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JUST-IN-TIME ACCOUNTING

JUST-IN-TIME ACCOUNTING

HOW TO DECREASE COSTS AND INCREASE EFFICIENCY

SECOND EDITION

STEVEN M. BRAGG

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To my lifelong partner, Melissa

About the Author

Steven Bragg, CPA, CMA, CIA, CPM, CPIM, has been the chief financial officer or controller of four companies, as well as a consulting manager at Ernst & Young. He received a master's degree in finance from Bentley College and an MBA from Babson College. He has also written *Advanced Accounting Systems, Outsourcing, Financial Analysis, Accounting Best Practices, Cost Accounting,* and *Managing Explosive Corporate Growth,* and has coauthored *Controllership* and *The Controller's Function.* Mr. Bragg resides in Englewood, Colorado.

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Preface

The second edition of *Just-in-Time Accounting* demonstrates for the controller or chief financial officer how to streamline an accounting system so that transactions can be processed with minimal errors and staff time, resulting in high levels of efficiency that result in more time for other activities.

Part One of the book uses a multistep approach to improving accounting systems. The first step describes and charts an existing process, focusing on the inputs, processing steps, and outputs associated with each transaction. Also included, if necessary, is an analysis of wait times and paper movement among employees and departments, in order to differentiate this labor from the labor needed to complete the actual transaction.

Second, a number of suggestions are advanced for reducing the work at various steps, including:

- Apply new technology to the process.
- Eliminate redundant or unnecessary control points.
- Reduce the number of people involved in processing transactions.
- Remove from the transaction any steps that can be handled in advance.
- Automate control points.

Each chapter outlines the effects on accounting controls of the suggestions for improvement. Ways to replace the existing controls with other control points or new controls are suggested. It is usually possible to reinforce a deleted control point with controls at another point.

Each chapter also lists the quality issues resulting from the proposed revisions. Quality in this book is defined as *error-free accounting,* so a number of suggestions are made regarding ways to keep errors to a minimum. Each chapter contains samples of cost/benefit analyses that can be used as models when creating actual cost/benefit analyses for justifying the implementation of revised systems. Special problems with identifying costs and associated savings are described.

Streamlining the accounting function eliminates some of the old accounting reports. However, new reports are required to control the new systems. Sample reports are described in detail in each chapter. These samples can be used to design actual reports for a new accounting system. In addition, new performance measurements are provided to compare the performance of the systems. Finally, implementation problems that may occur when installing new systems are noted, along with solutions.

This multistep approach applies to Chapters 2 through 8, covering transactions in the following areas: cash, sales and accounts receivable, inventory, accounts payable, cost accounting, payroll, and the budget.

Part Two of the book discusses other accounting areas that either require streamlining or are needed in the streamlining effort: Internet and intranet accounting applications (new to this edition) in Chapter 9, electronic data interchange in Chapter 10, advanced data collection and storage systems (new to this edition) in Chapter 11, the quick close of the accounting records in Chapter 12, outsourcing the accounting department (new to this edition) in Chapter 13, process documentation in Chapter 14, and the effect of change on employees in Chapter 15.

The introductory chapter contains an overview of how to properly organize a new accounting department to achieve maximum levels of efficiency, so that there is less need to alter the department's activities at a later date. The activities addressed include the creation of job descriptions, performance reviews, work calendars, policies and procedures, training programs, and capacity planning—all basic "blocking and tackling" issues that are all too frequently completely ignored by accounting managers.

This book is intended for use by the accounting or finance manager who wants to improve the performance of the accounting department. It surveys best practices culled from the accounting literature and the author's experience and describes how to install changes successfully and justify them to upper management. The performance improvements that one can realize by implementing the changes described in this book can lead to remarkable increases in operating efficiencies.

STEVEN M. BRAGG

Englewood, Colorado
June 2001

JUST-IN-TIME ACCOUNTING

PART ONE

Traditional Accounting Areas

The first half of this book describes ways to increase the speed of operations in several key areas—cash, sales and accounts receivable, inventory, accounts payable, cost accounting, payroll, and the budget. Each chapter details the steps of a typical accounting function and methods for shortening the process by such means as reducing the number of controls, automating procedures, and reducing paperwork transfers among employees.

There are always problems associated with changing systems, and the remainder of each chapter deals with those problems. Topics covered are control issues that arise as a result of specific changes, quality problems, samples of cost/benefit analyses for each suggested change, new reports that are needed to support the changes, technology that can be used to support the changes, ways to measure the altered systems, and possible implementation problems. The intent of these chapters is to provide readers not only with a description of methods for speeding up accounting functions but also with a guide for implementing them.

1

Setting Up the Accounting Department

Before we can dig into the minutia of how to improve each of the various accounting functions, it is first necessary to set up the infrastructure that will ensure that the accounting department will function in a reliable manner. These basic tasks are ignored all too frequently when first setting up an accounting department.

In many instances, accountants are given a pile of work to complete, with no hint as to the priority of each item or how they interrelate. The result is a daily scramble to complete whatever is "hot" on that day. Assignments of accounting staff members are often changed with excessive regularity, so that no one acquires an area of expertise in which he or she can improve skills and overall level of confidence. As a direct result of this unstructured work pattern, the number of transactional errors is extremely high; employees do not have the expertise to "lock in" the procedures and related training that will keep errors from occurring. Once errors are found, staff time must be reallocated to the task of fixing them, which requires large amounts of time. Thus, we enter into a vicious circle of constant daily problems, with the department always struggling to keep up with the work load. The simple organizational techniques outlined in this chapter can resolve many of these problems.

CASH FORECAST

The top priority for any accounting department is forecasting the flow of cash. Without money to pay employees or suppliers, a company will very quickly find itself out of business. All other considerations are secondary to this issue. Accordingly, there should be a weekly cash forecast update, such as the one shown in Exhibit 1.1. This format can vary considerably by type of business, and may be automated in some computerized accounting systems.

Exhibit 1.1 Cash Forecast

Date Last Updated $\boxed{\textbf{10/2/00}}$

	For the Week Beginning on											
	10/2/00	**10/9/00**	**10/16/00**	**10/23/00**	**10/30/00**	**11/6/00**	**11/13/00**	**11/20/00**	**11/27/00**	**Dec-00**	**Jan-01**	**Feb-01**
Beginning Cash Balance	$87,691	$ 98,992	$67,517	$ 89,195	$ 40,153	$27,935	$31,751	$27,551	$41,551	$ 62,856	$ 56,288	$ 13,720
Rcpts from Sales Projections:												
Bullow Bros. Bay Cos.									$ 4,500	$ 30,000	$ 10,000	$ 10,000
Calgary Field Office										$ 10,000	$ 10,000	
Callow Consulting Co.										$ 6,000	$ 6,000	
Caribbean Oil Co.								$ 7,000			$ 25,000	$ 75,000
Deep Drilling Divers										$ 15,000	$ 15,000	$ 15,000
Dunston & Sons Consulting										$ 9,000		
Eastern Europe Pipeline										$ 15,000		
Entre Gas Delving Pty.					$ 7,000				$ 7,000	$ 7,000	$ 7,000	$ 7,000
Metheny Oil Fields Co.									$ 4,000	$ 6,000		
National Training Center						$11,000	$11,000	$11,000	$11,000	$ 10,000	$ 5,000	$ 5,000
New Mexican Drillers Ltd.							$45,000		$25,000	$ 5,000		
Winsome Oilfield Co.						$ 1,495						
Commercial, Various									$23,505	$ 25,000	$ 25,000	$ 25,000

Uncollected Invoices:												
Australian Petroleum			$ 8,646									
Barnes Flight Fuel	$18,212	$ 23,109										
Colway Downs Oil & Gas	$ 5,611											
Deep Drillers Inc.			$ 7,454	$ 2,835								
Foreign Gas Pipeline Ltd.	$ 6,160											
Geffen Oilfield Services			$ 9,578									
Cash, Minor Invoices	$ 3,986	$ 916	—	$ 1,823	$ 450	$ 2,471						
Total Cash In	$33,969	$ 24,025	$25,678	$ 4,658	$ 7,450	$14,966	$56,000	$18,000	$75,005	$138,000	$103,000	$137,000
Cash Out:												
Payroll + Payroll Taxes		$ 43,000		$ 49,700			$49,700		$49,700	$ 99,400	$ 99,400	$ 99,400
Commissions		$ 6,500					$ 6,500			$ 6,500	$ 6,500	$ 6,500
Rent	$10,668				$ 10,668					$ 10,668	$ 10,668	$ 10,668
Capital Purchases						$ 5,150				$ 5,000	$ 5,000	$ 5,000
Other Expenses	$12,000	$ 6,000	$ 4,000	$ 4,000	$ 9,000	$ 6,000	$ 4,000	$ 4,000	$ 4,000	$ 23,000	$ 24,000	$ 24,000
Total Cash Out:	$22,668	$ 55,500	$ 4,000	$ 53,700	$ 19,668	$11,150	$60,200	$ 4,000	$53,700	$144,568	$145,568	$145,568
Net Change in Cash	$11,301	$(31,475)	$21,678	$(49,042)	$(12,218)	$ 3,816	$ (4,200)	$14,000	$21,305	$ (6,568)	$ (42,568)	$ (8,568)
Ending Cash:	$98,992	$ 67,517	$89,195	$ 40,153	$ 27,935	$31,751	$27,551	$41,551	$62,856	$ 56,288	$ 13,720	$ 5,152

The forecast in Exhibit 1.1 starts with a sales forecast for each main customer, showing detailed expectations by week for the first six weeks of the forecast, after which the following three months' worth of forecasted sales are listed in a monthly format. Next is a breakdown of the largest accounts receivable items by expected date of cash receipt, as well as a single line item that describes, in lump sum, all other cash receipts from smaller accounts receivable. The next section lists all expected cash outflows from accounts payable and payroll, with the largest expense categories being individually listed. The bottom of the spreadsheet lists the rolling cash balance at the end of each reporting period.

This forecast should be verified with the sales staff, collections personnel, and purchasing employees to ensure that the numbers are accurate. The main area in which the numbers tend to be inaccurate is in the sales forecast. The payables area is of less concern, since these figures are more directly under the control of management, and can be managed to some extent to fit the requirements of the forecast.

This type of report reveals the time periods when there may be cash difficulties, which enables management to plan for additional financing or other activities that will ensure that the company safely passes through the danger period unscathed. The report is hand-delivered to the proper recipients every week, discussing any key problem areas. Leaving the report on someone's desk to be reviewed alone is an invitation for future trouble, since he or she may not see the prime indicators of a cash shortfall that are so evident to the person who prepared it.

LEGAL AGREEMENTS

A complete examination of all unexpired legal agreements ranks high on the priority list for anyone reorganizing the accounting department. These may contain any number of requirements for cash expenditures or receipts that should be included in the cash forecast, such as a balloon payment on a copier lease. Another example is a periodic minimum royalty payment, either to or from the company. If not carefully tracked, these issues can result in very unpleasant and sudden crises, as well as missed opportunities to collect additional funds.

Rather than just reviewing legal agreements in a cursory manner, it is better to organize them into a summary-level format, such as the one shown in Exhibit 1.2. This summary should be included in the standard calendar of department activities, so that actions can be scheduled based on the agreements. In Exhibit 1.2, the manager can quickly determine the dates when payments are due, when key contractual dates occur, and with whom the contracts have been written. These are the key factors to be aware of when incorporating legal agreements into the accounting department's activities. Organize the filing system for the

Exhibit 1.2 Sample Format for Legal Summary

Party Name	Start/Stop Dates	Revenues or Expenditures	Description
Acme Leasing	1/01–12/03	$304.52/mo, due on 15th of month.	Copier lease. Requires balloon payment of $2,400 on 12/31/03.
GEM Leasing	Ongoing	$128.15/mo, due on 10th of month.	Storage trailer lease. Ongoing. Review quarterly to ascertain continued need for trailer.
Bartony Design Co.	6/01/05 Renewal	8% of sales on KidJump product, due on 20th of month.	Royalty on KidJump product, payable as long as there are sales on this product. Licensing agreement is up for renewal on 6/01/05.
Play & Go Inc.	Lifetime franchise	4% of sales, incoming franchise fee, due on 5th of month.	Franchise fee paid by operator of Play & Go store, based on a percentage of net sales.

legal documents that are referenced in the summary so that anyone who needs to can quickly access the original document. The summary may not be sufficiently clear about a particular legal point. This is in contrast to the more common approach of merging legal documents into other accounting agreements, so that they are both difficult to find and in perpetual danger of being disposed of along with other accounting documents during the annual archiving process. Not only should they be segregated, but they should also be locked in a fireproof safe.

Proper custody and knowledge of the contents of legal agreements is a fundamental requirement for the proper management of an accounting department.

JOB DESCRIPTIONS

Accounting staffs often do not know precisely what they are supposed to do. Instead, they are hired, trained briefly in a few key tasks, and then left alone. They do not know if there are any additional tasks that are expected to be completed less frequently (a common problem), nor do they know when tasks are to be completed, or what constitutes a good job. This has several ramifications. First, it is impossible to review the work of such a person when there is no baseline against which to judge; this makes the periodic performance review a time of considerable confusion. Second, key tasks that are performed infrequently tend to be completely ignored, because no one knows who is supposed to do them. Third, it is difficult to determine what an employee has been doing after he or she leaves if there is no record of specific activities. Furthermore, it is difficult to determine the correct pay scale for an individual if no one is completely sure of the boundaries of that person's job. Finally (and perhaps most incredibly), many employees do not know for certain to whom they report. There is no clear listing of a supervisory relationship, so they do not know who to talk to about problems. All of these factors present a strong case in favor of creating a job description for every employee as soon as possible.

An example of a job description is shown in Exhibit 1.3, which lists the following main categories of information:

- *Job title.* There is no listing of the employee's name, but rather a job title. By focusing on creating job descriptions by title, the number of job descriptions that must be created is greatly reduced.
- *Effective date.* This is a very necessary item, because job descriptions change over time. There may be confusion during the performance review process if the manager doing the review is basing an evaluation on a job description that has a different effective date (and description) than the one that has been used by the employee.

Exhibit 1.3 Sample Job Description

Job Description for:	Cost Accountant
Effective Date:	7/15/01
Supervisor:	Assistant Controller
Responsibilities:	1. Calculate job costs. 2. Monitor inventory cycle counts. 3. Verify standard product and component costs. 4. Create costing data collection systems. 5. Maintain activity-based costing system. 6. Determine the divisional cost of capital. 7. Calculate transfer prices to downstream divisions. 8. Investigate the causes of variances from standard. 9. Supervise assistant cost accountant positions.
Review Dates:	January 5 April 5 **July 5 (Pay Review)** October 5

- *Supervisor.* The title of the person to whom the employee reports should be listed.
- *Responsibilities.* This section itemizes every task for which the employee is responsible. This section should also list the employee positions over which this person has direct supervisory responsibility, since this person is also responsible for the work of these additional employees.
- *Performance and pay review dates.* The last section should itemize the exact dates on which both performance and pay reviews will be conducted. Quarterly performance reviews are highly recommended over annual ones, if only because they increase the amount of feedback to the employee. In Exhibit 1.3, the four quarterly reviews are listed, with the one in bold being the annual pay review date as well as a performance review date.

PERFORMANCE REVIEWS

The job description does not provide a sufficient amount of detail about exactly what level of performance is expected to conduct a performance review. To use the job description in Exhibit 1.3 as an example, item number four is "create costing data collection systems." Does this mean that all possible systems must be created to give the cost accountant a good review, or is some lesser achievement acceptable? If something less is okay, how will this translate into a salary adjustment? If neither the supervisor nor the employee knows the answers to these questions, the performance review can be quite tense; the expectations of both parties to the meeting may be quite far apart, resulting in anger and confusion.

To resolve this problem, it is necessary to precisely define expected performance levels in advance. This information should be developed as soon as the job description is complete, and then be reviewed with the employee in detail to make sure that there is no confusion about the expectations for each item. The description of these performance levels take a considerable effort to develop, and they are the basis for a great deal of ensuing employee activity that is vital to the operation of the department.

One way to write performance level expectations is to list them in terms of low performance, average performance, and exceptional performance. Each of the three categories should be thoroughly described. Exhibit 1.4 contains a review that is based on item 4 in Exhibit 1.3—for the cost accountant to create data collection systems.

Exhibit 1.4 will take a great deal of time to complete if all other job functions are described in a similar manner. Nonetheless, this level of detail is needed to convey to the employee the exact expectations for the job. Since job requirements will change, the manager must review and adjust these written expectations

Exhibit 1.4 Example of Performance Level Expectations

Performance Expectations:

1. Create costing data collection systems.
   a. *Low performance.* The cost accountant creates no additional data collection systems beyond those already in place, but may create plans for new ones.
   b. *Average performance.* The cost accountant creates new data collection systems, but the level of data accuracy is not increased by more than 10% or the amount of labor required to collect the data does not decrease by more than 20%.
   c. *Exceptional performance.* The cost accountant creates new data collection systems that result in data accuracy of more than 10% and reduction in data collection labor of more than 20%.

frequently. Each time a change is made, the manager must review the changes with employees.

The performance review format can also be expanded to include the precise amount of pay change that can be expected as a result of meeting each objective. For example, the low performance category in Exhibit 1.4 might have listed alongside it a pay decrease of 1%, with average performance worthy of no change, and a 2% pay increase associated with the exceptional performance level. Using this approach, an employee can tell precisely how much of a pay change will be occurring before a pay review even begins, which takes all of the tension and uncertainty out of the process. However, this approach can result in excessively high or low pay changes if the person preparing the document does not pay enough attention to the difficulty of completing those tasks against which automatic pay changes are listed.

WORK CALENDARS

Even with a job description, an employee does not know *when* tasks are to be completed. It may be necessary to always complete a report on a Monday, so that it is available for a Tuesday meeting, or perhaps one employee has to complete a deliverable so that it can be used as input to some other process by a different employee on the following day. These are issues that have a major impact on the efficiency of the entire department.

A good way to handle the timing of work steps is to schedule them on an individual work calendar that is handed out to each employee. There should be two calendars—one that lists the major tasks to be completed on a monthly basis, and another that itemizes the daily tasks within each month. An example of a monthly calendar is shown in Exhibit 1.5. This calendar itemizes those tasks that are not necessarily repeated constantly, such as government reports that need only be created once a year (such as the VETS-100 report in August that lists the number of employees who are veterans), and which could easily be forgotten if not itemized.

A monthly calendar of activities contains all of the tasks noted on the annual calendar, plus all of the continuing daily activities that are repeated within the department. An example is shown in Exhibit 1.6. Of the two calendars, this one is used much more frequently; it becomes a daily reference for every employee.

Though the concept of the calendar is an extremely simple one, it is highly effective, for it ensures that the accounting staff completes its assigned tasks on

Exhibit 1.5 File Calendar

January 1st Commissions 10th Calc. Denver Sales Tax 10th 1099 Forms 15th NM Sales Tax Report 20th NV Sales Tax 20th Merker & Sons Royalty 20th UT Annual Sales Tax Return	**February** 1st Commissions 20th Merker & Sons Royalty 28th Property Taxes 28th Trademark Review	**March** 1st Commissions 15th 401(k) Enrollment 20th Merker & Sons Royalty 22nd Audit Begins	**April** 1st Commissions 10th Calc. Denver Sales Tax 15th Property Declaration Due 20th Merker & Sons Royalty 20th NV Sales Tax
May 1st Commissions 20th Merker & Sons Royalty 31st Trademark Review	**June** 1st Commissions 15th 401(k) Enrollment 20th Merker & Sons Royalty 28th Property Taxes	**July** 1st Commissions 10th Calc. Denver Sales Tax 15th NM Sales Tax Report 20th Merker & Sons Royalty 20th NV Sales Tax	**August** 1st Commissions 10th VETS-100 Report 20th Merker & Sons Royalty 31st Trademark Review
September 1st Commissions 15th 401(k) Enrollment 20th Merker & Sons Royalty	**October** 1st Commissions 10th Calc. Denver Sales Tax 20th - NV Sales Tax 20th Merker & Sons Royalty	**November** 1st Commissions 20th Merker & Sons Royalty 30th Budget 30th Trademark Review	**December** 1st Commissions 15th 401(k) Enrollment 20th Merker & Sons Royalty 30th Issue W-9 Mailing