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What Happened to My ‘General’ Ledger?

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Executive Summary

What does being a Journal Entry Jockey have to do with a THICK general ledger? The need for more detailed decision-support information has driven accountants to make their trusted tools of the trade do things they were never intended to do – and they are still not getting the information their executives need and can't provide it in a timely manner. Because of this, the financial close process is bloated, slow and costly. What can turn this situation around? Performance Ledgers and Performance Reporting.

Introduction

When executives want information in different strategic or decision-making categories, guess what the accountants do? That's right, they become Journal Entry Jockeys (Exhibit 1) using the double entry system -- specifically designed to meet statutory requirements, not management or performance needs – to try to dig out the information their executives desire..

Figure 1 - Journal Entry Jockey

Accountants add more and more accounts and operational dimensions to the GL to move dollars into different reporting formats using this familiar process; they use what they know and feel comfortable with – more journal entries. Every time different or more detailed analysis is requested, an opportunity for another journal entry presents itself; but even with all the new accounts and segments, revenues and expenses are not always recorded in management-desirable categories, so allocations are additionally needed to further reclassify. Before you know it, the general ledger close process becomes just "too"… too long, too inefficient, too costly, too untimely – and, in many cases, too unsustainable.

Slowly, one change at a time, the GL evolves until eventually it becomes so bloated and unrecognizable that one day you just have to ask yourself, “What happened to my ‘General’ Ledger?”

Thick Versus Thin Ledger

The definition of general is to not be specific or definite. For decades, accountants have referred to their book of record as the general ledger (GL). Based on this generic definition, you might assume the GL would be a high level summary of records, right? Today, not so much.

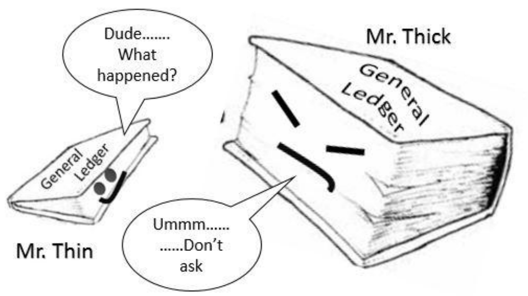

Figure 2 - Thick Versus Thin Ledger

As executives demand more and more performance information, and as technology continues to advance, the GL has exploded into what many consultants call a “thick ledger” (see Exhibit 2). More and more accounts and segments are continuously added to meet reporting requests. Traditional accounting designs contain cost centers, departments, accounts, subaccounts, etc., but decision-makers need even more granular details to understand performance. Not only do they want more detail, but they want it in completely different performance formats such as by customer, by product, by channel, etc. Over time, the number of accounts and segments in a chart of accounts (COA) grows exponentially, thus driving unnecessary complexity to an already heavily burdened accounting process. This continued progression consumes expensive resources (people, processes and technology) and drives inefficiency into the GL close process. The maintenance of accounts, segments, mappings, journal entries, reconciliations, eliminations, adjusting entries, allocations, etc., many on a monthly basis, are all negatively affected. Downstream financial activities, such as planning, budgeting, forecasting, consolidation and reporting are also adversely affected by the “thick ledger” syndrome. Do we really need this burden added on top of already complex statutory accounting processes?

The Accountants–What Were They Thinking?

To resolve this dilemma, it’s important to first understand the mindset of accountants.

The double entry accounting system (debit/credit) has been around for centuries. Every single transaction is collected and recorded into one of five categories: requires you to fill out the Properties dialog box for your file so customers can find your white paper. To do this, identify words or phrases that a customer might enter as a search term in Google and follow these steps:

1. Revenue
2. Expense
3. Asset
4. Liability or
5. Owners' Equity

Universities teach accountants this process to keep the books in balance and report their financial position on a periodic basis. Accounting has its own language and every accountant will smile at the memory of first learning "T" accounts; debits on the left, credits on the right (The same T that they are now riding as Journal Entry Jockeys!). Accountants are drilled with this process to create a universally accepted accounting standardization.

Over time, countries and even industries created laws and regulations that mandate certain reports to govern how the financial position is reported. In the U.S., accountants are most familiar with the accounting standard GAAP. According to Investopedia (www.investopedia.com), "Generally Accepted Accounting Principles (GAAP) are a common set of accounting principles, standards and procedures that companies use to compile their financial statements." Some other statutory authorities interested in mandated reporting are the International Financial Reporting Standards (IFRS), Security Exchange Commission (SEC), Sarbanes-Oxley Act (SOX), and, of course, the beloved Internal Revenue Service (IRS). In order to meet these requirements, accountants know only one way to capture transactions and categorize information - - once again - - using the double entry system. Accounting software applications are continuously evolving to help accountants with requirements using this method, so the mindset of accountants is to use the double entry process for practically everything.

Spreadsheets, in many companies, suffer a similar fate. Many companies try to use spreadsheets for more than they were intended – for example, as databases or to manage their entire company; but, eventually the spreadsheets outgrow their original purpose and managing them becomes extremely time consuming and inefficient. Similar to spreadsheets, it's not a question of whether the general ledger can be used to produce management and performance information, it's a question of should it be used this way?

Is there a better way? Yes, enter the Performance Ledger.

The 'Performance' Ledger

In 2012, Deloitte published an article called "Unlock value through your Chart of Accounts" 1[1]. In this paper, Deloitte outlines eight key steps organizations can take to create a Chart of Accounts (COA) that delivers real value. Step 3 (Listen to the business - not every answer can be found in the COA), talks about not overburdening the general ledger (thick versus thin) while introducing the concept of a management ledger or in our terminology, a performance ledger. The objective of the performance ledger is to supply detailed operational and strategic decision-making information in the timeliest manner possible without interfering with the statutory accounting process. Historically, technology has focused mainly on improving the general ledger. But recent advances by software companies, like Oracle, now have performance ledger abilities – separate from the GL– that focus on performance reporting and analysis, leaving the GL to do what it is good at – statutory reporting.

1 https://www2.deloitte.com/content/dam/Deloitte/au/Documents/audit/deloitte-au-audit-chart-accounts-0812.pdf

Why is this such a big deal? Really, the benefits are four fold:

1) If changes are made to the company, or another company is acquired, rather than making hundreds if not thousands of journal entries to reflect it, changes to a few drivers in a performance ledger can accomplish the same thing. The process is much more automated so there are fewer manual updates that can go wrong

2) Complex allocations require flexibility in how they are calculated (different methods). A performance ledger provides this capability so that allocations reflect the way you do business without having to "fudge" the numbers

3) You cannot run scenarios or model different options in a GL – performance ledgers are BUILT for this purpose

4) Maintaining a thin GL enables you to close your GL quicker, your consolidation software will take care of the higher level rollups for statutory reports, and your performance ledger can deal with the thousands of allocations you need to generate very accurate and detailed analysis and decision-supporting information.

If a company has multiple business units or multiple GLs, THICK GLs magnify the close issue multiple times driving hours, days and sometimes even weeks into the process. In order to address this problem, an organization must evaluate its accounting close cycle from start to finish, and unravel the financial mandated steps from the performance reporting steps. The desired, modern-day accounting close process structure is outlined in Exhibit 3.

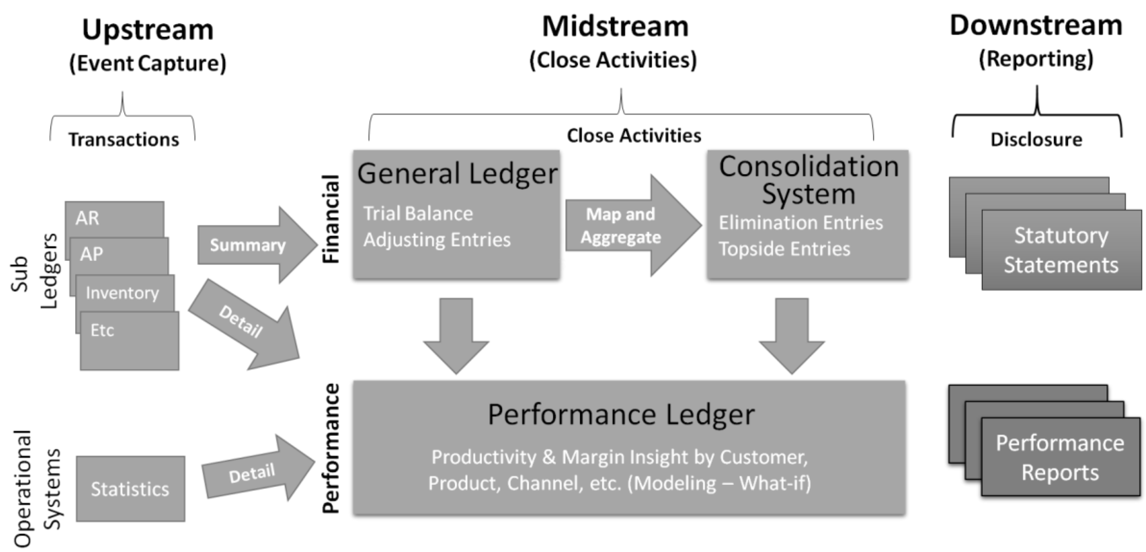

Figure 3 - Modern Day Accounting Close Process

Accounting closes can be divided into upstream, midstream, and downstream processes. Instead of only one part to the close process, there are now two:

The Financial Close

Benefits greatly from a simple and thin chart of accounts that simplifies the mapping required, especially where there are multiple general ledgers involved. Financial/statutory reports typically contain this type of summary information.

The Performance Close

Takes the thin General Ledger data and uses drivers to allocate costs and profit to a much more granular level, enabling you to answer questions such as – who are my top 5 most profitable customers, or which of my sales channels are generating the most profit.

The reason for the separation is to reduce complexity and speed up all types of reporting that can be slowed down by a THICK GL.

There are six main steps involved in creating an efficient financial close process, enabling the consolidation process to efficiently perform, and the performance ledger to generate the details needed to make informed decisions. Unravel the financial close process from your performance reporting this way:

1) Start with your requirements. Identify the minimal requirements for financial and statutory reporting and the detailed requirements for performance reporting
2) Streamline your Chart of Accounts to match the financial and statutory requirements (# of cost centers, accounts, etc)
3) Separate processes involved in the close as either financial or performance driven. The allocation process should be left to your performance ledger
4) Move the detailed information from the GL to the performance ledger
5) Create and use operational drivers in your performance ledger instead of journal entries in your GL to re-categorize and allocate dollars for performance reporting.
6) Design your close process so that the thin GL runs independently, without performance reporting. Use your performance ledger to generate the detail needed for performance analysis.

Ask questions as you evaluate the contents of your GL:

- Why do we have so many revenue, cogs and expense accounts? Do we need them?
- Why so many cost centers?
- Can what we need be captured without requiring new accounts?
- Can we use operational drivers in our performance ledger to allocated and reclassify money instead of making journal entries?

After streamlining the chart of accounts and unraveling the performance reporting requirements, there will be fewer journal accounting entries, a faster GL close, an efficient allocation process in the performance ledger, and better performance information -- all with less resources required.

A Case for Change

Case #1 BestLife Global Insurance Company (pseudonym)

Over time, BestLife had indeed created a THICK GL. Each month, BestLife processes 20,000 lines of pre-allocated actuals which generates over 19 million lines. Best Life's monthly forecast generates 471,000 lines which results in 93 million allocated lines. Before implementing Oracle Hyperion Profitability and Cost Management (HPCM), BestLife's allocations of actual numbers were managed within a PeopleSoft ledger. Managing the process in PeopleSoft required hundreds of steps and frequent time-consuming maintenance. In addition, BestLife's budgeting and forecasting processes were being completed through a Microsoft Access database. The inefficiencies caused by Microsoft Access resulted in a lack of internal transparency due to the software's generalization of account details.

Following the implementation of the HPCM performance ledger system, BestLife is experiencing an improvement in transparency as it can trace cost and profit back to individual accounts. To make better use of the data that BestLife processes on a monthly basis, BestLife plans to integrate all corporate shared services and business lines into their performance ledger system. Their implementation plan consists of an America-wide implementation followed by a global rollout. Managing their statutory reporting in PeopleSoft and the decision-making operational and management data in their performance ledger system has indeed simplified their processes, improved time to process each, and provided them with the details needed to make better decisions.

Case #2 AudioMeetings Inc. (pseudonym)

AudioMeetings Inc. was seeking to better understand the core drivers of profitability on their business. Due to the complex nature of their business combined with their THICK GL, AudioMeetings was only able to conduct a detailed analysis annually (it was very painful). Their experience told them that many of their customers were not using their services efficiently, but their THICK GL was not transparent and therefore they could not prove it or fix it. After implementing Oracle Hyperion Profitability and Cost Management (HPCM), a performance ledger system, AudioMeetings was able to successfully determine the customers, products, and channels that were driving the greatest sources of profitability and the greatest sources of cost, and perform the analysis monthly.

AudioMeetings' implementation partner was able to implement their performance ledger system in a smooth and timely manner by integrating AudioMeetings' existing financial hierarchies (from their GL and their consolidation system) with the new technology. Their partner found that the performance ledger solution efficiencies enabled them to reduce their implementation time by 30-40% by reusing these hierarchies. Since the implementation, AudioMeetings has been able to provide targeted support to inefficient customers and lower costs for their customers and themselves.

Confessions from a Recovering CFO

It is interesting to observe the evolution of the office of the CFO over the last few decades. Back when there were interest rates to speak of, the office of the CFO was asked to not only debit and credit the financial performance of the enterprise, but to also manage the cash. This dual role led to the rise of the investment banker CFO. These CFO's did not have a traditional accounting background, and were more deal-makers than bookkeepers. Paramount to the survival of the enterprise was managing financing. The increasing sophistication of accounting and finance systems further enabled this evolution and were, in fact, the tools used to get it done.

In 2008, external financing started to become scarce. Profitability relied more on expense management rather than revenue growth. The rising tide had receded and only nimble, clever ships stayed afloat. Since the CFO's office had already repurposed the financial systems for treasury/ equity management, at the time, it made sense to repurpose them again. After all, the financial information was already in the GL, what could it hurt to add a little bit more to the GL. As chronicled earlier in this article, this led to the birth of the "thick general ledger".

Ironically, in my experience, the THICK GL is the number one driver of the lack of nimbleness now ubiquitous in organizations. The performance ledger cures this. It does not "contain" anything. In fact the GL performs best when it is limited to containing trial balances rather than statistical data. The performance ledger is the aggregation of operational/ statistical data and financial data to produce actionable information that can lead to better decision-making and bring back the nimbleness necessary to run today's enterprises.

Good accountants do accounting really well. Today, filing and regulatory requirements (SOX, SEC, IFRS, etc.) should be THE primary role of the accounting department. A thick general ledger, that has many uses and masters, is an inefficient way to accomplish this. It would be inappropriate for operational people to file the 10k, and it is just as inappropriate to expect accountants to produce operational information from the GL. Instead, the best practice is to have a performance ledger that is an aggregate of all available information, and is flexible enough to get the information they need to make decisions. As a bonus, the office of the CFO will be freed up to start the treasury function again just in time for the next interest rate rise. But that is fodder for a different article.
-Doug Orsagh CFA, CPA, Recovering CFO

OK, So Now What?

Consider putting your THICK GL on a diet and unravel the statutory accounts and dimensions from the performance dimensions using the performance ledger philosophy. Let your performance ledger do the heavy lifting, that's what it was designed to do. If you are having trouble letting go of dimensions and complexity, consider talking to a management consultant about an unbiased evaluation. Lastly, be sure you have the right GL, consolidation tool, and performance ledger solution to get the job done.

If you do decide to put your GL on a diet, expect the following three benefits immediately:

- Reduce the total cost of ownership of the financial close process (fewer journal entries, less allocations and reconciliation points which mean fewer mistakes and corrections)
- Shorten the time to close a thin GL
- Get better performance information and make better financial and operational decisions

So go on, get OFF your horse, get some juicy performance information, and make some awesome decisions that will financially improve your company.

Authors

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