,000 and $19,000.

5 Lean and Smart Methods

Around the world, teams are challenging old out of date work methods "other people's thinking" as Steve Jobs called it, and replacing this thinking with twenty-first-century smarter work methods. This section covers a number of tools in the lean toolkit and explores some of the management lessons I have gathered on my journey to writing The Leading - Edge Manager's Guide to Success[9].

5.1 Post-it Re-engineering

This 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? When it is done only the consultants will understand the resulting data-flow diagrams.

You should Post-it reengineer the following:

- Month-end routines
- Annual planning routines
- Rolling forecasting and planning routines
- Annual accounts routines
- Inefficient processes

Reengineering Month-End Routines

The first place to start is to Post-It reengineer your month-end procedures in a workshop see Exhibit 5.1 below for an outline of the workshop which has been provided in the electronic media. This takes a full day and involves seven stages.

Exhibit 5.1: Extract of the Agenda for a Post-it Re-engineering Workshop

Re-engineering month-end

Agenda for workshop

Date and Time: ____________

Location:

Suggested attendees: All those involved in month-end including accounts payable, financial and management accountants, representatives from teams who interface with month-end routines, e.g. someone from IT, payroll etc

Learning Outcomes: Attendees after this workshop will be able to:
- Discuss and explain why _________ should have quicker M/E reporting
- Implement the steps required to move month-end reporting back to day 3 or less
- Describe better practice month-end routines
- Recall all agreements made at the workshop (these will be documented)

Stage 1 Invitation

Having set the date, ask the CEO to send out the invite (there is a draft invite in the electronic media). The finance team needs to send out instructions, a week or so prior to the workshop, outlining how each team is to prepare their post-it stickers, see Exhibit 5.2.

Exhibit 5.2: Post-it Re-engineering Instructions to be Sent Out to Attendees a Week Prior to the Workshop

Although our month-end has been streamlined in our pursuit of continuous improvement, we need to eliminate more waste from the process. I have organised for _____________ to run a breakthrough lean technique to streamline the processes. During the session, ________will talk about the leading practices from around the world. This session will enhance your job satisfaction as you spend more time in the future scoring goals.

Date & Time: ________ 8:45 a.m. for refreshments, start 9 a.m., Finish at 4:45 p.m.

Location: Room_________, __________________________

Your presence at the workshop is important. In order to run this workshop, we need you to prepare a list of all the processes you undertake as a team at month-end.

This process is quite simple, all it requires is:

- Teams list all their processes on to the "Post-it" stickers allocated to them prior to the workshop and document each process with the whiteboard pen, enclosed. It is important that these stickers can be read from a distance of four to five metres. Please do not use a pencil or ballpoint pen.

+2 Close-off Accounts Payable

- List one procedure/process per Post-It (please note, every Excel spreadsheet is a process)
- State when it is done—time scale is -2, –1 (last working day), +1 (first working day), +2, etc.

Suggested attendees include all those involved in month-end, including accounts payable, financial and management accountants, representatives from teams who interface with month-end routines (e.g. someone from IT, payroll).

Set up a schedule to ensure all the main teams have a unique colour of post-it stickers, see Exhibit 5.3.

Exhibit 5.3: Allocation of coloured post-it stickers

AP	Yellow
AR	Green
Production	Red
Financial Accounting team	Blue

6 Technology Worth Adopting

Many finance teams have underinvested in twenty-first-century systems and relied too heavily on spreadsheets. Far too much time and money has been reinvested in upgrading the general ledger (G/L) and far too little on planning tools, intercompany software, collaborative disclosure management software, and consolidation software.

In a modern company, the G/L does only the basic task of holding the financial numbers for the year. Monthly reporting, latest forecast numbers, budget numbers, and even the drill - down facility available to budget holders often reside outside the G/L package, so why reinvest?

6.1 Banning Spreadsheets from Core Finance Routines

Spreadsheets have no place in forecasting, budgeting and many other core financial routines. Spreadsheets were not designed for many of the tasks they are currently used to accomplish. In fact, at workshops I often remark in jest, that many people, if they worked at NASA, would try to use Microsoft Excel for the US space program and many would believe that it would be appropriate to do so.

A spreadsheet is a great tool for creating static graphs for a report or designing and testing a reporting template. It is not, and never should have been a building block for your company's finance systems. Two accounting firms have pointed out that there is approximately a 90 percent chance of a logic error for every 150 rows in an Excel workbook[10].

Some of the common problems with spreadsheets are:

- **Broken links or formulas**. An individual might add +50 to a formula to force the spreadsheet to report the right number. The trouble is these short cut amendments come back to haunt us. In additional users often find out the password and then add or eliminate a row or column so that, when a group of spreadsheets is rolled up, the master spreadsheet is taking the wrong number from the one that was modified.
- **Consolidation errors**. Often, a spreadsheet will lock up or show a screen full of "REF", "REF" "REF" errors, because it was not designed to be a tool for handling a rollup of dozens of different worksheets.
- **Input of the wrong numbers**. Entering the wrong number can happen in any process, but spreadsheet-based systems often require rekeying of information, which can produce data inconsistencies. A spreadsheet might use a look-up table that is out of date or an entry might have been inadvertently or mistakenly overwritten.
- **Incorrect formulas**. A subtotal might omit one or more rows, columns or both. An individual might overwrite a formula because they believe theirs is more accurate. Or, someone might use an outdated spreadsheet. Another problem that arises with spreadsheets is that allocation models might not allocate 100 percent of the costs. Allocation methods might also be inconsistent.
- **No proper version control**. Using an outdated version of a spreadsheet is very common.
- **Lack of robustness**. Confidence in the number a spreadsheet churns out is not assured. Many times you cannot check all the formulas because they can be found in any cell of the spreadsheet.
- **Inability to accommodate changes to assumptions quickly**. What would you do if your CEO asked, "If we stopped production of computer printers,

what would be the financial impact? I need the answer at the close of play today." Your spreadsheets are not able to provide that quick answer.

- **Design is by accounting staff who are not programmers**. Most accounting staff have not been trained in system documentation and quality assurance, which you will expect from a designer of a core company system.
- **Lack of corporate office control**. Many people in a business can use spreadsheets to create their own view at a ridiculous level of detail. This can lead, as a friend once said to me "To the march of a million spreadsheets."

Jeremy Hope[11] points out that Sarbanes - Oxley may be the sword that finally removes the spreadsheet from key financial monthly routines. "In theory at least, every change to a formula or even a change to the number of rows needs to documented."

<u>Rule of 100 Rows</u>

I believe you can build a model in a spreadsheet application and can keep it within 100 rows without much risk. Pass this threshold and you expose yourself, your finance team and the organisation.

Finance teams require a robust tool, not a spreadsheet that was built by an innovative accountant and that, now, no one can understand. I always ask in workshops, "Who has a massive spreadsheet written by someone else that you have to pray before you use it?" You can see the pain in the instant response. Most people know that the person who built the spreadsheet certainly was not trained in operational systems design. The workbook will be a collage of evolving logic that only the originator has a chance to understand. Often, the main hurdle is the finance team's reluctance to divorce itself from the spreadsheet program. It has been a long and comfortable marriage, albeit one that has limited the finance team's performance.

New CFO finds an error

A financial controller came to me with a great tale. He had just completed the annual budget that his team had been working on for many weeks long into the night and on weekends. Proudly, one Friday afternoon, he walked into the office of the recently appointed CFO and announced the first cut of the annual plan. The CFO spent five minutes looking at the plan and after quickly calculating some numbers said, "This annual plan is wrong; the numbers do not make sense."

The financial controller was taken aback, because he had made a special effort to conduct quality assurance on the numbers, and he had done comparisons to last year's plan, along with a few other things. He had wanted to make the best impression.

The CFO called him over to look at his brief calculation, "Pat, we know the planned sales have been signed off already, gross profit margin historically has been around __ percent, overheads are roughly $___, and thus, I am expecting a number around $___- $___." The financial controller could only agree.

That weekend, the team poured over the spreadsheet, which was enormous and included the consolidation of many worksheets from many sources. Late on Sunday, they experienced an "eureka" moment. An error was found and rushed to the financial controller. As they processed the correction, they looked with disbelief because the new number was within the outline the CFO had suggested. "We have a pretty smart CFO; let's see how long this error has been around. Please look at the last two year's annual plan models," Pat requested.

As Pat recalled to me, with a wry smile, the error had been in the plans for the previous two years and had gone completely undetected.

Career Limiting

As a corporate accountant, being an expert at Excel will show you are a technical dinosaur, one who has not embraced modern tools and does not understand the inherent risks in running core financial systems with a high-risk tool.

To those readers who believe spreadsheets are still appropriate for financial systems, I say to them, why not build your general ledger in a spreadsheet program and while you are at it, all your operations systems? Try explaining to the CEO that only one person knows how these systems work and he or she left four years ago. You might as well clear your desk now.

6.2 The Technologies You Need to Understand and Evaluate

Instead of changing your G/L, I believe the CFO and the finance team have better investment opportunities elsewhere, which will turn the accounting function into a paperless office.

There are seven must adopt technologies on the journey from average to good to a great finance function. These are:

A planning and forecasting tool	These tools replace Excel. You need to place these larger models in the appropriate software.
Accounts payable solutions	Moving to a paperless accounts payable situation is a must have for larger organisations. The investment in systems pays off in a reduction in transaction volumes, eliminating re-keying and the taking of all prompt payment discounts.
A reporting tool to enhance accuracy and make them paperless	Reporting tools enable the finance team to move to paperless reporting utilising better practise presentation styles e.g. Tableau, Qlikview, Dundas, Targit Add a drill - down front end to the G/L if it is not already part of your G/L e.g., PowerPlay and Crystal Reporting
Fast close software	Software to automate processes and reduce month-end activities.
Consolidation & intercompany transaction software to remove the disputes	A proper consolidation tool is a must have for any organisation with over two subsidiaries. We all have built a consolidation tool in Excel, however, it is not appropriate for large consolidations.

9 Limit Your Account Codes for the P/L to Less Than 60

Show me a company with less than 60 account codes for their P/L and I will show you a management accountant who has seen the light. However, I have seen many charts of accounts with more than 300 expense account codes in the G/L, with up to 30 accounts for repairs and maintenance creating a volume like the one shown in Exhibit 9.1.

Exhibit 9.1 A chart of Accounts that is Certainly not Lean

Why is it that the least experienced accountant volunteers for re-setting the chart of accounts? I think I know the answer! All the wise owls duck for cover. Yet, the chart of accounts sets the Finance team up for disaster in many ways. It determines how we report and set targets.

Common sense goes out the window, the CFO eyes just glaze over at the chart of accounts progress meetings, the objective to reduce the account codes by over 40% gets lost and slowly but surely, just like the budget instructions, the chart of accounts takes on a life of its own.

My suggestions are:

- Do not breakdown costs into a separate account unless they represent at least 1% or greater of total expenses. This will reduce your costs to somewhere between 40 to 60 account codes.
- Do not break revenue in separate codes unless revenues represent over 5% or greater of total revenue. This will reduce your revenue to somewhere between 15 to 20 account codes.
- Only have separate project accounting for major projects, say over 3% of total annual expenditure. All other projects can be put in a bucket called "Other projects". Leaving the project manager to spend, where it is necessary, providing they live within their total budget for these minor projects.
- Have larger buckets and when you are asked a stupid question ask them what decision is going to be made based on the information requested or tell them the answer is '42'. A skilled management accountant can always investigate 6 weeks of expenditure and then annualise the number. Remember whatever the answer is you can assume it is a true and fair view, besides nobody else is going to follow you into that canyon!

"Appoint a hardnosed 'keeper of the chart' who can ensure that the following disciplines are continually maintained."

Quote from a wise CFO

10 Lean Reporting -Informatively and Error Free

Many management reports are not management tools; they are merely memorandums of information. They arrive too late, well after the horse has bolted, and contain errors due to quality assurance steps being undermined by late adjustments. They also contain far too much detail and are produced just because we did it last month. As management tools, management reports should encourage timely action in the right direction, by reporting on those activities the board and management, need the staff to focus on.

10.1 Foundation Stones of Reporting

Board members and the senior management team have complained for years that they are sent too much information, yet we still insist on preparing a large month --end finance report. The cost of preparing, analyzing, and checking this information is a major burden on the accounting function, creating significant time delays and consequently minimizing the information’s value.

Over the years of studying reporting I have developed some foundation stones for reporting:

- Reports should be completed quickly on a true and fair view basis avoiding unnecessary detail. For example is it necessary such as sales of $23,456,327 — surely $23.5 m is much easier to read and relate to.
- Where possible limit the report to one page, albeit sometimes a fan fold page (A3). This forces one to be concise by keeping it to commentary to highlight points and inserting only graphs that really matter.
- Have a comprehensive quality assurance process so the reports are totally consistent internally, and agree to the source numbers, every time.
- Use best practice graphics— following the guidelines of Stephen Few, an expert on data visualization. Incorporate trend analysis on key lines going back at least 15 months and so that you have a direct comparison to last year.
- Utilize 21st century reporting tools so managers can see their reports on their tablet.
- Reports need to be completed quickly on a true and fair view basis as discussed earlier. This requires that at all times we reflect on materiality at a group level and ensure that the numbers agree to source, are prepared using robust systems (that excludes spreadsheets), and have been reviewed for reasonableness.

10.2 Concise One Page Formats

The following formats comply with the reporting rules and only show a line if it represents over 10% of the total revenue or expenditure. Thus, reporting by account code is a thing of the past. Managers can do this by reviewing their unit’s numbers in the drill down reporting tool. Variances are only highlight by an automatic icon if it is over a threshold and over 10% of the budget.

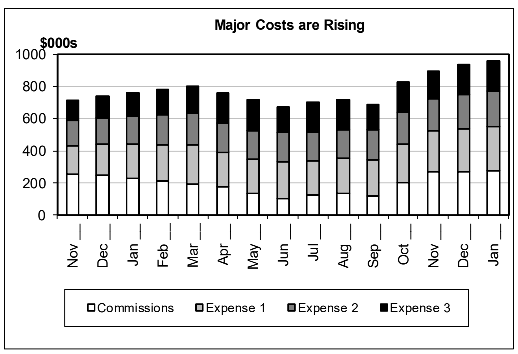
10.3 Reporting a Business Unit’s Performance

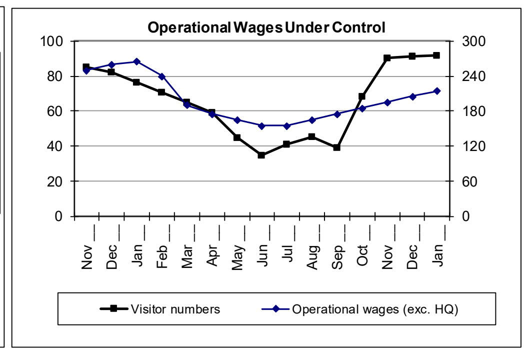
A business unit’s report should be limited to one page and should be completed in 20 to 30 minutes. Nobody wants a dissertation, and nobody will read it. If the business unit manager is having problems, it is far too late to bring them up in the monthly report. The finance team should have alerted senior management during the month, and discussions should have been held then on what best to do.

Exhibit 10.1 is an example of a monthly business unit's report. The profit and loss statement (P & L) is summarized in 10 to 15 lines. Two graphs are shown; one looks at the trend of the major expenditure items and the other looks at revenue if a profit center, or a graph may contrast financial and nonfinancial numbers, in this case tourist numbers against personnel costs.

Operating Statement for the Period Ending 31 January 20__

Month $000s				Year-to-date $000s			Full Year $000s		
Actual	Budget	Variance		Actual	Budget	Variance	Budget	Forecast	Variance
			Revenue						
1,430	1,380	50	Revenue 1	5,720	5,520	200	17,200	16,600	600
1,430	1,380	50	**Total Revenue**	5,720	5,520	200	17,200	16,600	600
			Less						
267	220	(47)	Commissions	1,068	880	(188)	3,200	2,600	(600)
1,163	1,160	3	**Gross Profit**	4,652	4,640	12	14,000	14,000	0
			Expenses						
278	260	(18)	Expense 1	1,240	1,040	(200)	3,300	3,100	(200)
218	210	(8)	Expense 2	672	840	168	2,600	2,500	(100)
188	180	(8)	Expense 3	752	720	(32)	2,300	2,200	(100)
158	150	(8)	Expense 4	632	600	(32)	1,900	1,800	(100)
128	120	(8)	Expense 5	512	480	(32)	1,500	1,400	(100)
50	70	20	Expense 6	672	680	8	1,000	1,300	300
1,020	990	(30)	**Total Expenses**	4,080	3,960	(120)	12,200	11,900	(300)
143	170	(27)	**Surplus/(Deficit)**	572	680	(108)	1,800	2,100	(300)





Areas to Note

1. ______________________________

2. ______________________________

3. ______________________________

4. ______________________________

Exhibit 10.1 Example of a Business Unit's Report

An icon system has been established to highlight variances, as shown in Exhibit 10.1. A suggested way is to ignore all variances less than a certain amount. For all variances over this amount, allow a tolerance of, say, plus or minus 10 percent and show an icon for this, and then show as a positive or negative any variance over 10 percent. In this example the monthly variances threshold is $20,000, the year to date and year-end threshold are set at $100,000. For variances over these figures but within 10% we show a "within tolerance" icon < > and no comment is required.

12 Finish the Annual Accounts Inside Three Weeks of Year-End

If you are not careful, your year-end accounts can take on a life of its own. Led by the auditors, who delay the audit to fit into their work schedule, giving them the luxury of hindsight. The delay encourages the accounting team to process adjustment after adjustment only to find the accounts have gone full circle with the year-end audited accounts within 5% of the starting numbers. We need to change our viewpoint. Month 12 numbers are now the year-end numbers controlling all adjustments in the "over and unders" schedule.

While annual reporting is an important legal requirement, it does not create any value within your organization, and thus seldom is it a task where your team has received any form of gratitude. Accounting functions therefore need to find ways to extract value from the process, while, at the same time, bringing it down into a tight time frame.

Before you can have a quick year-end, you need to speed up month-end reporting monthly so staff are disciplined to a tight month-end. Your goal should be reporting monthly numbers and comments by day 3.

12.1 A Quick Year - End Is a Good Year – End

Many top U.S. companies report very quickly to the US stock exchange. In my days as an auditor, IBM was well known for its speed of reporting. There are a number of benefits of a quick annual accounts process, including:

- Better value from the interim and final audit visits
- Improved data quality through improved processing
- Reduced costs, both audit and staff time
- More time for finance staff for critical activities, such as analysis, decision making, and forecasting
- Improved investor relations

12.2 The Five Stages for a Quick Year-End

There are many ways in which we can improve how we process the year –end reporting, and they can all be grouped in five ways:

- **Selling the need for change.** To the finance team, the CEO and the board.
- **Get organized**. Embrace best practice year-end rules, preparing a comprehensive auditors' file, agree the audit deadlines, effective communication between the auditors and finance team.
- **Using technology to save time**. Use consolidation, intercompany and disclosure management software.
- **Minimize year-end stress**. Establish an audit coordinator role, efficient stock, debtors and fixed asset procedures, hard close at month 10 or 11.
- **Control the "last mile" and maintaining quality.** Handle the myriad of data, quality assurance of the annual report, and avoid the number noise of a constantly shifting bottom line.

See the electronic media for a chapter on how to achieve this fast outcome.

13 How the Finance Team Can Help Their Organisation Get Future-Ready

13.1 Look to Introduce Rolling Forecasting and Planning

In a quarterly forecasting process, management determines the likely revenue and expenditures for the next 18 months. The focus is on what is happening in the forthcoming quarter but with an eye to the bigger picture six quarters out. The quarterly forecast thus updates the annual forecast but gives a view of the next financial year. Each quarter's forecast is never a cold start because management has reviewed the forthcoming quarter a number of times. Provided you have appropriate forecasting software, management can do their forecasts very quickly. The average time spent on the four quarterly forecasts during any given year is five weeks.

Exhibit 13.1 shows how the quarterly rolling process works for a June year-end organization. The dark shaded zone is the forecast for the next quarter and the most important part to get right. The light shaded zone is the second quarter. Quarters one and two will be forecast monthly and quarters three to six are forecast in quarterly blocks as less detail is required.

As a guide, budget holders should spend 60 percent of their time on the first quarter because first quarter numbers will become targets, 20 percent on the second quarter and 20 percent on the remaining four quarters.

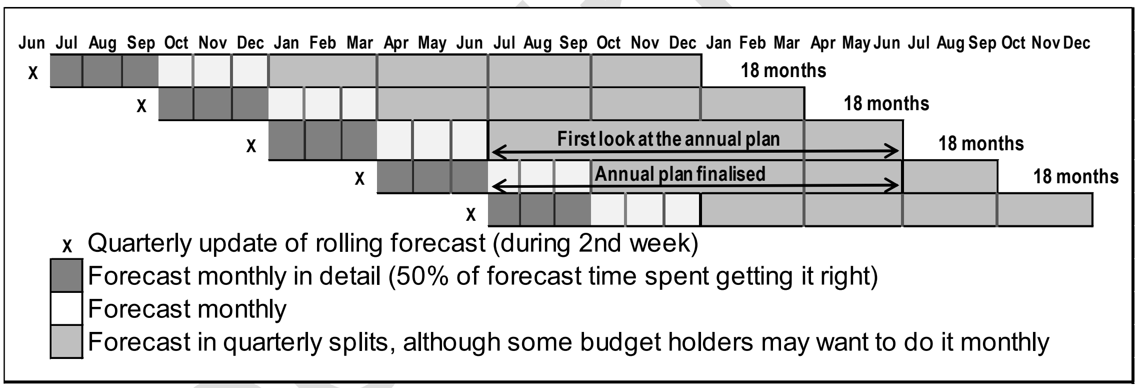


Exhibit 13.1: How the Quarterly Rolling Process Works for a June Year-end Organisation

Most organizations can use the cycle set out in Exhibit 16.2 if their year-end falls on a calendar quarter end. Some organizations may wish to stagger the cycle say May, August, November, and February. An explanation of how each forecast works, using a June year - -end organization, follows.

December update (taking one-week)

In the second week of December, budget holders forecast to the end of the year, with monthly numbers, and the remaining period in quarterly breaks. They obtain approval to spend January to March numbers subject to their forecast becoming part of the annual plan. At the same time, they forecast next year's numbers for the first time. Budget holders are aware of the expected numbers and the first cut is reasonably close. This is a precursor to the annual plan. This forecast is stored in the planning tool. This update process should take only one elapsed week.

March update and annual plan (takes two weeks)

In the second week of March, budget holders re-forecast to year-end and the first quarter of next year with monthly numbers, and the remaining period in quarterly breaks. Budget holders obtain approval to spend April to June numbers. The budget holders at the same time revisit the December forecast (the last forecast) of next year's numbers and fine-tune them for the annual plan. Budget holders know that they will not be getting an annual lump sum funding for their annual plan. The number they supply is for guidance only.

For the annual plan, budget holders will be forecasting their expense codes using an annual number and in quarterly lots for the significant accounts, such as personnel costs. Management reviews the annual plan for next year and ensures all numbers are broken down into quarterly lots. This is stored in a new field in the forecasting and reporting tool called "March ___ forecast" This is the second look at the next year, so the managers have a better understanding. On an ongoing basis, they would need only a two-week period to complete this process.

June update (takes one week)

Budget holders also are now required to forecast the first six months of next year monthly and then on to December in the following year in quarterly numbers. Budget holders obtain approval to spend July-to-September numbers, provided their forecast once again passes through the annual goalposts. This is stored in a new field in the forecasting and reporting tool called "June ___ forecast." This updated process should take only one elapsed week.

September update (takes one week)

Budget holders reforecast the next six months in monthly numbers, and quarterly to March 18 months forward. Budget holders obtain approval to spend October-to-December numbers. This is stored in a new field in the forecasting and reporting tool called "September ___ forecast." This updated process should take only one elapsed week.

You will find that the four cycles take about five weeks, once management is fully conversant with the new forecasting system and processes.

Papers to read

I have written a paper, commissioned by IBM, that looks into how to implement rolling planning in a planning tool. Go to wwwIBM.com and search "parmenter"