

THE NEW APPROACH to Financial Accounting, Auditing, and Reporting

Risk Analysis Overview

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Overview

Risk Analysis is a technique used to identify and assess factors that may jeopardize the success of a project or achieving a goal.

In our case, we have a goal to minimize the risk that data integrity breaches, intentional or unintentional, will go undetected and adversely affect the accuracy and completeness of the financial accounting records, and the related financial statements and reports.

- **Who is responsible?** The accounting department has a duty to maintain the accounting system and provide financial statements and reports to the oversight body. The oversight body, whether a board of directors of a public corporation or a governing body of a local government, has a responsibility to protect the interests of the general public (i.e., shareholders and taxpayers).
- **What works, and what does not work?** Placing too much reliance and trust in the accounting department, without some degree of independent verification is not acceptable in most quarters. It might be a matter of malfeasance, or it might be a matter of incompetency. In either case data integrity breaches lead to inaccurate financial reporting and, therefore, must be minimized.

As an oversight body, you owe your trust and allegiance to the accounting department. But you also owe your trust and allegiance to other parties who rely on the financial reports and statements created by the accounting department. Hence, "Trust But Verify" is always the best policy.

- **NA Offers Viable Alternative to Current Practice.**

Current Practice – Annual CPA Audit of Financial Statements. Annual CPA audits have traditionally included a review of the accounting entity's compliance with internal control procedures. This is a good thing, and it helps. But it clearly is not sufficient. Too many cases of theft, fraud, and corruption go undetected for long periods of time. Further, the objective of the annual CPA audit is an opinion on the financial statements, not on the adherence to internal controls that may or may not exist.

Current Practice – Internal Audit Function. Many accounting entities adopt an internal audit function to independently monitor adherence to internal control procedures. This practice is limited to larger entities because of the cost.

Current Practice Suffers from Two Ailments. Current practice has two huge problems that NA does not have. **First**, with the exception of NA, all comprehensive financial accounting systems do not lend themselves to effective verification of internal control compliance. This becomes obvious when you look at current practice, and then compare that to NA's Risk Analysis. **Second**, both the cost and effectiveness of current practice leave a lot to be desired, especially compared to NA.

NA's New Approach to Internal Control and Verification. NA has huge advantages when it comes to financial statement accuracy and reliability.

First, NA is a highly sophisticated comprehensive financial accounting system yet is relatively simple to maintain day in and day out. The simplicity permeates the entire system - bank reconciliations, accounts payable, accounts receivable, and payroll. Even our approach to preparing GAAP financial statements is relatively simple. This is a good start because complexity increases the likelihood of errors, and also requires more expertise, which increases the cost.

Second, NA is totally integrated and has built-in reconciliation reporting to demonstrate that electronic internal controls are working as intended. At the same time, these reconciliations alert the accounting department on a daily basis of possible problems.

Third, to protect all stakeholders, including the accounting department, the business owner, the oversight body, and the general public, the NA Risk Analysis offers a simple, convenient, effective, and efficient alternative to current practice.

Risk Analysis Is Quantified

We quantify the overall risk of data integrity breaches by using a rating system that assigns a risk value to each of the risk factors. The higher the risk value, the more critical the factor is to the achievement of our goal to minimize risk.

Risk Analysis = Self Audit

The NA Risk Analysis is essentially an on-going, periodic self audit. The analysis consists of a series of audit procedures, each of which is designed to answer a related question either Yes or No. If the answer is No, that means risk is NOT being minimized. A No answer to a critical risk factor (i.e., one with a high-risk value) by itself might be a serious problem.

We recommend that the NA Risk Analysis be conducted on a monthly basis to provide assurance that potential problems will be identified and dealt with in a timely manner.

The NA Risk Analysis

The NA Risk Analysis focuses on financial accounting records first and foremost. The related audit procedures are designed to examine and verify the accuracy and completeness of the financial transactional data that serve as the basis for all financial statements and reports.

The Analysis audit procedures are normally conducted by the accounting entity itself. And while the auditor is usually not independent of the entity, he or she is (or should be) independent of the accounting department. A Risk Analysis program is both a deterrent and a monitoring tool to prevent and detect sloppy record keeping, intentional or unintentional.

Important: The purpose of the NA Risk Analysis is crystal clear – we use very specific and thorough procedures designed to detect data integrity breaches, whether intentional or not, that might bring into question the accuracy of the financial statements and reports being provided to the business owner. This is our way of allowing you to monitor very closely your

most vulnerable asset – CASH. And we do it in a timely manner. **The Cost is Minimal, and the Benefit is Enormous.**

Risk Analysis Concept Not New

The Risk Analysis concept is nothing new. And despite the protective benefits provided by the related audit procedures, the concept is not very widely practiced. Why is this? Outside of The New Approach, the old technology on which all other accounting systems are based does not lend itself to a simple, thorough, convenient, and efficient Risk Analysis program.

NA Risk Analysis Is New and Unique

The NA Risk Analysis program is new and different. Many of its audit procedures are not even possible in any other accounting systems because NA technology is so much more advanced. NA has a uniquely integrated system of electronic internal controls which provide the framework for most of the Analysis audit procedures.

The NA Risk Analysis audit procedures are extremely efficient, effective, and simple to administer. Further, the audit findings are equally simple to understand.

Two Types of NA Risk Analysis Audit Procedures

Similar to typical annual financial statement audits, the NA Risk Analysis program employs two types of audit procedures – 1) internal control compliance testing procedures, and 2) transactional data testing procedures.

- **Internal Control Compliance Testing.** Most of the audit procedures consist of internal control compliance testing. These procedures are designed to provide assurance that 1) the accounting department is following NA's built-in electronic internal controls, and 2) the internal controls are working as intended.

And while internal control compliance testing is critically important, adding transactional data testing procedures to the mix reduces the risk of data breaches to an even more acceptable level.

- **Transactional Data Testing.** These additional procedures primarily involve testing transactional data in the data warehouse. For example, are checks being issued to fictitious employees or fictitious vendors? Are checks being issued to pay for fictitious invoices, or invoices otherwise not owed by the entity? Are payments to vendors or employees being padded, or otherwise paid in excess of the amount owed?

Why is NA Risk Analysis so important?

The vast majority of accounting entities across the nation are never audited because 1) an audit is not required, and 2) the cost is too high. But even with an audit there is no guarantee that data breaches and accompanying embezzlements will be detected. Witness that embezzlements often take place over a period of years, involve millions of dollars, and some of these entities are audited.

The NA Risk Analysis audit procedures do not guarantee 100 percent protection against data integrity breaches, or embezzlements. However, the Analysis provides you with a powerful

protective tool that includes our support, and will significantly reduce the risk of data integrity breaches, intentional or unintentional.

Consider this:

- **If you ARE NOT currently being audited.** Our Risk Analysis provides you with substantially similar audit protections that you would get from an annual audit of your financial statements. BUT: 1) the NA Risk Analysis is significantly less invasive to the accounting department, and 2) the cost of the NA Risk Analysis is basically limited to any payments to the auditor conducting the Analysis. Put another way, the NA Risk Analysis has a huge benefit-to-cost ratio.
- **If you ARE currently being audited.** Our Risk Analysis cannot help but reduce the risk of data integrity breaches that might have a significant (negative) impact on the financial statements presented in your annual financial report, and the auditor will (should) understand this. You might have to train them on “the new approach to financial accounting, auditing, and reporting” and our support includes preparing for an audit.

NA Risk Analysis Frequency

Because the NA Risk Analysis program has such a huge benefit-to-cost ratio, we suggest conducting the Analysis on a monthly basis. Less frequently means less timely findings.

Selection of Auditor to Conduct Risk Analysis

Probably the most important qualification of the auditor is that he or she be completely independent of the accounting department both in fact and in appearance. Also, the auditor should report directly to the business owner or oversight body. No special type of experience is needed.

- **Suggestions.** There are no requirements on how to select a Risk Analysis auditor, or who to select. Thus, you could select a current employee of the entity, a member of the oversight body, or even an outside consultant. Under certain circumstances it would even be appropriate for the business owner to act as the auditor.

An advantage to selecting an inside person is that the Risk Analysis audit procedures provide valuable training and related financial accounting and reporting knowledge that is largely absent outside the accounting department. A possible disadvantage is the likelihood that the audit findings and related audit documentation (i.e., working papers) would be a matter of public record (for local governments but not for businesses). That means even the smallest of issues can become political fodder which generally is counter-productive. If an outsider (e.g., consultant) performs the self-auditing procedures the related audit documentation is not generally a matter of public record.

- **Caveat:** A Risk Analysis can be self-defeating if the auditor has a conflicting relationship with the accounting department, or any member of the accounting department. While the accounting department should not have veto power over who is selected as the auditor, neither should the accounting department be subjected in any way, shape, or form, to any kind of intimidation, in fact or in appearance.

At the same time, the accounting department must understand that the oversight body has the obligation to hold the accounting department accountable for the purpose of protecting the interests of the accounting entity. And the NA Risk Analysis program is an indispensable tool that can be used for protecting all parties, so long as it is used **judiciously**.

How to Handle NA Risk Analysis Audit Findings

The NA Risk Analysis audit findings consist of Yes-No answers to a list of questions. The answers are largely based on a review of documentation generated in accordance with the related audit procedures.

Some questions might not be as simple to answer as they seem to be. Despite this, the questions and the Yes-No format were deliberately designed to indicate “No Problem” with a Yes answer. Hence, any answer that is not a Yes, likely needs an explanation, but not necessarily an interpretation.

- **Important:** The Risk Analysis auditor is charged with following the procedures and answering the questions. That's it! We do not want the auditor introducing any bias they might have.
- **DO NOT Over-React to “No” Answers.** More often than not, a “No” answer to a question has a reasonable and simple explanation. In virtually any type of audit, the auditor is going to see red flags. Red flags need an explanation, and that is all. You should NEVER react to a red flag, meaning a “No” answer, other than seeking an explanation.
- **Who should provide the explanation to a “No” answer?** It almost all instances the explanation to a “No” answer should come from the accounting department. The accounting department is most likely accountable, and most qualified to provide the explanation. NA technical support is also available for assistance.
- **Preferable to Deliberate as a Group.** Try to avoid putting a single person in charge of how the entity should react, if at all, to the explanation of a “No” answer. We suggest a small group, with at least one accounting department representative and at least one person in the group who is independent of the accounting department.

A major concern is to over-react and waste the time of the business owner or oversight body. You will find “No” answers, but in deciding how to react, you must consider that most accounting departments have many responsibilities, are busy throughout the day, and are getting interrupted constantly with phone calls and over-the-counter inquiries. Is the problem with the accounting personnel? Or, is the problem that you as an entity are asking the accountant to do 40 hours of work and only want to pay them for 20 hours.

Keep in Mind:

- Don't be fooled into thinking that because you see a few “No” answers there are big problems. There might be, but likely not. NA has so many built-in electronic internal controls it's impossible to count them all. Other accounting systems have very limited testing capability making it difficult to test, not to mention determine if something might be wrong. Be thankful that you have this testing capability, and use it wisely.

- The vast majority of accounting departments do good work. Try not to discourage them. Instead we want to discourage sloppy accounting work or intentional data integrity breaches. Be able to recognize good accounting work when you see it. And be able to recognize bad accounting work when you see it.
- A good accountant is going to get fed up with constant “undeserved” criticism. As a deliberative body, the group reviewing the Risk Analysis auditor’s work needs to view itself as working in the best interests of the accounting entity as a whole. This does not mean fighting the accounting department or telling them what to do. It means working with the accounting department, focusing on the issues, how to resolve them, and doing a follow-up.
- **Our Support:** You should never hesitate to contact us for support. We can help you decide what issues need immediate attention, and even how to resolve them.