BlackLine and Protiviti

Scaling Finance and Accounting with Confidence

How to Maintain Growth Momentum and Strong Internal Controls with an Incremental Financial Close

Moving at the Speed of Business

In this era of innovation, digitization and entrepreneurialism, new companies are sprouting across the global landscape like mushrooms after a rainstorm. The time period from the conceptual phase of a business through its formation, revenue generation and geographic expansion—formerly a years-long process—has contracted. Within a few months, an organization launched with little more than an idea and a few backers has spread its wings across the globe.

This dizzying pace of growth is an all-hands-on-deck experience. Everyone in the enterprise is impelled to seize the day. In this extraordinary, exhilarating environment, there is a downside, however. Companies often allocate less attention and capital to the organization's back-office efficiency and effectiveness, and their technology, systems and processes fail to keep pace with their accelerating market expansion.

Understandably, the bulk of capital is invested in building the customer-facing business. But overlooking the needs of finance and accounting increases the risk of a material weakness—a deficiency or combination of deficiencies in the organization's internal control over financial reporting.

There is a way for fast-growing businesses to have their cake and eat it, too. It's called continuous accounting, and it promises a new way of operating the finance and accounting function to reduce the possibilities of internal control deficiencies causing a material weakness. This paper describes the strategic and operational value of automated financial and accounting systems with continuous accounting processes.

Have a Material Weakness?

A material weakness indicates a reasonable possibility of a material misstatement within the company's annual or interim financial statements, one that cannot be prevented or detected on a timely basis. Under Section 404 of the Sarbanes-Oxley Act (SOX), such internal control deficiencies must be disclosed. Emerging Growth Companies are not exempt from this requirement, as per the JOBS (Jumpstart our Business Startups) Act.[i]

The repercussions of disclosing a material weakness can be severe, forging perceptions of inefficient finance and accounting processes, operational misalignment, and inferior or immature technology. These perceptions affect the reputation of the organization, giving rise to serious questions about the caliber of management and drying up investment capital for future growth. Yet, many fast-growing companies rush forward without considering the consequences of a material weakness.

Alarmingly, nearly one-third (31 percent) of organizations filing an IPO in the first three quarters of 2015 disclosed a material weakness in their internal control over financial reporting.[ii] While the total number of IPOs listed on the New York Stock Exchange and Nasdaq more than doubled between 2011 and 2014 (from 128 to 293), the percentage of IPOs reporting material weaknesses jumped from 23 percent to 27 percent, respectively. The first three quarters of 2015 continued this incline.

The impact of disclosing a material impact is severe. One day after such disclosure, the share price of a company with a market capitalization in excess of $75 million falls an average of 0.67 percent (relative to market movement), according to a study by proxy advisory firm Glass Lewis. After 7 days, it drops 0.90 percent, and after 30 days, 1.96 percent. Within two months, the share price has declined a whopping 4.06 percent. "The mere announcement of a material weakness, independent of the auditor opinion, appears to solicit a negative reaction from investors," the study stated.[iii]

Why do investors rush for the exits? There are several possible reasons, including negative perceptions of executive managers' ability to accurately report the company's financial condition and the results of its operations and/or cash flows.

Such observations foster doubts about the competence of corporate leaders to maintain the financial viability of the business. For instance, a material weakness may indicate significant inefficiencies in the organization's financial and accounting processes. It may send a message that the company's back-office technology is unable to scale at the same pace as the front office. And it may conjure an image of accountants struggling mightily with the controls around financial reporting in their financial close tasks.

When these perceptions of ineptitude arise to the surface, they stick to a company's reputation like tar. For a hyper-growth enterprise seeking to fuel its momentum with investor capital, this is a textbook example of how not to do it.

This Is No Way to Run a Business

Growth is everything in running a profitable company. According to a study by McKinsey & Co., high-growth companies yield shareholder returns that are five times bigger than those offered by medium-growth businesses.[iv] However, the speed to maintain this trajectory may come at the expense of back-office finance and accounting needs, resulting in non-scalable systems and processes.

For example, when the accounting staff readies the financial close, they may manually attend to these tasks using spreadsheets. As they near the annual, quarterly or monthly close, it becomes a mad dash, wearied accountants working long days under extremely stressful conditions. When a discrepancy arises, they tear at their hair trying to pinpoint the reason. In such an environment, there is a higher risk of a material weakness.

The problem with such processes is that spreadsheets lack visibility. Different people frequently document transactions and other account information using spreadsheets in

different ways. When a question arises over the accuracy of the data, accountants must accumulate and review tens of thousands of spreadsheets to verify and document that the balances are correct. Determining who did a reconciliation (or should have done it) is often a maddening forensic challenge.

This was the case at a large global insurance company. Without an automated reconciliation system, there was no visibility into the overall reporting environment. When questions arose over a single ledger account that was unaccounted for, the reconciliation preparers, approvers and auditors had to hunt down individual reconciliation owners to ensure the accuracy of the numbers and prove the balances were correct. Accountants at the insurer reached out to coworkers with their queries by phone, email and text. Sometimes a colleague couldn't locate a document, had failed to preserve it, or left the company's employ. Stressed out and overwrought by these complex workflows, the accountants were more apt to make errors, regrettably when their accuracy counted most.

Approximately 70 percent of the repetitive manual tasks that are common in financial close activities can be eliminated through automation, saving time and reducing operating costs.[v] More importantly, automation is the means toward reducing the possibility of a material weakness.

Automation Is Everything, Really

Automation is the alternative to manual processing. By automating account reconciliations, journal entries, transaction matching and other financial close processes, accountants are able to actually see each day's transactions. This highly transparent way to collect, manage, track and analyze financial data provides a level of control unavailable with spreadsheets.

By automating the close process, enterprises can more easily verify the accuracy of the transactional data. With less time spent on validating the data, finance and accounting staff achieve a more efficient and faster close, liberating them to strategically assist the office of finance to improve the company's financial health, the precision of its business forecasts, and compliance with SOX and other regulatory requirements.

This is now the environment at the aforementioned global insurer. More than 50 percent of the company's accounts are auto-certified monthly, saving an enormous amount of time within its finance and accounting group, time that is now dedicated to more value-added analysis work. Other benefits include unprecedented visibility into the account reconciliation and financial close process, greater confidence in the accuracy of the numbers, improved workflow efficiencies, and minimized compliance risks.

This is good news for CFOs. One of the top five priorities of CFOs, according to the findings of the annual Financial Executives Research Foundation/Protiviti 2016 Finance Priorities survey, is to "generate greater value from the financial data within the organization through more timely and accurate data collection and analysis."[vi]

Automating the financial close assists accountants in reconciling millions of transactions in a fraction of the time this task previously absorbed. At a large cable TV provider that automated its financial close processes, the company cites time-

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savings of 96 percent by automating its journal entries and 83 percent by automating the account reconciliations. A large heavy airfreight company that also automated its processes estimates that its monthly reconciliation review process had declined by five business days, with filings to the Securities and Exchange Commission occurring approximately three days earlier. Overall cost savings are estimated at approximately $125,000 per year, due to reductions in audit fees, supplies/storage and headcount.

The strategic value of the finance and accounting department to these organizations has increased, now that accountants spend more time on analysis, making sense of the numbers to understand business drivers, as opposed to merely tallying them up. Accountants can easily track to-do lists such as close calendars, auditor PBC lists, and regulatory compliance controls. And they can automatically retrieve and configure currency rates for international bank statement formats. These benefits combine to reduce the risk of a material weakness and the reputational wounds that follow.

When companies digitize data, manual processes become automatic, putting the accounting function in front of more people, without the need to staff up sizably for the financial close. Companies can now take the next step toward the development of a world-class finance and accounting function—a continuous accounting process.

Faster Financial Close, Incrementally

With a continuous accounting process, the financial close period often is referred to as the "last mile," the wretched period when a month's worth of work to prepare the books for the financial reporting is awkwardly squeezed into a few days. As a horde of accountants and hired temps hurry to close the books, their sheer exhaustion increases the risk of errors. Certainly, this is no way to professionally close the books, much less treat skilled people. It also results in unnecessarily high costs to staff up for the peak overload period.

Instead of herding accountants into a corral to perform the financial close in a compressed period of time, why not have them undertake this work at their own pace? Why not enable them do the data summations, reconciliations, error checking and correcting, apply the allocations, and make the necessary adjustments incrementally, instead of squeezing 30 days of work into a five-day time frame?

By more efficiently distributing their workload, accountants no longer are restricted to a rigid period of time in which

to perform their duties when there is a critical mass of transactions. Rather, through continuous accounting, they can reconcile an account after the inception of a transaction. This optimizes accounting tasks through iterative work rhythms or cadences.

How does it work? With continuous accounting, accountant time is managed by accountants. The peaks and valleys of labor output are flattened into regular work cadences, allowing actions to be taken closer to when business occurs. There's no need to staff up for peak overloads, providing significant labor cost savings. There is also the opportunity for the financial planning and analysis (FP&A) team to make timelier and more accurate business forecasts. With manual, spreadsheet-based processes, FP&A typically must wait till the end of the month, quarter and/or year to do their analyses. By giving teams the ability to view the financial close data on a real-time basis, the FP&A team is able to deliver more precise and judicious business projections to the CFO and other senior executive decision-makers.

There are other cascading benefits, as well. By being able to test the SOX controls and perform audits on a timelier basis, internal audit can attend to its work more efficiently. And with accountants reviewing the business data on a continuous basis, they can determine ways to improve overall accounting processes.

These many benefits are too valuable to ignore. Fast-growing companies interested in automating their financial and accounting systems and implementing continuous accounting processes should begin their due diligence with an assessment of their existing systems and processes. Questions to ask are:

- Can they handle the increased complexity of the evolving and growing business?
- Do they support localization requirements as the company moves into new markets?
- Do they provide robust and flexible reporting?
- Can they be relied upon to support appropriate controls like SOX?
- Are they able to scale with the company's growing volumes and workloads?

If the answers to any of these questions appear doubtful, the organization will be at substantial risk of financial close timing, accuracy and compliance complications, ensuring its fast growth will stumble and stall.

The Time Is Now

Automating the financial close and implementing continuous accounting are vital ways for hyper-growth companies to maintain their momentum at much less risk of a material weakness. Since fast growth is a powerful predictor of business success, organizations can advance at lightning speed, their reputation intact to ignite their future growth.

About BlackLine

BlackLine is the world's most trusted platform for finance and controls. BlackLine's vision is to modernize the finance and accounting function to empower greater productivity and detect accounting errors before they blow up into a devastating financial restatement. BlackLine enables clients to move beyond outdated accounting processes and point solutions that help accountants and finance professionals work smarter and more efficiently. The finance and accounting departments of more than 1,300 worldwide clients currently leverage the unified BlackLine platform to perform mission-critical processes in near real-time — including financial close, reconciliation management, journal entry management, intercompany clearinghouse, and controls assurance.

About Protiviti

Protiviti is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit, and has served more than 60 percent of Fortune 1000® and 35 percent of Fortune Global 500® companies. Protiviti and our independently owned Member Firms serve clients through a network of more than 70 locations in over 20 countries. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

Ranked 57 on the 2016 Fortune 100 Best Companies to Work For® list, Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

[i] https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm

[ii] https://www.pwc.com/us/en/deals/publications/assets/pwc-deals-ipo-material-weakness-disclosure.pdf

[iii] https://www.sec.gov/rules/other/265-23/glasslewis091405.pdf

[iv] http://www.mckinsey.com/industries/high-tech/our-insights/grow-fast-or-die-slow

[v] http://betanews.com/2014/04/16/dont-waste-another-6-million-on-your-financial-close-automate-for-better-accuracy-and-efficiency/

[vi] http://www.protiviti.com/en-US/Documents/Surveys/2016-Finance-Priorities-Survey-FERF-Protiviti.pdf