



Understanding the Importance of Preserving Historical Financial Data

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By Jim Hammond

The hours have been billed, the client invoiced and the payment recorded, what happens next in your firm? Does your financial management software preserve a detailed financial history? For many firms, once an invoice has been collected in full, the process of utilizing the associated data stops — a hard copy of the invoice is filed and the numbers lie dormant in the financial system. This scenario is problematic because it does not allow for long-term flexibility in accessing and manipulating the data for best practices and/or analysis purposes.

The truth is, many financial systems — even those designed in the last few years — don't maintain enough historic detail to solve tomorrow's problems. Why? Financial systems are transactional databases that are primarily designed to process transactions rapidly. In order to save database storage space and improve operating performance, the millions of rows of detailed data associated with billing are often discarded when an invoice is generated or paid in full, at month's end or at year's end. At that point, ad-hoc analysis is nearly impossible without custom programming or report writer specialists, unless the specific report desired was envisioned and configured in advance. How many times have you attempted to generate a report from your time and billing system only to stop because the information wasn't readily available in a usable format?

Risks of Not Preserving Financial Data

From a preventative or best practices standpoint, there are several reasons why your firm should be able to easily access old numbers. Perhaps most well-known are retention mandates and policies (eg, Federal rules, ABA guidelines) that have come into play post Enron/Arthur Andersen. However, failure to preserve historic financial data unnecessarily puts the firm in reactionary mode, which presents several problems (eg, added expense, last-minute scrambles, etc.) as the following examples highlight:

A partner has left the firm and demands to see a detailed audit of his earnings from the firm's income statement or balance sheet. With little or no back-up historic transaction detail, producing these numbers could be challenging. Most systems have a real-time interface between the time and billing and A/P and general ledger modules. However, they typically only import summary information into the accounting applications as opposed to detailed information from the financial management system. Therefore, you would not have the detail needed to troubleshoot the general ledger.

Your firm is attempting to audit past transactions and there is no audit trail. Best practices require the use of an audit log to keep track of transactional-level details such as what was changed, when and by whom. Sounds simple, but most systems do not provide this functionality.

The firm's CFO is reviewing the historic aging information for the clients of one billing attorney and wants an exact copy of an aging report as it was on 12/31/03. Without a date-in-time snapshot, it's nearly impossible to generate reports that reflect prior accounting periods. An aged A/R report run today for the period ending 12/31/03 will not look the same as the report that was actually generated on that date. The concept of aging receivables is standard in all systems, but what isn't standard is maintaining a true historic prospective of the information. In attempt to circumvent this issue, some firms archive a static copy of all month-end reports for later reprint. Not only does this approach lack the flexibility for later analysis, but if a report wasn't generated on the date in question, then it could never be recreated again.

A client discovers an error in the previous month's bill, which included entries from another client. The firm's system "recreates" the bill, but it does not include the historic data of the original outstanding balance at the time. From an auditing point of view, both bills should be permanently stored. Recreating is not the same as printing a copy in the original format from an image.

It's impossible to predict how your firm might have to pull and present financial data in the future. That's why having a system in place for responding to these types of requests and mandates is imperative.

Implementing a Process for Storing & Retrieving Historic Financial Data

Before implementing any new technologies or processes, your firm's CFO, management team and risk management committee should work together to set firm policy regarding financial data preservation. While the risk management partner may be concerned with time parameters and adhering to best practice mandates, the CFO may be more interested in how the information can be used in the future. Once guidelines are set, there are many readily available technologies that can help your firm adhere to the policies set forth.

Most financial systems are robust enough, from a server and hardware perspective, to store data indefinitely. The problem is that they are not designed for post-transactional access, review and analysis. Fortunately, there are financial management systems today that either include or integrate with business intelligence systems. This allows the firm to maintain all transactional detail and send it to a business intelligence system, with a separate data warehouse database, that is used exclusively for reporting.

"Many firms are choosing to use data warehousing, and rightly so," says Mark D. Grant, CPA and president of his own financial system consulting firm headquartered in the Washington, DC metro area. "An accounting system is designed to process transactions rapidly. Whereas a data warehouse is designed for fast generation of reports. From a technical perspective, the two systems are tuned very differently to achieve maximum speed. By pulling the information into a data warehouse, firms can efficiently and effectively manipulate the data for further analysis as needed."

When evaluating a business intelligence system, be sure that it allows your end-users to create on-the-fly reports with no custom programming required. It's also important that the system provides the end-user with the ability to easily customize views and report formats - the data is worthless if it's not in a usable format. Confirm that the system is designed to store a financial prospective or "snap-shot" of financial information. Further, look for systems that have audit log capabilities for maintaining data from the current year and at least 1 year prior.

It's also prudent to image and electronically store client invoices and back-up expense invoices. This not only reduces the amount of staff time involved in locating, copying and refilling invoices, but also reduces costs associated with both internal and off-site storage space. Further, imaging provides the necessary exact copies of invoices from any date in time. The financial management system should image invoices automatically as they are finalized and printed.

Proactive Uses for Archived Financial Data

Once you have a system in place that makes it easy to access, your firm's financial history provides numerous benefits and strategic planning opportunities. The value of the information that resides in your financial system extends beyond billable hours, WIP and A/R. According to Grant, today's numbers don't tell the full story. While isolated numbers are important, they are more meaningful when paired with information from prior months and years in order to identify trends and the direction the firm is heading in relation to those trends. For example, is the firm collecting slower than usual as evidenced by an increasing percentage in the over 90 days column? What are the reasons behind this trend? Could the billing rates be too high? Is the collections department understaffed? Is this a problem across all practice areas or just isolated to a particular one, or a particular billing attorney. First, identify the trends, explore the "whys" behind the numbers and then bring about the changes necessary.

"Use your financial history to monitor and decide where you want to put firm resources. It's a great tool to help grow the business, see where deficiencies lie and where the firm needs to be more efficient. Look at revenue growth and decline, fees billed and collected, and expenses. Identify trends and take the time to find out the reasons behind them, then gage where you need to be according to your firm's goals," says Mary Lou Shefrin, a partner in the financial consulting firm, Shefrin Lynch Associates, LLC., located in Connecticut. "For example, I work with a firm that wanted to look at specific business practices and their growth patterns over the last 5 years. Once identified, they were able to dig deeper into the data to identify the clients and timekeepers that made up the difference."

Finally, leveraging the knowledge that comes from analyzing historic financial numbers and understanding trends helps firms to maintain a competitive edge and preempt declines in profitability. Firms that proactively look at their data and manage the firm accordingly will win in the long run.

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