BACK TO BASICS – INITIATION TO REPORTING

For financial reporting purpose, the auditor follows the various mandatory standards and guidance as per reporting jurisdiction and regulatory authority. Common standards across the world followed for financial reporting purpose and followed by internal auditors are US GAAP, FCPA, IFRS, IAS, US SOX, PCAOB, J SOX, C SOX, and IIA Standards. The UK SOX in the draft stage will be implemented in the coming years.

For Fraud and control deficiency as per US SOX sections 302 and 404, 302 requires that the principal executive and financial officers of a company, personally attest that financial information is accurate and reliable. Section 404 requires that companies annually assess and report on the effectiveness of their internal control structure. SOX requirements mandate that public companies have an independent external auditor inspect their internal control practices and include the audit report within the company's financial report.

Any financial transaction passes through the following cycle and it is originated or initiated by different people, departments, locations, and countries. The economic activity takes place, the transaction is originated/initiated, measured/valued, approved/authorized, recorded, processed, reported, and archived. This financial transaction is audited or verified for various assertions such as existence/occurrence, completeness, rights and obligations, valuation/allocations, and presentation and disclosures.

The data for various financial transactions are summarized and reported in the financial statements. This data/information/economic activity originates at the various points in the company that could be as follows, below is a typical example of a manufacturing company.

- Production – Number of units produced;
- Quality – Passed or failed or rework or scarp units;
- Sales - Number of units sold or hours of services;
- Costing – Cost of products and competitor analysis;
- Pricing – Selling price of product/service with standard margin and competitor analysis;
- Warehouse – Units purchased, issued, and closing (RM/FG);
- Credit – Customer credit;
- Accounts Receivables – Receivables balances, contracts, collections, discounts, and bad debts;
- Accounts Payables – Payable balances, payments, contracts, discounts, and rebates;
- Logistics – Inbound and outbound units, and GIT;
- Marketing – Expenses incurred on products/services;
- Legal – Legislation and cases with litigation;
- Payroll – Total compensation to the employees;
- Treasury – Finance, banking facilities, exchange rates, interest rates, and other financial products;
- Information Technology – Data integrity, information processing, system errors, third-party applications, and interfaces.
- Taxation – Total taxes payables, new legislation, and any litigation amount.

Each of the above functions generates financial transactions/information and forms part of the financial statement either in absolute terms or to the notes to the accounts. Such information in the case of multi locations and different parts of the world becomes more difficult unless and until a strong reporting process exists which is timely, accurate, and data integrity is maintained.

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Communication between Finance and various department becomes so crucial to ensure that all the financial and non-financial information is processed on a timely basis to avoid misstatement.

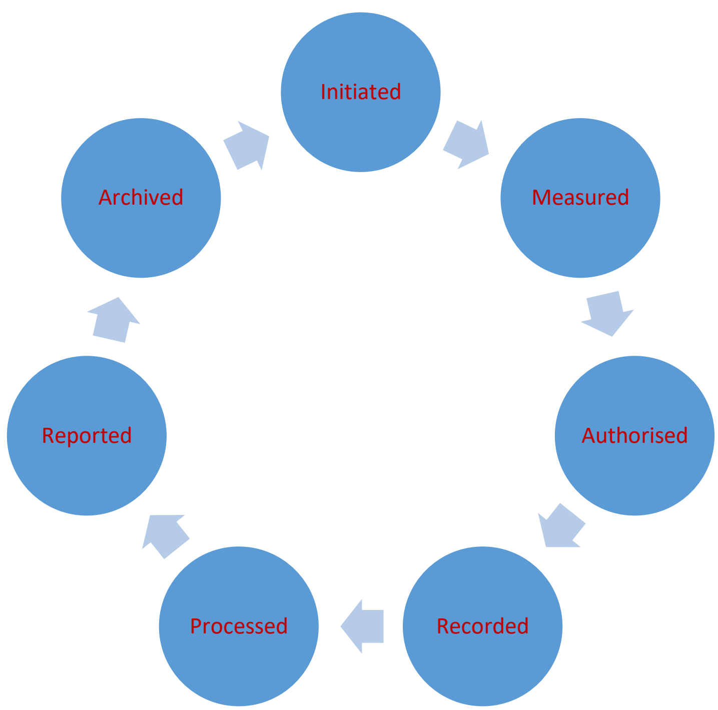
The auditor while doing any assignment whether it could be external or internal or ICFR, and processes review of audit cycles such as order to cash, procure to pay, or payroll cycle should ensure that where the transaction is initiated, till it is presented and disclosed in the financial statements.

Most errors/frauds/overstatement/understatement occurs at the initiation of transactions where the transaction is designed with intention of fraud, and when such transaction is processed with millions of transactions, the chances of getting caught is limited due to audit or auditor limitations. Consider the following example where the design of the transaction is with intention of fraud at the initiation stage;

- Manufactured rejected goods accepted as a passed quality test to avoid loss;
- Supplier inferior quality goods accepted for kickback;
- Credit granted to the customer more than creditworthiness or clean credit;
- Contractual terms with suppliers/customers are not documented or documented one-sided;
- System prices are manually overridden for special customers;
- Manual discount/credit note provided apart from system processes;
- Services exchanged with certain customers/suppliers at abnormal prices;
- Foreign currency revaluation was deliberately removed for high-risk fluctuating currency or taken a lower hit.

We as auditors always try to ensure the financial statement or our professional work is in compliance with US GAAP, FCPA, IFRS, IAS, US SOX, PCAOB, J SOX, C SOX, IIA Standards or local standards/guidance, but ***every transaction has a story to tell to the auditor, how much each auditor knows about each transaction is professional skepticism.***

Transaction Cycle



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