SAP Thought Leadership Paper
Banking

Achieving Financial Excellence in Banking
Facing the Future with Agility and Strength

The Best-Run Businesses Run SAP™

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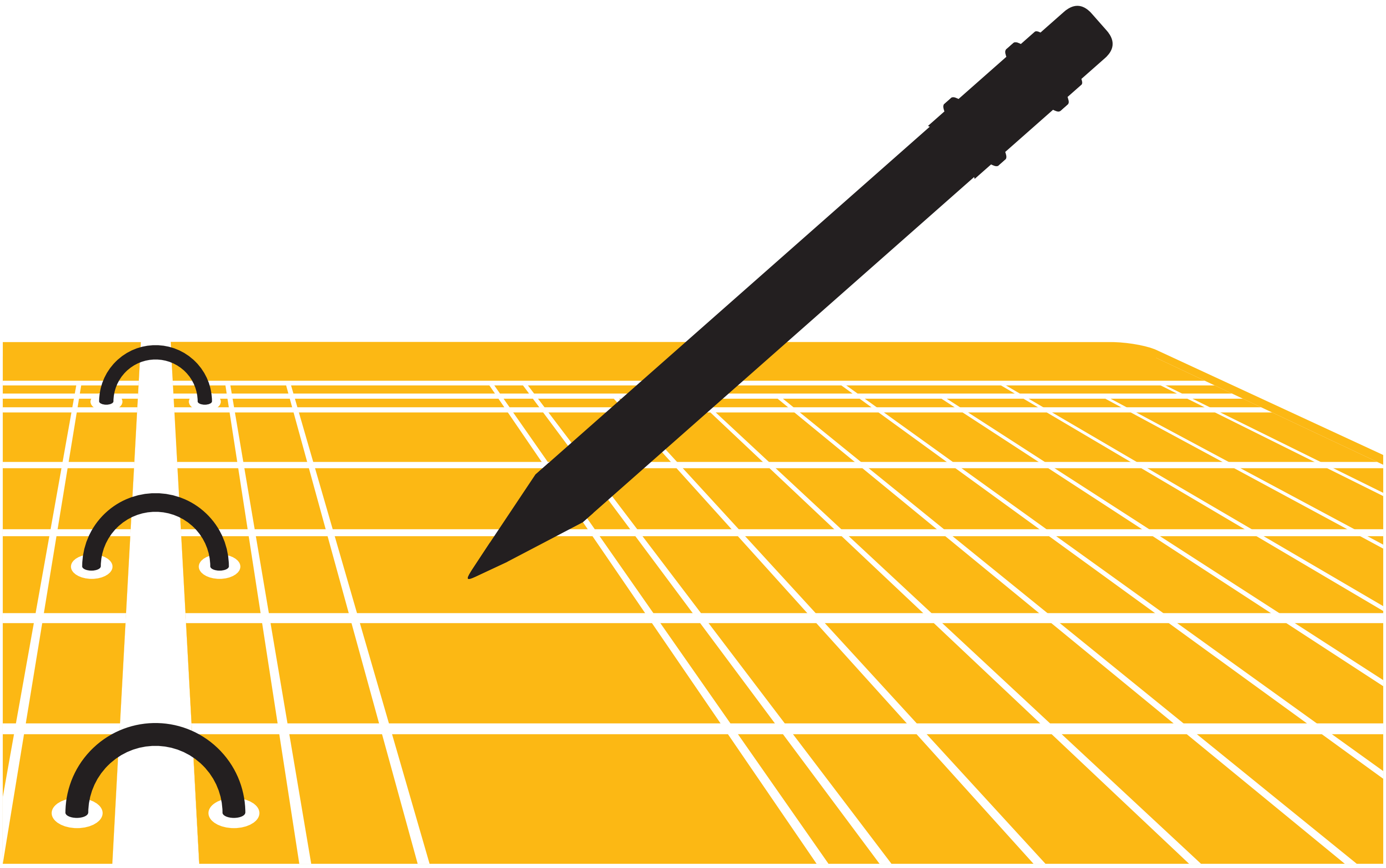
For banks that are not prepared for consolidations, the road to financial excellence will become even more difficult. However, the right technology can help you update outmoded systems and eliminate obsolete processes. SAP offers solutions that work together to provide a harmonized IT architecture, bringing greater efficiency to your operations. With SAP solutions, you can build a strong yet flexible foundation that supports innovation in your business mix and lowers risk and costs inherent in technological changes.



Executive Summary

Recent times have been challenging for banks, with uncertainty and increased scrutiny by regulators, investors, and customers. Against this backdrop, banks have to stay viable, comply with regulations, keep stakeholders informed, and, hopefully, be profitable. This tall order calls for financial excellence and the coordination and use of skills, assets, people, and technology.

For many banks, the road to financial excellence is made uneven by outmoded technology, inherited practices, and disjointed processes. Going forward, it will be even bumpier for those unprepared for the changes that the ongoing wave of consolidation in the industry is bringing, for those whose back offices are too rigid to support the innovation that customer centricity demands, and for those whose back-end operations are tightly yoked to their core banking systems.

With the right technology, though, a firm yet flexible foundation can be laid-one that makes finance operations more efficient, supports innovation and change in business mix, lowers risk and costs, better informs business decisions, and eliminates the obstacles inherent with technological changes.

The Changing Face of Banking

Today's banking industry is quite different from what it was before the recent financial crisis started in 2007. Bank failures, scandals, and historic market losses have led to intense scrutiny by regulators and investors, who now demand extensive and transparent information on financial performance and risk management.

Regulatory deadlines are also shorter than before. This puts pressure on the finance organizations of banks to provide timely and accurate evidence that they can remain in compliance with regulations or policies, that the proper controls are in place, and that they can mitigate critical risks before business performance or compliance status is jeopardized.

The market turmoil has also changed how banks are structured. Together with mergers and acquisitions, this has resulted in highly complex organizations. Accounting standards are also more demanding, with an increasing number of countries either adopting International Financial Reporting Standards (IFRS) in full or converging IFRS with their own national accounting standards.

In short, banks are expected to comply with ever-changing regulatory mandates, align their actions with corporate initiatives, and protect asset values – all while staying profitable and giving shareholders and investors a fair rate of return. It is a tall order indeed, and analyst studies confirm this view, as shown in Figure 1.

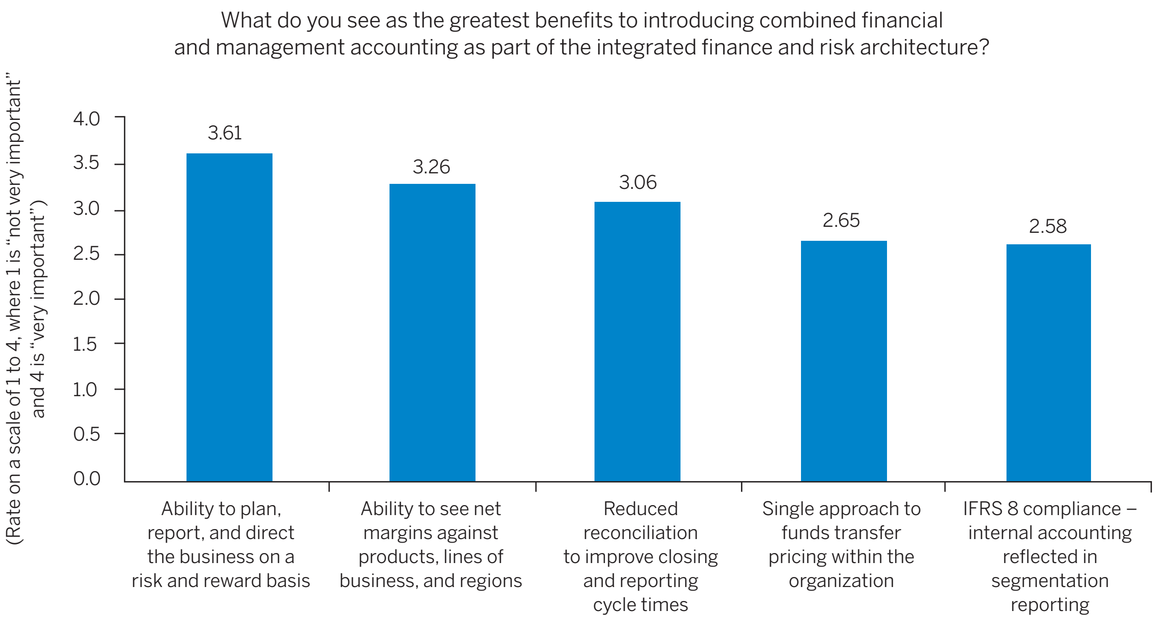


Figure 1: Key Challenges Facing Banks Today: Managing Finance and Risk

Source: Results of an online survey of 108 banks in Europe (East and West) and the Middle East, carried out by the European Financial Management and Marketing Association (EFMA) in conjunction with SAP and Datamonitor: *Achieving customer centricity throughout the enterprise*, published by EFMA, June 2008.

Striving for Financial Excellence

To thrive in the challenging environment in which they operate, banks need to leverage resources, people, and technology to ensure strong cash flow and liquidity, compliant and accurate financial reporting, and profitability. To achieve such financial excellence, banks require greater visibility into and control over the drivers of their finances and operations.

Efficient finance operations provide the foundation for financial excellence. The bulk of the responsibility for providing this visibility and control has fallen upon the finance organization and the CFO who heads it. Now more than ever the finance organization and the CFO must:

- Provide analytical support and help to optimize overall business operations and meet regulatory requirements
- Report on results of core finance activities and maintain investor and shareholder relations
- Ensure the appropriateness, fairness, and accuracy of company financial reports, thereby minimizing risk of noncompliance

Key ingredients of financial excellence include a fast financial close, the ability to support mergers and acquisitions, and back-office support for innovation.

FAST FINANCIAL CLOSE

The term "financial close" describes the ability to complete accounting cycles and produce financial statements for internal management and external legal reporting.

The benefits of a fast and efficient close have multiple internal and external touch points:

- Faster access to financial information relating to performance
- More time for value-added analysis due to streamlined processes that reduce the number of staff days required for financial close activities
- Improved control systems and better quality reporting that delivers greater value and improves the audit sign-off process
- Time and cost savings across a variety of close processes
- Better investor relations by publishing statutory results faster than industry peers and more closely monitoring business performance

While there is no 100% right or wrong answer as to what counts as a fast close, banks need to understand where they stand when compared with their competitors and how this standing relates to the relative complexity of their performance management and financial reporting processes.

SUPPORT FOR MERGERS AND ACQUISITIONS

Banks have been in competition to increase top-line revenue by driving growth through mergers and acquisitions. Together with the ongoing market turmoil, consolidation has made banks more complex and harder to manage, especially when new businesses and territories are added.

Mergers and acquisitions have made financial control more challenging. To achieve financial excellence, banks have to make the role and responsibility of each organizational unit very clear and ensure that group requirements are met while giving local entities the ability and autonomy to meet regulatory requirements and satisfy local market conditions.

In the IT area, underlying systems must be able to support the unification of processes and reporting with an application infrastructure that can meet broader group demands while adapting to local requirements.

To achieve financial excellence, banks require greater visibility into and control over the drivers of their finances and operations.

BACK-OFFICE SUPPORT FOR INNOVATION

Worldwide, banks are shifting from a product focus to one that is centered on customers. Such customer centricity demands that banks create innovative offerings that are tailored to specific customer needs. These new offerings need to be supported in the back office, with the necessary processes as flexible and nondisruptive as possible. This is best done when the accounting preparation is decoupled from the core banking applications through the use of a central layer for accounting processes for the different applications. In addition to supporting innovation, this enables simplification and migration of the operational systems landscape and provides an easier route to compliance with future regulatory requirements.

Decoupling accounting preparation from the core banking applications supports innovation, enables simplification and migration of the operational systems landscape, and provides an easier route to compliance with future regulatory requirements.

Barriers to Financial Excellence

While banks work on making their finance operations more efficient to move closer to achieving financial excellence, many are finding their efforts hindered by barriers. Found at the head-office, country, and branch levels, these can be grouped around organizational culture, technology, processes, and practices.

ORGANIZATIONAL CULTURE

The culture within a financial institution is influenced in part by the organizational structure and external market dynamics. Many institutions acknowledge the benefits of integrated risk and finance methodology, infrastructure, and processes, but few could successfully put these in place due to challenges posed by their organizational culture. Most banks are still running separate risk and finance functions, which makes it difficult to achieve financial excellence. However, some banks have started to align these two functions by having the head of risk and the head of finance report to the same executive represented on the board. To achieve the ultimate objective of integrated financial excellence across the organization, banks will need to effectively introduce and execute change management.

TECHNOLOGY

Banks have deployed a wide range of core banking applications to run their business. Many manage multiple information silos for individual lines of business and use point systems designed for particular regulatory regimes. While these offer some accounting functionality, they tend to use disparate technologies and have complex interfaces.

Having a wide variety of IT systems can make it difficult for banks to meet local accounting and IFRS requirements, apply groupwide accounting standards, and provide homogenous, reconciled, and auditable accounting information across units. Cross-system accounting issues, such as hedge accounting, where different core banking applications are involved, can also arise.

In addition, many banks deal with financials and risk management separately. This approach results in a wide range of challenges and problems. Data sits in isolated applications, making regulatory reporting and closing complex, time consuming, and error prone as the bank tries to reconcile the results from a variety of business and controlling systems. Consistency in risk and financial reporting as stipulated by Basel II and IFRS, for example, is hard to achieve in a silo architecture.

Not having financials and risk management on a common technology architecture limits the ability to correctly price risk into products. Without a risk-based pricing framework that is integrated with finance, banks are unable to gain a complete economic perspective on new-business profitability, including the market price of the risks taken on, the economic capital required to write the product, and the cost of commission and other expenses.

PROCESSES

In a financial close, data needs to be collected from multiple sources, including product subledger systems, enterprise business components, and spreadsheets. When all this data is available, the necessary adjustments can be made, foreign currency valuations executed, and consolidation can begin, yielding consolidated statements of group accounts. Process inefficiencies, including manual data entry, lack of validation and controls, and lack of integration across multiple close processes, make it hard to achieve a "right-first-time" financial close.

While elements of the close process lend themselves to automation (such as currency conversion and equity elimination), these are still done manually in many banks. Automation gaps inhibit agility and drive up costs. Fragmented processes spread over several applications and locations result in a weak audit trail, which in turn drives cost every time accounting results need to be validated.

PRACTICES

In the current accounting process of many banks, accounting valuations are carried out either in operational applications or in a closely associated set of interfaces and accounting rules. Completed accounting information is posted to a central general ledger (GL), often referred to as a "fat GL" due to the large amount of data posted from high-volume transactions and the number of analytical fields used. A fat GL, with its complex chart of accounts, is costly to maintain. And because it supports the entire business, enormous effort is needed to align processes, historical and current data after organizational changes, mergers and acquisitions, and shifts in business mix.

In a different approach, some banks have tried to move to a "thin GL" but still have had to satisfy reporting requirements from a data warehouse–like application that is fed in parallel to the GL, leading to extensive reconciliation issues.

Together, these barriers prevent banks from making their finance operations more efficient, reporting performance and risks quickly and accurately, and improving the quality of business decisions. They also hinder efficient integration of acquired companies or incorporation of shifts in business activity.

SAP provides solutions that work together to provide a harmonized IT architecture that can help banks bring greater efficiency to their finance operations and lay the foundation for financial excellence.

Benefitting from an Integrated Financial System Landscape

To achieve financial excellence and gain the integrated, real-time insight they need to track profitability and manage the business more effectively, banks need to harmonize their accounting methods and accounting processes. To do this, they need to standardize the chart of accounts and additional GL fields, valuation methods, accounting-rule interpretation, and the approach used for management accounting.

Banks need to integrate financial accounting and risk management into a common technology architecture. At a minimum, this architecture has to have a general ledger, a business analytics application with detailed reporting functionality, an application for evaluating financial products, an accounting rules engine, and software for data extraction, transformation, and loading. Banking requirements grow over time, so this architecture must be able to adapt applications and processes as business needs change. And, of course, it has to meet international accounting standards and local requirements in parallel.

With such an architecture, banks would have a unified data repository that can be accessed by other systems or lines of business, resulting in less data inconsistency and disparity, reduced costs, and a more robust audit trail. This architecture would also enhance compliance and reporting capabilities, enable fast financial close, and provide management the granular information it needs to make risk-based business decisions.

From an organizational point of view, a single architecture facilitates the implementation of competence centers and shared services for both accounting and IT operations. This helps cluster scarce and valuable business know-how, improve quality and process control, and lower IT costs. Moreover, business process costs can be reduced and freed-up resources shifted to more strategic tasks.

On a functional level, this architecture provides a single source of truth by supporting a harmonized model of source, result, and reporting information across entities, business lines, and accounting functions. This reduces vertical reconciliation efforts, with the information available for use in risk control as well.

A harmonized accounting architecture brings cost savings as well. One of the major cost components of a bank's current accounting landscape is the myriad of interfaces it has to maintain. A common architecture reduces the number and complexity of these interfaces, thereby significantly reducing the overall cost.

Additional drivers to invest into a streamlined accounting architecture are outlined in the table below.

Driver	Example
Business requirements	• Inadequately solved accounting requirements • New requirements from regulators • Alignment of financial and management accounting
Integration	• Replacement and enhancement of core banking systems • Integration of new units as a result of mergers and acquisitions • Enforcement of groupwide financial accounting standards
Architecture	• Volume problems or limitations (number of posting documents or coding combinations) • Processing time and fast-close problems • Lack of technological support for audit trails
Cost	• Decentralized accounting valuation engine (multiple methods and technologies) • Reconciliation cost • Outsourcing (cost cutting or centralization)

SAP® Solutions and a Harmonized Architecture

SAP provides solutions that work together to provide a harmonized IT architecture that can help banks bring greater efficiency to their finance operations and lay the foundation for financial excellence. These solutions address the key areas of general ledger, operational costs processing, financial instruments, and business planning and consolidation, as depicted in Figure 2.

The target architecture includes the following SAP® software solutions:
- **SAP ERP application as the overall integration cornerstone to support general ledger and controlling**
- **SAP Bank Analyzer set of applications as:**
  - **Results data layer for data backbone**
  - **Central accounting methods layer**
  - **Source data layer for raw data**
  - **Analytics layer**
- **SAP BusinessObjects™ Planning and Consolidation for Banking analytic application for financial performance management**
- **SAP NetWeaver® Business Warehouse component or SAP BusinessObjects software for financial statements and reporting**

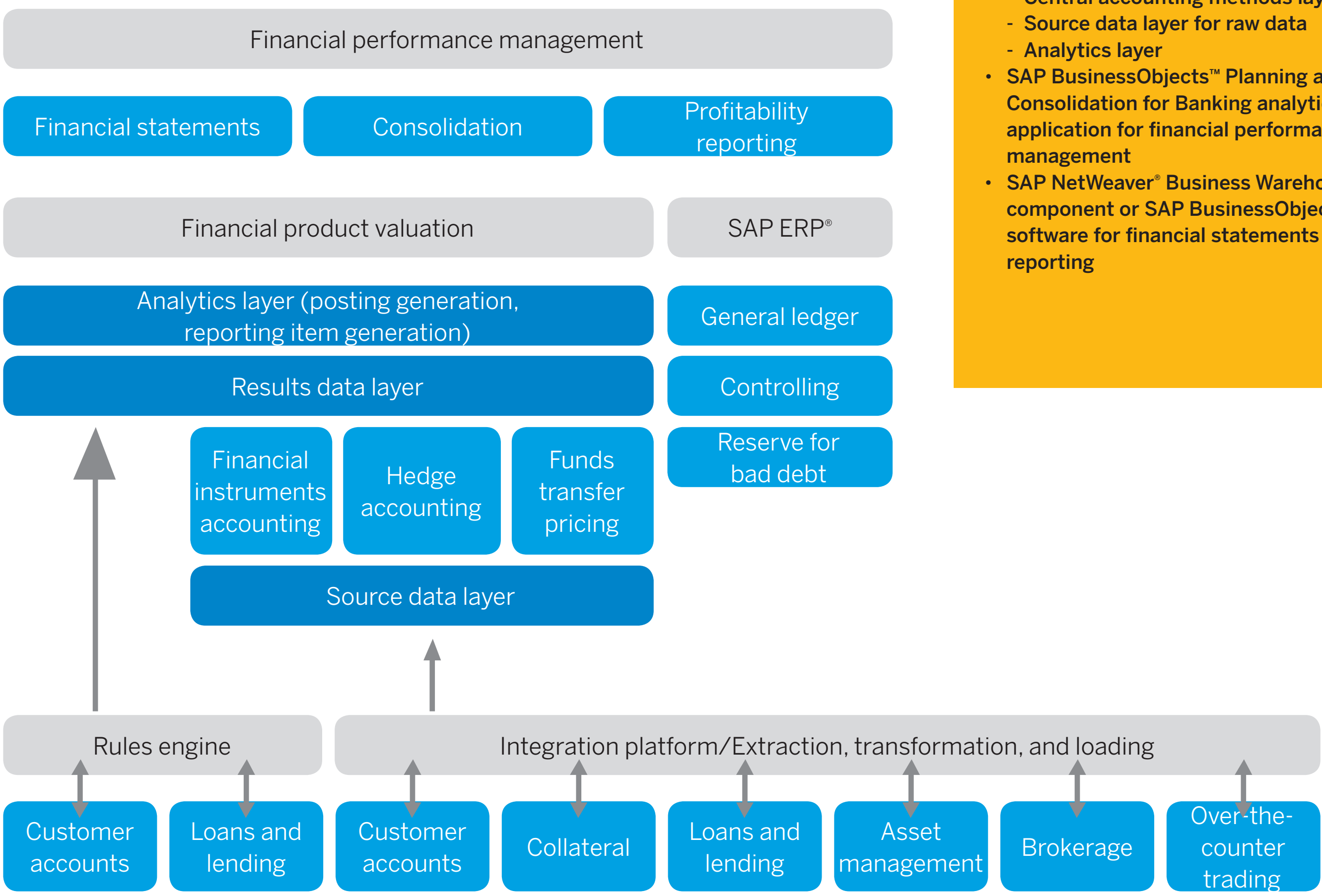


Figure 2: Target Architecture for Greater Efficiency and Financial Excellence

GENERAL LEDGER

GL functionality serves control purposes and supports management of GL positions, closing activities, and corporate actions. A thin-GL approach in which only aggregated postings are sent to the GL provides a control ledger that allows a daily trial closing, which minimizes unexpected results at month's end and promotes fast closes.

The GL also serves as a point of integration for nonbanking information handled in enterprise resource planning (ERP) functions and for banking information handled in the subledger. This integrated solution also serves as a launching pad for operational investigation of accounting and other discrepancies. The GL in the SAP ERP application supports multiple GAAPs, upholding compliance by the bank's legal entities in their respective domiciles and reflecting banking operations around the globe as a single global instance.

OPERATIONAL COSTS PROCESSING

Operations functionality in SAP ERP provides control for nonbanking-specific operational processes. It covers operational management and transaction accounting activities for nonfinancial products in the areas of financials, controlling, materials management, sales and distribution, HR, and travel management. Procure-to-pay, order-to-cash, intercompany clearing, and record-to-report processes are supported, as are asset lifecycle management, project management, cost accounting, IT and plant maintenance, and HR management.

ACCOUNTING FOR FINANCIAL INSTRUMENTS

The SAP Accounting for Financial Instruments application is subledger and valuation software for financial products within the banking environment. It captures, valuates, and posts results for all the relevant events in the processing lifecycle of financial products in accordance with IFRS and local GAAPs. The application enables banks to post daily aggregated subledger documents to a GL. Furthermore, it provides banks with detailed and flexible reporting functionality that they can use for financial statements or additional internal reporting.

Most notably, SAP Accounting for Financial Instruments serves as the single source of truth for financial instrument–related information spanning finance and risk. This reduces reconciliation efforts and supports a complete audit trail from a thin GL into valuation data with single-contract granularity.

BUSINESS PLANNING AND CONSOLIDATION

SAP offers two applications for business planning and consolidation: SAP BusinessObjects Financial Consolidation and SAP BusinessObjects Planning and Consolidation.

For business planning, the solutions support the strategic decision-making process and activity management at the operational level. They meet bottom-up and top-down financial and operational planning requirements, enabling banks to:

- Improve decision making with risk-adjusted planning that provides a greater understanding of the probability that a situation may occur, so corrective action can be taken
- Reduce cycle time by giving managers a unified landscape in which they can collaborate and by streamlining the process of creating and approving plans and budgets
- Increase user productivity with an intuitive interface and familiar office tools that help workers make the most of their time

In the area of consolidation, the applications provide banks with the power, agility, and confidence to close their books quickly by enabling:

- Faster close through streamlined financial consolidation and reporting processes
- Safer adaptation to changing needs without having to rebuild or destroy previous reporting processes
- Greater confidence and corporate compliance with reliable data for legal reporting and management decisions

LEARN MORE

Smooth the road to financial excellence by updating your technology, obsolete practices, and outmoded processes. Gain the flexibility you need to support the innovation that customer centricity demands.

With SAP solutions you can build a strong yet flexible foundation. As a result, you can make finance operations more efficient, support innovation and change in business mix, lower risk and costs, make better-informed business decisions, and eliminate the obstacles inherent with technological changes.

To find out more about how SAP can help your bank gain financial excellence, go to www.sap.com/industries/banking/solutions-overview.epx.

www.sap.com/contactsap

The Best-Run Businesses Run SAP™