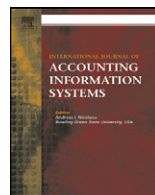




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The financial close process: Implications for future research [☆]



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ABSTRACT

This study advances our understanding of the current financial close process. Attention to the topic is warranted for four reasons. First, economic volatility and growth in restatements have increased pressure on companies to report performance timely, completely, and accurately to market participants. Second, recent regulations have increased the workload for accountants at period end thus negatively impacting the efficiency of the close process. Third, several SEC filings have contained control weaknesses related to the financial close process. Finally, academic research suggests that the time needed to complete the financial close process may serve as a proxy for a company's internal information environment quality. We draw upon prior research and conduct a field investigation with corporate financial officers from 22 different organizations to examine the role of four factors – need to meet expectations, collaboration among multiple participants, estimation process, and ability to incorporate new regulations – in the financial close process. Results suggest that researchers should examine further how the need to meet (or beat) expectations impacts management's actions and the effectiveness and efficiency of the financial close process. Future work could also explore how hidden profile task research and technology advances may improve the financial close process. Finally, research needs to examine how ex post estimate analysis may improve not only estimate quality but also the effectiveness and efficiency of the financial close process.

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1. Introduction

“The economic volatility of the past few years has left businesses hungering for more timely and uniform financial information to help them react quickly to fast-changing conditions.”

[Emily Chasan, *Wall Street Journal*, 2012]

“Finance organizations need to proactively manage the challenges of data quality and prepare for the upcoming regulatory requirements to avoid creating a perfect storm for their financial close and consolidation processes.”

[Raj Chhabra, *Deloitte Consulting Director*, 2010]

The financial close process, i.e. the routine process of completing the accounting cycle and preparing internal and external reports, has recently received increased attention from business executives, regulators, auditors, and academic researchers (Chasan, 2012; O’Leary, 2012). The increased attention reflects recognition that the financial close process can impact the effectiveness and efficiency of the performance reporting process (PCAOB, 2007). Further, the financial close process involves a trade-off between information quality and timeliness. However, some researchers and practitioners may question whether emphasis on a routine accounting process is justified (Busco et al., 2007; van der Steen, 2011). Our goal is to enhance understanding of the current financial close process, provide practical recommendations to companies that may ultimately improve the effectiveness and efficiency of the performance reporting process, and develop recommendations for future research in this important area.

Attention to the financial close process is warranted for four reasons. First, the economic collapse in late 2008 and subsequent volatile economy increased emphasize on providing accurate performance measures in a timely manner to the marketplace and thus reduce the trend of increasing restatements by publicly-traded companies (PricewaterhouseCoopers, 2007; Badertscher and Burks, 2011; Burks, 2011; Files et al., 2013). Further, senior management is now requesting more analysis during the financial close process to timely identify emerging external and internal risks and thus allow companies to better react to economic downswings without restricting the ability to profit from upswings. Second, the efficiency of the financial close process may be negatively impacted as accountants’ period end workload expands to include meeting several new regulation requirements (e.g., reducing the report lag between period end and issuance of financial reports (SEC, 2002, 2005; Geerts et al., 2013), changes in materiality thresholds (Chhabra, 2010), new disclosure requirements such as XBRL (SEC, 2009), new fair value accounting standards (FASB, 2007), and potentially IFRS (Clark, 2010)). Third, audit standards (PCAOB, 2007) now identify the financial close process as a high risk area and several companies have disclosed internal control weaknesses related to the financial close process in recent SEC filings (Approva, 2006; Doyle et al., 2007; PCAOB, 2007, 2010; Klamm et al., 2012). Finally, some academic researchers use the speed of the financial close process as a proxy for the quality of a company’s internal information environment (Jennings et al., 2012; Gallemore and Labro, 2013).

Accounting systems often vary by company size. Further, large companies are more likely to have adopted at least one ERP system over the past two decades (Brazel and Dang, 2008; Ugrin, 2009). However, regardless of size or accounting system used, all companies are impacted by the financial close process. Interestingly, despite its importance to financial reporting, accounting practitioners and scholars have made little progress understanding the current financial close process and how technology specific to the financial close process may improve this process. In this study, we engage prior research in financial accounting, psychology, regulation, and information systems and conduct a field investigation with corporate financial officers from 22 different organizations to provide a systematic examination of the role of four factors – need to meet management expectations, collaboration among multiple participants, estimation process, and ability to incorporate new regulations – in understanding the current financial close process and how it can be improved.

Our results suggest four major recommendations. First, we recommend that researchers examine further how the need to meet (or beat) expectations impacts management’s actions and the effectiveness and efficiency of the financial close process. Second, we suggest future research examine whether hidden

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