EMERGENT PARTNERS

BUSINESS PROCESSES AND HOW THEY AFFECT FINANCIAL DATA

Maurice Nassar, Harvey Stalarow, Amy Delaney – Emergent Partners

TABLE OF CONTENTS

1. Introduction

2. Data Generating Processes

4. Making Improvements

6. Conclusion

7. About the Authors

Financial data plays an important role in the success of any company. This data feeds internal management reports which facilitate good management decisions. It also feeds external reports which satisfy regulatory requirements and provide information to third-parties such as banks and outside lenders. How good a company is at generating reports to measure its success plays a tremendous role on how great its success really is.

When generating reports, companies use a variety of tools and processes. Tools that are used include reporting systems, financial models, and report templates. Examples of processes that are used include those governing accounting close and timelines for the periodic generation of reports. However, generating accurate reports involves much more than just processes and tools. It even goes beyond having well-trained personnel responsible for reporting activities. In order to generate accurate reports, the data that those reports are based on must be accurate. That accuracy starts with the very processes within the company that originally generate the data.

Small, privately-held companies have tremendous opportunities to improve the accuracy of their financial data and subsequently their financial reports. This is because the reporting function is generally not isolated from the data-generating functions by multiple layers of the business.

DATA GENERATING PROCESSES

What are the processes within a business that generate relevant financial data? The answer to that question depends on the business itself. Essentially everything that every employee does every day generates some kind of data. In order to determine what business processes are critical to generating accurate financial data, each business needs to start by looking at the end result and tracing all the way back to a basic, physical action.

For example, there is a company that manufactures a single product and that company would like more accurate reporting on revenue. The revenue figure on the income statement can be traced back to a series of invoices that represent sales of the product. So does improving the invoicing process improve the accuracy of the revenue figure? It does to a degree, but there is more to it. Before the invoice is generated, a salesperson makes the sale. This involves exchanging information with a customer such as prices and quantities, confirming the customer's commitment to make the purchase through a contract or agreement, confirming delivery of the product, and communicating relevant data on the sale to the invoicing function. It is this sales process that truly determines whether revenue is represented accurately on the income statement.

There are several parts of the sales process that could lead to inaccurate financial data. The process for confirming customer orders could be poorly defined and lack controls leading to last minute changes, returns, or incorrect data being sent to the invoicing function. A system for confirming deliveries may not be in place which results in products that are invoiced for incorrectly or not invoiced for at all. Communication with the invoicing function may lack structure and consistency leading to invoicing errors. In a worst case scenario, there may be a lack of a process altogether that leads to consistent incorrect invoicing or product sales not being invoiced for at all.

If the company in this example has in place an organized process for handling sales that is easy for salespeople to follow with appropriate controls, then it has a strong foundation for generating accurate data to support revenue figures on financial statements.

A more complicated example using the same manufacturing company is the evaluation of business processes that affect direct expense or Cost of Goods Sold. For this example the company does not use standard cost and there are three distinct components that go into manufacturing its product. Using the method of tracing backwards from the income statement starts with accounting processes for allocating costs then moves to the process for tracking Bills of Materials followed by inventory management and finally procurement all the way to the issuance of purchase orders.

Starting with improving how purchase orders are issued and tracked allows the company to ensure that proper quantities are ordered at the correct prices and that the delivery of each raw material and its associated price is confirmed. If prices are not verified correctly at the point of delivery, direct expense or Cost of Goods Sold calculations on the income statement will not be accurate no matter how good cost allocation, Bill of Material tracking, and inventory management processes are. Once improved procurement processes with adequate controls are implemented then the company can look at inventory management, which will ensure that true cost for raw materials are recorded including handling and carrying costs. Next, improving Bill of Material tracking will ensure that raw materials and their associated costs are allocated property to each finished product. Finally, improved processes and techniques for accounting will ensure that proper cost allocations are translated correctly to the income statement.

In order to make the most effective and sustainable process improvements that will positively affect the accuracy of financial data, a company must first be able to identify the core business processes that serve as the foundation for that financial data.

MAKING IMPROVEMENTS

There are several dynamics to consider when looking to improve core business processes. Adding extra steps to a process or implementing new controls will not necessarily remedy issues that have been identified. Additionally, the issue may not be with the process itself, but how the process is followed. Here are a few things to keep in mind.

Determine what type of change actually needs to be made. Consider whether or not the physical process is what really needs to be changed. Is there a good process in place, but it is not being followed correctly? Maybe the necessary change is cultural in nature. For example, a company has a good, easy to follow sales process and system in place for entering and verifying sales orders, but there are still issues with accurate sales data getting to the invoicing function. The cause of these issues could be that there is an attitude within the sales function where salespeople do not see a benefit in closely following the sales process or using necessary features of the system because they feel doing so does not directly improve their sales. In this case, changing the culture of the sales function to emphasize excellence in operation and not just high sales numbers would be the start to implementing a long-term solution. Another possible cause could be that the process and system are not being used as they should because sales management does not properly motivate salespeople to use the system. In this case, coordinating priorities with management and creating a culture within the sales department where processes and systems are used correctly would be the first step towards solving the issue. Putting in place new controls or extra verification steps over the existing process would be counterproductive in either of these examples. Adding additional verification may increase measurable compliance, but the more complicated the process becomes, the more of a chance it generates inaccurate data.

Analyze the complexity of the processes in question. Business processes may be ineffective at generating good data because they are too complicated for the process owners to follow or too cumbersome to allow them to work efficiently. Over time, basic business processes may become complicated by the addition of extra steps and controls in response to exceptions that were identified. The complexity of the process should always match as closely as possible the complexity of the task. If a process reduces an employee's productivity or its complexity creates frustration, it is less likely to be followed properly. Using the sales process example again, if a salesperson has to go through multiple layers of confirmations and approvals before completing a simple transaction they are likely to find short cuts in the process. This is because they feel that the process is slowing down their ability to effectively make sales. Those short cuts could prevent accurate sales data from reaching the invoicing function. Since the sales transaction in this example is simple, the process should be simple as well. If the sales transaction was complicated, then the process should match that complexity. In a department culture geared towards both operational efficiency and increased sales, both managers and salespeople will understand the necessity of following the more complicated process.

Understand the role of different tools and how they support key processes. While in many cases tools can automate certain parts of a process, they are designed to support business processes not replace them. Taking the time to understand how a tool fits within an overall process is critical to selecting the right tool and properly implementing it. Also important is making sure that the complexity of the tool matches the complexity of the process.

CONCLUSION

By improving the flow of information through process improvements, the efficiency of operations will improve as well as the reporting of data. In order to make the correct process improvements, a company must have an understanding of which core business processes to focus on and how to properly implement the improvements.

Companies that have the ability to find and improve business processes that generate financial data can realize significant improvements, both in the quality of their financial data and subsequently on financial reports. By utilizing the right methodology and having the right focus, any small, privately-held company can achieve excellence in operational processes and financial reporting.

ABOUT THE AUTHORS

Maurice Nassar is the Managing Partner for Emergent Partners. He has served in a variety of positions for companies both large and small in management and as a business consultant. Formerly the Chief Financial Officer for a privately-held, international company, he was responsible for building the processes and infrastructure which led to exceptional growth. Throughout his career he has developed the business model and methodologies that Emergent Partners uses to help businesses improve their operations and succeed in their respective markets.

Harvey Stalarow leads the small business consulting practice for Emergent Partners. He brings diverse experience to the Emergent Team having served in a variety of roles in accounting, finance, audit, and operational management in several different industries. Harvey has developed a unique approach to helping privately-held companies address a variety of challenges which serves as the basis for Emergent Partners' small business consulting.

Amy Delaney is a Senior Manager for Emergent Partners focusing on process improvement. She has worked within various industries for both large publicly-traded and privately-held companies. Amy specializes in operational process which includes inventory management, supply chain, ERP systems, and development and documentation of policies and procedures. She is an integral member of Emergent's Business Excellence and System Implementation Support Practices.