

Accounting treatment and internal controls in financial shared services of multinational corporations*

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Abstract: Financial shared services (FSS) play an important role in multinational corporations for the effective cost management. FSS also can reduce errors and fraud so as to achieve perfect internal controls by standardized and procedural business processes which are important parts of internal controls. This paper emphasizes on two popular procedures and methods in multinational corporations. One is balance sheet reconciliation. It can illustrate the situation of accounts on an accrual basis which are the focus of internal audit and external audit. The other is Interco-Sop (Intercompany-standard operating procedure) which are important for to ensure the accuracy and effectiveness of accounting system and internal controls.

Key words: financial shared services; balance sheet reconciliation; Interco-Sop

1. Financial shared services in multinational companies

With the economical globalization, it becomes increasingly uneconomical for multinational companies to maintain duplicate infrastructures within each area. And many multinational companies have entered into a relatively stable period of growth in which the way to increase profit by increasing revenue has gradually been ineffective and is steadily replaced with compressing costs. Now most multinational companies have established shared services in developing countries. The shared services provide the services in one location which to be used by several recipients in several other locations. It consists of the shared part that is used by several recipients such as internal customers and partners, and the services part which focuses on the services for internal and administrative purposes. The shared services almost only concentrate on the supporting functions such as human resources, IT and finance. Financial Shared Services (FSS), therefore, is a professional financial services centre.

FSS caters for the company's growth whether organic or through acquisition in a cost-effective way. Usually, the costs of human resources in developing countries are notably lower than those in developed countries. In general, the costs of non-production staff in developing countries (such as China, Malaysia) are only equal to 1/10 of those in U.S., 1/13 in Japan and 1/6 to 1/5 in Hong Kong. On the other hand, Financial Shared Services offers the centralized services to the companies. The standardized and clear treatment procedures which are realized by advanced electronic and communication techniques can largely save accounting cost.

Besides cost saving, the most important advantage of FSS is that it can reduce errors and fraud so as to achieve perfect internal controls by standardized and procedural business processes. As mentioned by its director of Financial Shared Services, Charlotte Herndon, "We really realized the benefits of shared service when we faced

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with Sarbanes-Oxley. We shudder to think what it would like without shared services, as we would have had to take all of the work and multiply it by every single unit. Our business units spent very little time on Sarbanes-Oxley matters because the processes are standardized and documented (Management Report, 2007)".

In FSS, there are many effective procedures which are applied to ensure accuracy and objectivity of accounting. Of course, they are important parts of internal controls. This article will introduce and analyze some typical procedures and methods in FSS of multinational companies.

2. Balance sheet reconciliation

Many businesses related to accrual, amortization and so on, especially for main cost and expenses adjustment, are on an accrual basis. These accounting treatment are with large subjectivity and certainly are the focus of internal audit and external audit. So Balance Sheet reconciliation are required to illustrate the situation of the regarding accounts. For example, if one accrued expense is \$100,000, reconciliation is to list the composition of the \$100,000 and the details of each composition such as occurrence time, description and amount of money. In the FSS of multinational companies, the tools for Balance Sheet reconciliation are usually integrated in the system of accounting and it is very effective and convenient for audit.

The Motorola Accounting Services Center (MASC) which is located in Tianjin, China is one of the significant examples to demonstrate the organization and the function of this service model. In MASC, account reconciliation tool has been used to replace manual account reconciliations. The account reconciliation template is available on the finance website for balance sheet accounts. Once accessed, the user has the option of 4 or 5 functions plus a help function. The account reconciliation template allows users to select the template that best fits their needs. Templates are pre populated with all general information including beginning and ending account balances, monthly transactions, reconciler, approver, time period and functional currency.

The benefits of account reconciliation template are obvious. It reduces manual efforts and can attach supporting documentation to the template. It can clearly describe workflow and open items reporting. What's more, it enables users to designate and recall responsibility.

3. Interco-Sop

As a multinational corporation, it is undoubtedly that there are number of internal trades in the corporation. And errors and embezzlements are apt to take place in the internal trades. So the internal trades are certainly the focus of internal controls. Strict and impartial regulations and procedure are necessary to ensure the accuracy and effectiveness of accounting system and internal controls. MASC has institute standard operating procedure (SOP) for internal trades.

Internal Trades Sop establishes the process of internal Motorola transactions. It can insure all internal Motorola transactions are booked accurately and timely and minimize out-of-balance among Motorola entities/business. In many multinational corporations, the expenses always have been planned in the budget. If there any expense has not been planned should be charged, it should be checked up by strict process.

3.1 Non-regular HO request

When expense needs to be charged to other Motorola legal entity, the first step is that the requestor shall fill out HO (House order) form. HO request form is the unique official form which should include all the key information. Then email form to inter-co accountant and also copy requestor's manager. Original supporting

document is kept in requestor's hands. Threshold for HO is \$250 applied to each single line. Exceptions are regular HO, statutory requirements and mechanical files. In normal conditions, the currency requirement is USD, while exceptions for countries which local currencies are legally required and EMEA functional currency is EUR, other currency agreed to be used by both sending and receiving entities.

The cut time for non-regular HO request is WD-3 (3 working-days), and late requests will be processed in the following month.

Inter-company accountant working process on HO is as following chart:

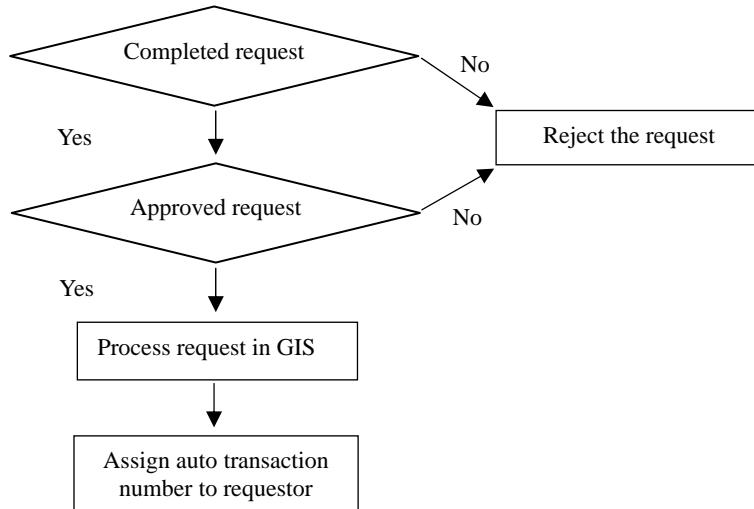


Figure 1 Inter-company accountant working process on HO

3.2 Process HOs in GIS

The Inter-Co Sop also institute detailed regulation accounting treatment. Accounting entries in GIS (Goods in Transit) are as following:

At sender side:

Dr: GIS staging AR (accounts receivable) account

Cr: Department expense (or other accounts)

At receiver side:

Dr: Department expense (or other accounts)

Cr: GIS staging AP (accounts payable) account

Inter-co accountant will uploaded or manual input transactions in GIS. For the uploaded transactions, the status will change to "approved" after transaction created. For manual input transactions, accountant should submit and approve it. Inter-co accountant will not send HO request form to receiver's finance contact unless it is required by receiver.

3.3 Regular HO request and booking

Before booking, inter-co accountant need verify the request and approval, any incomplete request will be returned to requestor for modification. The working process is like this:

- (1) Keep a mapping file;
- (2) Use FIRE report to extract the department MBR and generate a feed file to create GIS transactions;
- (3) Check the feed file details and document the checking results;

(4) Upload the feed file to create GIS transactions.

Any entries booked to HO department after MBR cutoff, the expense will not be charged out in current month. Email notification will be sent to inter-co accountants after interface. Inter-co accountants need to check whether the JV (Joint Venture) is posted to FOCUS (the ones should be given priority). Any interface error needs to be investigated and corrected in the current month.

3.4 GIS invoices generation

All the invoices are created by interface in the first week of the following period. GIS-Invoices will be sent from the sending entities to the respective receiving entities -unless prior arrangement has been made that the receiving entity will print off invoices from the web site. Each receiving entity will be given monthly invoices from sending entity. Monthly invoices are summarized by transaction types. Invoices detail can be found on the GIS inquiry website.

3.5 GIS payments/receipt booking

It is receiver's responsibility to make payment to sender according to Motorola internal entity payment term. Of course, different corporations usually have different payment term. GIS system admin run GIS AR invoice extraction and send to receiver's FOCUS AP. GIS system admin run GIS AR invoice extraction and send to receiver's FOCUS AP. Receiver can get the monthly invoice from sender or web site. An email notification will be sent to inter-co accountants. The rejected invoices will be shown in the message. Receiver needs to investigate the reason and bring the invoice to AP. Receiver should make payment to sender in GPS (Global Positioning System) at main netting cycle. If the receiver or sender is not using GPS, the payment should be made through wire transfer.

On WD-4, GIS admin will trigger the automatic cash application process. All the paid invoices in the current period will be applied automatically in GIS AR. Inter-company accountants need to check the applied invoices against netting report (T/T Telegraphic Transfer receipt) to ensure all the paid invoices are applied properly. Manual receipt will be booked for those invoices not applied by auto cash application program by VATC (Virtual Asia Transaction Center) cash application team.

3.6 GIS AR interface

GIS-AR entries will be interfaced to each entity's ledger once a month GIS-AR has two types of entries.

Invoice generation entry will be:

Dr: GIS AR

Cr: GIS STAGING AR

Cash receipts entry will be:

Dr: Bank

Cr: GIS AR

It is very important that intra-company transactions should not be processed in GIS. Intra company transactions should be booked in each legal entity's ledger directly.

3.7 Related party accounts confirmation and accounts reconciliation

This step is a key step both in accounting and internal control. Inter-co accounts balances have to be confirmed and reconciled monthly. Sender (AR party) needs to send the AR statement to receiver (AP party) by WD+1 every month which contains the detail invoice information of customer. Receiver should confirm inter-company AP balance to sender by WD+2 via email. Inter-company accountants should follow up the confirmation from counterpart if there is no feedback.

If there is any variance or out of balance between sender and receiver, receiver needs to take in the balance

first before book closed to make sure AP balance ties to sender's AR balance. It is both sender and receiver's responsibility to investigate and solve the AR & AP variance in following month. After the confirmation, account analysis report should be finished in WD+10. This report should include: detail breakdown, aging report, follow up and confirmation status etc. Any items over 30 days, inter-co accountant should indicate the reason and action plan on it.

Inter-co supervisor will review all account analysis and approve it. Inter-co supervisor put all account analysis report in compass by WD+10. GL (General Ledger) accounting manager will review and approve the account analysis quarterly.

3.8 Documentation

For non-regular HOs, VATC will only documents HO request and requestor's email in shared folder. Any query about non-regular HOs, VATC will direct the query to the requestor who will be responsible person. For regular HOs, VATC will keep regular HO mapping in shared folder. If there is any request to change the mapping, the requestor's message will be kept in shared folder.

3.9 Special process

Countries with foreign currency need do inter-company AP/AR balance allocation and realize exchange gain/loss allocation. Inter-company AR/AP balance and realized exchange gain/loss need to be allocated according to each transaction's distribution detail before closing. For some countries with foreign currency control i.e. China, India, Korea, VATC needs to provide the appropriate documents per legal requirement before the payment is made. Any general exceptions to this SOP require the approvals of VATC General Accounting Manager and VATC General Manager.

4. Conclusion

So we can see that strict and impartial systems have been established in the FSS, which can help to reduce errors and fraud. Undoubtedly, these consummate accounting systems enable the corporation process healthily and efficiently control the risks. Investors also shall have more confidence in these corporations.

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