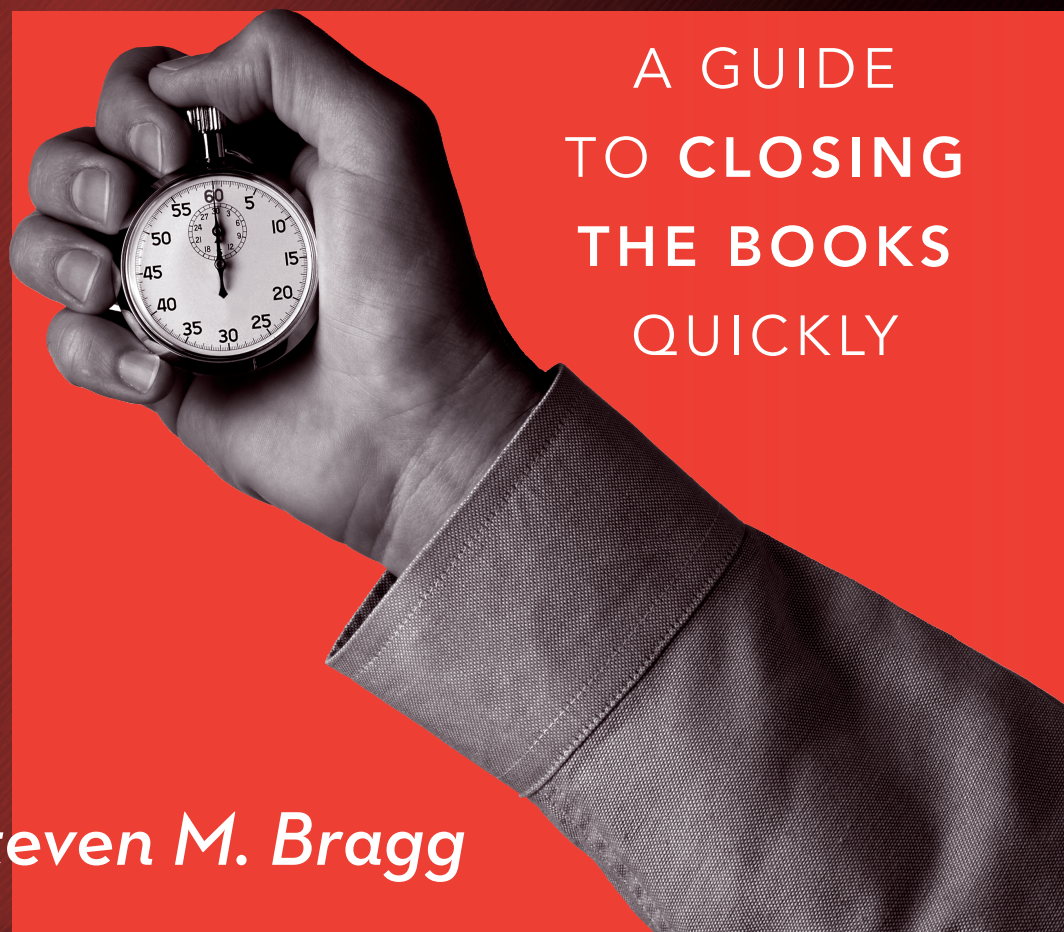


2nd
EDITION

FAST CLOSE



A GUIDE
TO CLOSING
THE BOOKS
QUICKLY

Steven M. Bragg

FAST CLOSE

FAST CLOSE
A Guide to Closing the Books
Quickly

Second Edition

Steven M. Bragg



WILEY

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*To Richard Souders,
who always operates at warp speed.*

About the Author

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Accounting and Finance for Your Small Business

Accounting Best Practices

Accounting for Payroll

Billing and Collections Best Practices

Business Ratios and Formulas

Controller's Guide to Costing

Controller's Guide to Planning and Controlling Operations

Controller's Guide: Roles and Responsibilities for the New Controller

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Sales and Operations for Your Small Business

The Controller's Function

The New CFO Financial Leadership Manual

The Ultimate Accountants' Reference

Throughput Accounting

Also:

Advanced Accounting Systems (Institute of Internal Auditors)

Run the Rockies (CMC Press)

Contents

Preface		xv
Chapter 1	Introduction	1
	Different Types of Fast Close	1
	Benefits of the Fast Close	2
	Legal Issues Impacting the Fast Close	3
	Steps to Achieve a Fast Close	4
	Summary	6
Chapter 2	Your Current Closing Process	7
	Traditional Closing Process: Basic	7
	Additional Closing Tasks for the Multidivision Company	11
	Additional Closing Tasks for the Multinational Company	12
	Additional Closing Tasks for the Public Corporation	12
	Problems with the Closing Process	13
	Summary	17
	Endnote	17
Chapter 3	Conducting a Review of the Closing Process	19
	Steps in the Process Review	19
	Payables Process Review	22
	Billing Process Review	22
	Inventory Process Review	24
	Cash Process Review	26
	Final Closing Process Review	26
	Total Duration of the Closing Process	29
	Summary	29
	Endnote	29

Chapter 4	Alter the Timing of Closing Activities	31
	Altering the Closing Mindset	31
	Review and Correct Subledger Transactions	
	Throughout the Month	32
	Complete the Bank Reconciliation Every Day	32
	Review Uncashed Checks	33
	Update the Inventory Obsolescence Reserve	33
	Determine the Lower of Cost or Market	33
	Calculate Overhead Allocation Bases	33
	Bill Recurring Invoices	34
	Conduct a Preliminary Comparison of the	
	Shipping Log to Invoices Issued	35
	Review Preliminary Rebillable Expenses	35
	Update the Bad Debt Reserve	35
	Review Preliminary Billable Hours	36
	Accrue Interest Expense	36
	Determine Pension Plan Funding	36
	Determine Flexible Spending Account Funding	37
	Accrue Unpaid Wages	37
	Accrue Unused Vacation Time	38
	Accrue Travel Expenses	38
	Reconcile Asset and Liability Accounts	39
	Calculate Depreciation	39
	Compile Preliminary Commissions	40
	Review Financial Statements for Errors	40
	Complete Selected Financial Reports in Advance	41
	Deferred Closing Activities	42
	Summary	46
Chapter 5	Revise the Contents of the Financial Statements	47
	Alter the Mode of Report Delivery	47
	Standardize Reports	48
	Eliminate Cost Reporting from the Reporting Package	49
	Separate Metrics from the Financial Reporting Package	49
	Summary	50
Chapter 6	Optimize the Use of Journal Entries and	
	Chart of Accounts	51
	Eliminate Immaterial Journal Entries	51
	Standardize Journal Entries	52
	Convert to Recurring Journal Entries	53
	Centralize Use of Journal Entries	54
	Use Journal Entries to Accrue Expenses Delaying the Close	54
	Automate Journal Entry Postings	55
	Use Accruals Only for External Reporting	55
	Define Accounts	55
	Standardize the Chart of Accounts	56
	Automate Eliminations of Intercompany Transactions	57
	Summary	57

Chapter 7	Standardization and Centralization	61
	Impact of Standardization on the Closing Process	61
	Impact of Centralization on a Multilocation Accounting Department	63
	Impact of Centralization on a Single-Location Accounting Department	65
	Incorporating Standardization and Centralization into Acquisition Activities	66
	Summary	68
Chapter 8	Closing the Inventory Function	69
	Create an Inventory Tracking System	69
	Implement Cycle Counting	73
	Reduce the Amount of Inventory	77
	Properly Record the Lower of Cost or Market Rule	84
	Reviewing Obsolete Inventory	85
	Preventing Obsolete Inventory	87
	Summary	89
	Endnotes	91
Chapter 9	Closing the Billing Function	93
	Bill Recurring Invoices in the Preceding Month	93
	Computerize the Shipping Log	94
	Eliminate Rebillable Expense Processing from the Core Closing Period	95
	Eliminate Month-End Statements	96
	Print Invoices Every Day	96
	Transmit Transactions via Electronic Data Interchange	97
	Summary	97
	Endnote	99
Chapter 10	Closing the Payroll Function	101
	Automatically Calculate Commissions in the Computer System	101
	Simplify the Commission Structure	102
	Install Incentive Compensation Management Software	103
	Post Commission Payments on the Company Intranet	103
	Avoid Adjusting Preliminary Commission Accrual Calculations	104
	Use a Bar-Coded Time Clock	105
	Use a Web-Based Timekeeping System	106
	Automate Vacation Accruals	107
	Merge Sick Time into Vacation Time	108
	Cap the Amount of Vacation Time to Be Carried Forward	108
	Summary	110
	Endnote	110
Chapter 11	Closing the Payables Function	111
	Automate the Month-End Cutoff	111
	Pay Based on Receiving Approval Only	112
	Automate Three-Way Matching	114
	Reduce Required Approvals	115

	Use Negative Assurance for Invoice Approvals	117
	Use Procurement Cards	117
	Have Suppliers Include Their Supplier Numbers on Invoices	122
	Receive Billings Through Electronic Data Interchange	123
	Request That Suppliers Enter Invoices Through a Web Site	124
	Audit Expense Reports	125
	Automate Expense Reporting	127
	Link Corporate Travel Policies to an Automated Expense Reporting System	128
	Issue a Standard Account Code List	129
	Link Supplier Requests to the Accounts Payable Database	130
	Automate Payments for Repetitive Processing	131
	Eliminate Manual Checks	132
	Use a Signature Stamp	133
	Ignore Supplier Invoices and Pay from Statements	134
	Issue Standard Adjustment Letters to Suppliers	135
	Summary	135
	Endnote	135
Chapter 12	Closing the Cash Processing Function	137
	Access Bank Account Information on the Internet	137
	Avoid Delays in Check Posting	138
	Collect Receivables Through Lockboxes	138
	Install a Lockbox Truncation System	140
	Access Online Check Images from a Lockbox	141
	Consolidate Bank Accounts	141
	Summary	142
	Endnote	142
Chapter 13	Impact of Automation on the Closing Process	143
	Principles of Fast Close Automation	143
	Implement Minor Programming Changes on an Ongoing Basis	144
	Automate General Ledger Interfaces	145
	Install a Web-Based Timekeeping System	145
	Install a Workflow Management System	147
	Install Consolidation Software	148
	Install a data Warehouse	148
	Install an Enterprise Resources Planning System	149
	Summary	151
Chapter 14	Closing the Books of a Public Company	153
	Overview	153
	Constructing the SEC Filing	153
	Quarterly Auditor Reviews and Audits	157
	Quarterly Legal Review	160
	Officer Certification	160
	Audit Committee Approval	161
	EDGARizing	162
	Summary	162

Chapter 15	Controls for Financial Reporting	165
	Overview	165
	Controls for Financial Reporting	165
	Summary	176
Chapter 16	Ongoing Improvements in the Closing Process	177
	Ongoing Improvement Process	177
	Improvement Measurements	179
	Summary	180
Appendix A	Comprehensive Closing Checklist	181
Appendix B	Fast Close Policies and Procedures	185
Appendix C	Soft Close Checklist	197
Appendix D	Year-End Close Checklist	201
Index		205

Preface

One of the most common challenges for the controller is to close the month-end books and issue financial statements as fast as possible. The resulting statements are being demanded by corporate management, outside investors, and the Securities and Exchange Commission (SEC) (for public companies) on the shortest possible timelines. However, the closing process has traditionally been a slow one—several surveys reveal that the average company requires about two weeks to close its subsidiary’s books, followed by roughly another three weeks to roll up the results into corporate-level financial statements. Companies with more organized closing systems can reduce this process to about two weeks, and those companies with the best closing processes can reduce the entire interval to four days. These results represent a slight improvement in closing times over the past—few years, but there is no massive improvement trend. Thus, companies are clearly having a difficult time shortening the closing process.

This book walks the reader through the process of closing the books and creating financial statements faster much faster. The author uses the principles outlined in this book to issue financial statements for a multidivision company in one day and has been doing so for years. Some of the key improvement steps discussed in this book are:

- Shift the timing of closing activities out of the core closing period.
- Reduce the contents of the financial statements.
- Standardize and automate the use of journal entries.
- Standardize the chart of accounts.
- Centralize accounting functions.

- Adopt inventory tracking and cycle counting systems.
- Shift rebillable expense invoices out of the core closing period.
- Use a web-based timekeeping system for consulting staff.
- Streamline the commission calculation process.
- Optimize the approval process for accounts payable.
- Link supplier invoice accruals to the purchase order database.
- Layer consolidation software onto the existing accounting software.
- Integrate an ongoing improvement review into the closing process.

These bullet points are only a microcosm of the large array of changes recommended in this book. No single change will achieve a massive reduction in the closing interval. Instead, only by gradually working through the changes listed here, in the order presented within the following chapters, can one expect to arrive at a closing interval that may encompass as little as a single day.

This second edition of *Fast Close* includes two new chapters that address critical considerations in the closing process. Chapter 14 describes the lengthy and tortuous additional steps that a publicly held company must endure while it converts its financial statements into a quarterly or annual report that must be submitted to the Securities and Exchange Commission. The chapter notes a variety of techniques for compressing these additional activities. Chapter 15 describes a number of controls over the accuracy of the financial statements. This is a particularly important issue for controllers who want to ensure that there is sufficient documentation and transactional verification to reduce the risk of issuing misleading financial statements.

This enhanced second edition of *Fast Close* is the best possible guidebook for issuing accurate financial statements within the minimum possible time period. Enjoy the journey!

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Centennial, Colorado
April 2009

1

Introduction

Achieving a fast close is a process improvement project that requires the full attention of the accounting staff for a long period of time. Before committing to such a project, one should be clear about what type of financial close works best for a company's specific needs, what kinds of benefits will result, and the general steps required to complete the close. This chapter provides answers to these questions.

DIFFERENT TYPES OF FAST CLOSE

Several variations on the fast close concept have appeared, causing some confusion about the nature of each one. The *fast close* is simply an acceleration of the standard closing process, resulting in approximately the same financial reporting package being issued (possibly somewhat stripped down). The focus of this approach is a careful examination of the closing process to strip out wait times, consolidate tasks, eliminate unnecessary functions, add transaction best practices, and selectively apply automation where necessary. It is a task in which an industrial engineer trained in efficiency improvements would feel quite at home.

The *soft close* is less labor intensive than a regular close, because it does not generate as much information. It is designed solely for internal corporate use, so its end product is only those management reports needed to run operations. With this reduced reporting goal in mind, the accounting staff can eliminate the use of overhead allocations. It may also be possible to stop some accruals and ignore the elimination of intercompany transactions, depending on the level of reporting detail desired. The soft close is most commonly seen in companies that issue only quarterly or annual reports to outside entities, leaving all other months available for the soft close.

The *virtual close* involves the use of a largely automated accounting system, one that can produce required financial information at any time, on demand. This approach is rarely used and only in the largest companies that can afford to install an enterprise resources planning (ERP) system that automatically consolidates and reports financial information. Also, the

underlying transactions that feed into the ERP system must be essentially error free, so an accurate virtual close is really the result of a hefty software investment as well as years of continual process improvements. The financial reports resulting from a virtual close tend to be stripped-down versions of generally accepted accounting principles (GAAP)-compliant reports, because this approach avoids the need for such manual tasks as overhead allocation, accrual transactions, and the establishment of various reserves.

If achieved, a virtual close can be useful in fast-moving industries where financial results must be monitored frequently in order to make rapid-fire changes to a company's tactical or strategic direction, or at least to identify problem areas for fast management attention.

BENEFITS OF THE FAST CLOSE

There are numerous benefits to achieving a fast close, which vary based on the perspective of the recipient—company management, outside investors, auditors, and the accounting department. These benefits are:

- *Quicker access to financial information.* Company management generally feels that the primary benefit of the fast close is having access to financial information more quickly, allowing it to take rapid steps to improve a company's strategic and tactical position in the marketplace.
- *Marketing tool.* A company's marketing staff can use the rapid issuance of financial information to trumpet the company's openness to the investing public. This does not necessarily mean that the company will issue sterling financial results, only that it will issue results faster. Still, it implies some level of expertise on the part of the accounting department in processing transactions and compiling them into reports, and so may impart some level of comfort to investors in that regard.
- *More time for financial analysis.* Closing the books fast does not necessarily mean that one must issue financial statements sooner. An alternative is to spend additional time analyzing the preliminary financial statements in order to issue more complete notes alongside the financials at a later date.
- *Improved processes.* Because the fast close improvement process requires careful attention to process enhancement, there will inevitably be side-benefit improvements to many accounting processes, leading to heightened efficiency and fewer errors. Within the accounting department, this may be seen as the top benefit of the fast close. A variety of controls for financial reporting are discussed in Chapter 15.

- *Improved control systems.* Internal and external auditors appreciate the enhanced attention to control systems needed to ensure that information is compiled properly and fast.
- *More time, period.* Although some aspects of the fast close simply push activities into the period either before or after the core closing period, some actions are completely eliminated or at least reduced in size. This results in less total time required for the closing process, which can be used by the accounting staff for a variety of other activities.

Consequently, the wide array of fast close benefits results in multiple supporting constituencies—management, investors, auditors, and the accounting department.

LEGAL ISSUES IMPACTING THE FAST CLOSE

The Sarbanes-Oxley Act has made it more difficult to achieve a fast close. The problem is Section 302 of the Act, which requires formal management certification of the accuracy of the financial statements. Specifically, Section 302 requires that the financial statements of publicly held companies not contain any material untrue statements or material omissions or be considered misleading. Understandably, those signing this certification want to spend more time ensuring that the financial statements are indeed correct. Some recent surveys of the time needed to produce financial statements have indicated a slight *increase* in the time required since the passage of Sarbanes-Oxley, probably because of Section 302.

However, Section 409 of Sarbanes-Oxley requires that public companies disclose to the public on Form 8K any information on material changes in their financial condition or operations. This must happen within four days of the occurrence of a triggering event. This requirement calls for financial and operating systems that bring issues to the attention of management faster than might previously have been the case.

Finally, the Securities and Exchange Commission (SEC) has accelerated its requirement for the timely filing of quarterly and annual reports by publicly held companies. The rule change calls for a three-year decline in the reporting period to 60 days for annual reports and to 35 days for quarterly reports (down from 90 days and 45 days, respectively). This rule applies to domestic companies having a public float of at least \$75 million and that have previously filed at least one annual report.

In short, corporate controllers and chief financial officers are caught between a rock and a hard place—they must file financial and operating information sooner but want to retain it in-house longer to ensure that it is correct. The solution is still the fast close—information is available quicker for filing requirements, while company management can still retain it for further review until the accelerated filing dates come due.

STEPS TO ACHIEVE A FAST CLOSE

Several steps are required to achieve a fast close, which are addressed in detail in the following chapters. They are listed in the following recommended order of implementation:

1. *Reviewing the closing process (Chapter 3).* The first step in achieving a fast close is to examine the current state of the closing process and determine the time required to complete each functional area (i.e., inventory, billing, payroll, payables, and cash processing, as well as final closing activities). It is useful to summarize the results of this investigation into a timeline that can be used to spot which segments of the closing process are particularly in need of improvement.
2. *Altering the timing of closing activities (Chapter 4).* A set of changes that are easy to implement and yet have a startling positive impact on the duration of the close is to shift many of the closing activities either into the preceding month or into the period immediately following the issuance of financial statements.
3. *Revising the contents of the financial statements (Chapter 5).* The close will take less time if there is less information to report. There are several variations on this concept, such as eliminating custom reports entirely, shifting to electronic modes of report delivery, and reporting some operating or metric information separately from the financial statements.
4. *Optimizing the use of journal entries and chart of accounts (Chapter 6).* Journal entries require excessive amounts of time, may be entered incorrectly, and do not always contribute to the accuracy of the financial statements. Thus, standardizing journal entries, eliminating inconsequential ones, and automating them can be of considerable assistance. Also, using a common chart of accounts or at least creating mapping tables will reduce the labor associated with consolidating results reported by subsidiaries.
5. *Standardization and centralization (Chapter 7).* If a company has multiple locations, the closing process will be nearly impossible to improve unless the controller pays considerable attention to the standardization of accounting transactions so that they are completed in exactly the same way in all locations. Even greater closing improvements can be attained by centralizing accounting functions for the entire company in a single location.
6. *Closing the inventory function (Chapter 8).* The topic of inventory makes many controllers shudder; because a combination of poor controls and large investments in this area makes the cost of goods sold an extremely difficult area to calculate, leading to massive time requirements during

the closing process. This problem can be reduced by implementing tight inventory tracking and cycle counting systems, as well as by adopting better materials management policies to reduce the overall level of inventory investment.

7. *Closing the billing function (Chapter 9).* Generating month-end invoices may be the bottleneck operation during the month-end close. This problem can be reduced by shifting recurring invoices and the rebilling of expenses out of the closing period, electronically linking the shipping database to the accounting department, and ensuring fast completion of billable hours reporting.
8. *Closing the payroll function (Chapter 10).* The payroll function principally interferes with the closing process because employees are late in recording their billable hours, which can be resolved through the use of automated time clocks and Web-based time recording systems. There are also several ways to streamline the commission calculation process so it takes much less time during the core closing period.
9. *Closing the payables function (Chapter 11).* Waiting for late supplier invoices to arrive, as well as pushing those invoices through a Byzantine approval process can seriously interfere with the month-end close. There are several approaches for streamlining the basic approval process, while the intelligent use of expense accruals, coupled with the purchase order database, can eliminate the wait for late invoices.
10. *Closing the cash processing function (Chapter 12).* Some controllers like to wait until the bank statement arrives in the mail before issuing financial statements, so they can first conduct a bank reconciliation. The postal float on the bank statement can be two or three days, which directly delays the issuance of financial statements. This can be avoided through the use of online bank reconciliations, while several techniques are available for improving the speed of processing incoming checks.
11. *Incorporating automation into the closing process (Chapter 13).* There are several ways to use automation to improve the closing process, ranging from a series of small efficiency-related improvements to workflow management software, a data warehouse, consolidation software, and an ERP system.
12. *Ongoing improvements in the closing process (Chapter 16).* Although the preceding action items may have achieved a considerable improvement in the speed of the close, there is always room for improvement. Consequently, constant attention to the process flow and measurement of key metrics will ensure that the fast close remains fast.

There are two other chapters that do not have a direct bearing on speed of issuing financial statements. Chapter 14 uses many of the techniques