Reconciliations: A Key to Financial Reporting

Performing adequate reconciliations can help agencies prepare accurate financial reports

Discussion Points

The Financial Reporting Challenge

GAO’s Report

GAO’s Guidance

What does the Law say?

What’s the Problem?

Recommended Solution

Improve Data Quality

Provide timely data

Train and communicate with the right People

Improve existing Financial Systems and Processes

1a GAO's Report

Fiscal Year 2003 U.S. Government Financial Statements

Sustained Improvement in Federal

Financial Management is Crucial To Addressing Our Nation's Future Fiscal Challenges (July 8, 2004)

Audit Opinions…

A determination is made as whether the Financial Statements are presented fairly in accordance with GAAP

4 Possible Opinions

Unqualified (Clean)

Qualified (Except for)

Disclaimer (No Opinion)

Adverse

GAO’s Disclaimer:

Material weaknesses in:

internal control

selected accounting and reporting practices

Prevented GAO from being able to provide an opinion as to whether the consolidated financial statements of the US Govt are fairly stated in conformity with GAAP

3 obstacles to GAO's opinion :

serious financial management problems at DOD,

the federal government's inability to account for and RECONCILE transactions between federal government entities, and

The federal government's ineffective process for preparing the consolidated financial statements.

Report results…

- 20 of 23 CFO Act agencies received unqualified (clean) opinions
- Only 3 (Energy, NSF & SSA) of the 23 had neither:
  - a material weakness in internal control,
  - an issue involving compliance with applicable laws and regulations, nor
  - an instance of lack of substantial compliance with FFMIA

GAO also found that…

Problems in accounting for and reconciling Intragovernmental activity and balances impair the government’s ability to account for billions of dollars of transactions between governmental activities.

Net Outlays reported by federal agencies in their Statements of Budgetary Resources do not reconcile to the records used by Treasury to prepare the Statement of Changes in Cash Balance from Unified and Other Activities

1b.GAO's Guidance to …

The Auditors

Federal Managers

1b1 To the Auditors…

According to GAO's Government Auditing

Standards (a.k.a. The Yellow Book issued

June 2003) Reporting Deficiencies in

Internal Controls

Section 5.13 'For all financial audits, auditors should report deficiencies in internal control considered to be reportable conditions as defined by AICPA standards.'

1b1 To the Auditors cont'd…

An example of matters that may be reportable conditions is:

evidence of failure to perform tasks that are a significant part of internal control, such as reconciliations not prepared or not timely prepared

GAO defines a Reportable Condition as…

Reconciliations

not prepared,

or not timely prepared

AICPA’s definition of a Reportable Condition?

AICPA standards define reportable conditions as significant deficiencies in the design or operation of internal control that could adversely affect the entity’s ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

In plain English - Reportable Conditions are…

significant deficiencies

that could adversely affect

the entity’s ability to record financial data.

Yellow Book cont'd…

Reporting Deficiencies in Internal Control

Section 5.14 states:

'When reporting deficiencies in internal control, auditors should identify those reportable conditions that are individually or in the aggregate considered to be material weaknesses.'

What’s a material weakness?

‘The AICPA standards define a material weakness as a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.’

A material weakness in plain English is…

A faulty internal control component where:

Misstatements occur,

That are Material, and

May not be detected.

Now, what's materiality?

According to AICPA Fieldwork Standard 4.04,

'Auditors should use professional judgment and consider the needs of users in applying the AICPA standards and related guidance to audits to a government entity or an entity that receives government awards.'

AICPA Fieldwork Standard 4.04 cont'd…

'Also, auditors need to be sensitive to the concerns of oversight officials regarding previously reported internal control deficiencies of the audited entity and, accordingly, may need to test the effectiveness of internal controls that have been changed in response to reported deficiencies even if auditors do not plan to rely on the effectiveness of such internal controls.'

Bottom Line…

Materiality is defined by the auditor

‘An item is considered material if it is significant enough to affect decisions made because of information disclosed in financial statements, or if it requires that the statements be adjusted.’ Public Dollars, Common Sense published by Coopers & Lybrand

How does Materiality affect Audit Opinions?

Source: Public Money, Common Sense

	Condition			
Level of Materiality	Departure from GAAP	Inconsistent Application	Scope Limitation	Uncertainty
Immaterial	Unqualified	Unqualified	Unqualified	Unqualified
Material – Does not overshadow overall statements	Qualified	Qualified	Qualified Scope & Opinion	Qualified
Material – overall fairness of statements are in question	Adverse	Qualified	Disclaimer	Disclaimer

1b To Federal Managers…

According to GAO's 'Standards for Internal Control in the Federal Government':
Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Specifically…

Internal controls should be:

Designed to assure that ongoing monitoring occurs in the course of normal operations.

Performed continually.

Ingrained in the agency’s operations.

Internal controls should also include…

Regular management and supervisory activities,

Comparisons,

Reconciliations, and

Other actions people take in performing their duties.

1c.What does the Law say?

Chief Financial Officer’s Act (CFO)

Federal Manager’s Financial Integrity Act (FMFIA)

CFO Act (PL 101-576)

Requires the preparation and audit of financial statements for 24 Federal agencies.

Auditors report on internal controls and compliance with laws and regulations

FMFIA (97-255)

Requires federal agencies to establish controls that reasonably ensure that:

Obligations and costs comply with applicable laws

Assets are safeguarded against waste, loss, unauthorized use, and misappropriation

Revenues and expenditures are properly recorded and accounted for.

Examples of ways to safeguard assets:

Perform Periodic Inventories and Reconcile:

The agency's Fund Balance with Treasury account (1010) with Treasury's balance. (What's the impact of GWA – No 6652 – Statement of Difference?)

Property, Plant and Equipment balances in the general ledger to the subsidiary ledgers and to the support documents.

Discussion Points

Material Weaknesses Prevent a Clean Opinion and Accurate Financial Reporting

Adequate Reconciliations prevent material weaknesses

1d.What’s the Problem?

Inadequate reconciliations

Why aren’t the recs being performed?

Lack of:

Time

Talent(Skills)

Resource

New Developments

Additional Guidance from OMB and Treasury

Accelerated Reporting – What is it?

1. Additional Guidance from OMB

Establish business rules for certain governmentwide transactions between federal government entities

Require quarterly reconciliations of intragovernmental activity and balances beginning in fiscal year 2003.

2. Accelerated Reporting – What is it?

A. OMB's mandate:

November 15th, 2004 for FY 2004 audited financial statements

December 15th, 2004 for the Government wide financial statements

B. Treasury's mandate:

From October 2003 on, all reporting on 3rd work day instead of 5 days with no supplemental reporting.

FMS 224, FMS 1219, FMS 1220, SF 1218 & SF 1221

In 2003 …

OMB encouraged agencies to try to make the

Nov 15th deadline early. Result, 8 agencies

made it:

1. ED	2. EPA	3. DHHS
4. NSF	5. SSA	6. Treasury
7. USAID	8. VA	

In 2003 results cont'd…

10 CFO agencies issued their Financial Statements by 12/31/03.

5 remaining issued their financial statements by the end of January, 2004.

DHS issued its financial statements on February 13, 2004.

Auditor’s caution…

Agencies may not be able to produce Auditable financial statements by 11/15/04 unless the agencies make fundamental changes to improve a number of their financial management practices. For e.g.: Management controls to monitor established policies and procedures for conducting Financial analyses and reconciliations throughout the year

According to OMB:

“Accelerated reporting will finally allow adequate time to have the financial statements considered in the budget process, and in time for decision-makers to fully consider financial performance in the management of their program.”

Treasury's Solution – Closing Package

Beginning with fiscal year 2004 Treasury plans to implement a new system and procedures to prepare the consolidated financial statements

This system will directly link information from federal agencies' audited financial statements to amounts reported in the consolidated financial statements and facilitate the reconciliation of net position.

2. Recommended Solution

Improve Data Quality

Provide Timely data

Train and communicate with the right People

Improve existing Financial Systems and Processes

2a. Improve Data Quality

How? …Agencies could:

Perform periodic analyses and reconciliations of account balances

Certify monthly balances (for e.g.unliquidated obligation balances)

Communicate frequently with internal and external agencies (e.g. DOL, OPM as well as intra and inter governmental entities) that provide accounting data for the financial statements

Prepare a draft ‘pro forma’ report early in the process (Quarterly accruals & estimates)

2b. Provide timely Data

Areas to consider:

Record transactions more timely after they occur

Document workpapers on a monthly, quarterly and year-end activities

Analyze costs monthly, adjust accounts quarterly

Establish funds management policies, procedures and controls to avoid substantial obligating activity at end of fiscal year

Utilize estimates and accruals with auditor/IG concurrence on methodology

2c. Train the right People

Agency management should consider:

Ensure that there is full commitment and involvement by the key players

Effect a change in the mindset of the team members

Demonstrate its commitment to its dedicated staff – getting the right tools, skills and effective training

Emphasize the fact that the audit is an agency –wide and not a CFO only effort

2c. Communicate with the right People

Agencies may consider the following:

The CFO should have a strong working relationship with Treasury and the agency auditors

Top management should participate in frequent audit meetings

As a team the agency personnel must work quickly to identify and develop a plan to resolve critical issues (e.g. prior year MW and RC)

Management should meet regularly to inform team about the progress and outstanding issues

2d.Improve existing Financial Systems and Processes

Agencies will realize that faster and more

accurate numbers can only come from good

systems and processes. They should consider:

- Implementing system and process refinement as obstacles arise
- Improving the day-to-day financial processes by reengineering certain business processes

2d. (Cont'd) Improve existing Financial Systems and Processes

- Explore any existing tools that may expedite the reconciliation process
- Research best practices used by other agencies
- Get good help inside and outside to perform and analyze the reconciliations as well as prepare for auditor questions.

We looked at:

1. The Financial Reporting Challenge

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What the Problem?

2. Recommended Solution

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Conclusion

Reconciliations are Key to accurate financial reporting

Performing adequate and proper reconciliations can help agencies obtain and maintain clean audit opinions and meet accelerated reporting requirements

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