ACCOUNTING

Best Practices

SIXTH EDITION

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About the Author

Steven Bragg, CPA, has been the chief financial officer or controller of four companies, as well as a consulting manager at Ernst & Young and auditor at Deloitte & Touche. He received a master's degree in finance from Bentley College, an MBA from Babson College, and a bachelor's degree in economics from the University of Maine. He has been the two-time president of the Colorado Mountain Club and is an avid alpine skier, mountain biker, and certified master diver. Mr. Bragg resides in Centennial, Colorado. He has written the following books published by John Wiley & Sons:

Accounting and Finance for Your Small Business

Accounting Best Practices

Accounting Control Best Practices

Accounting Policies and Procedures Manual

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

Controllership

Cost Accounting

Essentials of Payroll

Fast Close

Financial Analysis

GAAP Guide

GAAP Policies and Procedures Manual

Inventory Accounting

Inventory Best Practices

Just-in-Time Accounting

Managing Explosive Corporate Growth

Mergers and Acquisitions

Outsourcing

Payroll Accounting

Payroll Best Practices

Revenue Recognition

Running a Public Company

Sales and Operations for Your Small Business

The Controller's Function

The New CFO Financial Leadership Manual

The Ultimate Accountants' Reference

Treasury Management

Free On-Line Resources
by Steve Bragg

Steve issues an accounting best practices podcast, and posts many other accounting materials at accountingtools.com.

Preface

The accounting department is a cost center. It does not directly generate revenues, but, rather, provides a fixed set of services to the rest of the company, and is asked to do so at the lowest possible cost. Consequently, the accounting staff is called on to process transactions, write reports, create new processes, or investigate old ones—while doing so as an ever-shrinking proportion of total corporate expenses.

This cost-based environment is a very difficult one for most accountants, for their training is primarily in accounting rules and regulations, rather than in how to run a very specialized department in a cost-effective manner. They find a few ideas for improvements from attending seminars or perusing accounting or management magazines, but there is no centralized source of information for them to consult that itemizes a wide array of possible improvements. Hence the need for the sixth edition of *Accounting Best Practices*, which contains 406 accounting best practices, of which 57 are new to this edition.

This book is compiled from the author's lengthy experience in setting up and operating a number of accounting departments, as well as by providing consulting services to other companies. Accordingly, it contains a blend of best practices from a wide variety of accounting environments, ranging from small partnerships to multibillion-dollar corporations. This means that not all of the best practices described within these pages will be useful in every situation— some are designed to provide quick and inexpensive, incremental improvements, while others are groundbreaking events requiring six-figure investments (or more) and months of installation time. Consequently, each chapter includes a table that notes the ease, duration, and cost of implementation for every best practice within it. These tables separate best practices into a number of subcategories, and also contain a reference number that is useful for locating the main text for each best practice within the chapter. Also, a selection of best practices have an "Author's Choice" graphic posted next to them. These best practices are ones the author has found to be particularly effective in improving accounting operations. All best practices are also noted in summary form in Appendix A.

Although this book is the central source of best practices information for the accountant, there are several other books available that specialize in smaller niches within the accounting area. Each of these books contains many additional best practices not found in *Accounting Best Practices*. These include the author's *Inventory Best Practices* (John Wiley & Sons, 2004), *Billing and Collections Best Practices* (John Wiley & Sons, 2005), *Payroll Best Practices* (John Wiley & Sons, 2005), and *Fast Close*, 2nd Edition (John Wiley & Sons, 2009).

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Chapter 1

Introduction

A chief executive officer (CEO) spends months deciding on a corporate strategy. The plan probably includes a mix of changes in products, customers, and markets, as well as demands for increased efficiencies or information in a number of existing areas. The CEO then hands off the plan to a group of managers who are quite capable of implementing many of the changes, but who scratch their heads over how to squeeze greater efficiencies or information out of existing departments in order to meet their strategic goals. This is where best practices come into play.

A best practice is really *any* improvement over existing systems, though some consultants prefer to confine the definition to those few high-end and very advanced improvements that have been successfully installed by a few world-class companies. This book uses the broader definition of any improvement over existing systems, since the vast majority of companies are in no position, in terms of either technological capabilities, monetary resources, or management skill, to make use of truly world-class best practices. Using this wider definition, a best practice can be anything that increases the existing level of efficiency, such as switching to blanket purchase orders, signature stamps, and procurement cards to streamline the accounts payable function. It can also lead to improved levels of reporting for use by other parts of the company, such as activity-based costing, target costing, or direct costing reports in the costing function. Further, it can reduce the number of transaction errors, by such means as automated employee expense reports, automated bank account deductions, or a simplified commission calculation system. By implementing a plethora of best practices, a company can greatly improve its level of efficiency and information reporting, which fits nicely into the requirements of most strategic plans.

One can go further than describing best practices as an excellent *contributor* to the fulfillment of a company's strategy, and even state that a strategy does not have much chance of success *unless* best practices are involved. The reason is that best practices have such a large impact on overall efficiencies, they unleash a large number of excess people who can then work on other strategic issues, as well as reduce a company's cash requirements, releasing more cash for investment in strategic targets. In addition, some best practices link company functions more closely together, resulting in better overall functionality—this is a singular improvement when a company is in the throes of changes caused by strategy shifts. Further, best practices can operate quite well in the *absence* of a

strategic plan. For example, any department manager can install a variety of best practices with no approval or oversight from above, resulting in a multitude of beneficial changes. Thus, best practices are a linchpin of the successful corporate strategy, and can also lead to improvements even if they are not part of a grand strategic vision.

The scope of this book does not encompass all of the best practices that a company should consider, only those used by the accounting department. This area is especially susceptible to improvement through best practices, since it is heavily procedure-driven. When there are many procedures, there are many opportunities to enhance the multitude of procedure steps through automation, simplification, elimination of tasks, error-proofing, and outsourcing. Thus, of all the corporate functions, this is the one that reacts best to treatment through best practices.

Chapter 2 covers a variety of issues related to the implementation of best practices, such as differentiating between incremental and reengineering changes, circumstances under which best practices are most likely to succeed, and how to plan and proceed with these implementations. Most important, there is a discussion of the multitude of reasons why a best practice implementation can fail, which is excellent reading prior to embarking on a new project, in order to be aware of all possible pitfalls. The chapter ends with a brief review of the impact of best practices on employees. This chapter is fundamental to the book, for it serves as the groundwork on which the remaining chapters are built. For example, if you are interested in modifying the general ledger account structure for use by an activity-based costing system, it is necessary to first review the implementation chapter to see how any programming, software package, or interdepartmental issues might impact the project.

Chapters 3 through 18 each describe a cluster of best practices, with a functional area itemized under each chapter. For example, Chapter 9 covers a variety of improvements to a company's commission calculation and payment systems, while Chapter 18 is strictly concerned with a variety of payroll-streamlining issues related to the collection of employee time information, processing it into payments, and distributing those payments. Chapter 14 is a catchall chapter. It covers a variety of general best practices that do not fit easily into other, more specific chapters. Examples of these best practices are the use of process-centering, on-line reporting, and creating a contract-terms database. Chapters 3 through 18 are the heart of the book since they contain information related to over 400 best practices.

For Chapters 3 through 18, there is an exhibit near the beginning that shows the general level of implementation cost and duration for each of the best practices in the chapter. This information gives the reader a good idea of which best practices to search for and read through, in case these criteria are a strong consideration. For each chapter, there are a number of sections, each one describing a best practice. There is a brief description of the problems it can fix, as well as notes on how it can be implemented, and any problems one may encounter while doing so. Each chapter concludes with a section that describes the impact of a recommended

mix of best practices on the functional area being covered. This last section almost always includes a graphical representation of how certain best practices impact specific activities. Not all the best practices in each chapter are included in this graphic, since some are mutually exclusive. This chapter layout is designed to give the reader a quick overview of the best practices that are most likely to make a significant impact on a functional area of the accounting department.

Appendix A lists all of the best practices in each of the preceding chapters. This list allows the reader to quickly find a potentially useful best practice. It is then a simple matter to refer back to the main text to obtain more information about each item.

This book is designed to assist anyone who needs to either improve the efficiency of the accounting department, reduce its error rates, or provide better information to other parts of a company. The best practices noted on the following pages will greatly assist in attaining this goal, which may be part of a grand strategic vision or simply a desire by an accounting manager to improve the department. The layout of the book is extremely practical: to list as many best practices as possible, to assist the reader in finding the most suitable ones, and to describe any implementation problems that may arise. In short, this is the perfect do-it-yourself fix-it book for the manager who likes to tinker with the accounting department.

How to Use Best Practices

This chapter is about implementing best practices. It begins by describing the various kinds of best practices and goes on to cover those situations where they are most likely to be installed successfully. The key components of a successful best practice installation are also noted. When planning to add a best practice, it is also useful to know the ways in which the implementation can fail, so there is a lengthy list of reasons for failure. Finally, there is a brief discussion of the impact of change on employees and the organization. Only by carefully considering all of these issues in advance can one hope to achieve a successful best practice implementation that will result in increased levels of efficiency in the accounting department.

Types of Best Practices

This section describes the two main types of best practices, each one requiring considerably different implementation approaches.

The first type of best practice is an incremental one. This usually involves either a small modification to an existing procedure or a replacement of a procedure that is so minor in effect that it has only a minimal impact on the organization, or indeed on the person who performs the procedure. The increased level of efficiency contributed by a single best practice of this type is moderate at best, but this type is also the easiest to install, since there is little resistance from the organization. An example of this type of best practice is using a signature stamp to sign checks (see Chapter 3); it is simple, cuts a modest amount of time from the check preparation process, and there will be no complaints about its use. However, only when this type of best practice is used in large numbers is there a significant increase in the level of efficiency of accounting operations.

The second type of best practice involves a considerable degree of reengineering. This requires the complete reorganization or replacement of an existing function. The level of change is massive, resulting in employees either being laid off or receiving vastly different job descriptions. The level of efficiency improvement can be several times greater than the old method it is replacing. However, the level of risk matches the reward, for this type of best practice meets with enormous resistance and consequently is at great risk of failure. An example of this type of best practice is eliminating the accounts payable department in favor of

having the receiving staff approve all payments at the receiving dock (see Chapter 3); it involves the elimination of many jobs and is an entirely new approach to paying suppliers. A single best practice implementation of this sort can reap major improvements in the level of accounting efficiency.

Thus, given the considerable number and size of the differences between the incremental and reengineering best practices, it is necessary to first determine into which category a best practice falls before designing a plan for implementing it. Given the difficulty of implementation for a reengineering project, it may even be necessary to delay implementation or intersperse a series of such projects with easier incremental projects in order to allow employees to recover from the reengineering projects.

The Most Fertile Ground for Best Practices

Before installing any best practice, it is useful to review the existing environment to see if there is a reasonable chance for the implementation to succeed. The following bullet points note the best environments in which best practices not only can be installed, but also have a fair chance of continuing to succeed:

- *If benchmarking shows a problem.* Some organizations regularly compare their performance levels against those of other companies, especially those with a reputation for having extremely high levels of performance. If there is a significant difference in the performance levels of these other organizations and the company doing the benchmarking, this can serve as a reminder that continuous change is necessary in order to survive. If management sees and heeds this warning, the environment in which best practices will be accepted is greatly improved.

- *If management has a change orientation.* Some managers have a seemingly genetic disposition toward change. If an accounting department has such a person in charge, there will certainly be a drive toward many changes. If anything, this type of person can go too far, implementing too many projects with not enough preparation, resulting in a confused operations group whose newly revised systems may take a considerable amount of time to untangle. The presence of a detail-oriented second-in-command is very helpful for preserving order and channeling the energies of such a manager into the most productive directions.

- *If the company is experiencing poor financial results.* If there is a significant loss, or a trend in that direction, this serves as a wake-up call to management, which, in turn, results in the creation of a multitude of best practices projects. In this case, the situation may even go too far, with so many improvement projects going on at once that there are not enough resources to go around, resulting in the ultimate completion of few, if any, of the best practices.

- *If there is new management.* Most people who are newly installed as managers of either the accounting department or (better yet) the entire organization want to make changes in order to leave their marks on the organization. Though this can involve less effective practice items like organizational changes or a new strategic direction, it is possible that there will be a renewed focus on efficiency that will result in the implementation of new best practices.

In short, as long as there is a willingness by management to change and a good reason for doing so, then there is fertile ground for the implementation of a multitude of best practices.

Planning for Best Practices

A critical issue for the success of any best practices implementation project is an adequate degree of advance planning. The following bullet points describe the key components of a typical best practices implementation plan:

- *Capacity requirements.* Any project plan must account for the amount of capacity needed to ensure success. Capacity can include the number of people, computers, or floor space that is needed. For example, if the project team requires 20 people, then there must be a planning item to find and equip a sufficient amount of space for this group. Also, a project that requires a considerable amount of programming time should reserve that time in advance with the programming staff to ensure that the programming is completed on time. Further, the management team must have a sufficient amount of time available to properly oversee the project team's activities. If any of these issues are not addressed in advance, there can be a major impact on the success of the implementation.

- *Common change calendar.* If there are many best practices being implemented at the same time, there is a high risk that resources scheduled for one project will not be available for other projects. For example, a key software developer may receive independent requests from multiple project teams to develop software, and cannot satisfy all the requests. To avoid this, one should use a single change calendar, so that planned changes can be seen in the context of other changes being planned. The calendar should be examined for conflicts every time a change is made to it, and also be made available for general review, so that all project teams can consult it whenever needed.

- *Contingencies.* Murphy's Law always applies, so there should be contingencies built into the project plan. For example, if the project team is being set up in a new building, there is always a chance that phone lines will not be installed in time. To guard against this possibility, there should be an additional project step to obtain some cellular phones, which will supply the team's communications needs until the phone lines can be installed.

- *Dependencies.* The steps required to complete a project must be properly sequenced so that any bottleneck steps are clearly defined and have sufficient resources allocated to them to ensure that they are completed on time. For example, a project planning person cannot set up the plan if there is no project planning software available and loaded into the computer. Consequently, this step must be completed before the planning task can commence.

- *Funding requirements.* Any project requires some funding, such as the purchase of equipment for the project team or software licenses or employee training. Consequently, the project plan must include the dates on which funding is expected, so that dependent tasks involving the expenditure of those funds can be properly planned.

- *Review points.* For all but the smallest projects, there must be control points at which the project manager has a formal review meeting with those people who are responsible for certain deliverables. These review points must be built into the plan, along with a sufficient amount of time for follow-up meetings to resolve any issues that may arise during the initial review meetings.

- *Risk levels.* Some best practices, especially those involving a large proportion of reengineering activities, run a considerable risk of failure. In these cases, it is necessary to conduct a careful review of what will happen if the project fails. For example, can the existing system be reinstituted if the new system does not work? What if funding runs out? What if management support for the project falters? What if the level of technology is too advanced for the company to support? The answers to these questions may result in additional project steps to safeguard the project, or to at least back it up with a contingency plan in case the project cannot reach a successful conclusion.

- *Total time required.* All of the previous planning steps are influenced by one of the most important considerations of all—how much time is allocated to the project. Though there may be some play in the final project due date, it is always unacceptable to let a project run too long, since it ties up the time of project team members and will probably accumulate extra costs until it is completed. Consequently, the project team must continually revise the existing project plan to account for new contingencies and problems as they arise, given the overriding restriction of the amount of time available.

The elements of planning that have just been described will all go for naught if there is not an additional linkage to corporate strategy at the highest levels. The reason is that although an implementation may be completely successful, it may not make any difference, and even be rendered unusable, if corporate strategy calls for a shift that will render the best practice obsolete. For example, a fine new centralized accounts payable facility for the use of all corporate divisions is not of much use if the general corporate direction is to spin off or sell all of those divisions. Thus, proper integration of low-level best practices planning with high-level corporate planning is required to ensure that the correct projects are completed.

Given the large number of issues to resolve in order to give an implementation project a reasonable chance of success, it is apparent that the presence of a manager who is very experienced in the intricacies of project planning is a key component of an effective project team. Consequently, the acquisition of such a person should be one of the first steps to include in a project plan.

This section described in general terms the key components of a project plan that must be considered in order to foresee where problems may arise in the course of an implementation. We now proceed to a discussion of the impact of time on the success of a best practices implementation.

Timing of Best Practices

The timing of a best practice implementation, the time it takes to complete it, and the pacing of installations have a major impact on the likelihood of success.

The timing of an implementation project is critical. For example, an installation that comes at the same time as a major deliverable in another area will receive scant attention from the person who is most responsible for using the best practice, since it takes a distant second place to the deliverable. Also, any project that comes on the heels of a disastrous implementation will not be expected to succeed, though this problem can be overcome by targeting a quick and easy project that results in a rapid success—and that overcomes the stigma of the earlier failure. Further, proper implementation timing must take into account other project implementations going on elsewhere in the company or even in the same department, so there is no conflict over project resources. Only by carefully considering these issues prior to scheduling a project will a best practice implementation not be impacted by timing issues.

In addition to timing, the *time* required to complete a project is of major importance. A quick project brings with it the aura of success, a reputation for completion, and a much better chance of being allowed to take on a more difficult and expensive project. Alternatively, a project that impacts lots of departments or people, or that involves the liberal application of cutting-edge technology, runs a major risk of running for a long time; and the longer the project, the greater the risk that something will go wrong, objections will arise, or that funding will run out. Thus, close attention to project duration will increase the odds of success.

Also, the concept of *pacing* is important. This means that a best practices implementation will be more likely to succeed if only a certain number of implementations are scheduled for a specific area. For example, if corporate management wants to install several dozen different types of best practices in five different departments, the best implementation approach is to install one best practice in a single department and then move on to a different department. By doing so, the staff of each department has a chance to assimilate a single best practice, which involves staff training, adjustments to policies and procedures, and modifications of work schedules. Otherwise, if they are bombarded with