5 Ways to Know if Your Financial Software Supports Financial Integrity

By Kim Schaefer, CPA, SmartCFO.com contributor

High visibility and legal concerns are driving financial executives into the spotlight like never before. Ethics and integrity are topics that you hear in every boardroom. Financial Statements are being examined, accounting practices are in question, and the CFOs and controllers behind the numbers are staking their careers on the results. This heightened awareness is not just having an effect on public companies with compliance issues, but also private companies. Pressures include compliance with the Sarbanes-Oxley Act, stakeholder demands for financial transparency, and concern with the ongoing financial health of the organization. Executives must focus on mitigating risks and improving the efficiency of information management.

In their 2003 Fraud Survey, KPMG reported seventy-five percent of the more than 450 medium- and large-sized organizations they surveyed experienced fraud during the previous twelve-month period. This is up thirteen percentage points from their prior survey in 1998. The incidence of fraud involving financial reporting, while the lowest of all types of fraud reported, more than doubled from the 1998 to the 2003 survey and was the most costly area of fraud for an organization. In organizations where financial reporting fraud occurred, the cost averaged $250 million. With the magnitude of losses, it is easy to justify the costs of prevention and detection, such as enhanced internal controls and establishing or strengthening internal audit teams.[1]

Transparency and Strategic Planning

Integrity must be a key ingredient in the framework of any organization's strategic initiative. Organizations that are focused on transparency as an element of their strategic planning are more apt to be perceived by their stakeholders as highly credible. There is a direct correlation between executive and organizational transparency. The fundamental principles shared by transparent executives – honesty, integrity, and a core set of values – pave the way for organizational transparency. Plus, transparency provides a competitive advantage for organizations. The more your stakeholders know about your organization, the more comfortable they become. This is a key rationale for non-regulated companies that are adopting many of the disclosure requirements.

CFOs must manage the consequences of inadequate internal controls and disclosure and financial reporting weaknesses. These consequences include loss of executive credibility and termination, loss of stakeholder confidence, and even fines and imprisonment, as we have seen in many recent cases. It is difficult to place a value on stakeholder confidence in an organization or executive credibility, both internally and externally.

Key stakeholders are customers, employees, the community in which the organization operates, and stockholders. Communication with these groups is the key to the organization's ability to disseminate critical information while managing perceptions.

[1] http://www.us.kpmg.com/RutUS_prod/Documents/12/FINALFraudSur.pdf

Software that Supports Financial Integrity

Across the world, we are witnessing what the Hackett Group calls "Convergence" of technology. Software developers are no longer developing products they think their customers want to buy, they are focusing on their customers and what they need. Convergence is the union of people, computing, information, and communication. More and more financial executives recognize the importance of technology in building a sound foundation of financial control. Whether forced by regulatory requirements or simply to improve the financial reporting and control, when looking to invest in technology to assist in the process, there are many factors to consider.

How do CFOs get up-to-speed on how to best leverage their investment in technology and people in this ever-changing technological landscape? According to David A. J. Axson, co-founder of The Hackett Group, the following are the most significant best practice principles to follow when applying technology:[2]

1. Integrate business and technology planning.
2. Break down the functional walls.
3. Get your priorities right.
4. Don't implement new systems just for the sake of it.
5. Avoid automating inefficiency.
6. Get the basics right.
7. Implementation is a team effort.
8. Focus on use, not deployment.
9. Link the return on investment to business value.
10. Plan for rapid change.

First, define your problem. The culmination of the work of the CFO and other financial executives is financial reporting. Internal controls and audits are used to validate the processes used to arrive at the end result and to confirm the reliability of the information provided. Technology can contribute to an organization's success by providing the compliance analytics and framework required to expand stakeholder confidence in the information provided. The CFO must review the strategic objectives of the organization and identify how a change in technology, reporting, or internal control will support the corporate mission.

Next, review and evaluate existing internal controls and procedures. There are many obstacles that must be overcome before technology is able to make a difference in any organization. Concerns like privacy, cost of openness, organizational structure, and fraud will interfere with the acceptance of a transparency initiative and inhibit your ability to make the best decision technologically.

[2] David A.J. Axson, *Best Practices in Planning and Management Reporting*

Exposure

Exposure to risk dictates, to some extent, the intensity of an organization's focus on the key elements of the operational and reporting infrastructure. Regardless of the degree, all of these elements are relevant to the organization and must be considered in the technology design decision.

1. Does the technology provide the core infrastructure necessary to support and strengthen internal controls?

    a. Zero-client user interfaces are becoming more and more prevalent. Is confidential data protected in a distributed, Web-based environment?

    b. Does my organization have the requisite IT skills and processes required to operate distributed computer platforms and networks?

    c. Segregation of duties is crucial to the internal control infrastructure. Is there an approval mechanism in place that ensures appropriate authorization and separation of functions within the organization?

    d. Are approval mechanisms and notifications built-in to the software infrastructure so that distributed computing environments are easily supported and secured?

2. What functionality is available to support the implementation of an Audit Information System (AIS)?

    a. Does the system provide the reports necessary to comply with regulatory agency requirements, such as the Section 404 annual assessment of the effectiveness of internal controls for financial reporting?

    b. The AIS must contain the documentation required by the CEO and CFO in order to assess and verify the soundness of the internal control methodology and have confidence in the financial statements.

    c. Other regulatory reporting requirements, such as Section 302, require CEOs and CFOs to ensure the omission of misstatements and the inclusion of all material information in the statements. The AIS can provide for effortless compliance with these regulations when the proper audit procedures and disclosure controls have been adopted and implemented. Even governmental agencies and non-public entities are interested in the AIS as a mechanism for creating stakeholder confidence in the financial statements issued by these organizations.

3. Once the controls are in place, it is critical to establish the reporting mechanisms. In order to mitigate and monitor risk across the organization, it is best to establish guidelines for closed-loop reporting and performance management.

    a. Internal reporting is also key to measuring performance and must be considered in this model; therefore, the administration of user security across multiple organizational units and potentially multiple systems is a consideration.

b. In addition to required external reporting requirements, financial executives must address organization performance and continuity and potentially, the ability to obtain funds necessary for expansion.

c. The systems must have the ability to deliver timely and accurate information on all key indicators of organizational performance. These indicators and timeliness vary depending on the business; however, regardless of the business, we are very much in a real time society.

4. According to The Hackett Group research, in 2002 80 to 90 percent of all software had incorporated Industry Best Practices into their standard release.[3] Any technology solution should provide the ability to standardize business processes while establishing controls for common procedures.

   a. This will reduce exposure due to divergent business practices.

   b. As we have seen with Sarbanes-Oxley, the regulatory environment is changing rapidly, as are the expectations of the industry in general. Be sure that you have the flexibility to expand your technology solution as new regulations and requirements emerge.

5. With the proper internal controls in place and a technology solution based upon Best Practices, we have a solution that provides a reliable level of data integrity.

   a. With companies focusing on best of class systems, it is critical to ensure that integration is seamless and does not require manual intervention. Collaboration between systems that share data is critical.

   b. Security among and between systems and databases must be reviewed and audited for all systems that are interrelated in order to ensure data integrity across the board.

Our goal at the end of the implementation is a single version of accurate information, based upon repeatable results and auditable processes. This will provide your executives with the trust and confidence they need to sign off on the financial statements and related internal controls.

About the Author

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[3] David A.J. Axson, *Best Practices in Planning and Management Reporting*