



Highlights of GAO-05-407, a report to the Secretary of the Treasury and the Director of the Office of Management and Budget

## FINANCIAL AUDIT

# Process for Preparing the Consolidated Financial Statements of the U.S. Government Continues to Need Improvement

### Why GAO Did This Study

For the past 8 years since the first audit of the consolidated financial statements of the U.S. government (CFS), certain material weaknesses in internal control and in selected accounting and financial reporting practices have resulted in conditions that prevented GAO from expressing an opinion on the CFS. Specifically, GAO has reported that the U.S. government did not have adequate systems, controls, and procedures to properly prepare the CFS. In December 2004, GAO reported on weaknesses identified during its fiscal year 2004 audit of the CFS, including weaknesses relating to the Department of the Treasury's (Treasury) preparation of the CFS. The purpose of this report is to (1) discuss the details of the weaknesses relating to Treasury's preparation of the CFS, (2) recommend improvements to address those weaknesses, and (3) provide the status of corrective actions to address the 142 open recommendations GAO previously reported.

### What GAO Recommends

GAO is making 20 new recommendations to address compilation and reporting weaknesses identified during the fiscal year 2004 CFS audit. Treasury and the Office of Management and Budget stated that they generally concur with the findings in the report. Treasury also stated that it is addressing many of the recommendations from GAO's prior reports.

[www.gao.gov/cgi-bin/gettrpt?GAO-05-407](http://www.gao.gov/cgi-bin/gettrpt?GAO-05-407).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gary T. Engel at (202) 512-3406 or [engelg@gao.gov](mailto:engelg@gao.gov).

### What GAO Found

GAO identified weaknesses during its tests of Treasury's process for preparing the fiscal year 2004 CFS. Such weaknesses in the CFS preparation process impair the U.S. government's ability to ensure that the CFS is consistent with the underlying audited agency financial statements, properly balanced, and in conformity with U.S. generally accepted accounting principles.

The weaknesses GAO identified during the fiscal year 2004 CFS audit involved the following six areas:

- directly linking audited federal agency financial statements to the CFS,
- controls over the compilation process,
- consolidated reporting guidance to agencies,
- intragovernmental activity and balances—explanations for material unreconciled transactions,
- consistency of the Department of Justice's and agencies' opinions on legal cases, and
- conformity with U.S. generally accepted accounting principles.

During fiscal year 2004, Treasury made progress in laying the foundation to address certain long-standing material deficiencies in preparing the CFS. Foremost is the ongoing development of a new system, which is intended to directly link information from federal agencies' audited financial statements to amounts reported in the CFS. Additional actions are under way and planned.

Of the 142 open recommendations that GAO reported in September 2004 regarding the process for preparing the CFS, 135 remained open as of December 6, 2004, the end of GAO's fieldwork for the fiscal year 2004 CFS audit. However, 86 of these 135 recommendations relate to specific disclosures required under U.S. generally accepted accounting principles. Treasury has taken action to begin addressing the conformity with U.S. generally accepted accounting principles issue. GAO plans to determine the status of corrective actions to address its open recommendations during its fiscal year 2005 audit of the CFS.



Highlights of GAO-07-91, a report to the Director of the Office of Management and Budget

## FINANCIAL AUDIT

# Restated Financial Statements: Agencies' Management and Auditor Disclosures of Causes and Effects and Timely Communication to Users

### Why GAO Did This Study

GAO continues to have concerns about restatements to federal agencies' previously issued financial statements. During fiscal year 2005, at least 7 of the 24 Chief Financial Officers (CFO) Act agencies restated certain of their fiscal year 2004 financial statements to correct misstatements. To study this trend, GAO reviewed the nature and causes of the restatements made by certain CFO Act agencies in fiscal year 2004 to their fiscal year 2003 financial statements. Eleven CFO Act agencies had restatements for fiscal year 2003. Nine of those 11 received unqualified opinions on their originally issued fiscal year 2003 financial statements. GAO's view is that users of federal agencies' financial statements and the related audit reports need to be provided at least a basic understanding of why a restatement was necessary and its effect on the agencies' previously issued financial statements and related audit reports. This report communicates GAO's observations on the transparency and timeliness of the 9 federal agencies' and their auditors' restatement disclosures.

### What GAO Recommends

GAO is making 11 recommendations to the Office of Management and Budget (OMB) to further improve the restatement guidance available to agencies' management and the agencies' respective auditors. OMB stated that it would take GAO's recommendations under advisement. GAO reiterates its concern that it is critical for OMB to timely provide additional restatement guidance.

[www.gao.gov/cgi-bin/getrpt?GAO-07-91](http://www.gao.gov/cgi-bin/getrpt?GAO-07-91).

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### What GAO Found

The nine agencies GAO reviewed did not consistently communicate financial statement restatements. GAO found that all nine agencies could have greatly enhanced the adequacy, effectiveness, and timeliness of their restatement disclosures to users. Similar transparency issues existed with the associated audit reports regarding disclosure of all the essential information that would clearly explain the restatements. GAO highlighted the following issues as among the more prevalent issues to be addressed:

- columns of the agencies' restated financial statements were not labeled as "Restated,"
- agencies' restatement footnote disclosures lacked clarity or sufficient detail regarding the nature of the restatements and the effect on balances reported in previously issued financial statements,
- restatement information was not sufficiently disclosed in the agencies' Management Discussion and Analysis,
- audit reports did not disclose that the respective agencies had restated certain of their fiscal year 2003 financial statements,
- audit reports did not provide a statement that the previously issued audit report was withdrawn and replaced by the opinion on the restated financial statements, and
- material misstatements and potential material misstatements were not timely communicated by agencies to either their auditors or to the users of the financial statements.

The primary contributing factor for the restatement disclosure issues that GAO identified was insufficient guidance available at the time to both the agencies' management and their respective auditors for disclosure of the restatements and the timeliness of such disclosures. GAO believes that information regarding restatements should be disclosed in a transparent and timely manner consistent with the qualitative characteristics of information in financial reports described in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1. In GAO's view, more detailed accounting and auditing guidance on how to satisfy the financial reporting characteristics as outlined in SFFAC No. 1 as it relates to the disclosure of restatements would have been helpful. OMB revised Circular No. A-136, *Financial Reporting Requirements*, which provides additional guidance to federal agencies' management regarding disclosure of restatements to previously issued financial statements. Revisions made to OMB Circular No. A-136 address many of GAO's concerns regarding the agencies' disclosure of restatements. In addition, the proposed 2006 revision of generally accepted government auditing standards now includes a section on reporting on restatement of previously issued financial statements. In addition, on August 23, 2006, OMB issued Bulletin No. 06-03, which also provides some information regarding reporting on restatements. However, GAO believes that OMB needs to timely provide additional, though complementary, restatement guidance to both the agencies' management and their respective auditors.