When Do We Hold

We've all read about troubled accounting. One recent prime example involves Jon Corzine, former U.S. senator, former governor of New Jersey, former CEO of Goldman Sachs, and former CEO of MF Global. In testimony before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry last December about the bankruptcy of MF Global while he was CEO, he said, "I simply do not know where the money is, or why the accounts have not been reconciled to date."

How can that be possible? What actually caused MF Global to go bankrupt? Red ink? Bad investments? Leveraging client assets on investments that failed? Probably all of these things. But bad accounting certainly opens the door to allowing bad investments and confusion about managing your business. An automated account reconciliation system with robust policies and procedures in place surely would have shed light on the MF Global debacle and raised red flags a lot sooner.

It was just a year earlier in November 2010 that the newly public General Motors Co. (GM) set a record for the biggest IPO ever—valued at more than $23 billion. But let's also look at GM's internal financial controls. Deep in the fine print of its prospectus is: "We have determined that our disclosure controls and procedures and our internal controls over financial reporting are currently not effective. The lack of effective internal controls could materially adversely affect our financial condition and ability to carry out our business plan." In other words, GM essentially said all the numbers used to tout its success should be taken with a grain of salt—maybe a whole block of salt. This statement certainly shouldn't prompt investors to think a strategic strength of the company is knowledge of its own operations. So here's another situation where having a solid account reconciliation process in place from the onset might have headed off major financial reporting issues down the line. If GM had had appropriate controls in place, it wouldn't have had to disclose the weaknesses mentioned. Now let's hope the weaknesses won't lead to future errors since that would require more disclosure.

But GM isn't alone. The Securities & Exchange Commission (SEC) recently forced several other public companies to restate their financial statements, divulging a thread of common, underlying issues such as:

- Financial close processes and procedures that aren't adequately designed, documented, and executed to support the accurate and timely reporting of financial results.
- Controls aren't in place to provide reasonable assurance that accounts are complete and accurate and that account reconciliations are being properly performed, reviewed, and approved.
- Adequate policies and procedures to ensure the timely, effective review of reconciliations and related analyses aren't in place.

In these cases, it's clear that the companies didn't have internal processes in place to make sure their accounting records were accurate. They may have had transaction-oriented processes to move information through the accounting and operations processes, but those weren't designed properly. This is where controls come into play. Controls help establish processes to make sure something is done—and done properly—by a deadline. Without proper controls, companies don't have the ability to say with certainty that results of operations are stated fairly.

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the Accountants *Accountable*?

By Jeff Adler, CPA

mentation and communication. Many people involved in the process may have thought they knew what to do, but without appropriate documentation it isn't possible to know if what was being done was actually meeting the expectations of management and complying with the publicly disclosed policies shown in the financial statements.

All of these issues arose from what should have been part of basic reporting and control activities. In cases like this, it often takes a year after instituting controls before a company's financial processes can be relied on to generate accurate and timely financial statements. Once the new systems are in place, you have to have proof they are working, and that happens only with evidence documented during a period of time. You can't just *say* you're doing something—you have to actually do it and show you're doing it.

Imagine what the cost to a company would be for these sorts of weaknesses in basic controls. Of course, there's significant expense in hiring consultants and process experts to remediate the problems, but there's also the indirect cost of public scrutiny coupled with loss of credibility and investor confidence. One cost is clearly measurable; the other is only hypothetical. In the meantime, investment decisions are being made in the marketplace—not necessarily on facts but on hopes that everything will turn out all right in the end.

The Sarbanes-Oxley Act

We all remember the Enron scandal and bankruptcy that took place in 2001. Adelphia, Freddie Mac, Global Crossing, Kmart, Merck & Co., Qwest Communications, Tyco International, and WorldCom were all notable accounting scandals that soon followed Enron. These events led to the creation of the Sarbanes-Oxley Act (SOX) that was enacted in July 2002.

SOX placed a new emphasis on controls related to financial reporting. Among other things, it required companies to publish information in their annual reports about the adequacy and effectiveness of their internal control structure and procedures for financial reporting. Also, senior executives must take individual responsibility for the accuracy and completeness of corporate financial reports. Given these and other mandates for public companies, and remembering Enron, how did we wind up with the recent stream of issues and corporate restatements in today's financial reporting world? Several different groups need to take accountability and share some blame here.

The financial investing market. The MF Global investors and many customers wound up with significant losses, of course, but the investors in IPOs such as GM might have been ignoring the warnings and betting GM's business plan success would overcome accounting and reporting shortfalls. We've had an investment environment that seems to be saying, "This is pretty complicated, but we'll see what happens, and as long as we make more money, it must be okay." An example is the mortgage crisis that almost wiped out many banks except for the taxpayer jumping in to bail them out. While MF Global's business was a little more risky by nature, the risks taken with other people's money was uncalled for. And now JP Morgan/Chase. Even though there's lots of talk about risk management, investors (large and small) still give their money to big players without anyone being accountable in the end.

The accountants. Sometimes we accountants get caught up in transaction processing and top-level projections and forecasts and lose sight of the basic requirement that validation of the correctness of the account balances isn't just a convenience but a necessity. If the underlying numbers are wrong, then all the financial reports and financial analyses are worthless.

Senior financial management. Creating a reliable, accurate, and timely accounting process is work and needs management attention. I'm sure we all agree that the most challenging parts of accounting and financial reporting don't lie in the basics of account reconciliations and designing accounting procedures. But these basic rules must be part of continuous oversight. If the account reconciliations are done correctly at the outset, the resulting financial reports will be accurate and complete. But if basic accounting activities aren't addressed as a critical control in the beginning, a company is opening the door for potential issues down the line.

Audit committees. Clearly there's a meaningful place at the table for the audit committee to take some responsibility for adequate controls. But I'm not attempting to place too much blame here. Audit committees are made up of astute business leaders, many with significant financial management skills, but they are still a part-time committee. They aren't involved in the everyday operations of a company, and they rely in large part on management representations of what controls are in place. The fiduciary responsibility of the audit committee is still

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substantial, but we can't presume that putting additional pressure on three or four outside directors will immediately snap an organization into compliance.

Gaining Control

Given our responsibility and the mandates for internal and financial reporting accuracy, how do we management accountants get control of this? Accounting software can help. Right now there are applications available to help us monitor and control these basic functions. For example, Software-as-a-Service (SaaS) providers allow us to have rapid deployment and fast return on investment. Not only do we get better control, but we actually save time and document storage costs, which can lead to substantial cost savings. The cost savings relate to paper and storage costs, and time savings let us have more efficient control over the close process. It's still our obligation as financial accounting professionals to control and monitor our processes, but current technology allows us to do that efficiently and consistently with a readily auditable trail for proper documentation of the controls.

Regardless of how a company is currently handling its basic accounting procedures, to ensure accuracy and completeness of the numbers from the beginning, it needs to put a world-class process in place that includes:

- **Current policies and procedures** that are available to users when and where they need them.
- **Standardized reconciliation templates** so information is reported and explained consistently.
- **Secure information** that can be accessed easily by authorized users, regardless of time of day or location.
- **Multiple training delivery methods** in place to ensure staff is taking advantage of the full functionality of any technology tools and systems, meeting company standards, and following procedures.
- **Workflow that's defined, automated, and controlled** to ensure the highest level of visibility to reports, audit logs, and the like with minimal time commitment and/or effort from senior staff.

Then the CFO and CEO must review and attest at least quarterly that internal financial controls are in place and adequate. This is an SEC requirement that also includes annual attestation by the company's auditors that the CFO and CEO attestations are accurate.

Good Intentions

Good intentions don't always mean good accounting practices.

I recall an instance at a publicly held company many years ago where a senior VP in operations told local managers they needed to watch their expenses closely at the end of the month. It was a quarter-end month, and in order to meet quarterly profit goals it was critical that no extra expenditures be made.

One local manager (who wasn't an accountant) contacted a major local vendor and asked if his purchases for the last half of the month could be deferred and invoiced at the beginning of the next month. His request wasn't to just invoice as usual with delayed payment terms but to actually not invoice anything at all until the following month, even though material and product would be delivered. Because this division was a major customer of this local vendor, he was happy to oblige.

The manager thought he was doing a good thing—delaying company expenses. He legitimately thought he was saving the company money for that quarter. In his mind, he met the objectives of senior management—defer expenses. But from an accounting perspective, deferring billing wasn't really deferring expenses, so this was recorded instead as unrecorded liabilities, which resulted in a misstatement of financial results on the balance sheet.

We have to remember that not all of our business associates and partners are accountants. They have a desire to follow directions to meet company goals, but they might not have a complete understanding of all the consequences of the actions they take. It's our duty as management accountants and financial managers to take accountability and build communication and trust within our organizations. We must always remember that our first obligation is to generate complete and correct financial reports—which starts with having accurate account reconciliations.

If we don't have good financial information, how can we possibly make good management decisions? **SF**

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