Assessing financial statement preparation for state government entities 2019

Measuring the effectiveness of the financial statement preparation process

QAO is committed to improving the timeliness and quality of public sector financial statements. We measure timeliness and quality, and over time have seen improved and enhanced financial reporting practices across the sector.

Each year QAO reports on these measures in reports to parliament. This fact sheet outlines how we will assess and measure state government entities on their 2018–19 financial statement preparation process.

It also discusses areas of focus for entities and audit teams to improve financial statement preparation processes.

Preparing financial statements

We assess how effective each entity'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.

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.

What's new in 2019?

All metrics remain the same as the prior year.

This year, we are working with entities to bring forward the preparation and delivery of financial statement working papers, and to increase early close processes so entities can bring forward financial statement governance processes.

Progressive delivery of financial statement working papers will not impact on timing and quality ratings.

Timeliness of draft financial statements

To assess the timeliness of draft financial statements, we consider whether entities prepare financial statements according to the timetables agreed between management and QAO. This includes providing auditors with the first complete draft of the financial statements by the agreed date. A complete draft is one that management is ready to sign and does not expect any material errors or adjustments.

There may be earlier drafts that entities prepare and share with auditors that we may not use to measure the timeliness of draft financial statements.

The rating scale we use for timeliness

Rating	Timeliness of draft financial statements
● Timely	Acceptable draft financial statements received on or prior to the planned date
● Generally timely	Acceptable draft financial statements received within two days after the planned date
● Not timely	Acceptable draft financial statements received greater than two days after the planned date

Earlier delivery of supporting working papers

We encourage entities to progressively provide supporting working papers and early drafts of financial statements before the first complete draft of financial statements. This will support earlier clearance dates and allow more flexibility for final audit committee dates.

Earlier delivery to auditors will also give audit committees the flexibility to review and approve accounting positions and disclosures earlier.

- ✓ Don't wait until your entity has prepared a complete set of financial statements before providing working papers, specific notes and disclosures, and trial balances to auditors.
- ✓ Agree progressive delivery timetables with auditors.

Progressive delivery will <u>not</u> impact on QAO's rating for timeliness, which we will continue to base on the first complete set of financial statements.

Quality of draft financial statements

We assess the quality of financial statements in terms of adjustments the entity makes between the first complete draft of the financial statements and the final version we receive.

This includes adjustments to current year, prior year and other disclosures. This is an indicator of how effective management's review of the financial statements is at identifying and correcting material errors.

The rating scale we use for quality

Rating	Quality of draft financial statements
● No adjustments	No adjustments were required
● No significant adjustments	Immaterial adjustments to financial statements
● Significant adjustments	Material adjustments to financial statement components

Immaterial adjustments

We continue to encourage entities not to amend their financial statements for immaterial adjustments.

Making immaterial adjustments may impact on the overall timeliness and cost of the financial statement process and increase the risk of preparation errors.

When considering an adjustment to the financial statements, ask:

- is it quantitatively material?
- is it needed by the readers?
- are there laws, regulations or prescribed requirements that require your entity to change the disclosure?

✓ If the response is no to these questions, you are not required to make an adjustment.

Reporting identified errors to entities

We are required to record all corrected and uncorrected errors relating to the financial statements. We do this regardless of when the entity delivers the working papers to audit.

We report all errors we identify in our scoresheet, but only include adjustments made after the first complete draft of financial statements in the quality rating.

Our error reporting

We encourage entities to progressively provide supporting working papers before the first complete set of financial statements.

- ✓ We report all corrected errors to management and/or those charged with governance.
- ✓ We report all uncorrected errors to those charged with governance (for agreement that the uncorrected errors do not materially misstate the financial statements).
- ✓ We raise any errors we identify that may indicate that quality control mechanisms are not working with entities.

Progressive delivery will <u>not</u> impact on our rating for quality, which we will continue to base on the first complete set of financial statements

Common errors in financial statements

There are two areas that most commonly result in changes to the financial statements. These are:

- asset valuation, asset accounting and asset disclosures
- accounting for, and valuing, new transactions.

These errors indicate entities can improve year end close processes for these areas.

Entities can reduce errors through quality control processes before year end by:

- ✓ ensuring asset valuations are timely
- ✓ confirming asset valuation methodologies and models
- ✓ performing asset valuation outcome analysis with a clear understanding of why valuations have changed, and that the changes align with assumption and business changes
- ✓ engaging the audit committee on all material valuation methodologies and outcomes for their approval
- ✓ preparing timely position papers with accounting entries and proposed disclosure for management and audit committee review and approval.

Year end close process

A robust year end close process enhances the quality and timeliness of financial reporting.

There are five key elements for an effective year end close process:

1. Preparing pro-forma financial statements by 30 April
2. Resolving known accounting issues with us by 30 April
3. Completing non-current asset valuations by 31 May
4. Completing early close processes
5. Concluding all asset stocktakes by 30 June.

The rating scale we use for year end close processes

Rating	Year end close process
● Fully implemented	All key processes completed by the target date
● Partially implemented	Three key process completed within two weeks of the target date
● Not implemented	Two or less key processes completed within two weeks of the target date

Resolving known accounting issues

Identifying and resolving accounting issues by 30 April will support earlier delivery of financial statements.

Accounting issues usually include:

- material, complex or significant one-off transactions
- new accounting standards or changes in accounting policies
- past issues auditors have identified, including material misstatements and disclosure deficiencies.

Engaging with auditors early in the process provides a common understanding of the matter. It will help both parties to focus on the key issues, avoiding unnecessary rework and frustration.

Earlier resolution allows audit committees and those charged with governance time to consider the accounting position papers on these matters before 30 June.

For each accounting issue, prepare a position paper detailing the analysis.

Accounting issue position papers should:

- identify key issues—facts and circumstances
- consider more than the desired point of view, analysing the alternative approaches available under accounting standards
- refer to detailed requirements of accounting standards and other prescribed requirements, including relevant guidance material
- consider the actual application of the standards, including quantitative outcomes, such as journals, when the position is practically applied
- contain any required proposed disclosures.

Valuation of non-current assets

Completing the valuation of non-current assets early will support a balanced workload and earlier completion of financial statements.

Entities should perform valuations, provided they are not based on market volatile data, before 31 May. To bring future valuations forward towards 31 March (if appropriate), entities should start planning now.

A completed asset valuation should:

- identify assets or asset classes valued
- have an approved valuation methodology
- support all key inputs, assumptions and estimates
- analyse changes in inputs and assumptions (particularly for interim revaluations)
- contain a depreciation or amortisation methodology (including componentisation), assessment of useful lives and residual values
- be independently reviewed by management.

Better practice will include:

✓ updates to the asset register and general ledger

✓ proposed disclosures.

Early close processes

Nearly all public sector entities plan early close processes. We encourage entities to continue to identify additional financial reporting information they could prepare before 30 June.

Each entity will have different early close processes. Auditors and entities should work together to identify suitable areas and timing specific to each entity.

Identifying areas suitable for early close

✓ Review the processes for monthly management reporting, as they will highlight predictable balances.

✓ Perform all asset valuations not dependent on volatile market data.

✓ Prepare calculations and disclosures for new transactions while assessing and approving accounting.

✓ Review last year's financial statements and identify disclosure notes that can be accurately calculated (such as key management personnel, budget to actual, and estimates and judgements).

If entities perform early close processes with precision and support them with working papers, and the balance has moved within analytical expectations, we will not reperform audit testing after year end.

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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

Queensland Audit Office

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