Sep_15

Optimizing the audit of the consolidated financial statements, a further step towards fast close

What process should you follow to prepare for an audit of your accounts?
How can a software tool help?

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A well-prepared audit makes sure groups can facilitate the approval from the auditor and improve their Fast Close process. This has some serious advantages for the group, the consolidation team and for the auditors themselves.

What are the benefits of a well-prepared audit?

- **For the group:** the accounts are validated in a timely way and the group can perform a fast close.
- **For the consolidation team:** they can effectively prepare for the audit, free up time for analysis and manage the fees paid to the auditor and to consultants who develop special reports.
- **For the auditors:** in light of the recent changes experienced in the field (rapid changes in standards, increased liability, increase in productivity required due to increased competitiveness), an optimised process is essential for accelerating audits and maintaining mission quality.

How to reach this?

The keys to success are to anticipate the auditors' questions and to implement a good methodology.

Anticipate the auditor's questions

What does the auditor expect from his client? His role is to cover all the risks he encounters during the audit phase in order to guarantee the validity of consolidated figures and the annual report. For a consolidation, he will classically make sure the following risks are covered:

- Existence
- Completeness
- Accuracy
- Valuation
- Cut-off
- Presentation

Furthermore, he is not responsible for checking the software parameters. It is therefore important to prepare the process and to ensure that the auditor can focus on his tasks, being the validation and analysis of the accounts.

How?

- By answering to his methodology
- By taking full advantage of the audit functionalities provided by your consolidation software tool

The methodology

The consolidation methodology we believe to be most effective adopts the following key principles:

- Consolidation should be viewed as accounting applied at the group level
- In practice, every consolidation-related transaction (adjustments, eliminations, etc.) should be reflected as an accounting entry in an ad hoc journal
- The individual balance sheets of the companies in the scope should be in balance throughout the whole process
- All information should be easily traceable and available to the reader

Does your consolidation application provide you with a complete view of the consolidation process?

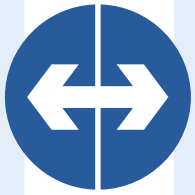
An incomplete consolidation application will give you a view of the consolidation process before/after the process. The optimal way however is when your consolidation tool provides you insights **during the process.** For instance, a professional tool is able to detail the major steps of the consolidation process, together with all data and reporting functionalities at any of these stages.

Consolidation steps for which a well-prepared audit can make the difference

The purpose of this document is to further develop the key steps of consolidation. We consider them to be key in the audit process, because (1) they are the source of the main risks for the auditor; and (2) they are challenging to justify for the consolidator.

We have identified the consolidation steps below which are further developed in this article through the risk they represent for the auditor and how the consolidator should be able to help to cover those risks and ensure an efficient audit process.

CONSO CONTENT	RISKS TO COVER
1. **Determine Group Structure**	**Existence**
2. **Local data**	**Completeness**
3. **Currency conversion**	**Accuracy**
4. **Interco matching**	**Valuation**
5. **Manual adjustments**	**Cut-off**
6. **Conso eliminations**	**Presentation**



Step 1: Group structure

The **consolidation scope** is one of the first things an auditor will look at. The major risks he encounters at this stage are the existence (proof of ownership) and the completeness (are all subsidiaries identified?).

The audit procedures for subsidiaries are based on risk assessment and materiality. At the planning stage, groups need to define, for each subsidiary, whether a full audit (ISA standards), a limited review (ISRE standards) or a desktop review will be performed. Close coordination with the local auditor is important.

To organize these audit procedures efficiently, the consolidation manager needs to provide the auditor with a **list of all subsidiaries, their position in the scope and their details** such as their currency, participation percentage and non-controlling interests. A professional consolidation software produces a summary of this key data under the format of a group diagram for instance and will highlight the changes in detention.

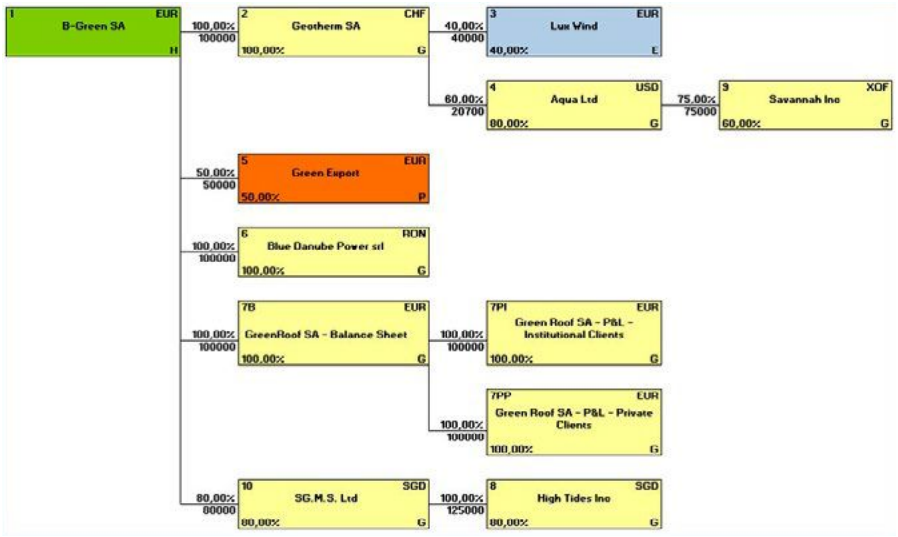


Figure 1: Example of a group diagram

Furthermore, a professional tool will give the possibility to make a distinction between voting rights and financial rights. This is key for certain groups as the voting rights are used to determine the **consolidation method**, whereas the financial rights are used to determine the **financial interest** of the parent company.

Step 2: Local data

The auditor will prefer a situation where a consolidation manual has been issued by the parent company. It gives him more assurance on the quality of the local data and possibly less time spent on the validation of the local bundles. **Validation of the local bundle** includes typically validation of mapping and opening balance, review of audited trial balance, fluctuations, interco positions and local adjustments.

Therefore, adopting a **trustworthy local bundle** might help validate the accuracy of the data in an efficient way. A **consolidation software** will include such local bundle, ideally standard over the years, built with an accounting mind. Additionally, it will deliver the following interesting functionalities:

- Automatic, uneditable generation of opening period
- Collection of all necessary information (even qualitative such as signing authorities, covenants)
- Quality controls

Having all this information gathered and available in the consolidation software, it also helps to provide the auditor with some additional information like:

- The mapping tables between the local chart of accounts and the group chart of accounts
- A comparison between closing balance Y-1 and opening balance Y
- A clear view of all local adjustments as they are kept separated (not automatically aggregated) and automatically managed over the years

For groups with several entities on a same ERP or accounting system, a direct integration between the consolidation software and accounting system is recommended. This ensures the auditor that no manual changes have been performed on the data. Furthermore, the consolidator will also be able to better manage the entities if the consolidation software provides various options for data collection, such as .xls and .cvs files, offline and online bundles and the integration with local systems.

Step 3: Currency conversion

A third step we can identify in the audit process is the currency conversion. The auditor will validate:

- **The valuation of the exchange rates per type**: closing, average or transactional/historical
- **The conversion of local bundles** and the rate applied on each account
- **The currency translation adjustment account** in the equity

How can the consolidation manager facilitate this step? First of all, he should provide the auditor with **a list of all exchange rates** per currency and the type of rate applied to each account; and a **converted local bundle before any other adjustment**. This mitigates the risk of accuracy at the local bundles level.

The auditor also needs to check the accuracy at conso level, whereas providing the following information will help him to cover the risks of accuracy and valuation:

- Details of conversion of equity and participation accounts
- Contribution by company to CTA (currency translation adjustment)
- Detailed calculation of the currency translation adjustment account (CTA) in equity: it shows all the entries having a translation adjustment and explains its calculation in detail

Working only with Excel does not provide sufficient information, especially regarding the CTA. Its recalculation is generally difficult for the auditor and as such, difficult to validate. Good consolidation tools have all these functionalities standard available.

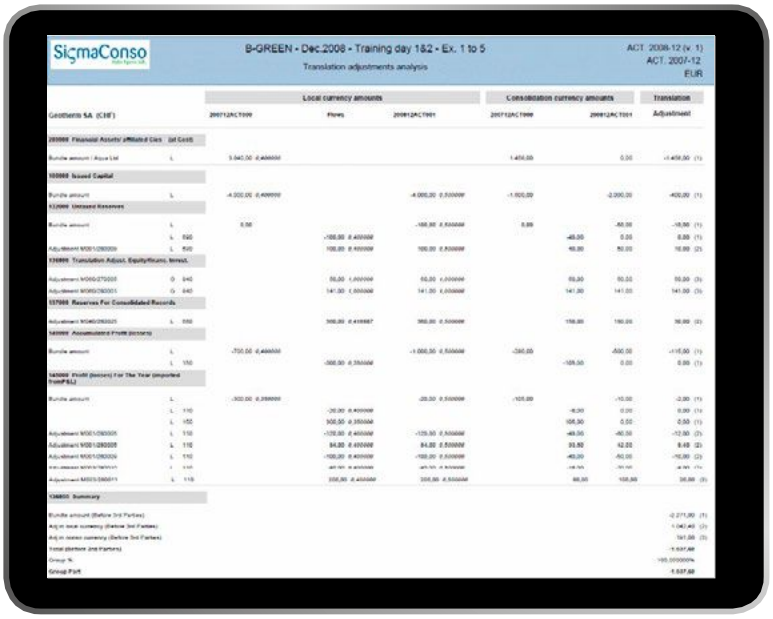
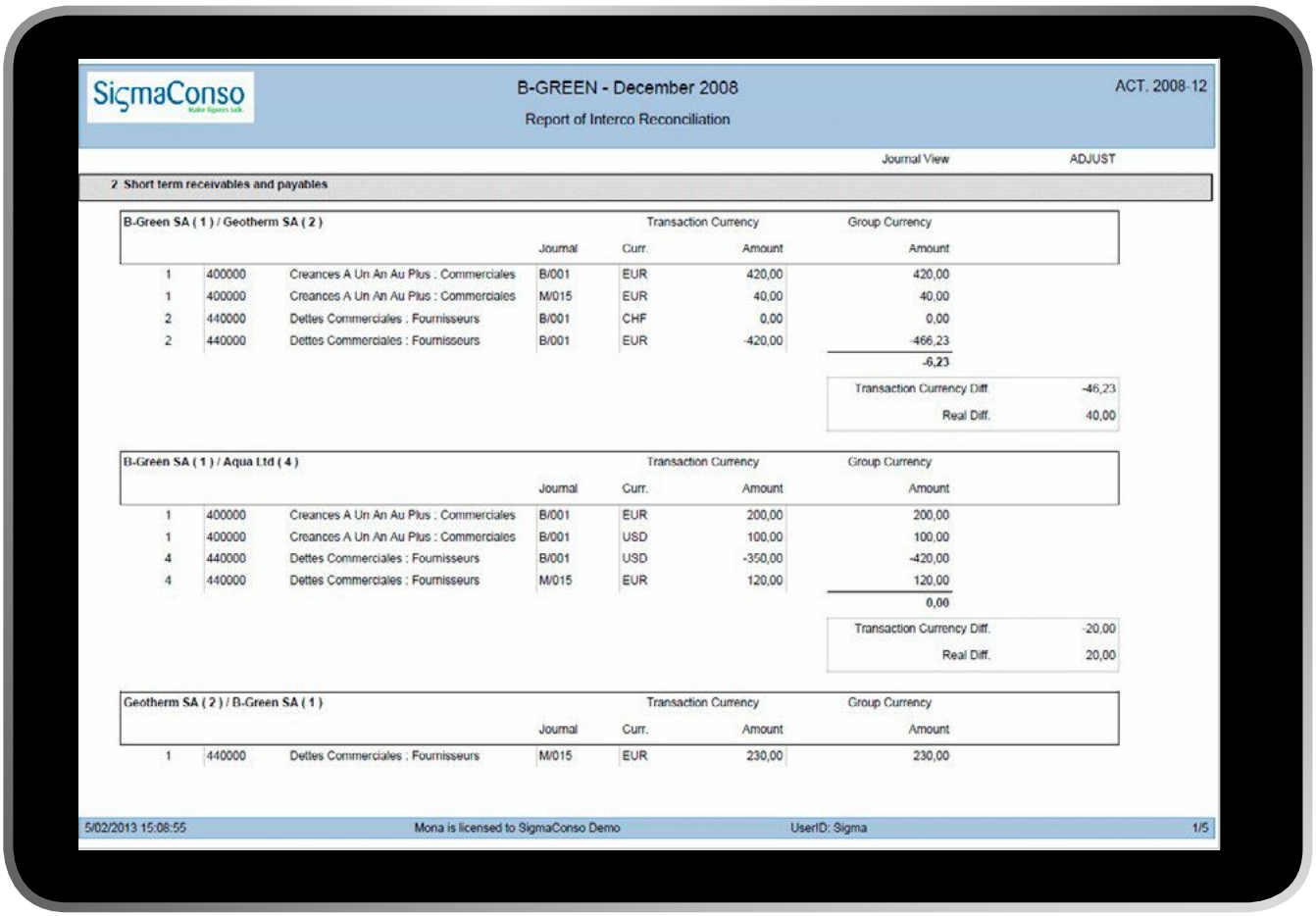


Figure 2: Translation adjustment analysis

Step 4: Interco matching

The auditor will also perform a **validation of the intercompany matching**, in order to check the completeness and accuracy of the information. Completeness can be achieved when the information is **centralized and validated by the local auditor** (in the local currency). Moreover, a **visualization** of the following information can be helpful for the auditor to check the accuracy of the information:

- Unmatched transactions (verify whether difference meets materiality threshold)
- Corrections performed for reconciliation (distinction made automatically between real differences and translation differences by the consolidation software)
- The eliminations of interco positions



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B-GREEN - December 2008

Report of Interco Reconciliation

ACT. 2008-12

Journal View ADJUST

2 Short term receivables and payables

B-Green SA (1) / Geotherm SA (2)

			Journal	Curr.	Transaction Currency Amount	Group Currency Amount
1	400000	Creances A Un An Au Plus : Commerciales	B/001	EUR	420,00	420,00
1	400000	Creances A Un An Au Plus : Commerciales	M/015	EUR	40,00	40,00
2	440000	Dettes Commerciales : Fournisseurs	B/001	CHF	0,00	0,00
2	440000	Dettes Commerciales : Fournisseurs	B/001	EUR	-420,00	-466,23
						-6,23

Transaction Currency Diff. -46,23

Real Diff. 40,00

B-Green SA (1) / Aqua Ltd (4)

			Journal	Curr.	Transaction Currency Amount	Group Currency Amount
1	400000	Creances A Un An Au Plus : Commerciales	B/001	EUR	200,00	200,00
1	400000	Creances A Un An Au Plus : Commerciales	B/001	USD	100,00	100,00
4	440000	Dettes Commerciales : Fournisseurs	B/001	USD	-350,00	-420,00
4	440000	Dettes Commerciales : Fournisseurs	M/015	EUR	120,00	120,00
						0,00

Transaction Currency Diff. -20,00

Real Diff. 20,00

Geotherm SA (2) / B-Green SA (1)

			Journal	Curr.	Transaction Currency Amount	Group Currency Amount
1	440000	Dettes Commerciales : Fournisseurs	M/015	EUR	230,00	230,00

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Figure3: Report of intercompany reconciliation

To facilitate this process, the consolidation manager needs to **provide a list** of all intercompany positions – both matched and unmatched. Thanks to this detailed list, the auditor will be able to identify potential risks of cut-off transactions and validate them.

Unmatched positions will be automatically eliminated in the same way as matched positions by the conso package. This is definitely a guarantee for both the consolidator and the auditor as these eliminations are available for consultation. The remaining differences from the unreconciled positions will remain on a specific account that the auditor can consult to verify that it does not exceed his audit materiality threshold.

Step 5: Manual adjustments

At this stage, the auditor is facing a risk of accuracy or even a risk of fraud. That's why it is important for him to analyze the manual adjustments, especially with respect to revenue.

The auditor will have to validate all adjustments, meaning the adjustments from the current period as well as previous year adjustments and the way they are automatically carried forward by the system. This will be done by analyzing the reconciliation between opening and closing reserves, a report that is typically automatically generated by good conso tools.

The consolidation manager should count on the automatisms of his tool to be able to provide some helpful information to the auditor, so that he can quickly verify whether the data is complete, like:

- A validation report at conso level
- Cash flow statement
- Reconciliation of group and 3rd parties' reserves (also called statement of changes in equity), which is available at conso view and by entity contribution
- Full audit-trail (by company, journal, flow, ...)

Next to the completeness risk, another special attention needs to be made to the relevancy of the information. A consolidation software will also help by providing a list of all adjustments, with filters such as:

- Date and time indication of 'modified data' on each adjustment
- User who made the entry
- Amount
- Classification by nature, distinction by journals

It is also possible that the application offers additional possibilities: for instance, in good consolidation tools, past adjustments are not automatically aggregated which means that the historic is available and fully detailed. Furthermore, entries are grouped in journals by type. It is thus sufficient to make a distinction between historical and new adjustments. Also, the use of linked accounts makes it possible to maintain balanced accounts by company. Furthermore, entries can be reversed in the case of a deconsolidation of the subsidiary.

Step 6: Consolidation Eliminations

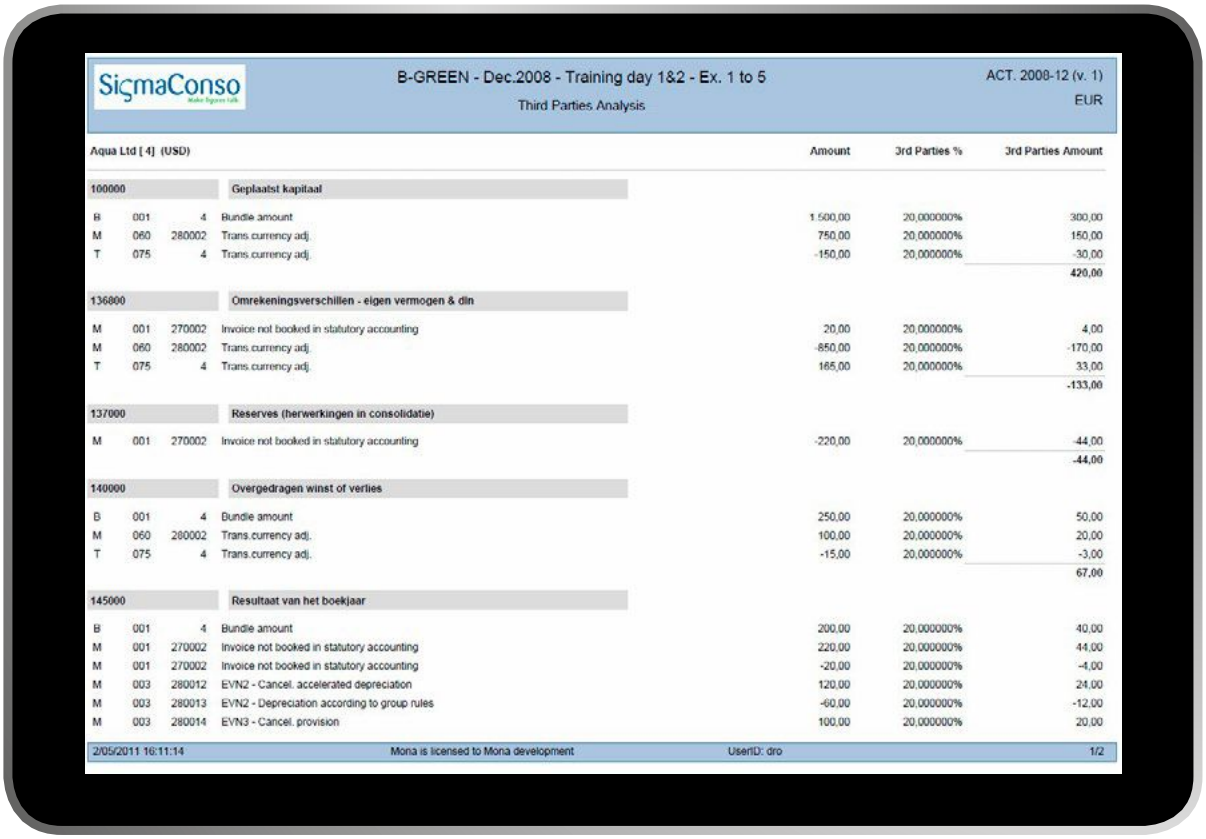
The auditor will also check the **conso eliminations.** Considered as technical as they are automatically performed by the tool according to the consolidation method. These include:

- Elimination of equity and participations
- Calculation of non-controlling interests
- Equity value calculation
- Proportional eliminations

Different reports can help the validation:

- Reconciliation of evolution of the reserves (by company)
- Consolidation difference calculation
- Non-controlling interests calculation
- Set of custom and system validations at conso level

In the example below, a consolidation software provides a predefined analysis of the minority shares in order to facilitate the audit phase.



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B-GREEN - Dec.2008 - Training day 1&2 - Ex. 1 to 5

Third Parties Analysis

ACT. 2008-12 (v. 1)

EUR

Aqua Ltd [4] (USD)				Amount	3rd Parties %	3rd Parties Amount
100000			Geplaatst kapitaal			
B	001	4	Bundle amount	1.500,00	20,000000%	300,00
M	060	280002	Trans.currency adj.	750,00	20,000000%	150,00
T	075	4	Trans.currency adj.	-150,00	20,000000%	-30,00
						420,00
136800			Omrekeningsverschillen - eigen vermogen & din			
M	001	270002	Invoice not booked in statutory accounting	20,00	20,000000%	4,00
M	060	280002	Trans.currency adj.	-850,00	20,000000%	-170,00
T	075	4	Trans.currency adj.	165,00	20,000000%	33,00
						-133,00
137000			Reserves (herwerkingen in consolidatie)			
M	001	270002	Invoice not booked in statutory accounting	-220,00	20,000000%	-44,00
						-44,00
140000			Overgedragen winst of verlies			
B	001	4	Bundle amount	250,00	20,000000%	50,00
M	060	280002	Trans.currency adj.	100,00	20,000000%	20,00
T	075	4	Trans.currency adj.	-15,00	20,000000%	-3,00
						67,00
145000			Resultaat van het boekjaar			
B	001	4	Bundle amount	200,00	20,000000%	40,00
M	001	270002	Invoice not booked in statutory accounting	220,00	20,000000%	44,00
M	001	270002	Invoice not booked in statutory accounting	-20,00	20,000000%	-4,00
M	003	280012	EVN2 - Cancel. accelerated depreciation	120,00	20,000000%	24,00
M	003	280013	EVN2 - Depreciation according to group rules	-60,00	20,000000%	-12,00
M	003	280014	EVN3 - Cancel. provision	100,00	20,000000%	20,00

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Figure 4: Analysis of minority shares

Conclusion

The audit process can be strongly influenced (in terms of delays, costs ...) by a tested and proved methodology and a certain preparation from the consolidation manager's side. Professional consolidation (and interco matching) software can definitely help through the delivery of the right information with the transparency and traceability needed.

Furthermore, from the point of view of the consolidation manager, audit definitely remains key, but is less and less often the only matter for him. Indeed, the consolidation manager is more and more facing the request of regular and flexible management. There is then a strong need for automation. The right tools, combining both legal and management consolidation, can definitely help improve financial processes and guaranteed quality, reliability and speed during the audit phase.

Did you use all of the functionalities described in this article during your last audit?
What were the obstacles you came across? Do you want to save precious time for your next closing?

Find out how our complete range of CPM solutions (consolidation, management reporting, intercompany reconciliation) can help! **Contact us now!**

About Sigma Conso

Sigma Conso provides software, training and services in the field of Corporate Performance Management (CPM) and offers:

- a comprehensive range of CPM solutions for groups who want to facilitate their financial management: financial consolidation, management reporting, intercompany reconciliation, performance analytics, financial forecasting, budgeting and strategic planning
- software that is rich in expert content, user-friendly, flexible, easy to maintain by users and with a low total cost of ownership
- a recognized expertise in the optimisation of the financial processes
- a dedicated team of consultants at your disposal
- an International expansion programme and continuous growth

About Sigma Conso Consolidation & Reporting

Sigma Conso Consolidation & Reporting is a 100% web-based financial consolidation and reporting solution for groups. It is ready to use, easy to learn, and can be fully customised by users. It enables the collection and consolidation of actuals, budget, and forecast data. The attention to ensuring information traceability and navigation makes it a particularly well-suited solution for users with demanding audit standards.

About Sigma Conso Intercompany

Sigma Conso Intercompany is a 100% web-based solution for the reconciliation of intra-group operations. The reconciliation process is carried out during the entire fiscal period by the partners involved. The result: amounts are reconciled prior to the consolidation step and independently of it as part of a regular process. The solution can be hosted at the client site. It is also available in PaaS and SaaS modes. *Sigma Conso Intercompany* fits quickly into existing application environments (ERP, consolidation software) and can be deployed in entities in just a few days (intuitive interface; facilitated change management).

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