CFGI

MANAGEMENT REVIEW CONTROLS

What You Need to Know

Long gone are the days when a signature and date on an account reconciliation was sufficient to satisfy the documentation and evidence requirements of a SOX audit. When it comes to evidencing SOX controls, particularly management review controls, public companies are being asked to do more — document more; retain more; and perform more. The ever-increasing expectations are reflective of the trickle-down effect of recent PCAOB Firm Inspection Reports, which have indicated that external audit firms are not sufficiently executing their integrated audits and companies are not effectively designing and executing their management review controls.

Within this CFGInsight publication, we will be addressing how public companies can efficiently and effectively execute management review controls, with a specific focus on account reconciliations.

Assessing Your Management Review Controls

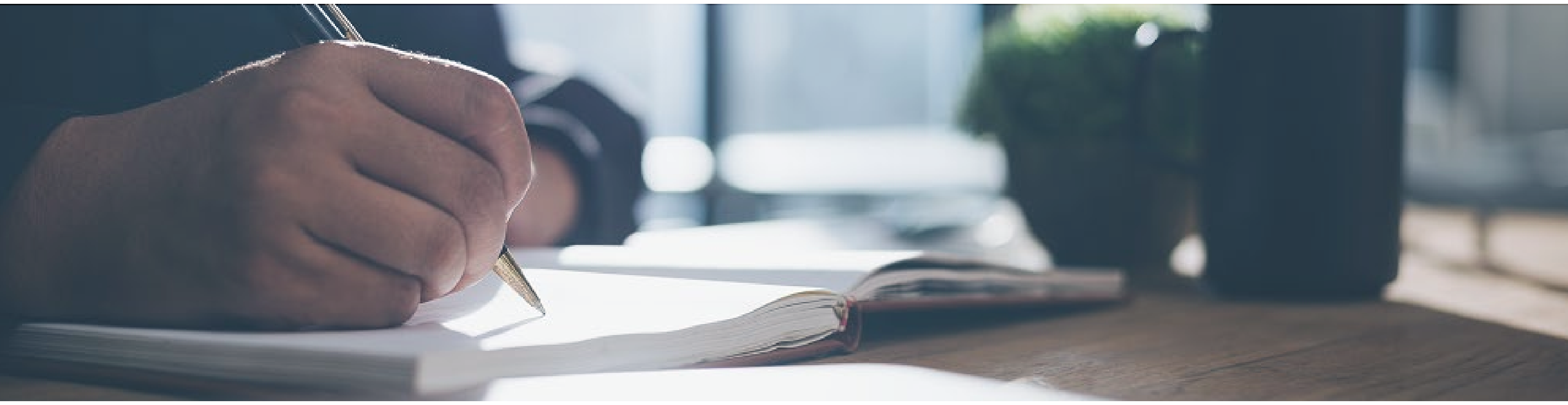
Management should regularly assess the design and effectiveness of controls. The following checklist can be utilized to identify potential design issues associated with management review controls:

CATEGORY	QUESTION
Precision	• Are the controls designed at a high level of precision? • Does the control description specify exactly what procedures or activities are performed by the control owner or is there ambiguity?
Threshold	• Are thresholds (both quantitative and qualitative) for investigation included within the control description?
Information Produced by Entity	• Are all files, spreadsheets, reports, etc. used to execute or review a control indentified and are there sufficiently-designed procedures over these underlying files, spreadsheets, reports, etc. to access their completeness and accuracy?
Risks	• Is the control adequately designed to address all significant risks for all relevant assertions?

Example of a Poorly-Designed Management Review Control

It is not uncommon to find the following control in a company's control matrix: *The Accounts Receivable account reconciliation is reviewed.* Using the checklist from the previous page, let's assess this control description's shortcomings:

CATEGORY	SHORTCOMINGS
Precision	• The control fails to specify (1) what specific procedures are performed as part of the review (2) how frequently the review occurs and (3) who is performing the review.
Threshold	• The control fails to specify thresholds (both qualitative and quantitative) for investigation and follow up.
Information Produced by Entity	• The control fails to identify and specify what underlying files and reports (e.g., the A/R Aging Report) are utilized in the execution of the control. Further, the control does not describe the procedures the reviewer performs to assess the completeness and accuracy of the underlying files and reports.
Risks	• Based on the current control description, it is unclear what risks the account reconciliation review is intended to mitigate.



A Practical Example: Account Reconciliations

Account reconciliations are arguably the most important management review control. Investing time upfront on the design of each significant account reconciliation will pay dividends in the end. *So where does management begin?*

We recommend that for each balance sheet account – prioritizing the most material and significant accounts first – management create an account reconciliation coversheet (see Exhibit 1). Establishing working groups consisting of individuals with varying levels of skills, roles and experience to create the coversheets often works well. Further, soliciting input from your internal and external auditors is also recommended.

RISKS	REVIEW PROCEDURES
Accounts receivable balances per the sub-ledger do not agree to the general ledger	Ensure the "A/R Aging" report (i.e., sub-ledger) agrees to the general ledger. Investigate (and document) any reconciling items greater than $1,000.
Accounts receivable balances are not reported at net realizable value	Assess whether an allowance for doubtful accounts needs to be established. Ensure there is sufficient documentation of management's assessment of the allowance. Items to consider include the customer's creditworthiness, date of last correspondence with customer, and the customer's history of payment.
Account receivable disclosures are inaccurate	Ensure all customers with Accounts Receivable balances greater than 10% of Total Accounts Receivable are appropriately identified as this information will be required for footnote disclosure purposes.
Account receivable disclosures are inaccurate	Identify whether any of the customers noted on the A/R Aging report are Related Parties as this information will be required for financial statement disclosure purposes.
Underlying reports utilized in the execution of the control are incomplete or inaccurate	Note all files, reports, and spreadsheets utilized in the execution of this control and perform the following procedures: 1. Identify what system/application the report is generated from 2. Assess whether the Company tests Information Technology General Controls (ITGC's) over the system/application 3. Validate parameters (e.g., dates) that are input to run the report 4. Assess whether the report can be edited after download (if so, refer to Step 5 for incremental procedures) 5. If the report is not generated from a system with ITGC coverage, is manually created, or can be edited after downloaded from a system with ITGC coverage, then consider performing the following procedures: • Verify that total agree to the general ledger or other validated reports/sources, • Perform checks on certain attributes, • Review formulas and for hidden tables and columns, • Retain screenshots from the system showing that totals tie to the report, • Perform procedures to assess the mathematical accuracy of the report.
As applicable	Document other procedures performed (as needed).

Conclusion

Management review controls are under increased scrutiny by the PCAOB and external audit firms. Companies have a vested interest in improving the precision in which their management review controls are designed and executed.

Prioritizing account reconciliation design and execution procedures often seems to work well given their importance to a company's overall system of internal control; however, management should also consider enhancing other management review controls, including controls over the review of accounting memos, budgets-to-actuals, Business Performance Reviews and other critical meetings.

Enhancing the design and precision of controls will not only lead to a more efficient audit, but will also provide management with additional assurance that all significant and relevant risks are being appropriately addressed. Further, we have found that establishing detailed review procedures is a game changer for companies undergoing significant turnover, transformation or growth, as it reduces the risk that critical review procedures are missed or inconsistently applied due to the transition of roles and responsibilities. CFGI has extensive experience designing management review controls that meet the ever-increasing needs and requirements of the company, its stakeholders, regulators, and auditors.

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