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Executive Summary

Financial consolidation is growing in importance because of factors like globalization and the popularity of mergers and acquisitions. In the past, it was mainly of interest to large multinational companies that were publicly traded and had sophisticated requirements, but now it is not uncommon for a mid-sized company to own several legal entities in different states or countries. Although such a company’s financial consolidation requirements may not be very complex, producing a set of consolidated accounts is a process that, done in spreadsheets, can be very time consuming and prone to error. There are now various financial consolidation solutions that can streamline and add value to existing processes and systems.

Overview of Financial Consolidation

Financial consolidation can mean different things to different people. On a very basic level, when a company that is a single legal entity uses the term it can mean simply combining data from multiple cost centers either as part of the planning process or for monthly reporting purposes. The data that is combined is usually general ledger data, which has been recorded by an ERP as associated with different departments or cost centers. The objective is to produce a set of financial statements that relate to the total company—usually where all entities being consolidated have the same fiscal year and the same chart of accounts.

However, financial consolidation normally means a lot more than this. Financial consolidation usually involves combining data not from departments of a single company but from multiple entities, normally multiple legal entities or companies. In these cases, simply aggregating data can be complex for various reasons. For example, legal entities can have different fiscal years or different Charts of Accounts. They may also be partially owned.

In addition to the above, most companies’ financial consolidation requirements will include making adjustments to the consolidated values. A simple example might be the requirement to allocate expenses incurred at Head Office (e.g. legal expenses) to subsidiaries; these may then be communicated to the subsidiaries for inclusion in their own accounts. A more common and complex example is to perform intercompany eliminations (ICEs). The most common ICE is to adjust for inter-company sales: if one entity sells goods to another entity then these sales should not be included in the sales of the consolidated entity; they should be eliminated from the total consolidated sales figures.

One way of looking at financial consolidation is that the objective is to produce a consolidated general ledger for a group of companies. There is usually a need
to adjust the figures and, just as in a regular general ledger, this is achieved through journal entries that can transact not only between accounts within a single company but also between the multiple legal entities that are being consolidated.

**What is the purpose of Financial Consolidation?**

The purpose behind financial processes like budgeting and monthly management reporting is reasonably straightforward. This is not necessarily the case with financial consolidation. For example, each legal entity in a consolidation will file its own tax returns and therefore, depending on the jurisdiction and the type of entity, there may be no requirement to file a consolidated tax return.

- **Publically traded companies:** There is usually a requirement to report on consolidated numbers; when a citizen buys shares in a company he or she wants to see the full picture, including overseas operations and subsidiaries. Regulatory authorities such as the SEC have made it a compliance requirement for publically traded companies to report consolidated results. In addition to obeying accounting standards (such as GAAP or IFRS), these types of consolidations also require an audit trail or a report that explains how source data from subsidiaries has been adjusted to give the consolidated results.

- **Private companies:** Depending on the jurisdiction, there may be no formal government or otherwise mandated requirement to produce or file consolidated financial statements; provided each legal entity pays its taxes, the government is satisfied. For such a company, reporting on consolidated numbers is either management reporting or non-legislated reporting to the shareholders. In such cases, there is not such a rigid requirement as for publically traded companies but the benefit of financial consolidation is that it gives management and other stakeholders an accurate consolidated view of the company.

Usually, financial consolidation is concerned with reporting historical, actual data. Some companies also want to 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.

When there is a mandatory reporting requirement, it will include a time frame; there may be annual, quarterly or monthly reporting (and hence consolidation) requirements. If there is a quarterly requirement, monthly consolidations may not be required but it is often advisable to produce monthly figures, either for
management reporting or to minimize the time it takes to produce quarter-end results. It is assumed in this document that there is a requirement for monthly consolidations.

Quite apart from legislated and management reporting, there are other reasons why companies perform financial consolidation. For example:

- Formally documenting intercompany sales in a consolidated entity that trades in multiple countries makes it easier to answer questions about transfer pricing and to demonstrate compliance.
- For a holding company, there may not be a need to have a separate general ledger but to 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 audited and approved by external auditors, rather than using spreadsheets that need to be fully audited every year.

Assessing Financial Consolidation Solutions

Financial Consolidation is not the same for all companies. Depending on external or legislative reporting requirements and management's need for information it can be very complex or relatively straightforward. Its scope and complexity depends on how rigorous the company wants its financial management to be. For this reason, before implementing a Financial Consolidation solution, it is important to be clear about your objective of the exercise and what you want as an end result.

From an accounting professional's perspective, financial consolidation consists of a series of processes, which may include the following:

- Mapping disparate general ledgers to a common chart of accounts
- Importing data from multiple entities
- Collecting ICE adjustments from entities
- Making adjustments to the consolidated data
- Producing reports for the consolidated entity

From a high-level perspective, consolidation can seem very simple—after all, we are simply adding together a series of accounts from different companies. However, having a multi-level requirement makes things a bit more complex and requires reporting considerations. This is especially true when there is also a multi-currency requirement.
Based on the following, there may be a more complex financial consolidation requirement:

- Entities that have different charts of accounts
- Entities that have different fiscal calendars
- Number of and types of adjustments
- Multi-level reporting requirements
- Financial statement reporting
- Multiple currencies
- Partial ownership
- Intercompany eliminations

Depending on requirements, companies have several options to perform consolidations:

- Spreadsheets
- ERP systems
- Packaged applications

**Spreadsheets**

Many companies use spreadsheets to perform Financial Consolidation, but this is not an “industrial strength” solution. While some companies may be content with spreadsheets, in order to minimize development, maintenance and operating costs, a true financial consolidation system requires functionality such as the following that is missing in a spreadsheet:

- Data importing that includes mapping between charts of accounts
- Formally defined journal entries
- Handling of intercompany eliminations
- A posting process for journal entries
- Workflow for submission and approval of journal entries
- Integrated, flexible and easy-to-use financial reporting
- Financial report distribution
- An audit trail
Another potential solution is to use the multi-company facilities of the general ledger component of an ERP system. This is usually only feasible if the following conditions are met:

1. The accounts for all entities are run on the same ERP system.
2. All entities use identical charts of accounts.
3. The ERP system includes consolidation functionality such as intercompany eliminations, segregation of adjustments, audit trails, etc.

It is not surprising that some ERP vendors recommend their software for financial consolidation, and provided the above criteria are met, using an ERP system is a feasible solution. However, usually this is not the case and, for example, converting every entity to use the same ERP software can be a very expensive proposition. Another issue is reporting; most ERP products have limited, relational reporting that cannot give consolidation accountants the reports they need. This limited reporting is precisely the reason many companies export general ledger data to third-party software for their regular reporting requirements.

In the 1980s, specialist software products were first developed to perform financial consolidation. The market was mainly enterprise level companies with over one billion dollars in revenues. These products have grown to be very sophisticated in terms of the types of calculations and accounting processes they can perform. They also tend to be very expensive, both in terms of software licenses and the services required to implement them. They are outside the budget of most midmarket companies.

For companies with more modest needs, specialized software, such as PROPHIX, is now available. PROPHIX is a cost-effective alternative to the above solutions that offers a very attractive value proposition and is designed to automate processes for finance professionals. In addition, financial consolidation in PROPHIX is fully integrated with all other PROPHIX components such as easy-to-use reporting, data import, data collection, workflow, report distribution and ad hoc OLAP querying of data. This integration lowers costs by minimizing training requirements and lowering the complexity of software installation.
5 Tips to Simplify Your Consolidation Process

1. Integrate data from multiple legacy applications and transaction systems.

Your company may employ one or several ERP systems, resulting in hundreds or even thousands of entities in a corporate structure, with different charts of accounts that need to be consolidated. It is crucial that the financial consolidation application brings the disconnected systems together to create a single set of consolidated results, which provides accurate, quality data. Packaged solutions contain flexible ways of getting subsidiaries’ data into the consolidated database. PROPHIX includes the following integration features:

- Scheduled Collection of Template Data by Email – Sometimes, the volume of data that is requested from subsidiaries is relatively modest and it is easier for it to be manually entered instead of transmitted electronically. Collection of manually entered data can also be needed for reconciliation of intercompany eliminations. PROPHIX has excellent capabilities for collecting data this way; users receive a spreadsheet to fill in and return to a specific email address where the data they enter is read and copied into database. This process is fully integrated into a workflow process, so that reminder emails can be automatically sent to users and the administrator is aware of which data has been collected.

- Debit/Credit Intelligence – ERP and accounting systems store data in many different formats. For example, many systems store Credit accounts such as sales data as negative numbers. PROPHIX automatically converts data from the general ledger format into a consistent consolidated format for easy reporting.

- Importing of Tabular Data – Data in a tabular format can be directly imported with a process that runs on a server. For example, users can send their monthly G/L data via email in tabular form in either text or spreadsheet formats, which is then imported into PROPHIX. Alternatively, if data is available electronically at the consolidated entity in an ODBC-compliant database, this can also be directly imported. Importing data includes standard PROPHIX functionality such as sub-fields and mapping tables.

- Data Mapping – Over 150 general ledgers seamlessly interface with PROPHIX. For financial consolidation, an important part of the data import process can be Data Mapping, which is used when a subsidiary is using a chart of accounts that differs from the consolidation chart
of accounts. Data mapping will automatically translate imported data from a subsidiary’s chart of accounts to the consolidation chart of accounts. As part of the PROPHIX import process, data is automatically aggregated if multiple subsidiary accounts map to a single consolidation account. The relationships between accounts are easily maintained within PROPHIX by non-IT staff in a mapping table.

- SmartLink – For specific ERP systems, like Microsoft Dynamics NAV, PROPHIX has unique SmartLink functionality to make importing data even easier.

2. Find a solution with flexible and easy-to-use reporting and analysis abilities.

Most financial consolidation applications use relational databases, but PROPHIX uses Microsoft SQL Server Analysis Services, an OLAP database. This is for two main reasons:

- OLAP databases are ideal for consolidating data across a number of dimensions. This is precisely what is required in Financial Consolidation, where data needs to be consolidated by Entity, Adjustment Type and Account.

- OLAP databases are also excellent for reporting and analysis. In order to understand how adjustments and consolidation of source data is giving rise to consolidated values, the type of “slice and dice” analysis available with PROPHIX is ideal.

From report design and process maintenance to report distribution, PROPHIX does not require IT skills; tasks are easily manageable by business users. Reports can be distributed to end users by email, in either Excel or PDF format. Also, PROPHIX helps organizations comply with industry regulations by supporting GAAP, IFRS, Sarbanes-Oxley regulations, and XBRL (extensible business reporting language).

3. Implement a consistent, secure workflow process.

Since financial consolidation tasks involve multi-person processes and often have tight schedules, workflow management is very important; users often need to be reminded when data must be made available. To help with this, PROPHIX’s integrated workflow can help manage the collection of data and the process of approving adjustments (if required). If a journal entry is rejected, it can be sent back for re-editing.
PROPHIX workflow also simplifies recurring monthly tasks. For example, recurring journal entries can be enrolled into the PROPHIX workflow as tasks, to eliminate the manual process and to manage journal entries in a secure, controlled environment.

All users that create or post journal entries have administrator access to data; however PROPHIX allows you to limit access rights to other users, such as reviewers, recipients of reports and data contributors, so they can only view data that is relevant to them.

**Don't overlook audit tracking abilities.**

When it comes to accountability, tracking user actions is crucial. In PROPHIX, all financial consolidation activities performed in the application, such as posting data or editing journal entries, are automatically recorded in an audit log. In addition, PROPHIX contains five built-in reports to help with auditing the data changes and workflow status.

**Find a solution that can speak your currencies.**

The adjustments due to currency translations are usually called Cumulative Translation Adjustments (CTAs), which are easily managed in PROPHIX to ensure the Balance Sheets balance. PROPHIX calculates the CTA in the reporting currency for each entity that is being consolidated and the values are then aggregated in the reporting currency to give a total CTA for the consolidated entity.

Another accounting convention that makes currency translation more complex is the use of historical (or temporal) exchange rates. Using PROPHIX, it is not necessary to keep a record of all the transactions in an account that is translated using historical rates. Beginning-of-year balances are sufficient for PROPHIX to accurately keep track of ongoing account balances for accounts requiring historical exchange rates.
About PROPHIX Software

PROPHIX Software is a leading developer of solutions designed to automate financial processes including budgeting, planning, reporting, analysis, and performance management for the midmarket. Thousands of finance leaders around the world use PROPHIX to empower their organization and gain greater insight into business performance. PROPHIX and its partners deliver the best value by combining high-end functionality, low total cost of ownership, and the fastest implementations in its class.

PROPHIX satisfies the needs of financial consolidations by providing the basis for a system of record, multiple reporting requirements, insight into true position, and centralized data for planning and budgeting purposes. To learn more, visit www.prophix.com.

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