Prophix

Financial Consolidation:

Get a true picture of your company's financials and performance

Financial consolidation is a process that is usually used to aggregate financial results from multiple legal entities and to make adjustments to the results. However, many financial professionals regard it as a necessary evil that can be handled either in a "hit and miss" way using spreadsheets or comprehensively with software that can handle extremely complex situations but that is also expensive. Prophix provides a third alternative that is easy-to-use, has a low cost of ownership, and is attractive to mid-market companies.

A Prophix white paper

Inside this document

Financial Consolidation is More Than “Closing the Books”

> In most jurisdictions, there is no legal requirement for a company to perform financial consolidation. If there is a mandated requirement it is for external stakeholders (such as the SEC for a US public corporation, or a lending institution if a company has debt) but governments are mostly interested in ensuring that legal entities pay their taxes. In many cases, external stakeholders require financial results in more than a single accounting standard and financial consolidation helps with this.

But reporting on historical data for external stakeholders is only one application of financial consolidation. Financial consolidation can also be used for internal reporting purposes, as a component of management reporting. For example, a group of vertically organized companies can better understand their business plans if intercompany sales are eliminated. The profitability of subsidiaries can be better understood if planned corporate costs, such as legal expenses or shared services, can be allocated to operating entities.

This type of management reporting can also be used to provide rigorous numbers for compensation purposes. It is more difficult for departmental managers to exaggerate their performance if the customer is external rather than internal and financial consolidation can eliminate internal sales.

Financial consolidation can also be invaluable for planning. Any multi-entity organization needs to understand what their sales are to external customers, since this is a better reflection of the market they are selling into. Financial consolidation can be used to plan what will happen if an operating unit is sold or if a company increases its stake in a partially owned subsidiary. There may be multiple planning scenarios involving acquisitions or divestitures. This type of planning is highly strategic and not as detailed as budgeting or forecasting; it is accomplished most easily with financial consolidation software.

Financial Consolidation is Changing

> Until recently, most companies that had a need for financial consolidation had the following choices:

- Use spreadsheets and compromise.
- Spend a lot of money on enterprise-level software that is used by large multinationals with hundreds of operating entities. This will get the job done, but will cost a lot and be unnecessarily complex to use.
- Try and use their ERP system. This is also a compromise that may work easily, provided every operating entity uses the same ERP software and the same chart of accounts. As every finance professional who has been involved on an ERP implementation knows, moving data between different technologies with different account coding can be a challenge. Most ERP systems are not designed for financial consolidation and have poor reporting capabilities.

Prophix is addressing the needs of mid-market companies that have a multi-entity financial consolidation and reporting requirement. There is a clear need for this in Europe and a growing awareness in North America.

Prophix is comprehensive enough to meet the current and future needs of its users, as well as flexible enough to be used for management reporting and scenario planning.

This is how the financial consolidation world is changing. It's no longer just financial reporting for large companies but is becoming a reporting and management tool for the mid-market.

Eliminate the Cost of Spreadsheet Consolidation

Most companies start on their financial consolidation journey using spreadsheets. However, spreadsheets leave a lot to be desired. Spreadsheets are:

Prone to error

Errors can include incorrect entry of numbers, formulas or even getting out of sync with the versioning of the current spreadsheet. What's more, even after an error has been noticed, it can take a long time to find the real problem, fix it, and realign all parties involved.

Labor intensive

Finance professionals who deal with financial consolidation are, almost by definition, highly educated; having them spend time copying data and formulas in a spreadsheet is a serious waste of resources.

Limited reporting

With financial consolidation, audit trails and flexible reporting are important.

Difficult to document

It is a major risk if your company's financial reporting depends on a spreadsheet model that is fully understood by only one employee.

Cannot meet deadlines

Not able to meet regulatory and internal deadlines for report submissions and compliance guidelines.

There are many other reasons why spreadsheets are not ideal when used for financial consolidation. Perhaps the most important is that financial consolidation is a very visible process that has to be done quickly and accurately. If the consolidated reports are late or don't add up correctly, the finance department can be in trouble. Using spreadsheets is risky but financial consolidation software like Prophix helps CFOs sleep at night.

However, when people think of financial consolidation software, they often assume it is expensive and complicated to implement. This is because most financial consolidation software has been designed to be used by large companies that have complex needs.

This is now changing; the world has become a smaller place. It is now recognized that mid-sized companies often have multiple legal entities either because of overseas expansion or through mergers and acquisitions.

Prophix software is designed to be easy to use for mid-size companies that have financial consolidation needs. Prophix customers have access to all the functionality that is required to meet sophisticated financial consolidation needs, but with a reasonable total cost of ownership.

What to Look for in Financial Consolidation Software

Financial consolidation software like Prophix exists because companies need more functionality than is available in their current processes. Before taking the plunge and using Prophix, companies are often using either spreadsheets or components of their Enterprise Resource Planning (ERP) software. But Prophix offers so much more:

Multi-user Journal Entry Management including:

- Automatic calculation of intercompany elimination journal entries
- Automatic reversing journal entries
- Managerial approvals for journal entries with Workflow

Support for Modeling Sophisticated Corporate Structures including:

- Multiple reporting entities for different accounting standards or planning scenarios
- Partial ownership of operating entities, variable over time
- Support for multiple currencies including automatic triangulation of exchange rates

Data Management Functionality such as:

- Importing of data from multiple ERPs including automatic debit/credit intelligence
- Mapping and aggregation of accounts when importing from ERPs
- Fully integrated reporting including report distribution as PDFs
- Scheduled collection of data from operating entities including Workflow reminders

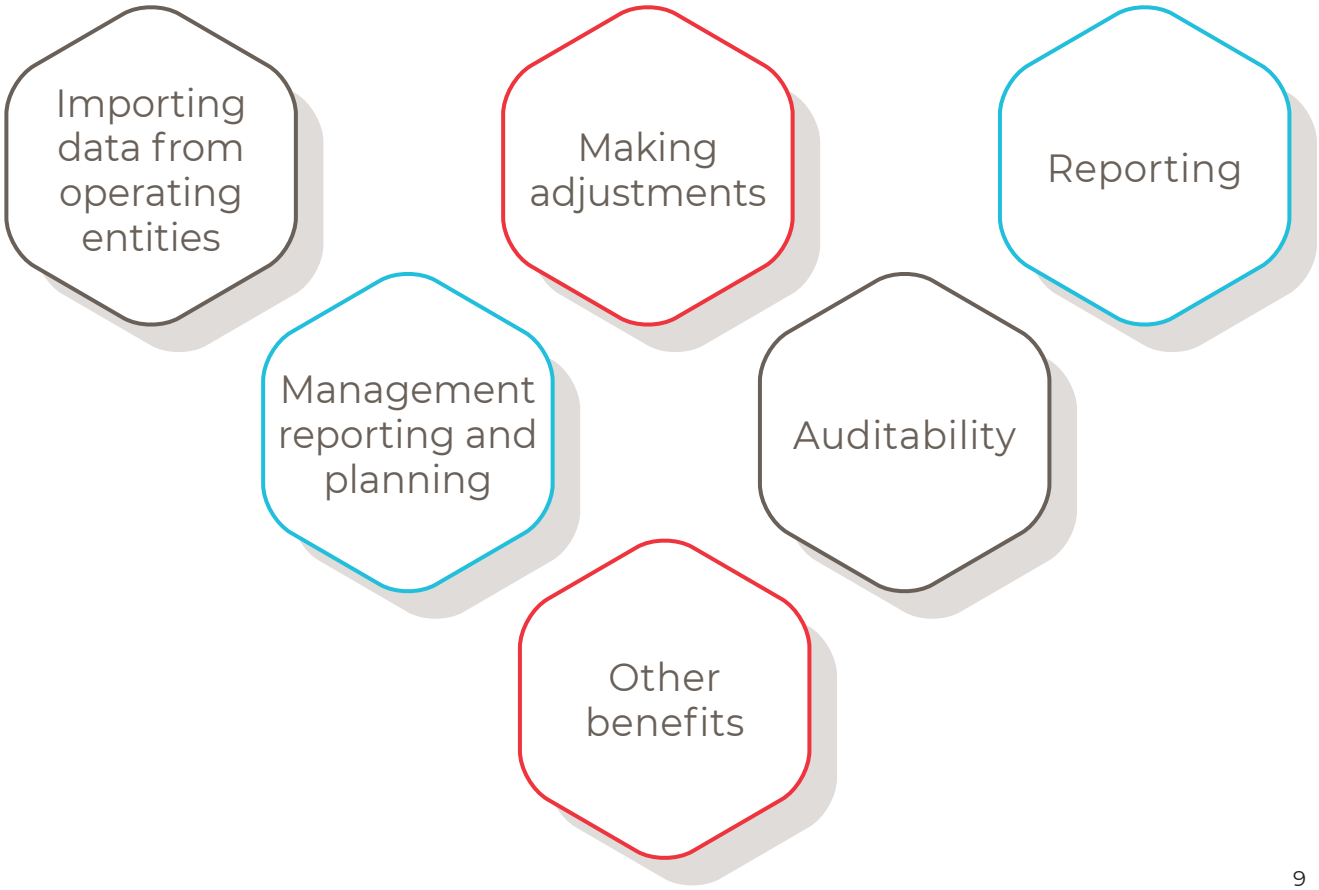
Some of this functionality may be available in your ERP system; most of it is lacking with spreadsheets.

Perhaps the greatest benefit of using Prophix for financial consolidation is ease of use; Prophix is designed to be used by finance professionals, not by IT consultants. Prophix is a fully unified system that is used for other applications such as planning, financial reporting and analysis, as well as financial consolidation.

This means that a company that uses Prophix just for financial consolidation has access to all the other capabilities of the system; without the need to acquire extra software, you can import data, calculate ratios, design reports, distribute data entry templates, and manage workflow for collecting data.

The Financial Consolidation Process

Financial consolidation is a process. For many CFOs, the challenge is setting it up in the first place; when it has been shown to work effectively, running the process every month or every quarter should not be a problem. Prophix's ease of use means that finance professionals can manage monthly consolidations themselves. When companies get started with Prophix they usually employ the services of our consulting staff to get started and make sure the data is correctly imported from the operating entities. This is often a collaboration between Prophix and our customer. Once your finance staff have learnt the system, they don't need to call in a consultant every time they need a new report or wish to change the way they do consolidations.



Importing Data from Operating Entities

One of the most common concerns about financial consolidation software relates to the ease of importing general ledger data from operating entities. There are two aspects to this – the technical aspect of physically accessing the data and the need to "massage" the data before it can be consolidated.

The first of these is not a problem; Prophix has been electronically interfaced with hundreds of different ERP and accounting systems. An alternative to interfacing electronically is to collect from operating entities using a manual process – either staff enter it directly or it is collected in spreadsheets that are automatically generated by Prophix.

The second aspect can be straightforward, provided all operating entities have identical charts of accounts and the consolidation process requires data at the same level of granularity as the operating entities. Often though, this is not the case; operating entities often have different ERP software and different charts of accounts. Prophix contains facilities to map data when it is imported to a common consolidation chart of accounts. This can also include automatic aggregation of data.

Making Adjustments

Once source data has been imported from operating entities, it is usually necessary to make adjustments. This is done in Prophix using debit and credit journal entries. Journal entry data is segregated from the source data and journal entry data can itself be segregated into different types for reporting purposes.

Intercompany eliminations – The most obvious type of journal entry is an intercompany elimination. This is usually used when a group of companies are vertically integrated and therefore, sales between operating entities need to be eliminated or "backed out". Companies also make adjustments for other reasons. For example, corporate costs can be allocated to operating entities.

Reporting

Flexible and comprehensive reporting from financial consolidation software is essential. This is not just dashboarding or other "BI" type reporting but proper accounting-style reports. Because Prophix is a unified system, companies that use Prophix for financial consolidation automatically have full access to all of its reporting capabilities.

Management Reporting and Planning

When financial consolidation is used for management reporting, it is usually a monthly exercise and less rigorous than if it was mandated. For example, for management reporting purposes, reporting using US GAAP may be sufficient. While at year-end, both IFRS and US GAAP reporting is required. An example of how financial consolidation and management reporting are related is when revenues or expenses need to be restated for internal reporting purposes. Marketing costs can be allocated from corporate to subsidiaries or intercompany eliminations can be used to understand exactly what was sold to customers (and not to other operating entities) and hence, the performance of the salesforce can be better understood.

Financial consolidation is not restricted to reporting historical, actual data. Some companies also perform a formal consolidation of planning data. For example, after all subsidiaries have formulated an annual budget, these are then consolidated and adjusted for intercompany eliminations to produce budgeted figures for the entire company. The requirements for consolidating planning data are usually a lot less rigorous than for historical data. Planning financial consolidations is especially important if a company is considering an acquisition or a divestiture. The planned transaction can be modeled using Journal Entries and multiple reporting entities can be created for different scenarios.

Companies also use financial consolidation to perform scenario analysis relating to intercompany transfer pricing. By modeling different transfer pricing scenarios, companies can minimize their tax obligations.

Auditability

Your business should always be prepared for an audit. When you are not, audits can get complicated and unnecessarily drawn out. Prophix helps to simplify audits by enabling the creation of detailed and auditable consolidated financial reports when you need them for greater transparency and compliance. This helps to minimize the time and associated disruption that comes during an audit.

Other Benefits

Quite apart from reporting and planning, there are other reasons why companies need financial consolidation. For example:

- For a holding company, they may not need to have a separate general ledger but they use the financial consolidation system as the system of record. An audit trail would meet external audit requirements.
- Future audit fees can be reduced when there are standard end-of-year journal entries that have been previously checked and approved by external auditors.
- Using Prophix for financial consolidation can remove the need for a group of companies to standardize on ERP software. Consolidating financial results in Prophix is usually more cost effective (and more functional) than moving all subsidiaries onto a single ERP.

Workflow

In some companies, financial consolidation is always run by a single person. However, when more than one person is involved, an important aspect of financial consolidation is keeping track of the various manual processes. This is because the financial consolidation process usually takes place at month-end and it is essential to produce consolidated reports as soon as possible. There are problems if the process is delayed because operating entities are late in submitting data (general ledger or intercompany sales) or if an approver takes too long to review consolidated figures. Delays can be due to sickness, vacations or any number of other reasons. In financial consolidation, there are potentially two main multi-user workflow requirements:

- When importing source data or intercompany sales data, users need to be reminded to submit information in a timely manner. If they are late, reminders should become more frequent. When data is submitted, the person in charge of financial consolidation needs to be informed.
- After consolidated results have been calculated, many companies have an approval process where people other than the person in charge of financial consolidation is required to approve the consolidated numbers. This can involve a detailed look at all the adjustments. Approvers should have the ability to force a recalculation of the month under review with revised adjustments. However, if no formal approval is given, this should merely be noted and no further action taken. An audit report will indicate those approvers who have given their formal approval, those who rejected the consolidated numbers, and those who did neither.

Summary

Business environments are becoming more sophisticated and companies are growing not only organically but also through mergers and acquisitions. Because of these factors, consolidation of financial results from multiple legal entities has become more important to mid-market companies.

Financial consolidations are performed by different companies for different purposes. Financial consolidation is used not only for reporting on historical financial reporting but also for management reporting and scenario planning.

Financial consolidation is a process that can touch many people, whether for data entry, approvals or reporting. Therefore, workflow is essential to make it work.

Financial consolidation is not just adding up company data in a hierarchy. It also involves journal entries to make adjustments and the ability to consolidate any chosen operating entities. Partial ownerships and currency conversion also make it more intricate.

What at first sight may appear to a simple process can become quite complicated. Because of this, spreadsheets are not adequate for the financial consolidation needs of most companies.

In the past, financial consolidation software has been expensive and designed for very large companies. Now, software like Prophix makes it cost effective for all companies to perform financial consolidations that are easy to use and managed by finance staff.

About Prophix

Your business is evolving. And the way you plan and report on your business should evolve too. Prophix helps mid-market companies achieve their goals more successfully with innovative, cloud-based Corporate Performance Management (CPM) software. With Prophix, finance leaders improve profitability and minimize risk by automating budgeting, forecasting and reporting and puts the focus back on what matters most – uncovering business opportunities. Prophix supports your future with AI innovation that flexes to meet your strategic realities, today and tomorrow. Over 1,500 global companies rely on Prophix to transform the way they work.

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