



Assessing financial statement preparation for local governments—2019

Measuring the effectiveness of the financial statement preparation process and internal controls

Each year QAO reports on the results of local government financial audits. This fact sheet outlines changes in how we will assess and measure councils on their 2018–19 financial statement preparation process and the effectiveness of their internal control measures. It also discusses matters that councils and audit teams should consider in the lead up to year end reporting to help them meet these measures.

We review our measures each year to determine their effectiveness in improving performance.

Preparing financial statements

We assess how effective each council's financial statement preparation process is every year. This assessment focuses on their ability to produce a **quality** set of financial statements in a **timely** manner.

Our key measures are how:

- quickly the financial statements are certified compared to the legislative reporting deadline of 31 October
- effectively a council identifies and corrects errors in the financial statements before providing the statements to the audit team
- successfully a council delivers on its agreed milestones for year end financial reporting processes.

What's new in 2019?

We have brought forward the milestone for an effective rating for timeliness. All other metrics remain the same as the prior year.

Financial statement preparation

In assessing the effectiveness of the financial statement preparation process we consider three components – the timeliness of financial statements, the quality of financial statements, and the year end close process.

We assess the timeliness of financial statements by comparing the date the independent auditor's report was issued against the legislative deadline of 31 October.

Fact sheet

Timeliness




Assessment	2018–19	2017–18
	On or before 14 October	On or before 16 October
	15 to 31 October, or meet approved ministerial extension	17 to 31 October, or meet approved ministerial extension
	After 31 October	After 31 October

We assess the quality of financial statements based on the materiality of the adjustments (including material prior period adjustments) made to figures and note disclosures between the first draft of the financial statements provided to audit and the version that is certified.

Adjustments are an indicator of how effective the council's review of the financial statements is at identifying and correcting material errors. When considering an adjustment to the financial statements, ask: is it material, will it significantly impact on the information needs of users of the financial statements, or are there laws, regulations or prescribed requirements that determine preciseness of the impacted disclosure.




If the response is no to all these questions, then no adjustment is required.

Quality of financial statements

Assessment	2018–19 (no change from 2017–18)
	No adjustments were required
	Immaterial adjustment to financial statements
	Material adjustments to financial statement components

Councils should have robust year end close processes to enhance the quality and timeliness of the financial reporting process. We assess the year end financial statements against the following targets.

Year end process

Assessment	2018–19 (no change since 2016–17)
	All key milestones achieved
	Three to four milestones achieved
	Less than three milestones achieved

Key milestones measured in year end processes:

- ✓ Final non-current asset valuations (expected by 30 April)
- ✓ Shell financial statements completed (expected by 30 April)
- ✓ Complex/contentious accounting issues resolved (expected by 31 May)
- ✓ Work-papers reviewed and available for audit
- ✓ Final draft financial statements completed

Assessing internal controls

Strong internal controls are key in minimising fraud and material errors in financial statements. Internal controls are an important part of ensuring that councils and their related entities comply with legislation and run efficient and effective operations.

We assess five elements of internal control using an internationally recognised framework.




Significant deficiency definition

- ✓ Deficiency in a **single** internal control, or combination of deficiencies, and
- ✓ Of **sufficient importance** to merit the attention of those charged with governance.
- ✓ Includes deficiencies that:
 - **may** lead to a material misstatement of the financial statements
 - represent a risk to reputation
 - **may** lead to financial loss, including fraud
 - management has not taken appropriate timely action to resolve
 - represent significant non-compliance with policies and applicable laws and regulations.

We have not changed the assessment criteria that measures the effectiveness of internal controls from those used in the prior year.

Effectiveness of internal controls

(assessed per element of internal control)

Assessment	2018–19 (no change from 2017–18)
	No significant deficiencies
	One significant deficiency
	More than one significant deficiency



What does this mean for councils?

- The 2018–19 financial statement deadlines have been brought forward.
- The quality of financial statements is based on the materiality of adjustments.
- Effective year end close processes are pivotal to timely audit clearance.
- Assessment criteria for the effectiveness of internal controls is based on the number of significant deficiencies identified per element of internal control.

This means that for a council to remain out of the 'red traffic light' zone, the onus is on working smarter and utilising resources in a more efficient and effective way. This will help councils achieve agreed milestones, and reduce the correction of errors and significant deficiencies reported at year end.

Those charged with governance (which includes management and councillors) should oversee the financial reporting process and the effectiveness of the internal control system. Some ways councils can do this in 2019 are listed below.

Communicate the new measure of timeliness

- Ensure the audit committee, chief executive officer, and senior management are aware of the changes.
- Filter the changes down to staff with key roles in the financial statement preparation process and internal control system.

Target signing of financial statements on or before 14 October 2019

- Councils should discuss and agree on the audit timetable and key milestones early in the planning process. Milestones need to be realistic and achievable, and bring forward work to relieve pressure on council staff after 30 June. Review the effectiveness of your month end processes.
- Has the chief executive officer confirmed the timetable and key milestones? How will you monitor and report internally on the achievement of key milestones throughout the audit? Do you need a detailed task plan or external assistance?
- Councils should reconfirm scheduled audit committee and council meeting dates. Do the meetings align with the key milestones? Is there adequate time for proper review and approval of the financial statements before the new timeframe?

Quality control process

- To improve the quality of the final draft financial statements provided to your auditors, councils should have internal quality control processes operating to review and challenge the information presented in the financial statements.
- Adjustments to financial statements require a level of rework by both councils and auditors resulting in increased costs.

Bring forward significant matters

- Prepare shell financial statements and obtain early feedback from your audit committee and audit team. Simplifying the financial statements by co-locating notes and removing immaterial information is a priority. Ensure comparatives are updated and new disclosures are included.
- Identify and address significant accounting matters that may impact the financial statements, such as asset revaluations and complex transactions. Brief and obtain clearance from your audit committee.
- Consider the status of prior year issues and the implication of new issues on your ability to meet milestones.
- Revisit the 2017–18 closing report issues and prioritise those that need to be resolved before year end, particularly significant deficiencies.
- Ensure that remediation plans for significant deficiencies or deficiencies are assigned to the right teams with a clear completion date. Senior management should monitor this closely on a regular basis.

Follow up

We routinely follow up on our previous audit findings and recommendations at the beginning of the next financial audit.

If we are concerned that appropriate remedial action has not been taken, we will advise the chief executive, audit committee and council of our concerns. Lack of genuine action by management to substantively address audit issues will affect our risk assessment and may mean we need to do more work.

Feedback

Feedback from our clients is important to us. We survey our clients and analyse their feedback to identify areas for improvement, and report on our own performance.





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T: (07) 3149 6000
E: qao@qao.qld.gov.au
W: qao.qld.gov.au
Lvl 13, 53 Albert Street, Brisbane Qld 4000

