Entreprise Resource Planning

Deciding The Accounts Chart

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< E X E C U T I V E   S U M M A R Y >

◆ Entreprise Resource Planning (ERP) is the latest buzzword in the corporate world today. It is a high-end solution offered by information technology to effectively tackle the problems of a business. Due to the initial high cost of an ERP package. the solution was available only to multinationals and other large companies. However, it is now within the reach of almost anyone.

This article looks at the chart of accounts, one of the key elements in an ERP system. It points out that decisions need to be taken on the structure of the chart of accounts and the contents of the structure. It elucidates some of the factors which must be taken into account while deciding the structure and content such as dimensions, provision for legal entities, etc.

Internal systems, including the billing, order entry, inventory, logistics and financial systems provide critical support at various stages for the larger business process of product delivery. These various business processes are integrated together by an ERP package which allows the sharing of common information across what previously used to be distinct functional areas.

One of the key decisions in an ERP implementation is deciding the chart of accounts, and, at least in theory, companies often have two alternatives available to them:
◆ Use the existing chart of accounts structure as was being used in the previous system being migrated from,
◆ Start from scratch, i.e. review and completely overhaul the chart of accounts and implement the changed structure.

In practice however, the choice to use the same chart of accounts as before is not even an option as most new ERP systems use concepts and mechanisms for chart of accounts in a manner completely different from the legacy systems being migrated from. There is also the question of how relevant the new chart of accounts still

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is, and an ERP implementation is often the much awaited opportunity for many companies to bring the chart of accounts in line with the realities of business that have changed over the years. Attempting to modify the existing chart of accounts into the new system also have the significant disadvantage of carrying forward the historical baggage, such as redundant data elements, inconsistent use etc.

Adopting a new chart of accounts therefore often becomes a necessity when implementing a new system or overhauling an existing one. Due to the sophistication and complexity of available ERP systems which allow for complex relationships and data validation rules etc., charts of accounts decisions are rarely simple and go far beyond a simple listing of nominal accounts.

From a strategic viewpoint, a chart of accounts is only one of the elements of an organisation's common business data model. The common business data model should provide information that the enterprise's managers need to run the business. The elements that constitute the common data model will be located across the different manual and automated systems that run the internal processes. One of these key elements is the chart of accounts that captures, revolving around the general ledger, all financial information.

There are two dimensions along which decisions need to be taken while considering a new chart of accounts:

◆ The structure of the chart of accounts: This includes decisions on issues such as the number and names of fields in the chart of accounts, order in which they appear, relationships & dependencies between them, validation requirements, length, numeric or alpha or both, uppercase or lower case or both, etc.

◆ The contents, or the values stored per the structure: These would be the actual codes that represent various nominal accounts, cost centres etc. per the structure decided above.

The following factors must be considered when deciding the structure and contents of the new chart of accounts

DIMENSIONS, OR GRANULARITY ALONG WHICH INFORMATION IS TO BE CAPTURED

The ultimate determinants of the chart of accounts will be the degree of detail that the company wishes to build into its transactional systems. While it is easy to be tempted and include all possible elements by which business data can be sliced, each extra element imposes an overhead on the data capture process besides increasing the possibility of data ' inaccuracy. Generally, the level of detail incorporated in the chart of accounts would bear an inverse relationship to the accuracy of the data captured using such a framework. The more are the data elements, the more is the possibility of erroneous classification. The right balance needs to be struck between the demands of analysts for better classified data and the internal capability of the transactional processes to capture such detail.

Depending upon the nature of their business, companies are interested in analysing their data by dimensions such as product, activity, cost centre, geography, legal entity, project, and _ occasionally customer as well. The specification for the chart of accounts must include these data elements that will form a part of the new structure, together with an explanation of the rules to be followed for recording information therein, and the means to be used to capture such information by data element.

ORGANISATIONAL CAPABILITY TO CAPTURE INFORMATION

There is always a risk of being tempted to include all possible business dimensions in a chart of accounts structure, and the risk is that elements that are difficult to capture will fall into disuse over a period of time. Since the decisions on the structure of the charts of accounts are often practically irreversible in an ERP context, it is important to consider the ability of the organisation to be able to capture correctly the various components of the chart of accounts.

When determining elements to be included in the chart of accounts, the exact details of the mechanism that will enable the capture of that information must be identified. While customer wise classification of revenue may be easy to achieve as this may be interfaced from the billing module, being able to split costs correctly and consistently over a period of time by cost centre and business process/activity may not be so easy.

Skills are a real issue here - qualified people having the skill and judgment required to code correctly, say a cost, are unlikely to be willing to do this work when it has to be identified by cost centre, geography, activity, product, customer, project & legal entity. And the people that are willing to do this, i.e. the bookkeeping clerks, simply may not have these skills. The design must have a humane aspect with consideration for the persons who will be responsible for the coding.

PROVISION FOR LEGAL ENTITIES

The chart of accounts must recognise the real world that the business operates in, and the entities through which its operations are carried out. It must meet the basic requirement that it should provide all financial information by real legal entities (as opposed to organisational classifications of business units, divisions etc.) - no matter how irrelevant this information might appear to pure management accountants. No matter how we organise our business, the reality of legal entities never goes away, and building these into a chart of accounts helps create the deepest level of detail that can potentially make the chart of accounts future resistant, if not future proof.

It also allows us to capture information along the dimension by which we hold ourselves out to the real world, and is extremely useful for tax and statutory reporting. The real legal entity must be a balancing segment, i.e. it should be possible to extract a self balancing chart of accounts by legal entity. This may not be a requirement for a business division where balance sheet elements may not be shared and separate information may be required only for the profit and loss accounts.

- Dimensions or granularity along which information is to be captured
- Organisational capability to capture information
- Provision for legal entities
- Statutory accounting requirements
- Ease of maintanence
- Process enabler
- The cost of complexity

STATUTORY ACCOUNTING REQUIREMENTS

In addition to the information required to be captured for the purposes of the organisation's own consumption, the chart of accounts must provide fields or segments where information necessary for compliance purposes can be held. The use of these would be dictated by local statutory compliance requirements and should not include any value which is used for say, local management reporting. If the local management requires any reporting, that should be catered for by the standard chart of accounts. If there is something in these local segments or fields, it should only be there to flag local fiscal requirements, and ideally the standard chart of accounts should be comprehensive enough to provide for all local management information needs.

EASE OF MAINTENANCE

Typically, intelligent use of dependencies, cross-field data validation and use of relationships where some codes 'roll-up' to another contribute a great deal to maintainability. These relationships will have to be thoughtfully reviewed in light of the capabilities of the ERP system. The design of the chart of accounts must look beyond the current quarter end or the current year end. While not recommending an exercise to predict the future, another factor go consider here would be to have a vision for the finance function that goes at least 2-4 years in the future.

PROCESS ENABLER—ABC, BALANCED SCORECARD, PROJECT ACCOUNTING

The design and structure of the chart of accounts should be mindful of the emerging processes and changing views of the business that are expected to take centre-stage for the company's managers in the coming months and years. The strategic direction and the view of the company towards activity based costing, product profitability, balanced scorecard and key financial indicators, project based management, decision support and cost modelling, datawarehousing etc are things which would be unwise to ignore as being considerations when deciding a new chart of accounts.

THE COST OF COMPLEXITY

Complexity carries costs which may not be readily quantifiable or even identifiable immediately. Extra time required for data entry, more time spent reclassifying, more complexity built into system administration, more time required for maintaining data validation rules, training time for new accounting staff, time spent on classification arguments etc. are all issues that comprise the cost of complexity. Often, though not always, this cost of complexity will present a reasoning countering the flexibility argument. The balance needs to be carefully struck.

How much complexity can the company really handle well is a question that must be answered objectively uninfluenced by top management expectations, and if this analysis reveals an expectation gap it should be bridged by an education process and not by imposing a clumsy and unwieldy chart of accounts.

CONCLUSION

We need to be regardful of the reality that there is no such thing as a right chart of accounts. There would always be alternatives available which would be equally attractive. Any chart of accounts will always be sub-optimum when looked at from a different perspective. It is necessary to view the chart of accounts as being a key component of the mechanism that helps the organisation find out more about its own internal dynamics. Foresight, coupled with business wisdom, are necessary to strike the right balance of the trade offs that will have to be made to arrive at the best fit chart of accounts.