GUIDE

# Pocket Guide for Managing Month-End Reconciliations

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# Balance Sheet Reconciliations: Why Do We Need Them?

If you're wondering why balance sheet reconciliations are so important, look no further than audits and financial statement assertions. Balance sheet reconciliations validate the accuracy of the general ledger balance by comparing it to financial documentation. Reconciliations are a critical business control, and demonstrate that a company's books accurately reflect its current financial status.

The balance sheet reconciliation process usually involves accountants consulting Excel files with financial data such as payroll, transactions, accounts payable, and subscriptions, along with independent, third-party back-up documents such as bank statements and invoices. Where errors or discrepancies are found, accountants must work to correct or explain them so that their company's financial statements make sense, and can be audited. The complexity of that work can be a significant administrative challenge, and result in reconciliations taking up an increasing amount of time during the overall month-end accounting process.

Fortunately, there are ways to make monthly reconciliations faster and more efficient. Let's take a closer look at what the process involves and explore strategies that could both streamline things for your business, and make your accountants' lives easier.

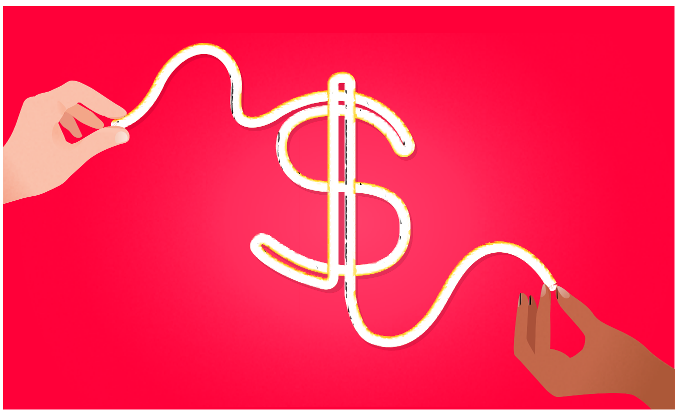
# What Does a Balance Sheet Reconciliation Involve?

The balance sheet reconciliations process ensures that your account balance, at a given point in time, is True and Fair. As part of the balance sheet reconciliations process, companies must consider 4 main assertions:

- **Existence:** Do the assets, liabilities, or equity balances included in the general ledger (GL) actually exist? A balance sheet reconciliation must validate these factors: for example, a bank account could be validated with bank statements relating to that account.
- **Completeness:** Are all of the company's assets, liabilities, or equity balances reflected in the GL? The reconciliation must capture everything: if during the month the company receives an invoice from a creditor, for example, it must be recorded in the GL.
- **Rights and obligations:** Does the company actually own an asset recorded in the GL. If a building is recorded, for example, the company should be able to produce documentation proving ownership.
- **Valuation:** Have accounts in the GL been valued correctly? Essentially, companies must ensure that entries accurately reflect the value of the asset, liability, or equity balance.

Acquiring and compiling the information and resources necessary for assertions on a reconciliation is a pain point for many companies, especially with accountants under pressure from numerous approaching deadlines. In this context, it helps to have a clear strategy in place for navigating the month end, including managing the necessary data resources, and the protocols for dealing with discrepancies and errors.

With that in mind, we've put together a high level framework for managing reconciliations.



# Framework for Seamless Management of Month-End Reconciliations

## 1) Accuracy check

The accuracy of a reconciliation depends on its timeliness. With that in mind, you'll need to ensure you have a current listing of reconciliations that include comparisons between GL balance and per backup (as an Excel file). Use the latest version of your trial balance to ensure that the data is timely and accurate.

## 2) Completeness

Make sure you're prepared to capture everything in the GL before the month end deadline. In practice, this means having an assigned preparer and reviewer in place to work on the items listed in the GL - and ensuring they have the due dates for all balance sheet ledger codes.

## 3) Centrally-managed compliance policies

Centralised compliance policies keep everyone on the same regulatory page during the reconciliation. Consider the following factors:

- **Materiality threshold:** Without a materiality threshold, teams may be unnecessarily balancing accounts to zero - and adding avoidable pain and pressure to the reconciliation process. By contrast, setting a materiality threshold (in coordination with your internal audit team and your auditor) means that you'll be able to complete reconciliations faster, and make life a lot easier for your employees.

  Materiality thresholds are set on an entity-by-entity basis since you'll need individual valuations or revenue numbers to calculate them. The bigger the company, the bigger the materiality threshold (hence the need to account for variances). You could consider using your threshold to facilitate an automated sign-off policy to give your accountants a little extra help during the reconciliation.
- **Segregation of duties:** To avoid confusion, your accounting team needs to know who is responsible for doing what during the reconciliation. Ensure you clearly segregate duties, and always assign a preparer and reviewer for every reconciliation file. Effective segregation of duties is also a useful control risk migration strategy: by having different people do different jobs you can spread responsibility and accountability, and help employees better support each other.

- **Grouped accounts:** Avoid repetition and duplication by grouping batches of reconciliations into one file. For example, multiple smaller bank reconciliations that need to be translated from foreign currencies to your primary reporting currency at month end could be grouped - with the help of a foreign exchange rate tab - and thus save accountants a lot of time.
- **Fixed balance reconciliations:** Do you have reconciliations that don't move from month to month, or that move only infrequently? These fixed balance reconciliations don't necessarily have to be completed monthly - instead, you could save time during the reconciliation by creating rules that allow for a less frequent cadence.
- **Consistent reconciliation template:** Establishing a reconciliation template is a huge advantage for achieving consistency in reconciliations across the company, and for ensuring all items have been completed. You could also add a checklist to your template format to help you track progress. Templates are particularly useful for factoring mergers and acquisitions into the reconciliation: it's important to ensure that the recently acquired entity is reporting its reconciliations to its acquirer in a consistent format in order to avoid differences, such as materiality thresholds, in reporting methodology.

## 4) Reconciling variances

Accountants must investigate any discrepancies that emerge during the reconciliation, and take necessary corrective action, such as posting adjustments. A discrepancy is a materiality consideration, and represents differences between the GL and back-up documentation (Excel file).

Dealing with variances can make a huge difference to your reconciliation, so it's important to understand how they occur, and how to manage them effectively.

- **How should firms track reconciling variances?** It's typically acceptable to hold-off the investigation of a variance for a single month-end reconciliation if it is not above materiality threshold, but you shouldn't delay for any prolonged period (3 months or more). The longer you leave the problem, the more likely it is to snowball and deliver an unwelcome surprise during the year-end audit. Put a clear methodology in place to track the variance resolution process: assign a date to each variance as and when they are found, perform age-analysis on variances to keep track of them, and set a deadline for resolution and write-off to avoid confusion. Templates are particularly useful for factoring mergers and acquisitions into the reconciliation: it's important to ensure that the recently acquired entity is reporting its reconciliations to its acquirer in a consistent format in order to avoid differences, such as materiality thresholds, in reporting methodology.
- **What causes reconciliation variances?**
  - **Timing differences:** The time at which an item clears often creates a variance. An outstanding cheque, for example, might not clear until a few days after the month-end.
  - **Missing transactions:** Differences are often the result of bank statement transactions that are missing from the GL. The opposite may also be true: a transaction that appears in the GL may not be located on a bank statement. This situation typically requires a journal entry to be posted.
  - **Mistakes/errors:** Simple mistakes can easily create variances. For example, a typo might see a €1,500 bank statement transaction input into the GL as €1,050, creating a difference of €450 and requiring a journal entry to be posted.
- **How to mitigate reconciling variances?** Excel files are a tested, reliable way to complete reconciliations, but as transaction volumes grow, you'll find this approach becomes more challenging. Accountants will have to lean-in to their spreadsheet skills, such as leveraging pivot tables and formulas to find and rectify errors.

  In practice, you'll need a more scalable and stable methodology to stay on top of variances - which is where a reconciliation tool like Floqast AutoRec comes in. Floqast Autorec can drastically decrease the preparation and investigation time involved in the reconciliation of variances, with the added bonus of generating an Excel file to serve as the reconciliation evidence needed for the month end balance. Depending on your ERP system, you can either integrate your general ledger or import GL transactions, along with comparative data like a bank statement Excel file. Floqast Autorec will match transactions based on the criteria you set, and leave a list of unmatched transactions for review, which you can investigate to close out the reconciliation.

  Manual processes always include a higher risk of human or system error, so it's a good idea to minimise "touch" when reporting. Slow, and often frustrating, manual processes create negative experiences for your team members - and it's well worth integrating automated tools to make their lives easier. Consider setting up criteria-based matching rules for areas like bank reconciliations and amortisation accounts to save on manual work hours.

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- **How can firms manage reconciling differences that arise after the GL lock date?** It's critical that you find an effective methodology to identify reconciliation differences as they emerge, and track them in a central location. By running a reconciling items report (at a suitable cadence) you can then track potential adjustments and identify risk areas.

  Performing age-analysis on variances can help you determine whether a journal entry is necessary, while using a live tracking spreadsheet will help you decide whether the journal entry is material enough to post in the GL.

## 5) Cleanup

It's important to review all reconciliations to determine whether any items are actually no longer required, and can be removed. A fixed asset which has been disposed of, for example, or a closed bank account are examples of items that would become zero balanced reconciliations - and as such could be dropped as a way to declutter.

## 6) Centralised storage

The fracturing of knowledge during reconciliations can lead to multiple sources of truth, duplication, confusion, and, ultimately, time wasted in the remediation of errors. To avoid these outcomes, firms should always establish centralised backup storage of reconciliation documents, creating a single, accessible source of truth that saves employees time when searching for files, and keeps everyone up to date and on the same page.

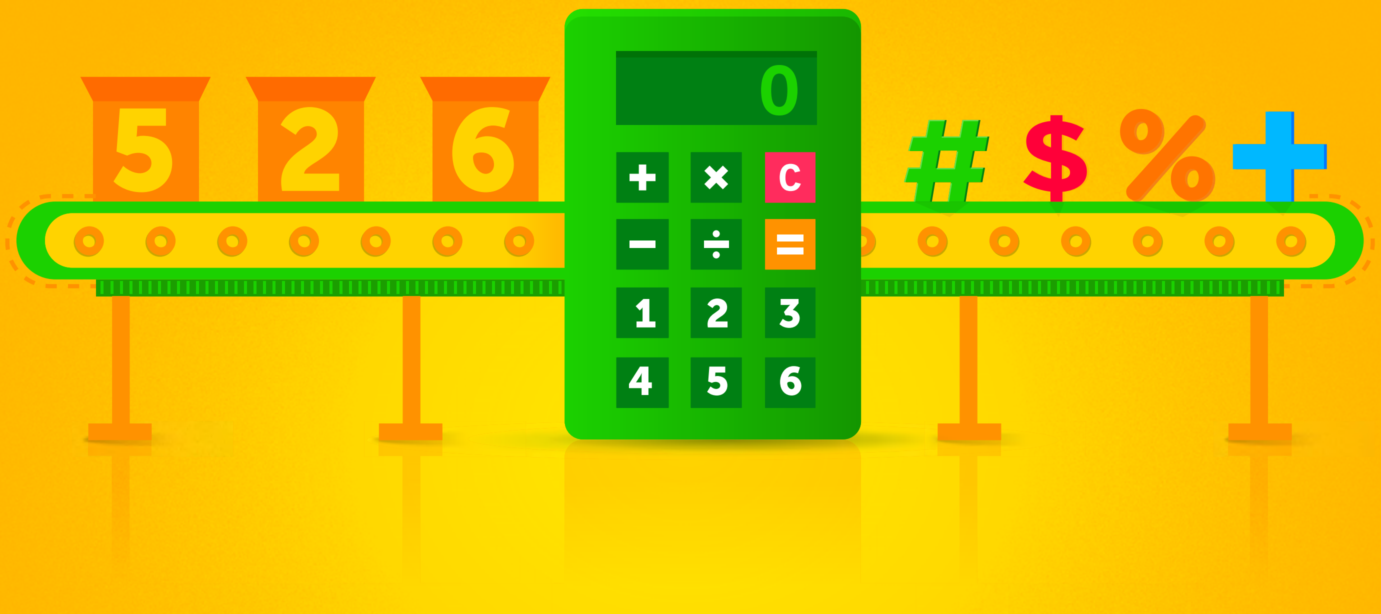
Centralised backup also makes communication about documents easier and more traceable. It's important to have a link from the trial balance (see step 1) to the backup storage so that reviewers and auditors know where to find the latest version of a reconciliation file. Centralised storage is also very useful for version control since it helps to prevent overlap as the preparer and reviewer are working.

## 7) Risk assessment

Complete a risk assessment of all your reconciliations in order to identify time-saving opportunities in line with your internal audit team and your controls. Think about the following factors:

- Categorise reconciliations across 3 categories: low risk, medium risk, and high risk. The assigned category should reflect the risk of material misstatement on the account as a result of the volume or complexity of transactions. Low risk reconciliations should represent zero balanced, fixed balanced, low value, or low risk accounts, with high risk at the other end of the spectrum, and medium falling somewhere between the two.
- Use the categories to assign a task frequency that best suits the account's risk profile. You can use your discretion to determine what that frequency entails: high risk might mean a monthly frequency (12 times a year), medium might mean twice a quarter (8 times a year), and low risk might mean quarterly (4 times a year).

An efficient risk assessment process can save a huge amount of manual hours and free up team members to work on more important tasks.



## 8) Time tracking

Document the time it takes to prepare and separately review all reconciliations. Understanding the time you spend completing reconciliations, especially in the wider context of your month-end process, will help you identify opportunities for process improvement initiatives.

Firms can take time tracking further, even using it to calculate the total cost of completing month end by attributing an hourly rate based on the assignees.

## 9) Individual and team bandwidth

Understanding how individuals and teams perform during a reconciliation is a key driver of efficiency. Use a tagging methodology like Team Tags to track progress and gain insight into metrics such as the number of reconciliations per team, and the monetary value of each. The more you know about your team's bandwidth, the better your decision-making and task assignment will be: for example, teams with a low volume of high value transactions might have a higher value of misstatement - which should help you decide how to allocate work to them.

## 10) Folder structure

The folder structure you use to complete reconciliations will play a big part in how smoothly the process goes. It's important to streamline your folder structure to allow for easy area-by-area progress tracking. For example, creating individual folders for financial statement line items (FSLI) will allow you to quickly gauge their lock deadline status, but also look back on the completion timeliness of prior months to see which FSLI carries the largest volume of reconciliations. In this context, accruals and prepayments will often carry the most reconciliations, but won't necessarily have the highest monetary value.

**Understanding the time you spend completing reconciliations will help you identify opportunities for process improvement initiatives.**

# Floqast Month End Solutions

Don't leave your month-end to chance. Floqast solutions help you build accuracy, speed, and efficiency into your workflows, helping our business save time and money, centralise data, and drive performance.

To learn more about Floqast solutions, [get in touch with us today.]