'Check yourself before you rec. yourself':
Eight things to consider when embarking on a reconciliation project

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ABSTRACT
Reconciliations are arguably a firm’s most vital function. Not only is it the last line of defence to guard against error, but it ensures the safeguarding of the firm’s assets and is the ultimate evidence of fiduciary responsibility. How can a firm looking to overhaul its reconciliation operations avoid certain pitfalls and ensure a more seamless integration? This article details eight key areas firms should explore before or during their next reconciliation project. Understanding the intersection of people, process, technology and data will greatly increase the chances of successful implementation and business adoption. While the author concentrates much of the article on consideration for reconciliations initiatives, many of these ideas are easily transferable to any project.

Keywords: reconciliations, lessons learned, project best practices, change management

INTRODUCTION
In financial terms, Oxford Dictionaries define reconciliation as ‘the action of making financial accounts consistent; harmonization’. For most firms, reconciliations are far more than that, they are the ‘castle walls’, the last line of defence, the ultimate control that captures any upstream process breakdowns and the insurance that counterparties are accurately recording transactions. In addition, reconciliation processes are assurance to...
auditors and regulators that a firm’s processes and controls are sound. So what should a firm consider the next time it wants to improve what is arguably its most critical process? What can be learned from others that have embarked on this journey?

The Project Management Institute (PMI) defines lessons learned as ‘The knowledge gained during a project which shows how project events were addressed or should be addressed in the future for the purpose of improving future performance’. Generally, these are a look back at everything that went right or wrong during the course of a project (the emphasis is typically on wrong probably because it is basic human nature to learn from failures). The goal of this reflection is to improve the firm’s project process and make it more efficient for the next go around. While good in practice (process improvement always is), the issue often is that, from a business process perspective, if a firm has just finished up a project, it is unlikely to be the ‘next cab off the rank’ for the next project. So the question becomes: ‘How can we proactively identify better mousetraps or at the very least learn from others?’ This paper will investigate some points to ponder based on others’ lessons learned, as firms start to think about their next reconciliation project. As will be seen, some of these points can be applied to any project largely because they are based on sound project principles.

**ASSESS THE CURRENT STATE**

In order for a firm to get where it is going, it has to know where it is and where it has been. An unbiased assessment of its current state is critical not only to define, but also to measure its current state in order that it can a) present a business case for change and b) quantify the benefits when it is done. There are four areas that should be assessed and documented when reviewing a firm’s current state: people, process, technology and data.

**People**

This is an overall assessment of a firm’s employees who are completing reconciliation processes. How many employees are performing the firm’s reconciliation processes? Where are they located? Are they solely dedicated to reconciliations or are they shared with other functions? What is the organisational and operating model? How many employees are dedicated to completing the process and how many to supervision or management?

**Process**

Catalogue the types of reconciliations that are being performed. This inventory will help to guide process mapping efforts and helps the firm understand how the data flows. In the author’s experience, looking at processes from two perspectives is helpful:

- **The data flow process:** In other words, how does a transaction flow through the process and decision trees.
- **Day in the life:** The view through the eyes of the reconciler or how their day looks when they walk in the door.

Another important aspect of the process mapping exercises is to overlay them with a view to the embedded controls, risks and metrics.

**Technology**

Inventory all of the solutions that are in place which support the firm’s end-to-end reconciliation processes. Include any vendor or IT-supported applications as well as end-user computing (EUC) solutions. Identifying the risks of these solutions is key as well. If the firm is using
EUCs, how supported and secure are they?

**Data**
The efficiency of the firm’s reconciliation processes is largely driven by data, so identifying where those data come from (both primary and secondary sources) is crucial to better efficiency in the firm’s future state. In most cases, reconciliation operations owners do not own the data sources (e.g., the reconciliation operations are not responsible for the maintenance of the accounting or investment book), so this step also helps to identify key stakeholders and dependencies for a project.

**WHAT IS IN A RECONCILIATION? DEFINING THE SCOPE**

Defining the scope of the firm’s reconciliation may be a more slippery slope than one might think. The term ‘reconciliation’ is used for many control processes within operations. It is used to define the process of ensuring a set of transactions are passed successfully from one system to another and it is used in the more traditional sense that is comparing the firm’s internal book of record to an external book of record (e.g., investment book versus custody book). Readers may remember grade 4 geometry class and learning about the rules of different geometric shapes, in particular, the rules of squares and rectangles? Every square is a rectangle but not every rectangle is a square (every square is also a parallelogram for any maths fanatics out there). So now readers may be asking ‘why are we talking about geometry in an article about reconciliations?’ The ideas of controls versus reconciliations can be applied much like squares versus rectangles. Every reconciliation is a control but not every control is a reconciliation. This is achieved by defining the ‘laws’ of reconciliations and, if all of the ‘laws’ are not fulfilled then it may not fit into the firm’s service offering. Here are some points to consider:

- If the firm is building a service for the enterprise, it cannot be all things to all people, so it should not try to build a service to fulfil everyone’s needs. It is important to identify what is critical to the firm and what can be scaled to define the reconciliation service offering.
- Is the firm solely in the business of comparing external books to internal books?
- Should the books be closed in order to be reconciled?

**BUSINESS CASE FOR CHANGE**

After the firm has thoroughly documented the current state of its operations, it needs to develop a case for change — the why and ‘what’s in it for me’ (WIFM) or for the firm in this case. Much of the information gathered from the current state assessment will help to drive the quantitative ‘savings’ that will support the business case. These savings will come in many forms and the firm probably will find more benefits in risk reduction than it finds in hard-dollar savings. For example, one benefit might be a reduction in EUCs. EUCs offer benefits in terms of speed to market and cost, but also introduce risks such as key person risk (i.e., the person who developed the EUC leaves the department or the firm), information security risk (data in EUCs tend to be less secure) and process risk (EUCs tend to be less secure so changes to queries and reports can produce unintended results). A long-term analysis of the return on investment (ROI) is also key as it will probably take a number of years to realise savings.
SOURCING MODEL/SOLUTION IDENTIFICATION

For any function or process, the firm should consider the most effective means for sourcing the service. Basically there are three options: insourced, outsourced or right sourced. The firm also should consider its sourcing model across three vectors: people, process and technology. Although the overall trend in the past few years has been towards outsourcing, especially in the reconciliation space, deciding which one of these strategies best fits a firm depends largely on size and scale. The other influencing factor to consider is who is servicing ‘the book’ as the reconciliation service tends to go ‘where the book goes’. For example, if a firm outsources its accounting book to a service provider, the reconciliation of that book probably would be part of that outsourcing arrangement.

WHERE IN THE WORLD? LOCATION MODEL

If a firm has chosen to insource its people, it will need to decide where in the world it should provide these services. There is no magic formula to determine the best location model for each firm, because every firm is different. Below are some points to consider to help guide developing the best location model for implementation.

- What are the firm’s current options for locations, ie where is the firm currently located?
- In what locations might the firm be in the future?
- What would the organisational model look like in each location?
- What are the service level demands of internal clients?
- What demand would each location place on employees? Would they be able to work ‘acceptable’ hours?
- When will all data be available to reconcile? When are internal data available and when are external data available?
- What are the firm’s contingency needs and how fluid does its reconciliation service need to be if one site is offline for an hour, four hours, a day or a week?

DATA, DATA AND MORE DATA

Data are the lifeblood of nearly every system, and reconciliations are no different. The quality and richness of inputs...
drive efficiency, scalability, accuracy and metrics. In a perfect world, a firm would have a single identifier on both sides that would enable it to match transactions together with 100 per cent confidence. In fact, in most market practices, there is reliance on the sender’s reference to serve as that identifier; however, the issue for most firms is that the sender’s reference is not available in the book that is being reconciled. There are two likely reasons for this:

- the book being reconciled does not generate the instructions to move money or assets; and/or
- transactions are aggregated or netted into single instructions and the individual transaction on the books does not reflect the sender reference.

For these reasons, market practice groups, such as the Securities Market Practice Group (SMPG) and the International Securities Association for Institutional Trade Communication (ISITC), have attempted to work around these issues to create higher match rates using ‘code words’. This agreed-upon list of identifiers is then used to tag individual transactions on the internal book, they are included in the instruction and are to be ‘played back’ on statement messages or external books. While there has been some success in increased match rates from code words, firms still struggle in their ability to have the code word included on both books. As there is no silver bullet, firms continue to search for ways to analyse their messages and data trends to attempt to find ‘safe’ ways to increase match rates without increasing mismatch risk. A potential solution to assistance in this space is to employ a ‘data layer’ between the source system and the reconciliation platform. The data layer serves as a transaction transformation and augmentation tool to add the common identifiers. For example, a firm might employ a data layer to append a trade reference or sender reference to the statement and/or ledger files to use for matching in its reconciliation solution. The critical component from an audit perspective is to ensure that the financial elements (dates, amounts etc) of the transactions are preserved so as to ensure the reconciliation is a valid control.

**CHANGE MANAGEMENT AND, MORE IMPORTANTLY, CHANGE LEADERSHIP**

In an October 2014 article in the McKinsey Quarterly, Gary Hamel and Michele Zanini wrote: ‘In 1996, Harvard Business School professor John Kotter claimed that nearly 70 percent of large-scale change programs didn’t meet their goals, and virtually every survey since has shown similar results’. Seventy per cent? — that is a staggering number. The article goes on to say: ‘The problem lies in beliefs about who is responsible for launching change and how change is implemented’.

The key to making an implementation successful is investment in both change management and change leadership. So, what is the difference between them? Change management is a process similar to project management. It is the human side of project execution that ensures people know what is happening, when it is happening and, most importantly, why it is happening. It is things like training plans, communication plans, stakeholder identification and impact analysis. Change leadership, on the other hand, is the advocacy for the change — the reinforcement of the ‘why’. It is ensuring people at all levels are prepared to lead the firm through the change. Change leadership is gaining buy-in and ownership from process owners and stakeholders. Often the project team is looked to when it comes to implementing...
change, but where a firm should look to is the operations owner(s) to champion the change. And finally, while it is true that change leadership starts at the top, it does not stop there — change leadership is the responsibility of everyone who is involved and impacted.

DISRUPTIVE FACTORS

The final issue firms should consider is what is happening in the reconciliations market that may change the course of the project. There are generally three disruptive factors that will influence how reconciliations are thought about and performed.

Changes in message standards

There is a lot of talk in the industry about the movement from the ISO15022 standard to ISO20022. Rather than go into the particulars about the differences, for the purposes of this paper, the author will leave it that ISO20022 provides much more flexibility than ISO15022. In the reconciliation space in particular, to date there has not been much (if any) movement towards ISO20022. The main reason for this is cost justification. For those firms that have automated their reconciliations in the 15022 environment, the opportunity to realise ‘significantly more’ savings with 20022 against their other priorities is challenging.

Artificial intelligence

It was not too long ago that the term ‘artificial intelligence’ or ‘AI’ was reserved only for sci-fi movies. But today AI is here and it is real. There are (some) cars that can drive themselves and now can learn from their environment to ‘drive smarter’. Similar ideas are being applied in the reconciliation space as a means to increase match rates. By exploiting big data concepts, systems can mine through inordinate amounts of data and identify trends where users have manually matched items over time, working much like a spam filter. As users report spam, the system constantly monitors and analyses e-mails to determine words and phrases that identify e-mails as spam and, more importantly, when they are not spam. In the past, firms have relied upon reactive metrics and human intuition to identify these patterns, and now they have solutions that can perform this much faster, over much larger datasets, finding patterns humans may not see.

Regulation

As with many processes, any change to regulation often ‘disrupts’ or changes how firms process, and reconciliation is no different. The burden on reconciliation services continues to grow as regulators introduce new requirements to ensure accuracy of data from point of origin to financial statements: Sarbanes-Oxley and the European Market Infrastructure Regulation (EMIR) to name just two. Add to this the increasing complexity of financial instruments and corporate structures, coupled with increased globalisation, and it is even more daunting for reconcilers to keep pace with the new reconciliations required to meet the demands of regulation. The complicated part about some of these regulations goes back to an earlier point regarding the scope of the reconciliation service and does the regulation become a burden on a firm’s reconciliation service or is the burden on the transaction service, therefore making it a control?

CONCLUSION

The introduction of any change into a firm’s operating environment, whether it is people, process, technology, data or any combination thereof, is challenging.
Through shared learning and best practices, firms can continue to evolve their implementation and change management practices not only to introduce savings in their daily operations, but also to create faster, cheaper value for their operations through more efficient project deliveries. By looking outside one’s own walls and involving the firm in industry discussions (via groups like the SMPG and ISITC, as well as other advertised conferences), and advocating for the creation and adoption of standard market practice, the financial services industry can continue to drive more value to the client.

REFERENCES


(5) Ibid.


(7) There is a great little reference book that describes the differences: ‘ISO20022 for Dummies’, it can be requested free of charge at: www.iso20022.org.
