

Straightening financial reporting

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Filbert Tsai
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Continued from last week

The completeness of financial and accounting data have changed the audit dynamics in recent times. Analytical audit procedures have changed significantly since the adoption of big data analytics and various tools to visualise these data.

Audit procedures are mainly performed to obtain reasonable comfort over transaction processing and balances for financial statement items. Prior to the adoption of data analytics using powerful journal entry analytics tools, the analytical procedures performed in audits are primarily used to test balances using ratio and trend analysis. These analytical procedures are indeed powerful short-cuts which provide experienced auditors glimpses of the potential red flags within a company's financial reports. However, these do not provide comfort on the financial transactions that transpired in determining the transaction balances in the financial statements.

To begin with, there are basically some key weakness on this approach: (1) this relies heavily on experience of the audit staff; (2) this is susceptible to manipulation in estimation; and (3) this does not provide comfort over accuracy of transaction processing. These shortcomings are the reason why traditional audits rely heavily on manual labor of individual transactions based on various audit sampling approaches to cover the excess audit risks. However, audit sampling can provide comfort on the accuracy of the transaction details and transaction processing for the selected samples only. These are then projected over the population using statistical approaches to minimise sampling errors.

The implementation of data analytics tools in audit have proven to improve significantly audit effectiveness and efficiency by providing a complete picture over the transaction history as well as transaction processing. These data analytics software used in audit are capable of synthesising transaction processing and identify any deviant pairings of accounts. This approach gives also a complete view over annual transaction processing history, thereby allowing auditors to minimize the use of client provided manual spreadsheets which are more susceptible to corruption.

Data analytics can be employed at the very onset of the audit to obtain understanding on the nature of the client's business and key business transactions. With this , auditors can

accurately identify the transaction processing points that are significant to the client and identify key estimation and judgment accounts.

Data analytics can be further employed in corroborating the understanding of the transaction processing cycle through the verification over the journal processing and the process owners involved. But most importantly, data analytics used in audit procedures can provide sufficient comfort that transactions are accurately processed throughout the year and exceptions from the normal transaction processing are regularly flagged.

Relating this to a real world scenario, one of my power and utilities sector audit clients would have never realized that the daily transaction processing of all the customer bills issued were erroneously processed since the revenue total amounts at the end of each period still corroborate with data from the power trading team. However, when we ran the data analytics tools to trace how the system actually processes these transactions, we were surprised that the entries were totally incorrectly processed with a correcting entry merely being posted at the end of the period. This transaction processing error would have never been discovered in traditional audits since this is a suspense entry within the system that is closed at the end of the year. Management would have never discovered that were constantly arising without the data analytics process.

Having worked with data analytics for the past three years for audits, I note that a significant number of auditors are still not familiar with the use of these powerful tools and lack understanding on how data analytics can aid in their audits. The change of mind set is necessary especially for those who have just been doing their audit work using traditional approaches and ignoring these of advanced analytics tools. I suggest that training programs should embed the use of data analytics to improve the quality and efficiency of audit for the junior audit staff.

However, as discussed above, audit data analytics is not just a means to detect error or fraud in audit. The use of the visualisation tools embedded in these software provides valuable insight that can be shared with clients to help them better understand their own business. Having said all these, it is of utmost importance now to go back to our clients and articulate the reasons for improving their data collection .

Filbert Tsai is a Filipino financial accounting advisory services executive in the UK with specialization in transaction accounting in the power and utilities sector. He had provided accounting advice to a significant number of government and financial institutions investing or providing financing structures in the renewables sector in Europe and in developing countries.

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