Closing the Books

Canberra   ACT
27 June 2003

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a business support process audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Closing the Books.*

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Oliver Winder
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra   ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Summary

Background

1. *Closing the books* processes—sometimes referred to as 'month-end or year-end processing'—are those processes undertaken by organisations in order to generate periodic financial information. These processes are used in the production of the organisation's annual financial statements (commonly referred to as *hard* closes) and also on a periodic basis, usually monthly, at times throughout the financial year, in order to provide an organisation's managers and governing body with key financial information for internal use (commonly referred to as *soft* closes)[1].

2. Organisations classified by the Department of Finance and Administration (Finance) as 'material'[2], are required to submit detailed estimates and monthly financial statements. There is an established timetable and framework for this reporting. The information is consolidated and published by Finance as soon as possible after each month-end. This information is provided to the Australian Bureau of Statistics for inclusion in the Australian National Accounts on a quarterly basis.

3. Managers in Commonwealth organisations continue to face challenges and changes to the financial and reporting environment. In the late 1990s, organisations adapted to the output/outcomes management framework as well as accrual-based budgeting and reporting. During 2003, the reporting timetable for material organisations has been shortened by four days each month as part of a continuous improvement process in whole of government financial reporting. Organisations are now required to submit key monthly financial data by the 10th day of each month.

Audit objectives and focus

4. This audit focused on the monthly *closing the books* processes undertaken at six of the material Commonwealth organisations, in order to provide some generic conclusions on the operation and effectiveness of these periodic processes in the Commonwealth and to identify opportunities for improvement.

5. The specific objectives for this audit were to determine whether organisations:

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[1] The ANAO's Better Practice Guide *Building Better Financial Management Support* (1999) provides additional discussion. Refer to p. 53.

[2] Material organisations are the group of Commonwealth organisations whose total expenditure constitutes 99 per cent of total expenses of the Commonwealth.

- have implemented adequate control frameworks and processes to mitigate the risks associated with *closing the books* obligations. These control frameworks contribute to the accuracy, completeness and timeliness of data and reporting;

- have implemented risk management strategies for *closing the books* processes, including the rigorous application of materiality[3] concepts;

- plan for the improvement of month-end processes to foster timely, efficient and effective close processes;

- have considered balancing the *closing the books* workload so that, where possible, activities are not all scheduled for month-end; and

- ensure there is consistency between the processes undertaken in each period to produce management reporting. The use of standard procedures, that are effectively followed, implies simplification, lower costs and greater accuracy.

Audit conclusion

6.   *Closing the books* is a standard financial process that should be routine and performed well. The audit found that all organisations had implemented adequate control frameworks and processes to mitigate the risks associated with closing their books, although there is a need to improve the quality of basic activities such as month-end reconciliations in half of the organisations.

7.   Organisations continue to experience changes in the reporting environment as well as challenges in attracting and retaining appropriately qualified and experienced staff in their *Closing the Books Teams*.[4] All organisations are encouraged to ensure that procedures are complete and documented to a high standard to provide adequate guidance to staff in such an environment.

8.   While there was evidence of an encouraging number of better practices across the organisations, some still faced challenges because systems are not integrated and most could improve the *closing the books* processes through the application of materiality in considering accruals and adjustments.

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[3]   Materiality is used in an accounting context in accordance with the definition in Australian Accounting Standard 5. Information is material if its omission, misstatement or non-disclosure has the potential to adversely affect:

(a) decisions about the allocation of scarce resources made by users of the financial report; or

(b) the discharge of accountability by the management or governing body of the entity.

[4]   The term *Closing the Books Teams* is used in this report to describe the staff responsible for *closing the books* and management reporting in the organisation.

9.   The organisations that participated in this audit have been part of the group already reporting financial performance to Finance on a monthly basis. These organisations have met the challenge of the tightened reporting timeline. Other organisations that commence monthly reporting in August 2003 will need to ensure they have robust frameworks, and should heed the experiences of these organisations. Chapter 2, in addition to reporting some of the issues faced by organisations in the audit, also sets out better practices to assist other Commonwealth organisations.

Key Findings

Framework

10. Most organisations had established control frameworks that properly supported month-end close processes, including detailed procedures, and the employment of qualified and experienced staff. Generally, organisations had established month-end processes that are similar to year-end processes in order to meet its internal and external reporting requirements.

11. The core Financial Management Information System (FMIS) at all organisations provided satisfactory systems support for month-end processing. In most organisations, operational managers had access to system data and reporting that enables the ongoing monitoring of programs and other activities. Most of the organisations run operational activities on separate applications or systems. In these cases, robust reconciliation and checking procedures are required to ensure the completeness of financial data transfer from other systems to the FMIS.

12. Three of the organisations needed to improve the way in which month-end procedures were designed. Opportunities for improvement included expanding procedures and checklists, as well as facilitating and encouraging the participation of operating units[5] in month-end processes, so that they, rather than the *Closing the Books Team*, can own and be accountable for reported financial information.

13. Several organisations can improve the efficiency of month-end processing by formally establishing and applying materiality.

Quality

14. The audit found very high quality processes at three of the organisations, with opportunities for improvement at the others. On several occasions reconciliations had not been completed as intended. Some organisations also needed to improve the way that financial information was captured and processed, so that complete accrual reporting can be produced.

15. Quality could also be enhanced in some organisations by allocating more time in the month-end cycle for review and analysis of draft financial information prior to producing reporting. Improved planning and workload balancing could also contribute to making time available for review.

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[5] The term operating unit is used in this report to describe various work groups, which may be known as sections, branches, divisions, or business units.

Effective Reporting

16.   Most organisations produce effective reports designed to meet user requirements. Often, reports include a high level of analysis, graphs, ratios and the presentation of key data. Two organisations needed to ensure reporting to Finance is checked properly and authorised prior to submission. Reporting deadlines are almost always met.

Continuous Improvement

17.   All of the six organisations had taken initiatives to ensure on-going improvement to the quality and efficiency of the *closing the books* process. However, some organisations did not action ANAO financial statement management letter points relating to *closing the books* matters on a timely basis. All could use performance measurement techniques as a tool to improve processes. All organisations are encouraged to continuously reassess their capacity to efficiently and effectively meet requirements, because of the evolving Commonwealth financial reporting framework, as well as the need to deal with operating complexity in today's environment.

Recommendations

The nature of the issues raised in this report are considered to have general applicability across the Commonwealth Public Sector. Accordingly, the following recommendations should be addressed by all Commonwealth organisations in the context of improving their closing the books processes.

Organisations should assess the benefits of implementing each recommendation in light of their own circumstances, including the extent to which each recommendation, or part thereof, may already have been adopted.

Materiality

Recommendation No.1 Para. 2.49 The ANAO *recommends* that organisations consider applying the materiality concept to month-end processing. Materiality levels should be clearly defined and documented in procedures according to their specific requirements.

Ownership and accountability for financial information

Recommendation No.2 Para. 2.50 The ANAO *recommends* that operating units be more extensively included in month-end processing to improve the quality of the financial information.

Documentation of procedures to make organisations more resilient to staff turnover

Recommendation No.3 Para. 2.51 The ANAO *recommends* that organisations ensure their procedural frameworks are complete, user friendly and up-to-date.

Reconciliations

Recommendation No.4 Para. 2.80 The ANAO *recommends* that organisations ensure their reconciliations are identified in a timetable; are performed thoroughly on a timely basis; and are subject to rigorous checking to improve the quality of month-end processes and reporting.

Authorisation

Recommendation No.5 Para. 2.97	The ANAO *recommends* that a senior member of the *Closing the Books Team* checks and authorises data before it is submitted to Finance to provide assurance that reports are accurate and authorised.

18. The organisations participating in the audit accepted the findings in relation to their particular organisation, and agreed with the overall recommendations made in this report.

Audit Findings and Conclusions

1. Introduction

The Environment

1.1   Managers at Commonwealth organisations continue to face challenges and changes to the financial and reporting environment. In the late 1990s, organisations adapted to the output/outcomes management framework as well as accrual-based budgeting and reporting. During 2003, the reporting timetable for material organisations has been shortened by four days each month, as part of a continuous improvement process in whole of government financial reporting. Organisations are now required to submit key monthly financial data by the 10th day of each month. Other Commonwealth organisations will be required to commence reporting to Finance on a monthly basis as from August 2003. These changes have been made in response to revised government requirements, following the Budget Estimates and Framework Review.

1.2   Forthcoming changes to the appropriation draw down procedures will also increase the need for organisations to have a robust understanding of their financial operations, particularly the timing of receipts and disbursements.

A Key Financial Management Process

1.3   Effective *closing the books* processes are required to facilitate the periodic generation of financial reporting. These processes can make a valuable contribution to the attainment of an organisation's objectives by:

*   providing high-quality financial information which is relevant, reliable and comparable;

*   supporting both internal and external decision-making processes; and

*   reducing *closing the books* cycle times, so that information is available on a timely basis, as well as enabling the redirection of finance resources to other tasks.

Scope of the audit

1.4   The audit included *closing the books* processes related to the reporting of 'Departmental'[6] and 'Administered'[7] revenue, expenses, assets, and liabilities.

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[6]   'Departmental' refers to those revenues, expenses, assets, and liabilities that are controlled by the organisation.

[7]   'Administered' refers to those revenues, expenses, assets and liabilities that are managed or oversighted by the organisation on behalf of the Government.

1.5   The audit focused on *closing the books* processes undertaken between October 2002 and January 2003 in six Commonwealth organisations.

1.6   Detailed fieldwork was undertaken according to the following phases:

- understanding processes at each organisation, including matters of structure, people, process and technology; and

- identification and testing of the design and operation of existing controls.

Audit objectives and approach

1.7   The audit evaluated *closing the books* processes against a framework for effective control developed for use in this audit. This framework, based on the principles from the ANAO's Better Practice Guide *Building a Better Financial Framework* (1999), was divided into the following broad components.

- Framework—the organisation has established a control environment that provides a framework for effective and efficient *closing the books* processes.

- Quality—the organisation has implemented standard and rigorous procedures, ensuring that *closing the books* activities are complete and accurate, as well as accurately reflecting business reality. These procedures include authorisation, checking, segregation of duties and the maintenance of an audit trail.

- Effective reporting—monthly reporting meets user requirements in terms of its usefulness, relevance and availability.

- Continuous improvement—the organisation actively seeks opportunities for continuously improving its *closing the books* processes.

Audit criteria

1.8   A series of evaluation criteria was developed, based on the ANAO's Better Practice Guide *Building Better Financial Management Support* (1999) and other research. Policies and procedures were rated against the evaluation criteria using a four point scale ranging from 'Poor', where no aspects of the evaluation criteria were met, through to 'Very Good', where all criteria were met.

1.9   Details of the evaluation criteria used in the audit, are set out in Table 1 below.

Table 1

Audit evaluation criteria

A. Framework The organisation has established a control environment that provides a framework for effective and efficient closing the books processes.
Policy: The organisation has a clearly defined strategy for month-end close processes that is aligned and supports the organisation's financial reporting objectives.
Procedures: Appropriate and complete *closing the books* procedures are documented and communicated to managers and staff.
People: Personnel are appropriately experienced, trained, and qualified.
Structure: The structure for managing *closing the books* is defined and provides for efficient processing, accountability, and adequate segregation of duties.
Information Systems: Information systems functionality provides a clear framework for financial recording and enables effective and efficient *closing the books* processes.
B. Quality The organisation has implemented standard and rigorous procedures that are monitored, ensuring that *closing the books* activities are complete and accurate as well as accurately reflecting business reality. These procedures will include authorisation, checking, segregation of duties, and the maintenance of an audit trail.
Planning: The organisation has plans that address issues that may affect the completeness, quality, and accuracy of *closing the books* processing and outputs.
Adjustments and journal entries: The organisation's approach adequately reflects the operating environment, and is efficient.
Reconciliations: Reconciliations are performed thoroughly as intended, and are subject to checking.
Review of Trial Balance: Senior staff are able to review preliminary results prior to the production of reporting.
Generating reports: Processes are efficient and outputs are subject to checking to ensure reports are accurate.
C. Effective financial reporting Monthly reporting meets user requirements in terms of its usefulness, relevance and availability.
Internal Management Reporting: Internal management reporting meets user requirements, and is timely.
Finance[8] Reporting: Reporting to Finance as required by the Government.
D. Continuous improvement The organisation takes a proactive approach to continuously improving its closing processes.

Performance information

1.10   Planning for this audit commenced in November 2002 with research into *closing the books* processes and the development of the audit program.

1.11   As well as preparing this report on the overall results of the audit, the ANAO provided each of the participating organisations with a comprehensive

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[8]   In this report Finance is used to refer to the Department of Finance and Administration.

briefing, including an assessment of their performance against the evaluation criteria and recommendations for improvement, where necessary. The organisations have responded positively to the findings and recommendations presented to them and where appropriate, advised of remedial action taken or proposed.

1.12   The total cost of the audit was $292 500.

2. Audit Findings

Introduction

2.1 This chapter discusses the audit findings and recommendations under the following four headings:

- Framework;

- Quality;

- Effective Reporting; and

- Continuous Improvement.

2.2 Together these four areas constitute the central elements of effective *closing the books* processes. The audit results are presented in two categories—audit findings from detailed fieldwork, and examples of better practices identified during the audit.

2.3 The audit findings from the fieldwork are largely process issues that affect the efficiency and effectiveness of the organisation's month-end processes. The better practice observations relate to business processes identified in the organisations audited, which, if adopted, could strengthen *closing the books* processes of other organisations and lead to improved effectiveness and efficiency.

Part A—Framework

Introduction

2.4 The basis of efficient and effective *closing the books* processes is the framework, or control environment, that supports all month-end processing activities. Complete frameworks are a combination of the following elements:

- *Policy*: the organisation will have defined its approach to month-end processing. This will be based on a consideration of the information needs of the users of financial information produced as the output of the process. For the audited organisations, this means that both government and internal management reporting requirements drive the approach to *closing the books* at month-end, principally the level of accuracy required. To meet these requirements, the organisation may undertake *hard* or *soft* closes, as well as using a level of materiality to limit the number of adjustments and investigations undertaken. All organisations should consider how the application of materiality might be useful in improving the efficiency of processing.

- *Procedures*: clearly documented month-end procedures provide guidance for those undertaking and managing month-end processes. In this context, procedures include Chief Executive's Instructions, financial and administrative procedures, Financial Management Information System (FMIS) manuals, checklists and templates. To be effective, these must be kept up-to-date and staff must know how to access them.

- *People*: experienced and qualified personnel who have received adequate training to properly undertake their tasks are essential to effective month-end processing.

- *Structure*: month-end activities have been organised and structured in a way that is efficient and encourages on-going communication and sharing of accountability between the *Closing the Books Team* and operating units. Usually, processing and reporting activity will be centralised in the organisation's *Closing the Books Team*, but key inputs will be required from business units.

- *Information systems*: the organisation has confidence in the information produced at month-end because the FMIS provides a clear framework for financial recording. System functionality supports processing and information needs.

Summary of audit findings

2.5   Three of the organisations had established very good frameworks for month-end processing, meaning that there was evidence of all of the elements described above. The other three organisations had less complete control frameworks because of gaps in their procedures. There were also opportunities to improve month-end processes by applying materiality to limit the capture of data, and by increasing the involvement of operating units.

2.6   Details of the evaluation criteria used in the Framework part of the audit, are set out in Table 2 below.

Table 2

Framework—findings and better practices against audit evaluation criteria

Principle
The organisation has established a control environment that provides a framework for effective and efficient *closing the books* processes.
Evaluation criteria
Policy: The organisation has a clearly defined strategy for month-end close processes that is aligned and supports the organisation's financial reporting objectives.
Procedures: Appropriate and complete procedures for *closing the books* are documented and communicated to managers and staff.
People: Personnel are appropriately experienced, trained, and qualified.
Structure: The structure for managing *closing the books* is defined and provides for efficient processing, accountability, and adequate segregation of duties.
Information Systems: Information systems functionality provides a clear framework for financial recording and enables effective and efficient *closing the books* processes.
Audit findings
Of the six organisations reviewed, the audit found:
• Five of the organisations undertook month-end processes that were very similar to year-end.
• Only one organisation had defined and applied materiality levels for month-end processing.
• Three of the organisations could improve, or update, their month-end procedures by including elements such as timetables, checklists, and detailed guidance on specific areas.
• Several of the organisations were experiencing turnover in *Closing the Books Team* staff.
• Five of the organisations recorded operating activities and transactions on information systems and applications that were not interfaced with their General Ledger systems.
Better practices
The following better practices were noted during the audit:
• A standard materiality level was agreed and rigorously applied to all elements of month-end processing (for example, adjustments made and reconciling items investigated).
• Detailed month-end timetables, including all activities, responsibilities and timelines.
• Clear, easy to follow instructions were included in procedures for a range of activities for consulting (for example, how to process individual journal entries for administered transactions or how to record accrued revenue.)
• Standard templates were used consistently for all activities of the same type (for example, all reconciliations were completed on the same template).
• Individual position descriptions were documented and clearly included responsibilities/ tasks and accountabilities.
• Staff received training in *closing the books* processes.
• An accreditation program was developed to raise skills in operating units in accrual accounting so they could properly raise adjustments.

Detailed findings and analysis

Hard and soft closing the books

2.7 The starting point for designing month-end closing processes is the identification of the needs of the users of the financial information that is the output of the process. For Commonwealth organisations required to report to Finance on a monthly basis, this means that there are several reporting needs to be satisfied:

- external reporting requirements, as defined by the Government;

- internal management reporting requirements, necessary for the organisation's managers to have adequate information to properly run their operating units; and

- the information needs of senior management or the Board to support decisions on the direction or strategy of the organisation.

2.8 These factors influence the requirements for outputs of the process as well as how the process is to be designed. For example, the level of required accuracy will affect whether estimates and materiality levels can be used. Reporting timelines will also be significant in determining the steps of each stage of the process and what time might be available for specific tasks.

2.9 While the audit found an acceptable level of variation in how month-end processes are designed, most organisations undertook processes that were more characteristic of *hard*, rather than *soft closing the books* processes; and so for most of the organisations, month-end processing was very similar to year-end.

2.10 The ability to undertake the same closing routine at the end of each period (each month, each quarter, during the interim audit or at year-end) fosters consistency in process. This ensures that *Closing the Books Teams* and line managers become increasingly familiar with *closing the books* procedures, developing skills and familiarity with requirements, benefiting both month and year-end quality and efficiency. It also means that emerging financial issues, including any accounting and auditing issues, will be identified on a timely basis. These can be actioned on a timely basis and this expedites the year-end process. However, it clearly makes sense to limit monthly activities, in the name of efficiency, providing the accuracy requirements of reporting are met.

2.11 Examples of ways in which the traditional *hard closing the books* process was modified at the audited organisations included:

- one organisation used materiality levels to limit reconciling items being investigated, accruals made and transactions (invoices to be paid and invoices to be billed) entered prior to month-end deadlines. The materiality

levels were higher than that required for year-end processes. Some reconciliations were not completed each month but on a quarterly basis;

• at another organisation, estimates were used for some adjustments and journal entries, and a materiality level was applied to prepayments; and

• the main difference between year-end and month-end processes at another organisation was the number of reconciliations undertaken and a requirement for operating division directors to sign-off on a reporting pack at year-end. For normal month-end, operating units provided comments on variances only.

2.12 The principal driver of another organisation's approach to month-end processing was a perceived need to improve year-end *hard* close processing, because of problems encountered at the end of 2001–2002. *Closing the books* processes for February 2003 and April 2003 were treated as rehearsals for year-end using a *hard* close approach, including operating unit sign-off on reporting packs, as well as additional review of data such as accruals and trial balance information.

2.13 Only one of those organisations included in the audit did not undertake a practice run for year-end in April 2003. At this organisation, the significant differences between year-end and month-end processes make it impracticable to carry out the *hard* close approach more than once a year. On a normal monthly basis, processing activity is almost entirely limited to the *Closing the Books Team*. There is limited input or accountability of the operating units into the normal reporting process—this is only required at year-end. This organisation did not close its books at the end of July 2002, which is not considered good practice, because staff were too busy dealing with the end of the previous financial year's results. In 2003, the organisation has implemented a number of initiatives that should assist in the year-end close, as well as starting to consider how operating units could be more involved to improve month-end processing.

Applying materiality to month-end practices

2.14 Materiality is a relatively simple and straightforward concept that can be applied by organisations to limit the extent of month-end closing activities.

> Achieving greater accuracy or greater precision in month-end processing and reporting, will generally require greater use of resources, higher costs and a longer elapsed time. There is a trade off between accuracy and cost. Materiality is a concept which, when applied to financial information, relates the cost of improving the accuracy of this information to the requirements of the users[9].

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[9] ANAO Better Practice Guide *Building a Better Financial Management Framework* (1999).

For example, a $10 000 materiality limit might be applied to the following month-end activities:

Month-end activity	Example
Operating units to advise the transaction processing staff of all prepayment adjustments.	Only calculate and capture prepayments greater than $10 000.
Financial Reporting Team to complete reconciliations.	Only investigate and clear reconciling items greater than $10 000 (analyse the variances before starting the reconciliations).

2.15 Finance has not stated a prescriptive requirement for the application of materiality at month-end. Organisations can therefore choose a level of materiality based on the accuracy and information needs of their managers and executive group.

2.16 Most of the organisations in this audit did not apply materiality to month-end processing. Only one organisation had defined the level of materiality to apply to month-end procedures and rigorously applied this across a range of activities—for example, invoices to be captured in the information system before a certain date, adjustments to be recorded and reconciling items to be investigated. The Chief Finance Officer (CFO) advised that the application of materiality was a relatively new development and one which was appropriate at this stage in the evolution of the process. The CFO had a high level of confidence in the quality of processing activities. Materiality was then applied to improve processing efficiency.

2.17 Two of the organisations had considered and rejected the use of materiality at month-end.

- In one of these organisations, user requirements at the detailed project level demanded a high level of accuracy. This meant that even relatively small inaccuracies were significant on an ongoing basis and the organisation had considered but was unwilling to limit activity.

- For the other organisation (one of the smaller organisations included in the audit), month-end processing was seen as so routine and straightforward that there was no perceived benefit in limiting activity by using materiality. However, this organisation was about to expand the application of its FMIS across a wider commercial operating area, and the CFO recognised that this might create time pressures in meeting government reporting deadlines. The CFO planned to consider using materiality if it was likely the Government's reporting deadline could not be met under the current procedures.

2.18   The ANAO considers that the other audited organisations would benefit from considering the application of materiality. Audit findings in these organisations included:

- one organisation used a materiality level to limit prepayment adjustments, but would benefit from its wider application, as well as documenting its application in procedures; and

- another organisation considered that materiality was not appropriate, when the real issue was the quality of adjustments and the ability of the operating units to provide quality accrual information. The CFO intended to progress further along the accuracy continuum before materiality could be introduced. However, the audit noted that different operating units of this organisation were applying different levels of materiality to their parts of the month-end process—one unit used $5000 and another used $500. Documenting the overall materiality level in procedures would help improve consistency.

2.19   Finally, one of the organisations used the concept of materiality to support its approach to dealing with 'Administered' and 'Departmental' transactions at each month-end. At this organisation, because 'Administered' transactions were so significant in dollar value, month-end activity was almost wholly focused on adjustments to these transaction streams, with very limited activity related to 'Departmental' close processes and adjustments. In such a case, an organisation might consider separately the information needs of the users of both 'Departmental' and 'Administered' information and conclude that two different materiality levels might apply—a higher one for 'Administered' and a lower one for 'Departmental' transactions.

Structuring roles and responsibilities

2.20   The audit found significant differences in the way in which the roles and responsibilities of *Closing the Books Teams* and operating areas are shared in performing month-end activities. Although the way in which an effective process may be organised varies, all organisations need to ensure that *closing the books* processes encourage and support operating unit involvement and subsequent ownership of the financial results.

2.21   The ANAO supports the underlying principle that reporting is an organisation-wide responsibility. Operating units must own their data and financial performance. While the *Closing the Books Team* leads and owns the process—setting the timetable, performing checks and reconciliations, and consolidating and distributing information, the information itself belongs to the operating units. Operating unit involvement might typically include the

contribution of accrual data, review of trial balance data, analysis of variances, contributing commentary, as well as taking ownership of financials by some form of sign-off. The greater the involvement of the operating areas, the more likely it is that reporting will capture the organisation's operating reality and that reports will be meaningful.

2.22 Two of the organisations in this audit had addressed this issue by placing qualified and experienced finance staff directly in operating units. These staff members had a reporting line into the central finance area, but were sufficiently close to the operating units to understand what was happening in operating terms. They initiated and raised adjustments as well as checked and contributed to results and reporting. Their contributions and activities were also subject to checking by more senior finance staff at the organisation's central finance area. One of these organisations had also placed dedicated additional management accountants at the project level specifically to manage the financial risks associated with these projects.

2.23 For the other three organisations *Closing the Books Team*s relied on administrative personnel in the operating units as their first point of contact. For two of these organisations, these administrative personnel provided very limited input to month-end although they are involved to a greater extent in both budgeting and year-end processes. The third organisation relied extensively on operating units to submit adjustment data at month-end. This organisation had a significant number of 'Administered' and 'Departmental' operating and policy programs. These vary enormously in the detail and, therefore, officers close to the programs are best placed to capture operating reality, such as understanding when prepayments have been made to third parties or if expenditure should be accrued.

2.24 If an organisation is to rely on administrative personnel in operating units to contribute to the financial reporting processes, as well as budgeting or planning, it must have a reasonable level of confidence in the basic accounting skills of these personnel. For example, since the late 1990s these personnel have needed to understand accrual accounting concepts as well as basic accounting principles. Two of the organisations were starting to plan training initiatives designed to address known gaps in skills and a third was actively promoting an accrual accounting training program that required all administrators to pass an accreditation test before they would be allowed to process monthly adjustments. The ANAO strongly encourages any organisations that are concerned about the basic accounting knowledge of personnel involved in financial reporting or budgeting processes to actively address these concerns as a matter of priority.

2.25 Notwithstanding the levels of accounting skills in the operating units, *Closing the Books Team*s still need to ensure they have robust and consistent

checking processes over activities undertaken elsewhere in the organisation, in order to have confidence in the integrity of reports. Some of the audited organisations could improve the rigor of their central control by ensuring the orderly completion of all tasks, and by questioning the integrity of input from diverse business units or functional areas. For example, in one organisation there is limited review of the completeness or accuracy of adjustments received on a monthly basis. In another, the *Closing the Books Team* relies on transaction processing areas, such as Accounts Payable and Accounts Receivable, to perform some reconciliations, without always checking that they have been completed.

2.26   In summary, the audit found many variations in the way in which organisations had structured or organised their monthly close processes. If the scale of the organisation permits, it may be cost effective to have specific finance personnel in operating units. Alternatively, organisations should consider the following better practices between *Closing the Books Team*s and operating units:

- clear central control and direction—evidenced in meetings, email communications, procedures and review activities;

- *Closing the Books Teams* require quality input from operating units and check and challenge that input;

- training of personnel in accrual accounting concepts;

- requiring operating units to identify and sometimes process adjustments;

- requiring operating units to review trial balance data or program reports before information is consolidated and distributed, so that adjustments can be recorded if necessary;

- operating units contributing analysis and commentary to monthly reporting;

- establishing reporting lines and service standards between operating unit administrators and *Closing the Books Teams*; and

- providing read and inquiry access to information systems to division administrators.

People

2.27   There is a direct relationship between an organisation's ability to attract and retain qualified staff with the right blend of experience and its ability to effectively manage month-end processing. In general, the better performing organisations in this audit had more experienced and qualified finance staff as well as lower turnover, although most organisations had many skilled and highly experienced staff.

2.28 Where turnover is an issue, it is particularly important that an organisation has clear, easy to follow, complete procedures and checklists. These are essential for an organisation in the event of staff turnover. The audit also noted that two of the organisations had completed detailed role and responsibility documents for all members of the *Closing the Books Team*.

2.29 In addition, one of these two organisations had completed individual month-end checklists for each person involved in month-end processing. These types of documents make it relatively easy for a new staff member to take over tasks. Developing the documents can also be a useful way of reviewing and checking the adequacy of segregation of duties as well as the continuing appropriateness of procedures. The ANAO considers that it is useful for all organisations to complete detailed role and accountability descriptions for all members of *Closing the Books Teams*.

Procedures

2.30 Disciplined, mandated procedures used by all, as well as training and tools to facilitate their understanding, are essential to effective month-end because they provide a framework for consistent and standard month-end closing. Properly detailed and easy to use procedures also empower staff by providing them with the ability and authority to make decisions without the need for referral.

2.31 While all organisations had detailed procedures, work plans and timetables related to year- end, the audit found that three of the organisations needed to improve their month-end processing. Audit findings included organisations:

- not updating financial procedures since 1994;

- not having procedures for some elements of month-end processing;

- having reconciliation and journal checklists that did not include enough detail (names of accounts and assigned reconciliation responsibilities were not always specified); or were incomplete (not all required reconciliations were included); or were out-of-date (former personnel were included in the assigned responsibilities); and

- using timetables that did not include all tasks and responsibilities or included generic rather than specific dates. Staff usually find exact days and times, individually defined for each month of the year, more useful.

Structure

2.32 All organisations are encouraged to examine the adequacy and completeness of their procedural framework as well as to consider better practice

applications. The audit noted a wide range of better practices at several of the organisations. These included:

- month-end procedures provide detailed and specific guidance on a wide range of tasks, such as the treatment of revenue and expense items, including accrued and unearned revenue, accruals and prepayments, journal entry processing and reconciliations, amongst other items;

- overall month-end timetable and checklist specifying tasks, responsible officers, due dates and times for task completion (specific times are useful for organisations with offices in different states and countries);

- separate timetables for separate areas of the organisation. For example, timetables for operating units, information systems departments and transaction processing functions such as Accounts Payable and Accounts Receivable;

- month-end reconciliation and journal checklists—listing tasks, responsibilities and timeframes;

- information system user manuals that include practical step-by-step instructions and detailed guidance examples;

- clear, easy to follow process flow charts for some month-end activities, including individual categories of prepayments and accruals; and

- clearly documented charts of accounts that are easy to use because they include plain English descriptions for each category of code. These types of user-friendly documents help staff code transactions right, first time.

Information Systems

2.33 Most organisations used their Intranet to communicate procedures to staff as well as making hard copies available. One organisation had placed a 'financial management' icon on the standard desktop for all employees. This provides access to a range of procedures as well as presentations and training materials aimed at informing personnel across a range of operating units and geographic locations.

2.34 The audit did not identify a direct relationship between the quality and effectiveness of month-end processing and the type of FMIS used by the organisation. The core FMIS provided satisfactory support for month-end processing for all of the organisations.

2.35 The design of core FMIS functionality often included the following internal control and better practice elements.

- Integration of Accounts Payable, Accounts Receivable and Fixed Asset modules with the General Ledger module.

- Batch or overnight updating to the General Ledger.

- Use of the same chart of accounts to apply to different ledgers, where the organisation has more than one, so that difficulties are not encountered during consolidation. Or alternatively, using a different chart of accounts, when this is more appropriate and there is no need for consolidating results (for example, to meet the requirements of 'Administered' and 'Departmental' transactions).

- Using charts of accounts that easily roll up into AIMS reporting categories without requiring extensive changes to reporting categories.

- Isolating specific groups of transactions—such as those related to 'Administered' and 'Departmental' transactions in separate ledgers or company codes.

- Establishing a coding structure so that transactions can be recorded and reported in overall and more detailed categories as required.

- Electronic matching of data to facilitate daily bank reconciliations.

- Electronic journal entry and posting.

- Automatic system journal entries for regular and system based adjustments. For example, depreciation, payroll and employee entitlements.

2.36   Most of the organisations provided operating units with access to on-line information provided by the core FMIS. The FMIS commonly allows end users to request and generate their own reports, tailored to their individual requirements, as well as to drill down into particular programs and transactions. In cases where operating units can access their own reports, detailed central timetables are particularly useful, in order for operating units to understand when data includes standard accruals or other adjustments. Otherwise, they risk making decisions based on incomplete data.

2.37   However, in one case, operating units were reliant on the *Closing the Books Team* to distribute hard copy or electronic reports. This situation increases the risk that information arrives too late to be useful or that it does not include information that the user wants to know.

2.38   Five of the organisations used sub-systems or separate applications to run core operating and support processes. In some cases, there were electronic interfaces and the transfer of data was straightforward. In other cases, the absence of interfaces, as well as the large number of separate applications, and the level

of transactions processed, both in dollar and volume terms, presented additional risks about data integrity and processing inefficiency to the organisation.

2.39 For example:

- two organisations maintained their commercial revenue earning activities on a separate system. This means that data is not always visible through the core FMIS as well as the risk of possible error in the data transfer between the two systems. In these cases, finance managers had implemented controls over the data transfer—basically ensuring the necessary journal entries and reconciliations were complete and authorised;

- one organisation had a Division that used a separate FMIS and results were transferred by journal entry on a monthly basis. These journal entries require additional checking and review, which had not taken place. In addition the Divisional results are not visible to the organisation's financial controller until the end of the month;

- one organisation consistently faced problems in being unable to access timely information on leave accruals from a separate HR system. The *Closing the Books Team* took a proactive approach to managing this issue by using estimates, but this was time consuming and had not always been accurate enough for reporting purposes; and

- one organisation maintained a separate purchasing database, for the purpose of processing approvals, and so purchases were entered twice—once into purchasing and once into the Accounts Payable module. If a purchasing module is used as part of the core FMIS it can be a useful, straightforward tool in calculating regular month-end accruals and commitments. In the case of this organisation, analysis of two separate sets of data is required.

2.40 All organisations are encouraged to simplify, integrate and streamline systems and software applications where possible. There will often be cost and operating reasons why this is not possible and so the ANAO encourages organisations with a number of separate systems to:

- maintain up-to-date documentation on the interfaces and relationships, perhaps in the form of a flow chart; and

- ensure that procedures and checklists define requirements for complete and timely transfers and reconciliations between all sub systems and the main FMIS. In some cases, it was unclear how *Closing the Books Team*s relied on these reconciliations being completed. The CFO would lack assurance on the integrity of reporting, without certainty that data from

separate systems has been captured completely and accurately in the General Ledger.

2.41   Most of the organisations relied extensively on spreadsheets to produce reporting both for Finance and management purposes. The audit noted that few of the organisations had considered basic internal cell protection functionality and this might be worth considering in the future, particularly in cases where the spreadsheet output is not reconciled back to the source.

2.42   Two organisations had purchased commercially available data analysis tools and were finding this highly useful in producing reports and analysing information. One planned to roll out this tool to the operating units to provide them with greater ability to analyse data on an ongoing basis.

2.43   One organisation had developed an in-house Executive Information System that failed to deliver on promised results. At the time of the audit, the *Closing the Books Team* was considering purchasing a commercially available application.

2.44   Finally, all organisations had implemented security controls around systems access—including regular review of access profiles and actual access, as well as providing audit trails for transactions and journal entries. Better practice included one organisation using a segregation of duties matrix to formally assess access control requirements in the context of processing needs.

Conclusion—Framework

2.45   Most organisations had established control frameworks that properly supported month-end close processes. Those control frameworks included detailed procedures, information systems that supported processing and the employment of qualified and experienced staff. Usually, organisations had established month-end processes that are a similar (slightly scaled down) version of year-end processes in order for the organisation to meet its internal and external reporting requirements.

2.46   Effective procedures provide guidance to staff as well as a level of assurance to the organisation that there are consistent, planned processes. In the current environment, *Closing the Books Team*s often experience significant levels of staff turnover and procedures can be essential tools in preventing internal control breakdown. Organisations about to commence reporting to Finance on a monthly basis from August 2003 are particularly encouraged to invest in the development of an appropriate framework, if it is not already in place.

2.47 Three of the organisations needed to improve the way in which month-end processes were designed. Opportunities for improvement included expanding procedures and checklists as well as encouraging the participation of operating units in month-end so that they, rather than the *Closing the Books Team*, can own and be accountable for reported financial information. Operating units are best placed to calculate adjustments, review trial balance reporting and provide commentary and analysis of results because they understand the day-to-day progress and activity related to specific programs and projects.

2.48 Several organisations can improve the efficiency of month-end processing by formally establishing and applying materiality.

Materiality

Recommendation No.1

2.49 The ANAO *recommends* that organisations consider applying the materiality concept to month-end processing. Materiality levels should be clearly defined and documented in procedures according to their specific requirements.

Ownership and accountability for financial information

Recommendation No.2

2.50 The ANAO *recommends* that operating units be more extensively included in month-end processing to improve the quality of the financial information.

Procedures

Recommendation No.3

2.51 The ANAO *recommends* that organisations ensure their procedural frameworks are complete, user friendly and up-to-date.

Part B—Quality

Introduction

2.52 The quality of processing depends on the way in which the procedures are implemented in an effective framework. In this context, quality refers to month-end processes that promote accuracy and are capable of producing reports that meet user requirements. Quality is achieved though a combination of the following:

- *Planning for the close*—finance managers plan to address issues that may affect the quality of month-end processing, including considering previous performance and planning for the next month;

- *Adjustments and journal entries*—processing adjustments so that transactions are reported in the right period according to basic accrual concepts, as well as improving the quality of information by including material transactions that otherwise may not be recorded in the FMIS;

- *Reconciliations*—the checking of General Ledger accounts on a regular basis to ensure information is complete and errors are identified; and

- *Review of Trial Balance*—the organisation reviews and analyses data prior to the close, as well as prior to the production of reports.

Summary of audit findings

2.53 The audit assessed the quality of processes at three of the organisations as Very Good. The other organisations satisfied some of the evaluation criteria but could improve the quality, accuracy and completeness of their month-end processing activities, principally by improving reconciliation procedures. Improvements are also required in the areas of formally planning for month-end activities and increasing the involvement of operating units in processing adjustments and contributing to reporting.

2.54 Details of the evaluation criteria used in the Quality part of the audit, are set out in Table 3 below.

Table 3

Quality–findings and better practices against audit evaluation criteria

Principle
The organisation has implemented standard and rigorous procedures that are monitored, ensuring that *closing the books* activities are complete and accurate as well as accurately reflecting business reality. These procedures will include authorisation, checking, segregation of duties, and the maintenance of an audit trail.
Evaluation criteria
Planning: The organisation has plans that address issues that may affect the completeness, quality, and accuracy of *closing the books* processing and outputs.
Adjustments and journal entries: The organisation's approach adequately reflects the operating environment, and is efficient.
Reconciliations: Reconciliations are performed thoroughly as intended, and are subject to checking.
Review of Trial Balance: Senior managers are able to review preliminary results prior to the production of reports.
Generating reports: Processes are efficient and outputs are subject to checking to ensure reports are accurate.
Audit findings
Of the six organisations reviewed, the audit found:
• Most undertook informal, ad hoc planning activities for month-end processing.
• Three of the organisations needed to improve basic reconciliation procedures.
• At several of the organisations, adjustments and journal entries were processed without timely authorisation or with incomplete documentation.
• Two of the organisations did not require operating units to submit adjustments, increasing the risk that FMIS data is incomplete.
Better practices
The following better practices were noted during the audit:
• *Closing the books team*s meet monthly to discuss issues for the next close as well as improvement opportunities.
• Using estimates and information system functionality to streamline the adjustment process.
• Operating areas submit adjustments based on their knowledge of operations.
• Using email to query financial information submitted from remote regions/offices.
• Multiple reviews of trial balance data as a check on each stage of the close process.

Detailed findings and analysis

Planning

2.55   Most of the audited organisations undertook some form of planning for the close, such as preparing to address particular issues that need to be managed at month-end. Usually, this included periodic internal *Closing the Books Team* meetings, but was often ad hoc and part of day-to-day routine communication. Organisations often rely on the established nature of the process and pre-communicated timetables as their key planning documents. Some organisations send reminder e-mails a few days prior to the end of each close reminding operating units of their particular responsibilities.

2.56 At some organisations, formal planning for the year-end was much more focused. For example, scheduling formal meetings from December to August to assess year-end; perhaps reflecting greater emphasis on year-end reporting in the organisations.

2.57 While most of the organisations in this audit had some form of planning for each close, the ANAO considers that it is worthwhile instituting regular formal meetings that include *Closing the Books Team* personnel and operating units as well as other corporate support areas. The prime focus of these meetings should be ensuring that issues addressing the quality of financial reporting are dealt with in a consistent and timely manner. They can also be used to discuss and launch wider continuous improvement initiatives.

2.58 *Closing the Books Team*s in some private sector organisations use this kind of meeting to prepare for and monitor improving their balanced scorecard indicators (time, cost and quality KPIs) for each month, as well as celebrating successes when key benchmarks have been achieved.

Adjustments and journal entries

2.59 Quality month-end processes ensure that adjustments are properly processed to allocate transactions to the right period and to pick up any known events that may not be visible in FMIS reporting.

2.60 Checklists, procedures, templates, and record-keeping standards that provide a good quality audit trail, and training are part of the basic framework that enables proper adjustment and journal processing. Most organisations had set up this framework properly and basic review and segregation controls were in place. An accrual framework was usually in place. Some organisations had recently undertaken major initiatives to improve performance in this area. For example, one organisation that processed a significant number of administered journal entries, both in terms of dollar amounts processed and volume of journal entries, had recently documented very clear guidance for calculating and processing each one of the journal entries. The procedures included details on the purpose, background, contacts, journal entry path, procedures and detailed instructions for each journal.

2.61 Another organisation had implemented a better practice initiative for journal entries—designed to provide the organisation with confidence that adjustments to monthly data raised by operating units were accurate. All officers responsible for raising and authorising journal entries are required to undertake an assessment to demonstrate their competence and understanding of accrual accounting basics. Only those officers who achieve a satisfactory rating in the

assessment process will be designated as competent to perform journal entries. Additional training is provided to those who fail the assessment.

2.62 The audit found some opportunities for improvement. Two organisations processed adjustments centrally in the *Closing the Books Teams* and did not involve operating units in the adjustment process. As discussed earlier in this report, this practice discourages divisional ownership of reporting and means reporting is less likely to provide accurate accrual data that can be meaningfully compared to an accrual based budget. In addition, one of these did not accrue expenditure for 'Departmental' reporting purposes because these sums were viewed as completely immaterial in the context of the huge volume of 'Administered' transactions processed.

2.63 The ANAO encourages organisations to make operating units responsible for calculating adjustments for their area of responsibility. The *Closing the Books Team* should check and challenge the reasonableness of an operating unit's adjustments by comparing them to known contract commitments and work in progress. One organisation maintained a central contracts database because it had encountered problems in the past with operating units failing to enter major invoices and not adjusting for expenditure in the correct month.

2.64 The audit tested small samples of journal entries at each organisation. While the majority were separately prepared and authorised and supported by logical documentation, there were some exceptions, whereby at different organisations:

- approximately one third of journal entries were posted at one organisation without authorisation. These journal entries were subsequently signed off;

- several journal entries had not been independently checked; and

- a relatively complex adjustment was authorised without the reviewer sighting or considering supporting documentation.

2.65 The ANAO considers that all organisations need to ensure that the basic controls around adjustments and journal entries operate as intended, as well as encouraging organisations to think about how the process can be streamlined.

2.66 The audit noted a number of better practices, including:

- using estimates, based on a prescribed calculation for accruing major centrally run suppliers, or deciding not to adjust for these items because they fall below the documented materiality level;

- using system accruals for journal entries such as standing adjustments, depreciation, employee entitlements, and purchases where the goods have been received on the FMIS;

- using a data field in the accounts payable processing template to record any prepayments so that a system report could identify any prepayments for adjustment;

- balancing the journal entry workload, for example, processing treasury journal entries weekly and use of journal entries that rely on estimates well before the end of the period;

- using information systems' functionality to speed up processing. For example, email authorisation attached to an spreadsheet journal, which is particularly useful for multi-line journal entries that can be interfaced into the FMIS. Or designing standard Excel spreadsheets to calculate estimates;

- using pre-populated standard templates for recurring journal entries. This minimises the time required for journal preparation; and

- compiling a 'journal summary report' each month or, better still, printing a 'Journal Batch Control Listing' report from the FMIS. This report includes all journal entries processed and can be quickly checked for completeness, any duplication and helps identify recurring problems that may merit further analysis.

Reconciliations

2.67 The performance of periodic reconciliations is the most basic check on the integrity of amounts recorded in individual accounts that comprise an organisation's General Ledger. All organisations' CFOs need to have confidence that reconciliations are performed as intended to assure the quality of month-end reporting. Reconciliations help ensure that there are no surprises in reconciling differences that might affect decisions, and that some types of inadvertent and intentional errors are detected.

2.68 Reconciliation processes include:

- formally agreeing the General Ledger balance to the source of its balance in a template;

- explaining and adjusting for the variation between amounts so that the level of unexplained difference is less that the organisation's stated level of materiality;

- independently checking and signing off that individual reconciliations are complete and accurate, within the specified timeframe;

- also applying these procedures to any miscellaneous, control and clearing accounts in the organisation's ledgers; and

- an overall check that all the organisation's intended reconciliations have been subject to these procedures.

2.69 Half of the organisations included in this audit needed to improve their reconciliation procedures. The audit found:

- incomplete reconciliations for important accounts (cash, receivables, payables). Sometimes these reconciliations had not been completed or sometimes not reviewed;

- accounts reconciled to clearing accounts that were not separately analysed, cleared or reconciled. In one organisation, a $15 million un-reconciled difference in a bank account reconciliation was explained simply as comprising $2 million in Clearing Account A, plus $13 million in Clearing Account B, without investigating these amounts further;

- invalid reconciliations submitted and accepted. The audit found some invalid reconciliations and some reconciliations with large un-explained differences and some old unexplained differences, dating back to 2000. Differences above a documented materiality level should be explained;

- the *Closing the Books Team*s had no assurance where other operating units were responsible for reconciling activities of ledger accounts and separate applications that these had been completed; and

- reconciliations being performed two or three months late.

2.70 The audit noted a number of better practices in this area. These included:

- a standard reconciliation checklist that includes all accounts to be reconciled by name, how often they are to be reconciled, whether monthly, quarterly, half yearly, or annually, what they are to be reconciled to, who is responsible and the date of completion;

- a key finance manager reviews and signs-off on this checklist as part of normal month activities. This is one of the defined responsibilities in the overall month-end checklist. It provides confidence that all tasks have been completed;

- using standard templates for **all** reconciliations. These define what the account is to be reconciled to, standard supporting documentation requirements, boxes for signatures and dates of preparers and reviewers. Standard templates make it easier for the preparer of the reconciliation because input is defined, and also for the reviewer as its easier to spot where there are gaps;

- standard reconciliation packs required from operating units according to the month-end timetable so that the *Closing the Books Teams* can check that they are complete;

- deciding which reconciliations need to be completed on a quarterly (not monthly basis). This may add an extra day to the quarterly cycle but means that monthly reporting can be produced a day earlier on the other months; and

- at one organisation, an officer from the financial management policy area i.e. not from the *Closing the Books Team*, is responsible for completing the reconciliation checklist as an independent check on the completeness and timeliness of performance.

2.71   Most organisations had some reconciliations being completed outside of the *Closing the Books Teams*, for example, leave accruals or specific sub-system reconciliations. Better practice *Closing the Books Teams* delegate this responsibility formally in procedures and checklists and then check their quality when reconciliations are submitted for review.

2.72   None of the organisations were able to complete all reconciliations prior to the production of monthly reporting, although many had balanced the workload. For example, bank reconciliations are often performed on a daily basis. Completion of all reconciliations prior to reporting was not seen as an aim because any differences could be adjusted for in the next month. This may be a reasonable approach if the reconciliations are generally up-to-date for the prior month, but is an area for continuous improvement in future periods.

Review of Trial Balance

2.73   Most organisations run the trial balance on several occasions as part of month-end processing to identify any irregularities and abnormal trends including prior to the final close; after adjustments have been made; prior to system reconciliations; and after the month-end close. The better performing organisations in the audit review and run the trial balance on several occasions. In these cases, a senior finance officer takes an interest in reviewing and checking the figures. Operating units also access key information. For example, once the Accounts Payable sub-ledger has closed they will review data and produce adjustments to be made by journal entry.

2.74   None of the organisations formally required operating units to sign-off on the results under their area of control, prior to the final run of the trial balance. However, for those organisations that require operating units to submit adjustment data, there is an implicit understanding that if the data for their area is inaccurate, they will submit an adjustment. As discussed earlier in this report,

the ANAO encourages all *Closing the Books Teams* to build this kind of input from operating units into normal procedures.

2.75   Some organisations distribute trial balance data, or draft project or program data to operating units and require them to contribute forecasts and information about variances, prior to the production of consolidated reporting. This is a useful check because those closest to operating activity should be best placed to vouch for the reasonableness and accuracy of reporting and can explain variances for expected performance. The timeframe allowed for this type of activity is between one or two days as part of the cycle. *Closing the Books Teams* then need another one or two days to consolidate the information received prior to producing reports.

2.76   Better practice ideas for facilitating trial balance review include:

- providing operating units with on-line access to financial data through the FMIS;

- the *Closing the Books Team* places first draft reports of financial data on a shared drive that the operating units must access and use to record comments on results and adjustments. After a two-day period, the *Closing the Books Team* reviews and incorporates all comments in finalising reports;

- the *Closing the Books Team* distributes project reports for operating units to input forecast data so that a revised forecast can be produced each month;

- another organisation requires analysis on all variations against budget greater than 10 per cent so these comments can be included in the organisation's reports; and

- one organisation had documented its requirements for checking trial balance data in its procedures. These checks included: checking specific General Ledger balances affected by major month-end journal entries to ensure accuracy, checking the reasonableness of specific account balances, and comparing trial balance data to the previous month and year.

2.77   One of the organisations found it difficult to provide operating divisions with the opportunity for review—basically because by the time adjustments have been completed, and the trial balance produced, financial reports are due for distribution to senior management. Organisations that face this kind of challenge are encouraged to explore ways in which processes can be streamlined and workload balanced. This is discussed further at Part D—Continuous Improvement.

Conclusion—Quality

2.78   The audit found very high quality processes at three of the organisations with opportunities for improvement at the others. On several occasions reconciliations had not been completed as intended. Some organisations also needed to improve the way that adjustment data was captured and processed so that complete accrual reports can be produced.

2.79   Quality could also be enhanced in some organisations by allocating more time in the month-end cycle for review and analysis of draft data prior to producing reports. Improved planning and workload balancing may be useful.

Reconciliations

Recommendation No.4

2.80   The ANAO *recommends* that organisations ensure their reconciliations are identified in a timetable; are performed thoroughly on a timely basis; and are subject to rigorous checking to improve the quality of month-end processes and reporting.

Part C—Effective Financial Reporting

Introduction

2.81   For Commonwealth organisations, users of reported financial information include program managers, executives, Chief Executive Officers (CEOs) and Boards as well as Finance, Government, Parliament and Parliamentary Committees.

2.82   The information included in financial reports must be useful, relevant and timely. Further, it must be presented in a way that is user friendly and easily understood. This means that the traditional statements of financial performance and position, while meeting the monthly reporting requirements, are of limited use in internal reporting unless supplemented with other information to meet the needs of users. Organisations are much more focused on tailoring reporting to meet the needs of decision makers. Analysis and interpretation is an important part of financial management reporting.

Summary of audit findings

2.83   The audit found that most organisations produced effective and timely reports. One organisation did not, because of significant delays in producing

project reports. Two other organisations did not approve the reports to Finance because the submission was perceived as a largely routine, administrative task.

2.84 Details of the evaluation criteria used in the Effective Financial Reporting part of the audit, are set out in Table 4 below.

Table 4

Effective Financial Reporting–findings and better practices against audit evaluation criteria

Principle
Monthly reporting meets user requirements in terms of its usefulness, relevance and availability.
Evaluation criteria
Internal Management Reporting: Internal management reporting meets user requirements, and is timely.
Monthly Reporting: Reporting to Finance as required by the Government.
Audit findings
Of the six organisations reviewed, the audit found:
Internal Reporting
• most organisations distributed internal reports on a timely basis to meet management and board deadlines;
• most organisations demonstrated effective reporting through production of quality information that was visually appealing; and
• some organisations needed to improve the quality of their reports (because of problems in reconciliation processes) as well as the way in which reports were presented.
Reporting to Finance
In general, all organisations submit monthly reports on a timely basis although two organisations (the largest) did not formally review or approve monthly reports prior to submission.
Better practices
The audit noted the following instances of better practice in effective reporting:
• Access to financial information on an ongoing basis by operating unit managers.
• Distribution of financial reports in electronic format on the organisation's Intranet.
• Maintenance of a Monthly Reporting log to monitor timely submission.
• Production of concise reports that limited financial information to key facts and data.
• Use of graphs and colour to make reports visually appealing and easier to analyse.
• Use of analytical processing tools to make data analysis and report generation easier.

Detailed findings and analysis

Quality and presentation of internal reporting

2.85 The quality of reporting in the Commonwealth sector has been discussed widely in a number of other publications, including for example, *Beyond bean counting*.[10] Better practice organisations should, by 2003, have enhanced the

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[10] *Beyond bean counting*, Effective Financial Management in the APS—1998 and beyond, Management Advisory Board December 1997.

presentation of financial reports by focusing much more on analysis and the usefulness of data included in reports.

2.86   The audit found that most organisations produce quality internal reports that are well presented, although the level of commentary, analysis and presentation required improvement at two organisations.

2.87   The following better practices were noted:

- high-level one-page summaries were used to report period results to senior management;

- financial information was limited to key data, including trends and ratios;

- analysis and comments are drawn from operating units, but are subject to scrutiny by the *Closing the Books Team*;

- revised forecasts are included in every monthly report;

- specific reporting on high risk or special projects—this helps make progress against budget more visible and open to scrutiny;

- producing different levels of reports on a quarterly basis that included additional detail;

- providing a diverse range of analysis at different levels and by different groups—by branch, region, expense category, program or output; and

- using visual presentation to make the information more user friendly— line graphs, bar charts, pie charts and colour are examples of visual techniques widely used by the audited organisations.

2.88   Some organisations still found it necessary to distribute the statements of performance and position in their traditional format. One CFO described these as the 'official record' that supported the additional analysis and key data presented to management.

2.89   As well as producing hard or soft copy reports many CFO's met regularly with the organisation's senior management team or CEOs to present and discuss results.

Timeliness of reporting

2.90   In most organisations, operating and project managers were able to access financial information on an ongoing basis. System functionality allows users to generate their own reports at any time, as well as to drill down into account-level detail to investigate transactions. This example of better practice makes it possible for those responsible to monitor operations and budget variances in 'real time'. In the organisation that relied on the hard copy distribution of reports,

these were not available until half way through the next month. This organisation intended to bring internal reporting timetables forward two or three days over the next year to improve the timeliness of providing information for decision making. Organisations facing this type of issue need to consider the cost effectiveness of upgrading reporting and enquiry capability of the FMIS, or other reporting systems, in order to better meet the needs of users.

2.91　Most organisations make use of a reporting timetable to set deadlines for the distribution of management reports. Usually this is to coincide with management or board meetings. A non-negotiable deadline of the 10th day of the month has been set for submission of reports to Finance as required by the Government. Audit testing indicated that *Closing the Books Team*s, with a few occasional exceptions, met their deadlines.

Technological tools and reporting

2.92　Analytical processing tools were used at two of the organisations to facilitate report generation. These tools make detailed analysis of information easier by providing different views and windows on data. One organisation uses it to sort information into the format required by Finance for their Administered reports. Analytical tools can also be used to customise presentation of reports to include ratios, graphs and colour. Some organisations were exploring the purchase of these types of tools, others were satisfied with their FMIS reporting functionality.

2.93　Technology can also be used to speed up monthly reporting. Some organisations use a flat file to upload financial data to Finance. Others did not because manual data entry was found to be more efficient, or because of upload problems. The use of the flat file is encouraged because it prevents data transposition error.

Authorising reporting

2.94　All organisations need to ensure that reporting outputs are checked before reports are distributed internally or externally to Finance. The audit found that all organisations rigorously review and check reports that are distributed internally. Usually, the CFO takes a high level of interest in the periodic reports produced for executive management and the Board, providing some additional analysis and checking elements of the reporting with operating units.

2.95　In most organisations, reporting to Finance is also checked prior to submission. However, in two organisations the submission of reports was regarded as a largely administrative task that was undertaken by more junior *Closing the Books Team* officers. While the ANAO recognises that Finance staff

check data and the software performs internal validation checks to detect basic errors, it encourages all organisations to ensure that a senior member of the *Closing the Books Team* checks and authorises reports prior to their submission to Finance. In part, this is to ensure errors are identified but it is also more appropriate that sign-off comes from someone who is accountable for the integrity of the process and reporting. In some organisations, the CFO formally signed a memo or a submission log to record the authorisation.

Conclusion—Effective financial reporting

2.96 Most organisations produced effective reports, which met the needs of users. Often, reports included a high level of analysis, graphs, ratios and the presentation of key data. Two organisations needed to ensure reports to Finance were properly checked and approved prior to submission. Reporting deadlines were almost always met.

Authorising monthly reporting

Recommendation No.5

2.97 The ANAO *recommends* that a senior member of the *Closing the Books Team* checks and authorises, data before it is submitted to Finance, to provide assurance that reports to Finance are accurate and authorised.

Part D—Continuous Improvement

Introduction

2.98 Continuous improvement involves improving the efficiency and effectiveness of month-end processing as well as adapting to challenges posed by the changing Commonwealth environment—from the introduction of accrual accounting to reporting against outcomes and outputs to meeting reduced reporting deadlines.

2.99 There are many initiatives that can be undertaken to improve *closing the books* processes. These can include workload distribution, performance measurement, increasing the use of technology and using special project teams to address specific concerns.

Summary of audit findings

2.100 The audit found many examples of better practice in continuous improvement. However, few organisations formally measured the performance of their *closing the books* processes.

2.101 Details of the evaluation criteria used in the Continuous Improvement part of the audit, are set out in Table 5 below.

Table 5
Continuous Improvement—findings and better practices against audit evaluation criteria

Principle
The organisation takes a proactive approach to continuously improving its closing processes.
Evaluation criteria
Continuous Improvement: The organisation continuously improves its *closing the books* processes.
Audit findings
All organisations took a proactive approach to continuously improve the *closing the books* processes. Some organisations however had not addressed ANAO management letter points from the financial statement audits relating to *closing the books* on a timely and complete basis.
Better practices
The audit noted many instances of better practice that indicate a continuous improvement approach to the *closing the books* processes such as: - distribution of workload over the month;   - use of performance measures specific to financial reporting;   - effective use of technology to automate and streamline month-end tasks; and   - using Internal Audit to examine processes.

Detailed findings and analysis

Evolving over time

2.102 The organisations included in this audit had successfully adjusted closing processes and timelines to enable them to meet the changed deadline for reporting to Finance, introduced in 2003. There was evidence that organisations had achieved this goal and actively managed timing pressures by distributing the closing workload over the course of the month.

2.103 The best organisations were able to undertake robust closing activities and still have time to analyse data before reporting. In particular, organisations balanced their workload, especially reconciliations and journal entries, and used information systems functionality to speed up transaction processing and

reporting. Detailed timetables are often a highly useful tool in improving and analysing activities against timelines—so that the necessary time for review can be enforced.

2.104 The audit found many better practices that organisations had implemented to meet the challenges of their changing environment and make processing more effective. Other organisations may wish to consider the following examples:

- Undertaking an organisation wide review of management reporting requirements with the intention of better understanding and meeting the needs of report users.

- Introducing commitment reporting as a regular monthly process in anticipation of Finance cash forecasting reporting requirements from 1 July 2003.

- Designing and actioning an annual work plan for the *Closing the Books Team* that includes responsibilities and timeframes for improvement initiatives.

- Negotiating and monitoring service level agreements with external service providers to help ensure quality adjustment and reconciliation information is received on a timely basis.

- Actively addressing foreign exchange conversion issues, which can cause unexpected gains and losses at month-end, by formalising a monthly procedure and using Internal Audit to review the process.

- Using Internal Audit to review closing processes.

2.105 The audit noted that three organisations had not resolved ANAO management letters points from financial statement audits relating to *closing the books* matters on a timely basis. Previous audit findings were still outstanding at the time of this audit. The ANAO encourages all organisations to address audit findings on a timely basis.

Performance Measurement

2.106 'Better practice organisations set time, cost and quality targets for the close process and track actual performance'[11]. While most of the organisations tracked the timing of month-end processes, largely by ensuring adherence to the standard timetable, government reporting deadlines and submission of internal reports to Boards or management, only one had formalised performance measures for

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[11] ANAO Better Practice Guide *Building a Better Financial Management Framework 1997.*

its financial reporting process. Measures and targets were monitored each month. Examples included:

Measure	Target
Monthly reports submitted to Finance by the 10th day of each month	100% achievement
XYZ reconciliation complete by 20th day of each month	100% achievement

Another organisation had built KPIs into employee performance agreements based on the timely completion of tasks and delivery of documents at month-end.

2.107 The ANAO encourages all organisations to set a few, key performance measures for which data can be obtained cost effectively and which help identify improvement opportunities. The following table illustrates some measures that might be monitored on a quarterly basis as part of a balanced scorecard approach.

Table 6

Measures of reporting performance

Measure	Objective	Example measures
Timeliness	Issuing reports according to deadlines.	Number of days variation from deadlines.
Accuracy	Reducing errors to improve efficiency.	Number of journal entries raised to correct errors.
No surprises	Forecast data is accurate. All exposures identified at pre-close planning stage.	Percentage variations in actual results against last month's forecast by program. Number of exposures greater than $100 000 that were not identified in pre-close assessments.
Quality	Meeting customer/ operating division expectations.	Qualitative measures provided by the users of financial information. e.g. scale of 1 (does not meet) to 5 (exceeds expectations).
Automation	Streamlining the process.	Number of automated journal entries as a percentage of total journal entries.
Cost	Reducing the cost of processing over time.	Cost of *closing the books* as a proportion of the total cost of the finance function.[12]

2.108 Finally, an earlier ANAO benchmarking report[13] provides additional information that may be useful to organisations considering performance measurement.

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[12] The ANAO Audit Report No.25 2000–01 *Benchmarking the Finance Function* provides benchmark data on the cost of *closing the books*.

[13] The ANAO Audit Report No.62 2001–02 *Benchmarking the Finance Function Follow-on Report.*

Conclusion—Continuous Improvement

2.109 All organisations had taken initiatives to ensure continuous improvement in the quality and efficiency of the *closing the books* process. However, some organisations did not action ANAO management letter points from financial statement audits on a timely basis. All could use performance measurement as a tool to improve processes. Because of the continuously evolving Commonwealth financial reporting framework, as well as the need to deal with operating complexity, all organisations need to continuously assess that their processes are capable of efficiently and effectively meeting requirements.

Canberra ACT

27 June 2003

Oliver Winder

Acting Auditor-General

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