CHAPTER ONE

Getting Your Finance Team Future Ready

OVERVIEW

Many finance teams are far from being future ready. They spend long, frustrated hours working with antiquated error-prone systems—and to make it worse, they follow procedures because they were carried out last month. This chapter will take a brief look at areas the finance team can focus on to become future ready. It also explores how the lean movement affects modern accounting, the importance of Peter Drucker's abandonment, and why we should take Steve Jobs' advice and challenge the status quo.

This book outlines how finance teams can help their organizations by getting their team future ready. By *future ready*, I mean a finance team that is fast and light on its feet and able to react quickly to events as they unfold. A finance team that is nimble through utilizing world best practices, and is an advanced adopter of leading-edge technologies. Finally, a future-ready finance team embraces modern people practices, abandons the ill-conceived management practices of the past, and is thus able to retain its talented staff.

Many finance teams are far from being future ready. How many finance teams today have:

- Fully embraced all the lean finance team practices?
- An annual planning process that helps their organization prepare for the unexpected?
- Successfully adopted the tried and tested leading-edge technologies available in the twenty-first century?

A BURNING PLATFORM?

Many finance teams spend long frustrated hours working with antiquated, error-prone systems—and to make it worse, they follow procedures because they were carried out last month.

Yes, indeed the platform is on fire, and we need to jump off right now. Many performance management processes that I used during my brief time with BP Oil, and helped support as a consultant for Ernst & Whinney, are well and truly broken. I am talking about key performance indicators (KPIs), the annual planning process, forecasting, using outdated technology, and, to round it off, slow month-end and year-end reporting.

These processes have not worked for years—and possibly never worked. The finance teams have presided over an annual planning process where management and the board are told the lies they wanted to hear. The finance teams have issued reports that often end up in an executive's briefcase, which, on their third return journey back to the office, are deemed as read.

There are now significant performance gaps between what CFOs see as important and their current proficiency in that area. In the 2015 IBM Global C-suite study,[1] CFOs were saying that the two most important areas for them were "Identify and track new revenue growth opportunities" and "Develop talent in the finance organization". However, the biggest skill gap was with the integration of information across the enterprise, as shown in Exhibit 1.1.

REPORTING HISTORY OR MAKING IT

When Henry Ford said "You can have any color you like as long as it is black," the world of commerce was a simpler place. The Ford company only had to work

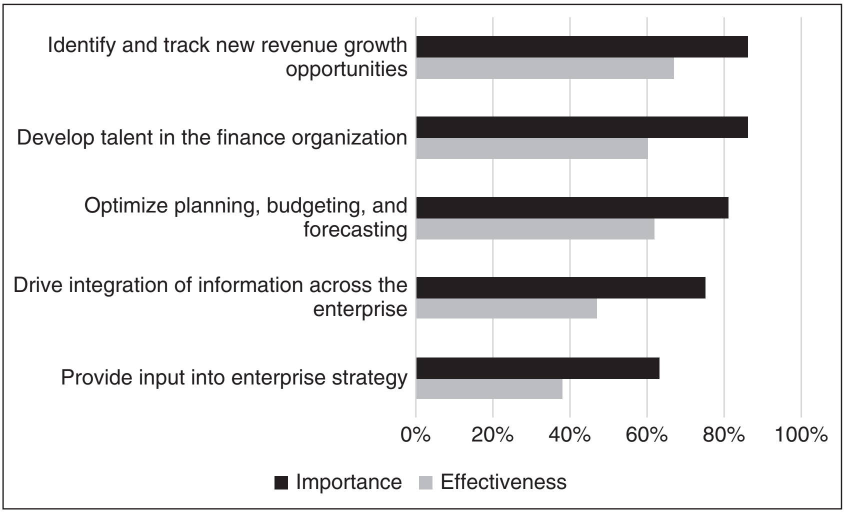

EXHIBIT 1.1 The biggest performance gaps in finance teams *Source:* IBM Global C-Suite Study 2015 based on approximately 600 CFO interviews.

out its production capacity in a year and it could then estimate sales, having backed out the expected movement in inventory.

Large production runs, lengthy month-end processes, were the order of the day. Charles Horngren's "Cost Accounting: A Managerial Emphasis" and books like it were locked into detail and a view into costing, budgeting, and allocation of overheads that is directly opposed to the lean movement.

When I was studying commerce at Liverpool University I was taught well to deliver services that Ford might have needed when building the model T Ford. The accounting profession has learned many bad habits:

Area	Bad habit
Direct labor costs are variable	Treating direct labor costs as variable, yet we cannot go back to the Victorian times and hire staff on a daily basis.
Transferring operating costs to the balance sheet	Absorbing as many fixed costs into WIP and closing stock as possible, thereby transferring costs from the current period to subsequent periods.
Wedded to complexity	Installing one complex system after another (e.g., timesheets, work orders, detailed inventory tracking systems, and activity based costing).
Detail is good	Having a large chart of accounts with 200+ account codes for the P/L.

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Area	Bad habit
Slow month-ends	Overseeing a slow month-end reporting process as finance teams pursue the perfect number. Yet we are only required to get to a true and fair number, and the "right" month-end number does not exist.
Slow year-ends	Signing up with the auditors for a slow year-end accounts exercise with most of the finance team's time in the first quarter being spent endlessly adjusting the month 12 number. The final audited numbers often being within 5% of those reported at month 12. In other words, we have in reality come full circle.
Spreadsheet epidemic	A spreadsheet for everything, and most certainly, multiple versions of the truth.
Maintaining an annual planning process	Managing the annual planning process, believing that it must be of some use. Each year, thinking that this time the annual planning process will be better, quicker, and easier than last year's disaster.
Generating unread reports	Generating reports that will not be read.
Reporting on a calendar month-end	Blindly following Julius Caesar's calendar, rather than explore the many benefits of reporting with four- or five week months that end on the same day each month.

Maybe It Is Time for Therapy

Two hundred years ago, when the Napoleonic Wars were raging, the English Navy had a device for retribution. It was called the cat o' nine tails. The English Navy stopped using this multi-tailed whip a long, long time ago, so why do so many accountants pick up the cat o' nine tails and whip themselves time and time again?

If it is not the cat o' nine tails, it is shooting ourselves in the foot. This book is about stopping this self-inflicted punishment and changing our ways.

Escaping the Catch-22

Joseph Heller's iconic 1961 book, *Catch 22*,[2] introduced a new term to popular culture. The *Oxford English Dictionary* defined "Catch 22" as "*a situation or predicament characterized by absurdity or senselessness.*"

I see many finance teams in this situation. The slow month-end reporting, the never ending annual planning process, and the long, drawn-out annual reporting cycle are both beautifully summed up by the above Catch 22 definition. How do we get out of this Catch 22? The finance team needs to create time for change, to have more time to act. Where do we find this time? We find it by aiming for these lean finance team benchmarks:

Area	Lean finance team benchmarks
Month-end accounts	Fast month-end by day three or less (by next month-end); reporting by the close of the first working day within 12 to 18 months and being able to report net profit intra-month (virtual reporting) inside of three years.
Year-end accounts	Commit the auditors, your finance team, your board and executives to a 15-working-day signed set of annual accounts.
Annual planning	Produce the annual plan in less than two weeks from the rolling planning exercises. Eventually, the annual plan will be dropped in favor of a quarterly rolling planning process.
Key performance indicators (KPIs)	Work with no more than 10 KPIs in the organization. The other operational measures that are not key to operational performance should number less than 80 and be renamed (see the 10/80/10 rule in Chapter 18).
Excel ad hoc systems	All spreadsheets over 100 rows are replaced with a robust solution e.g., for forecasting using one of the modern planning and reporting tools.
Streamlining the chart of accounts	Having less than 50 account codes for profit and loss. Any more is unnecessary and leads to miscoding.

LEAN MOVEMENT

The finance team needs to embrace the lean movement to slim down all of its processes so it can be less locked in to the past. This change will have an impact on the workload of the team, as shown in Exhibit 1.2, which compares an antiquated team and a lean finance team.

The significant increase in advisory time will lead to:

- Adding more value to the business units the finance team supports
- Selling and leading change, in particular with regard to new systems
- Leading the battle against waste as Jeremy Hope has suggested[3]
- Having time to adopt the profound lean practices such as Post-it reengineering, Scrum, Kanban, and action meetings

The end result will be participating in more rewarding work and a happy and more fulfilled finance team.

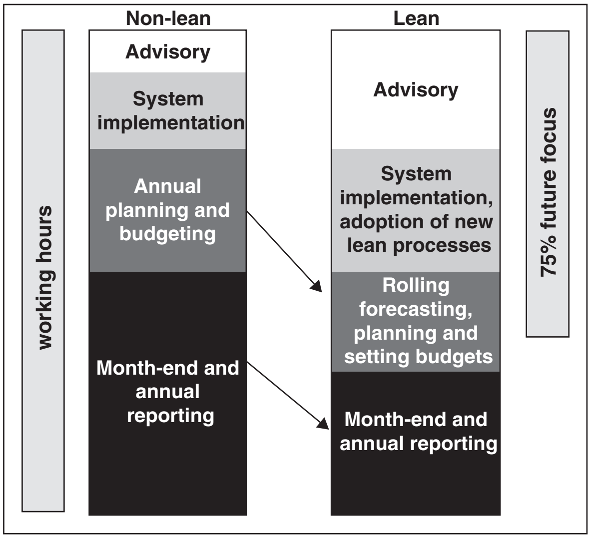

EXHIBIT 1.2 Lean versus a non-lean finance team

Background to the Lean Movement

The lean movement is largely credited as a Japanese process that was responsible for the meteoric rise of the Japanese multinationals over the period 1960 to 2000. However, when you look at its origins, you see the influence of American writers such as Edwards Deming. Over the years, there have been many institutes and consultancy methodologies that make up the lean movement as we see it today.

The lean movement has been part of workshops for more than 20 years, but lean accounting has been a much more recent phenomenon lead by a series of thinkers and dates back to roughly 2004. The key players include:

- Jeremy Hope[4]
- Brian Maskell[5]
- Jean Cunningham[6]
- Frances Kennedy[7]

Although most corporate accountants are aware of the revolution of *lean* and its positive impact on private, government, and nonprofit sectors, few have realized the profound impact it has on the accounting function. The pioneers of lean accounting have now blazed a pathway that all corporate accountants need to walk along.

Indeed, the *lean accounting* movement has been gaining momentum around the world. Thus, it will not be long before CEOs start asking questions about this hot topic. It is imperative that corporate accountants, sooner rather than later, understand the concepts of lean accounting and its implications for their finance team and organization.

In fact, the movement has progressed to such an extent that there is now an annual lean accounting summit, which can be found easily on the Internet.

Lean Is About Eliminating the Eight Wastes

In lean there are eight types of waste. These wastes are seen within the whole organization and within the accounting function. I have outlined the eight wastes below:

Eight types of waste	Within the accounting function
1. **Over-production:** Having long production runs that produce more product than the current customers' immediate demand. This is done to reduce downtime.	Our reports are too large and go into too much detail.
2. **Waiting:** Production operators waiting because a machine has gone down or a component is not available.	The processing of batches of AP or AR transactions where these batches wait for hours or days before processing. Also the month-end, year-end, annual planning processes have too much waiting time.
3. **Transportation:** Moving materials around the factory. Buying raw materials and components from distant suppliers.	The finance team is always shuffling information around team members.
4. **Extra processing:** Processes that appear productive but are unimportant to the customer. Painting and finishing components that are not seen. Designing additional features into a product that the customers do not use (e.g., the many features in Excel that are heralded each upgrade but in reality hardly used).	The chart of accounts, the month-end, year-end, annual planning processes all have extra processing within them.

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5. **Excess inventory:** Having materials, components, work-in-process, and finished goods levels above the immediate need.	The way we have transferred this period's sunk costs into next period production costs has created a blowout in inventory.
6. **Waste of motion:** Having to search for tools, parts, or forms.	The finance function needs a make-over in time and motion. We all need to know where everything is filed and be disciplined in maintaining this.
7. **Defects, scrap, and rework in production:** Complex inspection steps to overcome poor processes or poor design.	Accounting function generates many spread sheets that have a dubious function. They are completed because they were completed last month.
8. **Unused employee creativity:** Employee ideas having to jump over many obstacles before adoption.	Based on Toyota, we would need to have 10 innovations implemented per team member per year within the finance function.

> "Most businesses processes are 90% waste and 10% value-added work."
>
> —*Dr. Jeffrey Liker*

Liker points out that Boeing reduced over a trillion internal transactions through adopting lean.

Toyota's 14 Lean Management Principles and Their Relevance

I believe Toyota to be possibly the greatest company in the world. It has 14 lean management principles which are the backbone to its culture and Toyota can embed these principles in all countries it operates within. Its Kentucky plant in the USA exceeded all Toyota expectations with its acceptance of the Toyota Way. To understand the Toyota principles one needs to read Jeffrey Liker's book *The Toyota Way*. He has broken them down into four categories as set out in Exhibit 1.3.

I believe that Toyota's 14 principles should be embedded in all private, government, and non-profit agencies as best they can. They would make a profound impact on the organizations, benefiting the staff, management, board, and customers. I have included an overview of Toyota's 14 management principles in the attached electronic media.

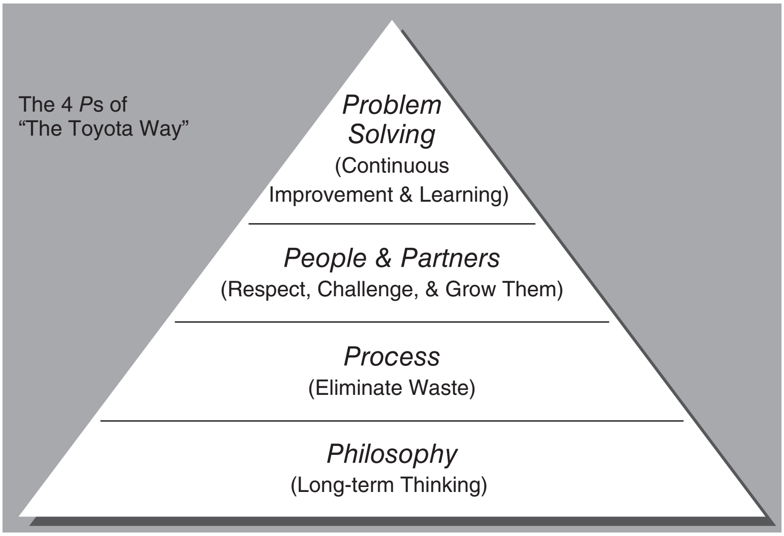
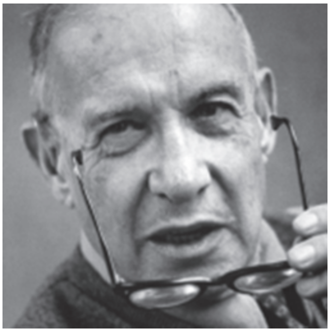


EXHIBIT 1.3 Jeffrey Liker's analysis of Toyota's 14 principles
Source: www.jeffliker.com

IMPORTANCE OF ABANDONMENT



From the time we were at kindergarten we have had a fear of ever admitting we were wrong. In our personal lives we have, in some cases, held onto an abusive relationship for too long because we were scared to admit, to the world at large, we had made a mistake. The longer the relationship goes on we hold onto the hope that it will come right and we can always then say to our family, "I told you so." In reality this does not happen. If I was to go into a reader's garage, what would I find? Maybe an exercise machine that started off life in great excitement as we envisaged a leaner self. After a couple of weeks in the lounge it started its inexorable journey to the garage, there to rest under the dust cover for a day in the future when we would use it again so we could say "I told you so."

In the world of commerce this trait is equally damaging. We will hold onto systems, keep going with projects, keep writing that report that nobody reads because to remove it would mean a loss of face. Let's get over it.

Management guru Peter Drucker,[8] whom I consider to be the Leonardo da Vinci of management, frequently used the word *abandonment*. I think it is one of the top 10 gifts Drucker gave us all. He said, "Don't tell me what you're doing, tell me what you've stopped doing." He frequently said that abandonment is the key to innovation. He left some rather telling statements.

If leaders are unable to abandon yesterday, they simply will not be able to create tomorrow.

Without systematic and purposeful abandonment, an organization will be overtaken by events. It will squander its best resources on things it should never have been doing or should no longer do. As a result, it will lack the resources needed to exploit the opportunities that arise.

In finance, many processes are followed, year-in and year-out, because "it's the way things have always been done." When staff question, "Why do we do this?" the CFO or financial controller will often answer, "There must be a reason; so please do it." In order for the better practices in this book to work, there must be an adoption of:

- An abandonment of processes and procedures that are broken
- A letting go of the past
- A commitment to challenge the rules of the past

An organization that embraced Peter Drucker's abandonment earmarked the first Monday of every month for "abandonment meetings at every management level." Each session targets a different area, so that over the course of a year, everything is given the once-over. This process would work well in the finance team, except we should meet once a week to discuss at least two abandonments.

Every organization I have come across should have an abandonment KPI measuring the number of abandonments that have been made around the organization last week. Teams that were no embracing the concept would soon want to get the CEO's attention and acclaim by embracing the concept.

The act of abandonment gives a tremendous sense of relief to the finance team, for it stops the past from haunting the future. It takes courage and conviction from the CFO. Knowing when to abandon and having the courage to do so are important leadership attributes.

I have included in the electronic media a book review of Elizabeth Haas Edersheim's *The Definitive Drucker*.[9] Read the book for more on abandonment and his other great advice. I consider this book one of the top 10 management books I have read. I hope, like me, you will become a follower of the great Peter Drucker.

THE IMPORTANCE OF CHALLENGING THE STATUS QUO

Far too often, we have accepted antiquated and anti-lean practices within the corporate accounting repertoire as the status quo. If the medical profession used our approach, it would probably still be using leeches. (Well, actually, I understand that leeches are still used in special cases.) The medical profession has breakthrough conferences on a regular basis, and all the practicing surgeons in that field attend and adopt the new procedure. This should be the corporate finance model. The problem with corporate finance is that the "surgeon," the CFO, is often too busy to attend, caught in the aforementioned Catch-22.

In an interview, called "The Lost Interview," Steve Jobs was asked, "As a 22-year-old worth $10 million, and a 25-year-old worth $100 million, how did you get your business acumen?" He said that over time, he realized that most business was pretty straightforward. He talked about when Apple had its first computerized manufacturing plant for the Apple II and the accountant sent Steve Jobs his first standard costing report. Jobs asked, “Why do we have a standard cost and not an actual cost?” The response was, “That is the way it’s done.” He soon realized that the reason was the accounting system could not record an actual cost quick enough. When that was fixed, standard costing reports vanished.

In business, Jobs believed that few in management thought deeply about why things were done. He came up with this quote I want to share with you. I believe this quote should be on every wall and in front of every work station in the finance team work area.

> *“Your time is limited, so don’t waste it living someone else’s life. Don’t be trapped into living with the results of other people’s thinking. Don’t let the noise of others’ opinions drown your own inner voice.”*
>
> —*Steve Jobs*

PDF DOWNLOAD

To assist the finance team on the journey, templates, checklists, and book reviews have been provided. The reader can access, free of charge, a PDF of the following material from www.davidparmenter.com/The_Financial_Controller_and_CFO’s_Toolkit.

The templates include:

- A book review of Elizabeth Haas Edersheim’s *The Definitive Drucker*
- The Toyota 14 management principles
- My analysis of Drucker’s top 10 gifts

NOTES

1. Joseph Heller's iconic 1961 book, *Catch 22* (New York: Simon & Schuster; 50th Anniversary edition, 2011).
2. Ibid.
3. Jeremy Hope, "Reinventing the CFO: How Financial Managers Can Transform Their Roles and Add Greater Value," *Harvard Business Press* (2006).
4. Ibid.
5. Frances Kennedy with Brian Maskell, "Why Do We Need Lean Accounting and How Does It Work?" *Journal of Corporate Accounting & Finance* (March/April 2007).
6. Jean Cunningham, "The Lean vs. Standard Costing Accounting Conundrum," *Finance & Management Faculty Journal, ICAEW* (June 2012).
7. Kennedy and Maskell.
8. To understand Peter Drucker's work, read Elizabeth Haas Edersheim, *The Definitive Drucker: Challenges for Tomorrow's Executives—Final Advice from the Father of Modern Management* (New York: McGraw-Hill, 2006).
9. Ibid.