

## Internal Controls Need Regular Testing

*Gary Simon, Group Publisher, FSN Publishing Limited*

**This essay is part of a series, *Controllers' Corner: Two-Minute Essays on Financial Management and Control*, which asks industry thought leaders for their opinions on critical issues facing today's finance organizations.**

*The renewed emphasis on internal controls created by SOX and other transparency regulations has forced many organizations to invest additional time and resources in compliance. While the focus of SOX was on controls for financial reporting, many organizations performed audits and reduced the number of general and application controls.*

**Q. How important is it for organizations to continue upgrading their internal controls and what areas are most in need of improvement?**

There is a tendency for organizations to treat the controls environment passively rather than manage it actively as a part of the group financial reporting cycle. Sarbanes-Oxley (SOX) helped to change attitudes and helpfully raised the profile of controls. Nevertheless, once the control environment had been designed and revised principles had been implemented, how many organizations challenged their initial blueprint or reviewed the need for change?



Many assume that controls, once established, are relatively static, but financial reporting is in a constant state of flux, courtesy of new accounting standards and regulatory reporting. In fact the last few years have seen change on an unprecedented scale. This means that application controls, should be reassessed and potentially new controls introduced. But it is not just changes in rules that give

rise to challenges around controls. Technology too, can impose the need for change.

Take for example, the so called, "Last Mile" of finance. Over the next few years we are likely to see the introduction of document management and workflow systems to help steer financial statements through the closing stages of production. These

## *Internal Controls Need Regular Testing*

new processes will require new controls, such as, who can change a note to the accounts, who can authorize a late change to a schedule, or perhaps who is allowed to open and read a sensitive draft of a document.

The move to “interactive data” (XBRL) and the publication of electronically tagged financial information also gives rise to new risks. What controls will be needed in this novel environment to ensure that anything published is complete, accurate and authorized? What new controls will external auditors wish to see before they give their blessing?

Striking an appropriate balance between controls and risk is central to an effective controls environment. Many organizations tend to over-engineer their controls, placing too many hurdles in the way. Such an approach is both time-consuming and costly. A complex web of controls can also mask real problems. The essence of an effective environment is one that identifies the key controls on which management absolutely depends, as distinct from underlying controls that perform a perfunctory role. A clear understanding

of compensating controls, i.e., higher level controls that compensate for weaknesses identified lower down the food chain, will help to avoid the development and management of too many controls.

In broad terms, it is better to have automated controls rather than manual controls. Once created, more reliance can be placed on automated controls. However, organizations sometimes forget that the opposite is also true, i.e., that an automatic control that fails will continue to fail reliably until it is spotted!

The lesson is that controls need to be regularly and frequently tested – a burden that most organizations do not relish but is nonetheless vital. It is quite a problem. Responsibility is often divided between finance and internal and external auditors, with nobody clearly taking stewardship. On the other hand, it is important to avoid a “box ticking” or compliance mentality. The production of financial statements strikes at the heart of an organization and its reputation. Testing financial controls should be thorough and when in doubt, business judgment rather than the completion of a checklist should rule the day.

Regular review of the controls environment, and testing, if appropriately managed, will lead to process improvement. In the long run this is less costly, with the additional benefit that it may even contribute to business insight.

### **About Gary Simon**

Gary Simon is the Group Publisher of FSN Publishing Limited, Managing Editor of FSN Newswire and the author of many product reviews and white papers on financial software. Simon is a graduate of London University, a Chartered Accountant and a Fellow of the British Computer Society with more than 23 years of experience implementing management and financial reporting systems. Simon was a partner with Deloitte for more than 16 years and has led some of the most complex information management assignments for global enterprises in the private and public sector. Gary Simon may be contacted at [gary.simon@fsn.co.uk](mailto:gary.simon@fsn.co.uk).

## About IBM Cognos BI and Performance Management

IBM Cognos business intelligence (BI) and performance management solutions deliver world-leading enterprise planning, consolidation and BI software, support and services to help companies plan, understand and manage financial and operational performance. IBM Cognos solutions bring together technology, analytical applications, best practices, and a broad network of partners to give customers an open, adaptive and complete performance solution. Over 23,000 customers in more than 135 countries around the world choose IBM Cognos solutions.

For further information or to reach a representative: [www.ibm.com/cognos](http://www.ibm.com/cognos)

### Request a call

To request a call or to ask a question, go to [www.ibm.com/cognos/contactus](http://www.ibm.com/cognos/contactus). An IBM Cognos representative will respond to your enquiry within two business days.



© Copyright IBM Corporation 2009

IBM Canada  
3755 Riverside Drive  
Ottawa, ON, Canada K1G 4K9

Produced in Canada  
May 2009  
All Rights Reserved.

IBM, the IBM logo and [ibm.com](http://ibm.com) are trademarks or registered trademarks of International Business Machines Corporation in the United States, other countries, or both. If these and other IBM trademarked terms are marked on their first occurrence in this information with a trademark symbol (® or ™), these symbols indicate U.S. registered or common law trademarks owned by IBM at the time this information was published. Such trademarks may also be registered or common law trademarks in other countries. A current list of IBM trademarks is available on the Web at "Copyright and trademark information" at [www.ibm.com/legal/copytrade.shtml](http://www.ibm.com/legal/copytrade.shtml).

Other company, product and service names may be trademarks or service marks of others.

References in this publication to IBM products or services do not imply that IBM intends to make them available in all countries in which IBM operates.

Any reference in this information to non-IBM Web sites are provided for convenience only and do not in any manner serve as an endorsement of those Web sites. The materials at those Web sites are not part of the materials for this IBM product and use of those Web sites is at your own risk.

