



Audit Committee
President's Council on Integrity and Efficiency

Best Practices Guide:

Coordinating the
Preparation and Audit of
Federal Financial Statements

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Audit Committee

President's Council on Integrity and Efficiency



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Message from the Chair

On behalf of my colleagues on the PCIE Audit Committee, I am pleased to present the Committee's *Best Practices Guide: Coordinating the Preparation and Audit of Federal Financial Statements*.

The 10th anniversary of the Chief Financial Officers Act is an appropriate milestone for agencies to take stock of their efforts to enhance financial management. This includes an assessment of the respective roles, responsibilities, and effectiveness of agency Inspectors General and Chief Financial Officers, and an analysis of the communication between these organizations.

The Inspector General community supports the fundamental proposition that effective relationships are built upon clear expectations defined early and often, continuous communication and a shared commitment to improving agency financial management and accountability. The objective of the *Best Practices Guide* is to continue to foster and refine constructive working relationships between agency Chief Financial Officers and Inspectors General, in the financial statement preparation and auditing processes.

Gregory H. Friedman
Chair, PCIE Audit Committee
Inspector General
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Best Practices Guide: Coordinating the Preparation and Audit of Federal Financial Statements

Objective

The objective of this Best Practices Guide is to foster constructive and professional working relationships between agency Chief Financial Officers (CFO) and Inspectors General (IG) in the financial statement preparation and auditing process. Fundamental propositions that underlie the guide are the need for clear expectations defined early and often, continuous communication, no surprises, and a shared commitment to improving agency financial management.

Shared Goals

Consistent with the purposes of the Inspector General Act of 1978 and the Chief Financial Officers Act of 1990, the IG and CFO communities have the shared goals of providing for (1) improvement of systems of accounting, financial management, and internal controls, and (2) the production of complete, reliable, timely, and consistent financial information. Both communities can contribute to these goals within the constraints of their differing statutory responsibilities and missions.

Background

The overall objective of the financial statement audit is to determine whether the financial statements are free of material misstatement. The financial statements are the responsibility of the agency's management, notably the CFO. The IG's responsibility is to ensure that an audit is conducted for the purpose of expressing an opinion on the financial statements.

An agency's management is responsible for: preparing the annual financial statements in conformity with generally accepted accounting principles; establishing, maintaining, and assessing the internal controls that provide reasonable, but not absolute, assurance that the broad control objectives of Office of Management and Budget (OMB) Bulletin No. 01-02, or its successors, are met; and complying with applicable laws and regulations.

The IG's responsibilities are to: express an opinion on the agency's principal financial statements in accordance with applicable audit standards; obtain reasonable assurance about the effectiveness of internal controls, based upon the internal control objectives in OMB Bulletin No. 01-02, or its successors; and test the agency's compliance with selected provisions of laws and regulations that could materially affect the principal financial statements.

Best Practices

The following best practices have been delineated to foster effective working relationships between the CFO and IG communities. These are based upon the experiences of various agencies in effectively and efficiently addressing the requirements of the Government Management Reform Act (GMRA). While every best practice may not be applicable to each agency, they attempt to give substance to the shared goals and objectives of this document.

Planning Meetings

Planning meetings begin the communication process that should occur throughout the audit. Among other things, this provides the participants the opportunity to explore options for addressing potential problems and implementing lessons learned from the prior year's audit.

- CFO and IG staff members participate in annual financial statement planning meetings.
- These meetings include both headquarters and field representatives, as appropriate, as well as contract auditors.
- Planning meetings should include the status of prior year significant audit findings and the potential effect on the required audit reports of unresolved internal control and accounting issues.
- Draft milestones should be discussed and agreement reached for a date by which to finalize them.

The Implementation Schedule

Detailed milestones provide a blueprint for the timely preparation and audit of financial statements and underlying documentation. They outline the IG's and CFO's common understanding and commitment to the effort, and provide accountability by which to measure progress.

- The agency CFO and IG jointly agree to a schedule of deliverables.
- Key milestones are established in writing, including the timely submission of complete financial statements by the CFO, management and legal representation letters by appropriate agency management, and draft and final audit reports by the IG.
- Adequate time is built into the schedule for:
 - ✓ periodic briefings;
 - ✓ agency involvement, as appropriate;
 - ✓ consultations with the General Accounting Office (GAO) and OMB, as appropriate;
 - ✓ review and comment on draft audit reports; and
 - ✓ transmission of the financial statement package to OMB by March 1.

- The CFO identifies key agency contacts or liaisons responsible for each area presented on the financial statements and for the required supplemental information.

Discussions of New Standards and Policy

Discussions between the auditors and agency representatives about emerging accounting issues can help establish realistic expectations about the impact of new standards on the preparation and audit of financial statements.

- The CFO seeks input from the IG on management's plans to implement new accounting standards.
- The IG provides input on accounting policy guidance pertaining to the implementation of the governing statutes.
- The GAO and OMB are also consulted, as appropriate, to ensure consistency of approach government-wide.

Regular Progress Meetings

Regular progress meetings should be a part of the continuing communication process during the preparation and audit of financial statements. While not intended to be an end in themselves, used appropriately, they can convey important information, provide opportunity for feedback, facilitate reaching agreements, and eliminate surprises.

- In addition to the entrance and exit conferences, IG and CFO personnel hold regular progress meetings at both the field and/or headquarters level, as appropriate.
- These meetings become more frequent as the financial statements are prepared and the audit draws to conclusion.
- At the earliest possible moment, IG personnel, CFO personnel or other agency management, as applicable, alert each other to any potential issues or known obstacles that could affect the audit opinion or the March 1 reporting deadline. This includes potential reportable conditions discovered by the audit and known problems with the financial statement balances.
- The best approach is one with no surprises.

Findings and Audit Adjustments

Auditors should seek concurrence from the appropriate levels of management with the facts and circumstances surrounding internal control findings, compliance issues, and audit adjustments. This should be done in a timely manner with the goal of expediting the reporting process at the end of the audit.

- During the course of the audit, and after appropriate discussion with agency personnel responsible for the area under audit, proposed audit findings and adjustments are formally issued to program office and accounting personnel.
- A written response to these proposals is requested.

- Copies of the audit findings and adjustments are also provided to the Headquarters CFO and IG offices.
- The findings and adjustments provide the basis for issues discussed in the internal control and compliance reports and the management letter.

Interim Financial Statements and Audit Procedures

Experience with the preparation and audit of financial statements has proven the value of preparing interim financial statements and performing interim audit procedures. These efforts contribute significantly to the timely completion of the preparation and audit processes by facilitating the early identification of potential problems and reducing the effect of yearend workloads.

- Interim test work should be performed whenever possible. Identified issues should be brought to the attention of agency management representatives.
- Interim financial statements should be prepared to facilitate the agency's early analysis of account balances and identification of systemic issues that may be affecting financial statement balances. Issues should be brought to the attention of the auditors as soon as they are identified.

Contract Audit Oversight

IG's using contractors must ensure that the key aspects of the best practices are included in the contractor's audit planning and methodology.

- IG personnel should be actively involved in managing the financial statement audit even when the work is done by a contractor. A senior IG auditor should be designated as the IG official point of contact and should facilitate an effective and professional relationship between contract auditors and agency representatives by requiring the contract auditors to implement the key concepts of this guide.
- The IG should ensure that the appropriate contractor and agency personnel meet when there have been changes in key personnel.
- The IG should issue headquarters and field notification letters, and host the entrance and exit conferences, as appropriate.
- The IG and contractor should arrange for the review and dissemination of contractor developed audit findings and proposed adjustments to CFO personnel.
- IG personnel should ensure that communications between contract auditors and agency officials are open and continuous, and that issues are addressed in a timely manner.
- IG personnel should review the contractor's working papers to ensure compliance with Government Auditing Standards and the specific requirements of the contract.

Final Financial Statements, Accountability Reports, Transmittal Letters, Legal Representation Letters, and Management Representation Letters

The final audit package and representation letters typically require high-level management approval and are some of the last documents to be reviewed by the auditors. Timely preparation and approval of final versions of these documents is key to avoiding surprises and delays late in the audit process.

- Management representatives should obtain final agency head approval of Management's Discussion and Analysis (MD&A), transmittal letters, other required information such as performance indicators, and management representation letters, as early as possible to avoid surprises and delays in final audit reporting.
- Management representatives and the auditors should work together to ensure final audit adjustments are provided to management and posted to the financial statements as soon as possible to avoid delays in issuing draft audit reports.
- Before the end of fieldwork, management representatives should re-familiarize the agency head with the prior year management representations and alert him or her to any anticipated changes for the current audit. Auditors should provide management with drafts of the required representation letters as early as possible to ensure timely receipt of the final signed letters.
- Requests for legal representation letters should include effective dates that satisfy the auditors as well as the requirements of OMB Bulletin No. 01-02, or its successors, related to the audit of the government-wide financial statements.
- Final agency head approval of MD&A, performance measures and other information in the accountability report should be obtained by management representatives early enough to allow final review by the auditors prior to distribution of draft audit reports.
- Signed representation letters should be provided to the auditors prior to the date for delivery of final audit reports. Any suggested changes to the auditors' required representations must be discussed early with the auditors to avoid surprises.
- Final CFO letters introducing the accountability report should be approved by management shortly after a determination is made by the auditors of the type of opinion to be rendered.

Reporting

Close communication and coordination during the reporting process is key to achieving a successful conclusion to the audit. Sufficient time should be allowed for the appropriate persons to review and respond to the reports, and for the auditors to incorporate comments.

- Key milestone schedules shall include details for the delivery, review, and revision of draft and final audit reports and the management letter.

- In the case of contracted audits, sufficient time shall be allowed for the IG to review the reports prior to their release to the agency to ensure IG concerns are addressed early.

Lessons Learned

The key to improving the preparation and audit process is to make improvements each year. Planning the current year's activities based upon lessons learned from the past will help ensure the IG's and CFO's efforts are effective and efficient.

- Following completion of the audit, representatives from the CFO and IG should hold a "lessons learned" meeting to discuss how coordination may be further improved and to highlight challenges for the next audit cycle.
- The IGs and CFOs sponsor joint workshops on Best Practices.

Conclusion

By working together on implementing these best practices, the IG and CFO communities can and should foster an environment that supports the purposes and objectives of the CFO Act and GMRA.