

Risk Management in Commercial Compliance

Australian
Customs Service

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Canberra ACT
20 October 1997

Dear Mr President
Dear Mr Speaker

In accordance with the authority contained in the *Audit Act 1901*, the Australian National Audit Office has undertaken a performance audit of Australian Customs Service and I present this report and the accompanying brochure to the Parliament. The report is titled *Risk Management in Commercial Compliance*.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

P. J. Barrett
Auditor-General

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

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Glossary

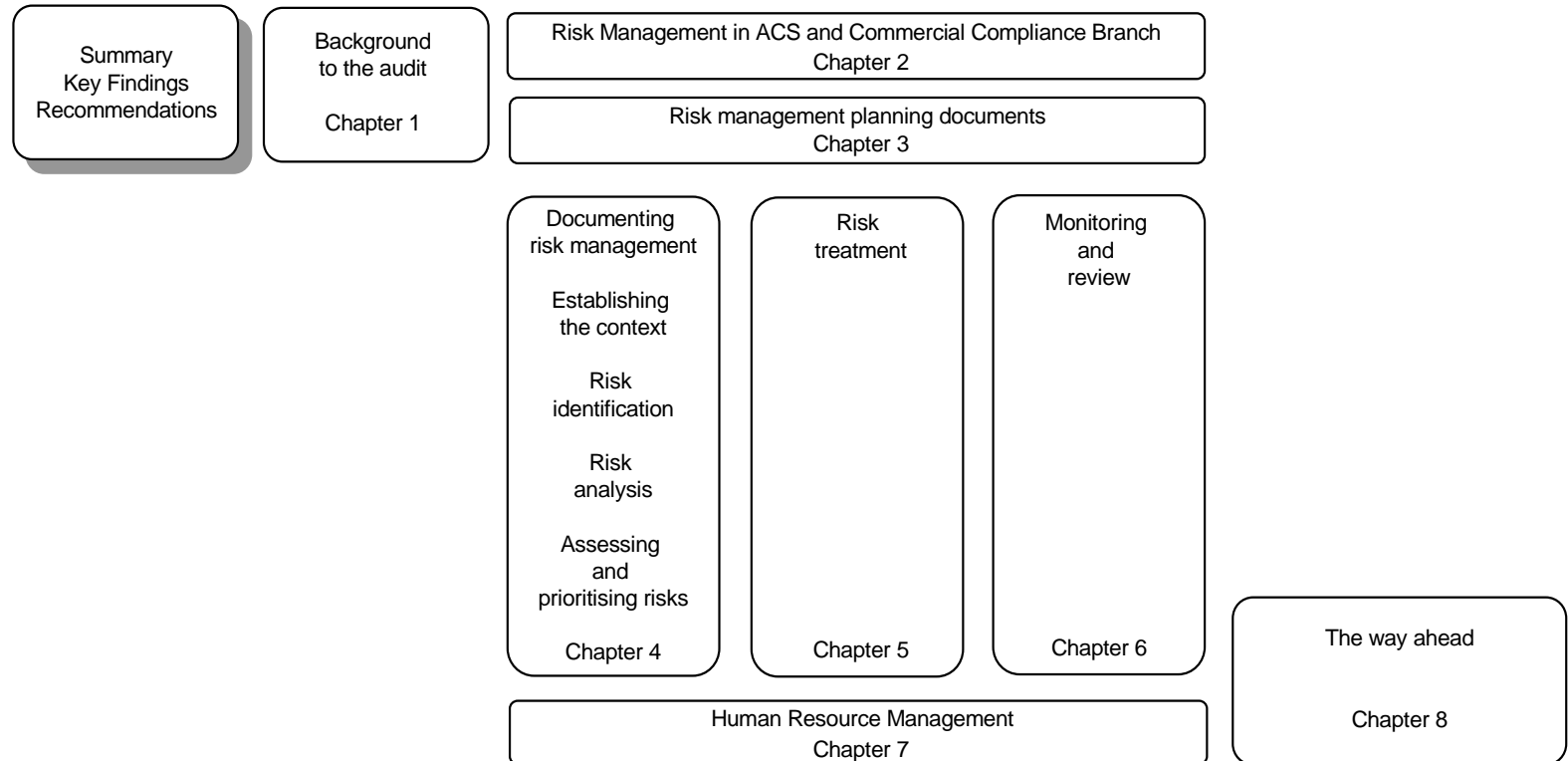
ABC	Activity Based Costing
ACN	Australian Customs Notice
ACS	Australian Customs Service
ANAO	Australian National Audit Office
APS	Australian Public Service
AS/NZS	Australian/New Zealand Standard
ATO	Australian Taxation Office
CAATs	Computer Assisted Audit Techniques
CARD	Compliance Activity Recording Database
CEO	Chief Executive Officer
CEP	Commercial Education Program
COMPILE	Customs On-line Method of Preparing from Invoices Lodgeable Entries
IG	Industry Group
Industry Panel	Industry Panel on Customs Audit Reforms
IT	Information Technology
IT&T	Information Technology and Telecommunications
KPI	Key Performance Indicator
MAB	Management Advisory Board
MIAC	Management Improvement Advisory Committee
NBC	National Business Centre
NCIP	National Compliance Improvement Plan
R and A	Research and Analysis
RACS	Review of the Australian Customs Service
RMCU	Risk Management Co-ordination Unit
TCF	Textile, Clothing and Footwear
TCOs	Tariff Concession Orders
the Branch	the Commercial Compliance Branch
the Division	the Commercial Services Division
the Profile	the Commercial Services Strategic Risk Profile

Part One

Summary and Recommendations

Figure 1

Framework for the report of risk management in the Commercial Compliance Branch



Summary

The structure of this report is illustrated in Figure 1 opposite.

The Australian Customs Service

1. The Australian Customs Service (ACS) is a service-oriented organisation with wide responsibilities covering industry, international commerce and travellers and the protection of the Australian community.¹ ACS is the Commonwealth's second largest revenue collection agency and is responsible for collecting approximately 13 per cent of total government revenue. It collected \$17.8 billion in 1996-97 and had responsibility for another \$6.1 billion through administration of various industry assistance schemes such as concessional duty regimes and rebates. The agency spent close to \$330 million on its operations during 1996-97 and at the end of that year had 4155 staff located across Australia and overseas.

2. The Commercial Compliance Branch (the Branch) is one of six branches in the Commercial Services Division and is responsible for assuring that clients such as importers, exporters and manufacturers of products subject to excise comply with ACS commercial reporting and financial requirements.² Its role in terms of financial requirements is to ensure that the right amount of revenue is collected, paid or forgone by ACS on behalf of the Commonwealth. The financial responsibilities of the Branch totalled approximately \$22.2 billion in 1996-97.³

¹ Australian Customs Service, *Annual Report 1995-96*, AGPS, Canberra, 1996, p16.

² Financial requirements relate, for example, to payments of customs duty or excise or concessions on those taxes. Non-financial requirements, for example, relate to reporting of exports and imports. This reporting is relevant to the collection of accurate trade statistics.

³ Branch responsibilities excluded the Diesel Fuel Rebate Scheme administered by the Excise Branch.

3. The Branch seeks to assure and improve commercial compliance through education and enforcement strategies. Education involves methods such as distributing pamphlets, presenting seminars and providing individual advice to clients to address their information needs and to raise awareness of their obligations under ACS requirements. Enforcement includes, for example, conducting audits and imposing penalties. The Branch had 287 staff located across Australia at 30 June 1997 and cost \$16.4 million⁴ to administer for that year.

Risk management

4. Risk management has been defined as:

*...the systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk.*⁵
(Emphasis added)

It is an integral part of the Australian Public Service (APS) reform program and an important element of the corporate governance framework in the public sector. Corporate governance is the framework of control and monitoring mechanisms to encourage stakeholders' confidence in the performance and integrity of the organisation.

5. Potential benefits available from risk management include an enhanced focus on performance and innovation in a dynamic environment, improved program efficiency and effectiveness, together with better strategic planning resulting from a systematic consideration of the key elements of risk. By requiring greater openness in the decision-making process and assigning specific responsibilities to particular people or organisational elements, risk management also enhances the accountability of agencies and officials.

⁴ Cost for salaries and administrative expenses on a cash basis.

⁵ Standards Australia, *Australian and New Zealand Standard Risk Management AS/NZ 4360: 1995*, jointly published by Standards Australia and Standards New Zealand, Homebush, 1995.

6. There has been significant impetus for change in ACS since 1993 which has heightened the emphasis on risk management in the agency. In part, this stemmed from the Review of the Australian Customs Service (RACS),⁶ the 1995 Report of the Industry Panel on Customs Audit Reforms (the Industry Panel)⁷ and subsequent government decisions affecting the agency. The Industry Panel advocated significant changes in the way ACS dealt with industry and the structure, operations and culture of the organisation.

7. The Industry Panel found that risk management in ACS had been progressed at the tactical and operational levels rather than the strategic level. Like RACS, it recommended that risk management be assigned a high corporate priority as a key element in a strategy for ACS to improve industry voluntary compliance with regulatory requirements. In accepting the reviews' recommendations, the then Government recognised the need for ACS to develop risk management techniques and an organisational strategy for risk management.

8. ACS therefore has had considerable exposure to the business and accountability pressures contributing to the public sector drive for the introduction of formal risk management approaches as part of the management culture. ACS was instrumental in the development of the APS risk management framework, formally documented in the Guidelines for Managing Risk in the Australian Public Service (the APS Guidelines).⁸ The agency was one of the 'front runners' in the APS to introduce formal risk management principles to its planning framework and the Branch was the first within ACS to formally adopt and implement systematic risk management processes. Consequently it presented a useful case study for raising awareness and commitment in other areas of the agency.

⁶ Committee of Review into the Australian Customs Service, *Review of the Australian Customs Service December 1993: The Turning Point*, AGPS, Canberra, 1994.

⁷ Industry Panel on Customs Audit Reforms, *Looking to the Future Compliance Improvement*, Australian Customs Service, Canberra, 1995.

⁸ Management Advisory Board and the Management Improvement Advisory Committee, *Guidelines for Managing Risk in the Australian Public Service*, Report No.22, AGPS, Canberra, 1996. The Guidelines were based on AS/NZS 4360.

Audit objective and scope

9. The objective of the audit was to review the efficiency and administrative effectiveness of the Commercial Compliance Branch's risk management processes and to establish whether the approach provided a sound foundation for the development and application of risk management across ACS.

10. The audit focussed on the Branch because ACS had not comprehensively introduced risk management across the organisation; the Branch was seen as a leader in the application of formal risk management; and it could provide examples of better practice. The ANAO also examined the wider risk management context across ACS in order to appreciate how risk management processes in the Branch related to the agency as a whole.

11. The audit sought to draw out lessons for implementing and continually refining risk management processes that are relevant both to ACS and the public sector generally. In this regard the audit was designed to complement a similar audit undertaken concurrently in the Australian Taxation Office.⁹

12. The audit reviewed the introduction and adoption of ACS risk management processes during the development and implementation of the 1996-97 National Compliance Improvement Plan (NCIP). This annual plan identifies the external compliance risks facing the Commercial Services Division and how they are to be treated. Preparation of the plan for the following year was underway during the final stages of the audit. Accordingly, the ANAO did not audit the implementation of the plan, but where able, has commented on the processes contributing to its formulation.

⁹ Auditor-General, *Risk Management Australian Taxation Office*, Audit Report No.37 1996-97, AGPS, Canberra, 1997.

13. The audit did not set out to assess the appropriateness of the Branch's identified risks nor the overall outcomes of the process (to do this would have been to attempt to 'second guess' the technical expertise of ACS). However, the ANAO engaged risk management consultants to assist it to analyse the underlying risk management principles and processes which support those overall outcomes and which could have wider application. Summary

Audit criteria

14. The criteria for the audit were based on the APS Guidelines and the Australian and New Zealand Standard on Risk Management (AS/NZS 4360). The criteria were used as a basis for examining:

- how the Branch determined the internal and external context (or environment) in which it operates;
- what information it used to identify the risks to commercial compliance;
- how it analysed those risks;
- how it assessed and established priorities for those risks;
- the mix of treatments used to address those risks; and
- how it reviewed and monitored both the risks and the management of those risks.

15. Issues of human resource management relevant to the adoption of formal risk management by the Branch were also considered.

Overall conclusion

16. The ANAO concluded that the Branch was making sound progress in introducing formal risk management. However, there is scope for the Branch to improve the

efficiency and administrative effectiveness of its future risk management processes.

17. While not yet having fully in place the framework for formal risk management advocated in the APS Guidelines, the Branch 1996-97 risk management framework and processes for managing compliance risks represented a solid basis for continued development over the next couple of years.

18. The Branch was three years into a process informally estimated by ACS staff to take five years. It was refining its risk management framework through its compliance risk management plan, compliance activity recording database and supporting organisational structure. It also had planned a major human resource development program and put other specific training measures in place to facilitate the continued development of risk management. Among the Branch's specific achievements since 1995 have been that it:

- adopted a new philosophy for the management of compliance emphasising a partnership with industry to achieve a continual improvement in voluntary compliance rather than merely the correction and penalisation of past errors;
- prepared the first ever risk profile to address ACS commercial risks on a national basis;
- devised and applied the National Compliance Improvement Plan which, for the first time, used a national approach to treating risks across industry sectors; and
- developed audit procedures consistent with contemporary professional audit approaches and a tertiary accredited educational program for all ACS staff who had dealings with the trading community.

19. Although the Branch was progressing with its application of risk management operationally, based on the framework it has established, we considered that the quality of documentation needed to be improved to support fully the processes of analysis and decision-making. We also found that some elements of

the risk management process were relatively underdeveloped compared to the framework advocated in the APS Guidelines. This was evident in the Branch's consideration and analysis of the interests of external stakeholders and processes to identify, analyse, assess and prioritise risks.

20. In concluding that a sound risk management framework has been established within the Branch for considering compliance risks, it is our view that ACS is now in a position to apply that framework to the whole of the organisation and extend consideration to other types of risks. In doing so, it can capitalise on its own considerable experience and achievements as well as those of other agencies, in adopting and implementing comprehensive risk management.

21. Applying the framework across ACS will help the agency to achieve its objective of making risk management an integral part of the planning and management processes at all levels of the organisation. This has the potential to lead to improvements in performance and accountability for ACS via improved administrative efficiency, effectiveness and transparency in the decision-making process.

22. ACS responded positively to the audit and the recommendations in this report, indicating that the report would assist the agency in its implementation of risk management procedures throughout the organisation.

Acknowledgments

23. The ANAO would like to thank all ACS officers who assisted in the conduct of this audit. We also appreciated the co-operation of representatives of the alcohol, textile, clothing and footwear, duty free and customs brokers industries consulted during the audit.

Key Findings

The Branch's risk management framework

24. The audit found that the Branch had developed a sound framework for the risk management process. Positive elements of this framework included:

- development of a national approach to compliance risk management in a comprehensive compliance risk management plan, referred to as the National Compliance Improvement Plan (NCIP); and
- implementation of a suitable organisational structure of Industry Groups and National Business Centres. These organisational structures are designed to provide a one-stop shop for the major industry sectors and to develop industry expertise in the Branch in those regions where there is a concentration of a specific industry.

25. The audit also found that the need for improved staff skills had been recognised by the Branch, a related long-term staff development plan was in place and it had implemented some measures to obtain specialist assistance. However, there is a continuing need for the Branch to supplement, and expedite the acquisition of, specialist audit, research and analytical skills to support the wider implementation of relevant risk management practices.

The Branch's risk management process

26. The audit identified a number of initiatives by staff in undertaking risk management processes. These included the development of:

- techniques such as education and leverage exercises to treat risks, to complement the existing strong focus on audit-based techniques;

- key performance indicators in three industries (petroleum, alcohol and tobacco) to monitor client production and excise duty trends; and
- a statistical measure of the extent to which industries are complying with their revenue responsibilities to monitor and review changes in compliance levels.

27. Our examination of the 1996-97 risk management process for the Branch revealed that its efficiency and effectiveness could be improved by:

- enhancing the quality and extent of documentation of the process undertaken and decisions made to enable review and continuous improvement;
- undertaking greater consideration and analysis of the interests of external stakeholders, canvassing both industry representatives and other relevant government agencies domestically and overseas;
- making greater use of qualitative and quantitative analytical techniques to identify, analyse, assess and prioritise risks;
- applying consistent risk management scales to allow for comparable risk assessment and prioritisation across Industry Groups;
- explicitly considering the cost and benefits of risk treatment options and (where cost-effective) further integrating the approach to treating risks, incorporating administrative arrangements (such as legislation and collection processes), client education and enforcement (such as audits and penalties);
- enhancing the quality of information contained in the compliance activity database to enable improved consideration of the cost-effectiveness of alternative risk treatment strategies, better monitoring of risks and review of the risk management process; and
- Central Office assuming a wider role in co-ordinating the development of the NCIP, undertaking quality assurance reviews and further developing and reviewing Branch performance indicators.

Risk management in ACS

28. Risk management is an important part of the corporate governance framework in the public sector. ACS advised the ANAO that it was developing a strategy for its corporate governance framework to include risk management along with other elements such as corporate planning, client service, financial benchmarking, resource allocation and performance measurement and reporting.

29. The ANAO found that the ACS Executive gave risk management a high corporate priority, the organisation had refined its risk management processes and developed a good infrastructure to support corporate risk management. ACS achievements included committing in May 1995 to, and subsequently:

- implementing a formal process of risk management using the theoretical principles in the then draft risk management standard AS/NZS 4360 and draft APS Guidelines;
- establishing an implementation unit designated to support the corporate introduction of risk management; and
- assigning responsibility for the task of managing the process throughout ACS to a senior executive.

In March 1996, ACS issued its risk management policy based on the APS Guidelines and AS/NZS 4360.

30. In our view ACS could advance the full implementation of risk management across the agency if it promptly established a realistic target completion date and prepared a statement which summarised the risks facing the organisation in its key operational areas. These measures would help senior management in ACS to secure the business and accountability benefits of risk management in a timely way.

Recommendations

Set out below are the ANAO's recommendations with the report paragraph reference. The recommendations are framed on the basis that ACS Commercial Compliance Branch has a sound risk management framework in place and this can be enhanced by applying the measures advocated. The ANAO considers that ACS should give priority to recommendations numbered 2, 4, 5, 8, 10 and 11.

ACS agreed to all recommendations. The agency's detailed comments are included in the body of the report.

**Recommendation
No.1
Para 3.14**

The ANAO *recommends* that to promote clearer communication of how risk management plans are integrated into the overall planning and reporting framework within ACS, the Commercial Services Division ensures that future plans include:

- an outline of the purpose of the plan;
- a clear statement of the relationship of the plan to other ACS planning documents;
- performance targets, measures and the reporting framework; and
- a description of the quality assurance framework and process.

**Recommendation
No.2
Para 3.28**

The ANAO *recommends* that to provide greater transparency, co-ordination and consistency in the preparation of the National Compliance Improvement Plan, consideration be given to an expanded role of the Commercial Compliance Branch in Central Office which would include:

- further developing risk management guides and pre-formatted documents for comprehensive and streamlined risk management record keeping;
- producing and maintaining risk measurement

scales;

- performing more quality assurance reviews of the risk management process; and

further formulating, monitoring and reviewing Branch performance indicators.

**Recommendation
No.3**

Para 4.18

The ANAO *recommends* that in order to provide a more substantial and comprehensive basis for the risk management process, the Commercial Compliance Branch undertakes a more structured approach to the analysis of the environment and stakeholders and further develops explicit and operationally applicable risk criteria for managing risk.

**Recommendation
No.4**

Para 4.24

The ANAO *recommends* that ACS strengthens and diversifies its techniques for risk identification, embracing data analysis and process analysis as well as brainstorming, to ensure that risks are comprehensively identified.

**Recommendation
No.5**

Para 4.41

The ANAO *recommends* that, in order to better support the structured analysis of risks and consideration of their significance, ACS further develops the use of qualitative and quantitative risk analysis techniques and risk measurement scales.

**Recommendation
No.6**

Para 4.48

The ANAO *recommends* that, to assist with strategic decision-making, including resource allocation decisions, the Commercial Services Division undertakes a risk assessment and prioritisation process across Industry Groups and develops an overall risk priority register as part of its Corporate Governance framework.

Recommendation No.7
Para 5.15

The ANAO *recommends* that to better support the cost-effectiveness analysis of compliance activities by Industry Groups and to assist in the selection of treatment options, the Commercial Compliance Branch puts appropriate mechanisms in place to improve the accuracy of information contained in the Compliance Activity Recording Database.

Recommendation No.8
Para 5.37

The ANAO *recommends* that to facilitate the selection of suitable risk treatments ACS:

- where appropriate, incorporates explicit cost-effectiveness analysis into its selection process; and
- makes greater use of integrated risk treatment approaches combining administrative arrangements, stakeholder education and enforcement activities.

Recommendation No.9
Para 5.51

The ANAO *recommends* that to contribute to the appropriate treatment of risks identified in the National Compliance Improvement Plan, Industry Groups profile and explicitly select clients on the basis of risks in the plan, taking into account the likelihood and consequence of those risks occurring at the client level.

Recommendation No.10
Para 6.20

The ANAO *recommends* that to enable the Commercial Compliance Branch to more effectively monitor and review how changing circumstances may alter risk priorities and to ensure the ways in which risks are managed remain relevant, the Branch enhances its management information framework by developing the systematic use of external and internal information sources and incorporating appropriate performance information.

Recommendation No.11

The ANAO *recommends* that to supplement and expedite the acquisition of specific audit and

Para 7.30

Information Technology skills ACS:

- continues to use external, professional assistance in these areas and establishes a framework for this assistance to be available in the longer term; and
- considers selective recruitment, secondments and staff interchanges of professional audit managers and team leaders into positions in the Commercial Compliance areas in regional offices to achieve more cost-effective outcomes.

**Recommendation
No.12**

Para 8.19

The ANAO *recommends* that to:

- assist strategic organisational and resourcing decisions by senior management, ACS prepares a statement summarising the risks facing the agency in its key operational areas; and
- ensure sufficient information for the development of such a statement, ACS sets a realistic medium term target for key operational areas to have consistent risk management plans in place.

Part Two

Audit Findings and Conclusions

1. Introduction

This chapter provides the background to the audit and outlines its objective, methodology and the findings of other significant reviews.

Background to the audit

1.1 The Australian Customs Service (ACS) is a service-oriented organisation with wide responsibilities covering industry, international commerce and travellers and the Australian community. The three principal roles of ACS are to:

- facilitate trade and the movement of people across the Australian border while protecting the community and maintaining appropriate compliance;
- assist Australian industry through the delivery of government support measures; and
- collect customs and excise revenue.¹⁰

1.2 ACS is the Commonwealth's second largest

revenue collection agency and is responsible for collecting approximately 13 per cent of total government revenue. It collected \$17.8 billion in 1996-97 and had responsibility for another \$6.1 billion through administration of various industry assistance schemes such as concessional duty regimes and rebates. The agency spent close to \$330 million on its operations during 1996-97 and at the end of that year had 4155 staff located across Australia and overseas.

1.3 The Commercial Compliance Branch (the Branch) is one of six branches in the Commercial Services Division and is responsible for assuring that clients such as importers, exporters and manufacturers of products subject to excise comply with ACS commercial reporting and financial requirements.¹¹ Its

¹⁰ Australian Customs Service, *Corporate Plan 1996-1999*, Australian Customs Service, Canberra, 1997, p3.

¹¹ Financial requirements relate, for example, to payments of customs duty or excise or concessions on those taxes. Non-financial requirements, for example, relate to reporting

role in terms of financial requirements is to ensure that the right amount of revenue is collected, paid or forgone by ACS on behalf of the Commonwealth. The Branch's financial responsibilities totalled approximately \$22.2 billion in 1996-97.¹²

1.4 The Branch seeks to assure and improve commercial compliance through education and enforcement strategies. Education involves methods such as distributing pamphlets, presenting seminars and providing individual advice to clients to address their information needs and to raise awareness of their obligations under ACS requirements. Enforcement includes, for example, conducting audits and imposing penalties. The Branch had 287 staff located across Australia at 30 June 1997 and cost \$16.4 million¹³ to administer for that year.

1.5 Appendix 1 depicts the organisational structure of ACS and revenue responsibility of the Branch.

of exports and imports. This reporting is relevant to the collection of accurate trade statistics.

¹² Branch responsibilities excluded the Diesel Fuel Rebate Scheme administered by the Excise Branch.

¹³ Cost for salaries and administrative expenses on a cash basis.

Risk management in the Australian Public Service and ACS

1.6. Risk management is a tool used by all managers, whether implicitly or explicitly and has been practised by ACS for a number of years. It has been defined as:

*...the systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk.*¹⁴
(Emphasis added)

Management of risk is an integral part of the Australian Public Service (APS) reform program designed to enhance both performance and accountability. It is an important part of the corporate governance framework in the public sector which relates to control and monitoring mechanisms to encourage stakeholders' confidence in the performance and integrity of the organisation. ACS advised the ANAO in June 1997 that it was developing a strategy for its corporate governance framework, to include risk management along with other elements such as corporate planning, client service, financial benchmarking, resource allocation and performance measurement and reporting.

1.7 Risk management leads the organisation to focus more closely on performance, encourages

¹⁴ Standards Australia, op. cit., p5.

greater innovation, the identification of organisational opportunities and fosters continuous improvement. It also promotes better strategic planning resulting from a systematic consideration of the key elements of risk. By requiring greater openness in the decision-making process and assigning specific responsibilities to particular people or organisational elements, risk management also enhances the accountability of agencies and officials.

1.8 The APS risk management framework is formally documented in the MAB/MIAC Guidelines for Managing Risk in the Australian Public Service (the APS Guidelines).¹⁵ These were based on the Australian/New Zealand Standard for Risk Management (AS/NZS 4360) which was developed and published by Standards Australia.

1.9 ACS has had considerable exposure to the business and accountability pressures contributing to the drive in the APS behind the introduction of risk management in formal terms and was instrumental in the development of the APS Guidelines. The organisation was among the first APS agencies to introduce formal risk management principles into its planning

framework and has promoted risk management practices in other Customs administrations internationally.¹⁶

1.10 The APS Guidelines are depicted by the ACS risk management model reproduced in Figure 2 below.

Reasons for the audit

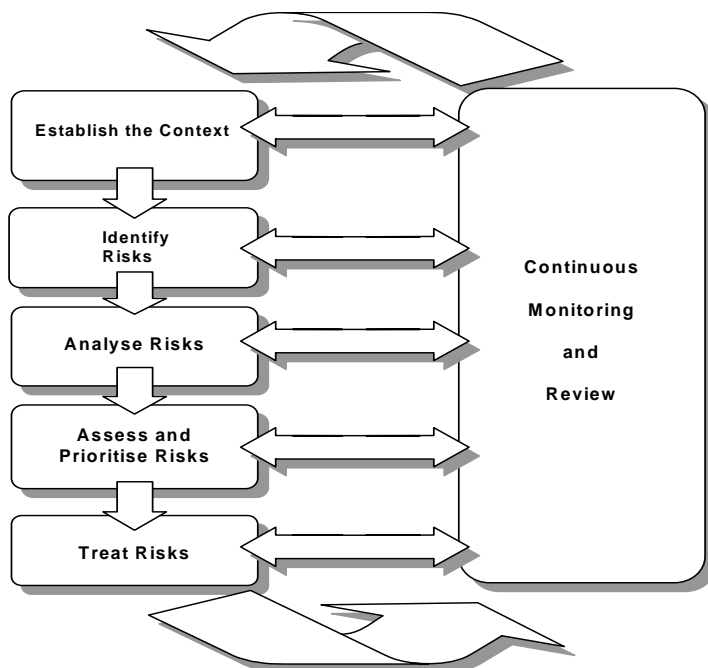
1.11 ACS is a large organisation with a diverse and complex role of collecting revenue, providing industry assistance through concessional duty and rebate schemes and protecting the community by preventing the movement of drugs, disease and illegal imports over the Australian border. Risk management therefore plays an integral part in managing the operations of the organisation to determine where its risks lie and establish the most appropriate and cost-effective ways of treating them.

¹⁵ Management Advisory Board and the Management Improvement Advisory Committee, op. cit.

¹⁶ ACS has taken a prominent role with Customs administrations internationally via the World Customs Organisation and the Asia Pacific Economic Cooperation organisation.

Figure 2

Australian Customs Service risk management model



1.12 The Commercial Compliance Branch undertakes a range of activities designed to maintain or improve compliance levels. As the second largest revenue collection agency and with the Branch responsible for some \$22 billion in revenue collections, payments and revenue forgone, small improvements in effectiveness and efficiency of its operations can have large implications in terms of dollars raised for the Commonwealth.

1.13 The Branch was a leader in implementing risk management within ACS. It introduced a formal

risk management process in 1996-97 which built on its work in the previous year. The ANAO sought to draw out examples of better practice and lessons learnt by the Branch in implementing and continually refining risk management processes that are relevant to all of ACS and the wider APS.

1.14 The audit reviewed the introduction and implementation of risk management processes and offers recommendations to improve the management of risks in the ACS. Audit findings generally relate to the preparation of the 1996-97 National

Compliance Improvement Plan although some comments have been provided on the 1997-98 round.

1.15 The audit was designed to complement similar performance audits undertaken in the Australian Taxation Office. During the preparation of this report, we tabled in Parliament an audit report on risk management in the Australian Taxation Office (ATO).¹⁷ Building on the first ATO report, a second audit focusing on the implementation of risk management in the Small Business Income area of the ATO is expected to be tabled later in 1997.

Audit objective

1.16 The objective of the audit was to review the efficiency and administrative effectiveness of ACS risk management processes. Because ACS had not comprehensively introduced risk management across the organisation, the ANAO focussed on the planning and operational application of risk management where it was most advanced, that is, in the Commercial Compliance Branch.

Audit methodology

1.17 A preliminary study of risk management in the Branch was undertaken in September 1996. At the conclusion of this study it was decided that an efficiency audit should proceed looking at the management of compliance risks by the Branch. The ANAO reviewed the risk management processes that the Branch used to deal with sources of compliance risks associated with collecting revenue and administering concessional duty and excise schemes.

1.18 Clients of the Branch are broadly categorised into nine industry sectors looked after by an Industry Group that specialises in each industry sector. The audit focussed on three Industry Groups, namely the Alcohol Industry Group, the Duty Free Industry Group and the Textile, Clothing and Footwear Industry Group. These were selected to cover the range of ACS revenue responsibilities in a variety of industries. Discussions were held with officers of all Industry Groups in the Branch and with several industry representatives.

1.19 The audit criteria were based on the risk management model in the APS Guidelines and AS/NZS 4360. The ANAO recognises that the APS

¹⁷ Auditor-General, op. cit.

Guidelines (Report No. 17)¹⁸ had only been released in draft form during the period that the initial planning and the 1996-97 NCIP were being formulated. However, we consider that their adoption for this audit as a reference point was appropriate as ACS has been practising the underlying principles outlined in both these publications for some time and contributed to the development of the APS Guidelines.

1.20 The ANAO engaged the services of risk management experts, Dr Dale Cooper of Broadleaf Capital International and Mr Colin Flynn of KPMG Management Consulting to assist the audit team analyse the ACS and Branch risk management strategies, plans and activities. In addition, Mr Pat Farrelly of Pat Farrelly and Associates provided specific audit expertise to assist the audit team assess the activities of the Branch.

1.21 Fieldwork for the audit was undertaken in four regions (South Australia, Victoria, New South Wales and Queensland) between November 1996 and January 1997 and in Central Office to March 1997. The ANAO also consulted representatives of the alcohol, textile, clothing and footwear, duty free and customs

broking industries and the Chairman of the Industry Panel on Customs Audit Reforms.

1.22 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of \$438 000.

Other reviews

1.23 The findings of the more significant reviews relevant to ACS risk management were taken into consideration during the audit. These included some recent coverage by the ANAO.

1.24 Until this audit, the ANAO had not undertaken an efficiency audit of risk management in ACS; mainly because of the relatively recent emergence of risk management as a formal and discrete issue in public sector management. However, an efficiency audit in 1996 on the administration of the Diesel Fuel Rebate Scheme found ACS lacked an established risk management framework for the Scheme.¹⁹

1.25 The 1994-95²⁰ and 1995-96²¹ financial statements

¹⁹ Auditor-General, *Diesel Fuel Rebate Scheme Australian Customs Service*, Audit Report No.20 1995-96, AGPS, Canberra, 1996.

²⁰ Auditor-General, *Results of the 1994-95 Financial Statements Audits of Commonwealth Entities*, Audit Report No.13 1995-96, AGPS, Canberra, 1995.

²¹ Auditor-General, *Results of the 1995-96 Financial Statements Audits of*

¹⁸ Management Advisory Board and the Management Improvement Advisory Committee, *Guidelines for Managing Risk in the Australian Public Service Exposure draft*, Report No.17, AGPS, Canberra, 1995.

audits of ACS examined the issue of risk management. These found that ACS was developing an implementation strategy for risk management in 1994-95 and that progress in 1995-96 on this strategy provided a good foundation for mature risk management in the future.

1.26 Other reviews of ACS of significance to this audit are noted below. They are also mentioned, as relevant, in later chapters of the report.

1.27 The 1993 report *Risk Management A Customs Perspective*²² canvassed risk management issues and practices in Australia and overseas Customs administrations. The report identified the common and distinctive aspects of Customs and related enforcement agencies in the design, development and application of risk management. The study found that risk management tended to focus on operations, strategic aspects of risk management were relatively less well developed and risk management applications were inadequately documented.

1.28 The Review of the Australian Customs Service

(RACS)²³ recommended substantial change to the structure, operations and culture of ACS and concluded that the agency needed to further develop risk management techniques.

1.29 The 1995 report of the Industry Panel on Customs Audit Reforms²⁴ further emphasised the need for applying risk management in ACS and highlighted its relevance in the commercial compliance function. The Industry Panel provided the blueprint for much of the wide-ranging change instituted by the Branch in recent years and adoption and implementation of its recommendations have been a priority for the Branch.

Commonwealth Entities, Audit Report No.19 1996-97 AGPS, Canberra, 1996.

²² C. Vassarotti, *Risk Management A Customs Perspective*, Australian Customs Service, Canberra, 1993.

²³ Committee of Review into the Australian Customs Service, op. cit.

²⁴ Industry Panel on Customs Audit Reforms, op. cit.

2. Background to Risk Management in ACS and the Commercial Compliance Branch

This chapter provides background to risk management in ACS and the key forces which have shaped its formal introduction in the agency and the Branch.

Risk management in ACS

2.1 As noted in Chapter 1, ACS has comprehended the principles of risk management in Customs administration, contributed to the development of the formal processes in the APS and has applied risk management to its operations for some time. The ANAO considers that ACS is at the forefront of the APS generally in its consideration of the functional and organisational requirements of risk management at the corporate level. This achievement is due in part to the economic, commercial and organisational forces for change operating on the agency, especially in the 1990s and ACS responses to them.

2.2 Since 1993 there has been significant change in ACS with the Review of the Australian Customs

Service (RACS)²⁵ and subsequent government decisions. The ACS Chief Executive Officer noted in the 1995-96 Annual Report that:

...it was a year in which many Customs tenets, which had been fundamental to our basic operational philosophies, were challenged: our role in Australian commerce and the international trading cycle; whether we should be in certain locations; our relationship with industry generally.²⁶

2.3 The significant changes in ACS subsequent to RACS involved key directional shifts in the approach and culture of the agency with an increased emphasis on trade facilitation and industry assistance, a more clearly defined client focus, a major organisational restructure and substantial staff reductions.

²⁵ Committee of Review into the Australian Customs Service, op. cit.

²⁶ Australian Customs Service, op. cit., p2.

2.4 RACS concluded that ACS needed to undertake new tasks requiring new skills with less emphasis on physical checking and more on the elements of risk management (risk assessment, information analysis, self-assessment by industry and post-transaction audit coupled with administrative penalties). In accepting the review's recommendations, the then Government recognised the need for ACS to develop risk management techniques and an organisational strategy for risk management.

2.5 Also in response to RACS, in 1994 the then Minister established the Industry Panel on Customs Audit Reforms.²⁷ The Industry Panel was formed to assist ACS reform its industry audit function and to provide advice on the development of appropriate risk management regimes for all relevant aspects of ACS commercial operations.²⁸

2.6 The Industry Panel provided the comprehensive blueprint for much of the wide-ranging change instituted by the Commercial

Compliance Branch in recent years. It advocated significant changes in ACS structurally, operationally and culturally; and in the way ACS audited industry. Like RACS, it recommended that risk management be assigned a high corporate priority as a key element in the ACS strategy to improve industry voluntary compliance with regulatory requirements.

2.7 The Industry Panel suggested that ACS raise the focus of its compliance initiatives from individual transactions to one which looked at the client as an entity and at the industry as a whole. It suggested that ACS place greater emphasis on assessing the overall integrity of client systems. The Industry Panel's strategy for ACS had the following elements:²⁹

- responsible and informed self-assessment;
- a partnership approach with industry;
- client education, advice and service;
- appropriate development and support for Customs staff;
- clear legislative and administrative requirements;
- a risk managed, co-ordinated approach;
- appropriate audit activity;

²⁷ Industry Panel on Customs Audit Reforms, op. cit.

²⁸ ACS briefing to Customs Advisory Board 26 May 1995. The Customs Advisory Board (replaced in 1997 by the Ministers Advisory Council on Customs) was established in 1994 to oversee the implementation process of the then Government's decisions in relation to RACS and to make recommendations to the Minister and the Chief Executive Officer on matters of ACS administration.

²⁹ Industry Panel on Customs Audit Reforms, op. cit., p2.

- an appropriate penalty regime; and
- quality assurance.

Previous approach to commercial compliance

2.8 ACS advised the ANAO that the sort of approaches applied before it embraced the reforms of the Industry Panel were:

- officers involved in compliance activities, including audit, traditionally undertook activities in specific functions such as imports, exports, excise, bounties, warehousing or other commercial functions. Because the functions were viewed in isolation some transactions regarded as significant or high risk in one function were insignificant when viewed in the overall ACS context. For example, a 'significant' import refund claim of \$5000 to a client was fully checked but an excise payment of \$50 million from the same client was accepted at face value because the latter amount was relatively insignificant in the context of the billions of dollars collected annually in excise;
- relatively little attention was paid to future compliance with regulatory requirements. Traditionally, ACS had a four step approach to compliance activities - audit a client, find an

error, penalise the client and leave; and

- the client focus and overall industry knowledge was not as strong as it might have been, since the diverse involvement that clients had with ACS were split across separate areas.

New approach to commercial compliance by the Branch

2.9 ACS advised the ANAO that in embracing the recommendations of the Industry Panel, it recognised the need to adopt a more co-ordinated approach to its activities. It also identified that it needed to derive an effective strategy to manage compliance with regulatory requirements and an overall view of compliance issues in the context of ACS total revenue responsibility.

2.10 The agency outlined its new approach to securing improvement in commercial compliance as:

- seeking to achieve a continual improvement in the level of voluntary compliance. The main focuses of compliance strategies are to secure future compliance rather than correct past errors; and to ensure there is an appropriate balance between service and enforcement;

- considering why an error was made and to ensure that it does not recur (for example, by addressing systemic problems in the client, formally clarifying the law or imposing sanctions); and
- focusing on industry sectors with units in each region responsible for all aspects of compliance for that particular industry sector. This is designed to sharpen the client focus and strengthen relationships with, and knowledge of, individual clients and industry groups.

2.11 To implement the new approach, in 1996 the Branch:

- reorganised its structure from a functional focus such as 'excise audit' and 'import audit' to nine industry lines, incorporating several functions to refocus national compliance activities; and later realigned industry groups within the Commercial Services Division to more closely reflect identified areas of risk and to allocate resources accordingly;
- gave regions a national co-ordination function for particular industry sectors by establishing centres which have national responsibility for specific industries, designed to achieve effective co-ordination of compliance activities; and

- introduced a national plan providing a national focus on compliance improvement that addressed risks across several functional areas.

2.12 The Industry Panel provided the strategic direction for the Branch and its specific recommendations on risk management have shaped the approach adopted in the Branch and, more generally, in ACS. Those recommendations included the preparation and implementation of a corporate risk policy, nomination of a senior executive in ACS to drive the process and formulation of an ongoing planning and management infrastructure. These measures are considered in more detail in later chapters.

2.13 The Branch has made good progress in implementing the relevant recommendations of RACS and the Industry Panel in the face of substantial reductions in resources. Since inception of the Branch in 1995 staffing has declined by approximately 80 positions.

3. Risk Management Planning

This chapter discusses the Commercial Services Strategic Risk Profile and the National Compliance Improvement Plan. It also reviews the roles of Industry Groups, National Business Centres, Research and Analysis Groups and Central Office in the development of the plan.

Introduction

3.1 The Commercial Services Strategic Risk Profile (the Profile) and the National Compliance Improvement Plan (NCIP) were first introduced as part of the formal ACS risk management planning framework in 1995-96. The documents are prepared annually using the APS Guidelines and AS/NZS 4360 to guide how ACS will address compliance risks faced by the Commercial Services Division (the Division). Business risks and issues such as information technology, human resource management and training are addressed through other Divisional and/or ACS planning documents.

Commercial Services Strategic Risk Profile

3.2 The purpose of the Profile is to:

...identify and rate risks and set the national strategy for risk treatment, providing direction for developing the NCIP.³⁰

3.3 The Profile is developed by the Central Office Research and Analysis Group, in conjunction with Commercial Services executives and other relevant managers. The ACS flow chart for the preparation of the NCIP shows finalisation of the Profile in January.

3.4 The initial Profile was completed in September 1995, before the APS Guidelines and AS/NZS 4360 were released and therefore, understandably, did not fully adopt the formal risk management processes which were evolving at the time. However, in the ANAO's view the Profile developed in 1995-96 provided a good basis for the one being developed in 1996-97.

³⁰ Commercial Services Strategic Risk Profile 1995.

3.5 The ANAO found that ACS adopted a logical, methodical process in compiling the Profile underway in late 1996 and that it closely followed the APS Guidelines and AS/NZS 4360 risk management framework. The draft Profile reviewed by the ANAO contained a detailed discussion of risks, how they might arise, their likelihood and potential consequences and, in some cases, an overall assessment of risk priority.

3.6 ACS has access to valuable information about its performance as viewed from the perspective of its clients and stakeholders. This includes their expectations and experiences with ACS. Although the ANAO understands that the agency has significant contact with external stakeholders and clients at the strategic level, the draft Profile did not document this contact. The draft Profile identified external stakeholders, however, documented analysis of their interests and their influence on the Division's environment was limited. ACS advised the ANAO in August 1997 that the final version of the Profile recognised contact with external stakeholders and that analysis had been undertaken.

National Compliance Improvement Plan

3.7 A meeting of senior executives from the Division in

August 1996 determined that the objective of the NCIP was:

...to address and determine appropriate treatment of the risks identified in the Profile.³¹

3.8 The meeting also considered that both the post-transaction treatments (which are Branch responsibilities) and real-time treatments (which are the responsibility of other Branches within the Division) should be included as part of the NCIP. The ANAO noted that although the 1996-97 plan did not adopt this approach, the Division advised that it intends that future NCIPs address all compliance risks and treatments across the Division.

3.9 The 1996-97 NCIP was developed along the nine industry sector lines adopted by the Branch: Petroleum; Alcohol; Tobacco; Duty Free; General Business; Textile, Clothing and Footwear (TCF); Automotive and Transport; Mining; and Information Technology and Telecommunications (IT&T). The plan contained four basic components for each industry:

- a general information section covering size and demographics of the industry and the top 50 clients by ACS revenue responsibility (collections and concessions);

³¹ Divisional Meeting Minutes August 1996.

- a national risk register listing industry risks and risk likelihood, consequence, overall risk level and risk priority within the industry sector;
- a national project profile indicating proposed treatments for identified risks; and
- regional work plans identifying which risks and clients were to be treated in each region.

3.10 This four part structure provided a detailed basis for the consideration of risks and proposed treatments. The ANAO considers the current use by ACS of risk registers (as described in AS/NZS 4360), standard documents for describing treatment projects and regional work plans provide excellent documentation for these aspects.

3.11 To ensure effective communication it is good practice for a planning document to have its objective or purpose clearly stated and its links to other planning documents properly identified. Inclusion of an outline of performance indicators, the reporting and monitoring framework and any quality assurance processes within a plan also help to make it comprehensive and clear.

3.12 The ANAO noted that the 1995-96 NCIP provided an outline of the development process for the plan, stating that it was based on the outcomes from the Profile

and that the relevant National Business Centre Manager was required to report to the National Manager Commercial Compliance at the end of each financial year on the results of the activities. The 1995-96 plan also specified the industry sector risk rating given to it in the Profile, thereby highlighting the overall risk rating for the industry sector and giving an additional link to the Profile.

3.13 The 1996-97 NCIP included a flow chart to show how the plan was developed but omitted some elements of the 1995-96 plan which the ANAO considers should be reinstated. These included a statement of the purpose of the plan and an outline of the reporting processes. The plan could also be made more comprehensive by including performance measures and a description of the quality assurance processes involved in maintaining and improving the plan.

Recommendation No.1

3.14 The ANAO *recommends* that to promote clearer communication of how risk management plans are integrated into the overall planning and reporting framework within ACS, the Commercial Services Division ensures that future plans include:

- an outline of the purpose of the plan;

- a clear statement of the relationship of the plan to other ACS planning documents;
- performance targets, measures and the reporting framework; and
- a description of the quality assurance framework and process.

ACS response

3.15 Agreed. The majority of these initiatives have been implemented in the context of the 1997-98 National Compliance Improvement Plan.

Preparation of the National Compliance Improvement Plan

3.16 The ANAO observed that the organisational structure in the Branch involved nine industry sector groups each with a National Business Centre. Officers appeared supportive of this structure and the ANAO noted that the framework fostered a high level of co-ordination and co-operation between Industry Groups across regions (which facilitated the development of the 1996-97 NCIP).

3.17 Broadly, the four elements of each industry sector are Industry Groups (IGs), National Business Centres (NBCs), Research and Analysis Groups (R and A Groups) and Commercial Compliance Central Office. The role of these elements in the

development of the NCIP is described below.

Industry Groups

3.18 All industry sectors are represented in each region, however, where industry sectors have only a small presence in a region, one group of ACS officers covers several industry sectors. As at 30 June 1997 there were 223 staff assigned to IGs across Australia.

3.19 In the development of the 1996-97 NCIP, IGs were responsible for preparing and implementing the regional risk treatment plans to address identified risks. This involved selecting the risks which were applicable to the region, identifying if treatment options were appropriate and selecting clients for treatment. The regional work plans were then incorporated into the 1996-97 NCIP.

National Business Centres

3.20 NBCs were introduced in August 1996. The concept evolved from the Industry Panel recommendation to establish 'centres of excellence' for industry groups with the aim of encouraging the development of industry expertise.

3.21 In addition to acting as the IG for the region in which they are located, NBCs are central information points which provide:

- co-ordination and leadership for other IGs within their industry sectors;
- co-ordination of industry sector research; and
- monitoring of national industry changes.

3.22 NBCs are also responsible for co-ordinating the development of the NCIP component relating to that industry. NBCs, in consultation with IGs and Central Office Branches with relevant policy responsibilities, establish the industry risk register and the best approach to treat those risks. Once the IG regional work plans are prepared, NBCs review them. The review involves, among other things, identifying clients who may be subject to treatment in several regions to determine if a national approach is required.

Research and Analysis Groups

3.23 The R and A Groups are an element of the Branch, however, they provide research and analysis support for all Branches within the Division. As at 30 June 1997, R and A Groups had 50 staff located in Central Office and all regions (other than Tasmania and the Northern Territory).

3.24 The R and A Groups undertake a wide variety of tasks for the Branch that contribute to the NCIP. They helped to identify industry sector clients and undertook analysis of population demographics for the 1996-97 NCIP. Such analysis included, for example, the number and value of clients for industry and sub-industry risk analyses.

Commercial Compliance Central Office

3.25 The Industry Panel identified several responsibilities for a central co-ordinating body, including the development, monitoring and review of:

- national Branch policies and standards;
- national compliance improvement plans; and
- performance indicators.

The central co-ordinating functions are undertaken in

Central Office, which had 14 staff at 30 June 1997.

3.26 Central Office provided significant national co-ordination, direction and support to NBCs and IGs during the preparation of the 1995-96 and 1996-97 NCIPs. It also made important contributions to the risk management training program, the computerised activity recording database and commercial compliance policy and audit manuals. In addition, it reviewed regional plans and produced the final version of the NCIP.

3.27 ACS advised the ANAO in May 1997 that it intended to have Central Office assume a wider role in formulating NCIPs in the future. The ANAO supports this direction and suggests Central Office could undertake the following functions:

- establishing and reviewing common risk measurement scales for use across the Branch in compiling the plan;
- building on and maintaining risk management guides, manuals, pre-formatted documents and worksheets;
- reviewing risk ratings and priorities for risks to improve consistency throughout the plan;
- further developing, monitoring and reviewing performance indicators against the plan; and

- undertaking more quality assurance reviews of the risk management process in IGs and promoting the results of those reviews.

Recommendation No.2

3.28 The ANAO *recommends* that to provide greater transparency, co-ordination and consistency in the preparation of the National Compliance Improvement Plan, consideration be given to an expanded role of the Commercial Compliance Branch in Central Office which would include:

- further developing risk management guides and pre-formatted documents for comprehensive and streamlined risk management record keeping;
- producing and maintaining risk measurement scales;
- performing more quality assurance reviews of the risk management process; and
- further formulating, monitoring and reviewing Branch performance indicators.

ACS response

3.29 Agreed. As noted above, ACS advised the ANAO of its intention to introduce an expanded role for Central Office. A number of these initiatives has already been implemented in the context of the 1997-98 National Compliance Improvement Plan.

4. Documenting the Risk Management Process and the Risk Management Cycle

This chapter discusses documentation requirements and the first four steps in the risk management methodology as specified in the APS Guidelines. These steps are Establishing the context, Risk identification, Risk analysis and Risk assessment and prioritisation. The final two steps: Risk treatment and Monitoring and review are covered in Chapters 5 and 6, respectively.

Introduction

4.1 Work on the 1996-97 National Compliance Improvement Plan (NCIP) began in February 1996, with risk registers finalised in May and the final plan endorsed by the ACS Executive in September. This was the first attempt by the Commercial Compliance Branch to implement the APS Guidelines. The ANAO's comments have focussed on this process. Issues Papers prepared as part of the audit were provided to ACS in time for consideration in preparing the 1997-98 plan. Although the ANAO has not audited the 1997-98 NCIP, where able, we have commented on the processes contributing to its formulation.

Documentation

4.2 The aim of the risk management framework in the APS Guidelines and AS/NZS 4360 is to produce a logical and structured approach to undertaking risk management with a transparent decision-making process.

4.3 Documentation is a central element to achieving this aim. Maintaining an appropriate level of documentation encourages clear communication through structuring, clarifying and articulating the decision-making process and any assumptions made. This supports the development of a transparent and accountable process, a corporate memory for when changes in personnel occur, a rigorous quality assurance and audit

process and continuous improvement in the risk management process.

4.4 Documentation requirements must reflect judgments about practicalities of recording and should be sufficiently flexible to accommodate different approaches without stifling the necessary process of analysis. The ANAO considers that the use of guides, pre-formatted documents and worksheets can be valuable in establishing appropriate documentation standards. Additionally, they can aid in structuring and steering the risk management process while providing the necessary flexibility for different approaches.

4.5 The ANAO found that the NCIP provided a good standard of documentation on the outcomes of the risk management planning process through the use of pre-formatted documents. However, the extent and quality of documentation which supported the processes of analysis and decision-making underpinning the plan was limited. The use of guides, pre-formatted documents and worksheets could have improved the standard of documentation of analysis and decision-making. (See Recommendation No.2 at paragraph 3.28.)

Risk management cycle

4.6 The APS Guidelines describe a six step methodology to assist an organisation to implement risk management. These steps are: Step 1 *Establish the context*; Step 2 *Identify the risks*; Step 3 *Analyse the risks*; Step 4 *Assess and prioritise the risks*; Step 5 *Treat the risks*; and Step 6 *Continuously monitor and review*. The remaining sections of this chapter discuss the first four steps of the risk management cycle depicted in Figure 3, below.

Establish the context

4.7 According to the APS Guidelines, this step involves establishing the external and internal environment, determining risk criteria and undertaking stakeholder analysis. This should be appropriately documented to ensure rigour and quality in the risk management process.

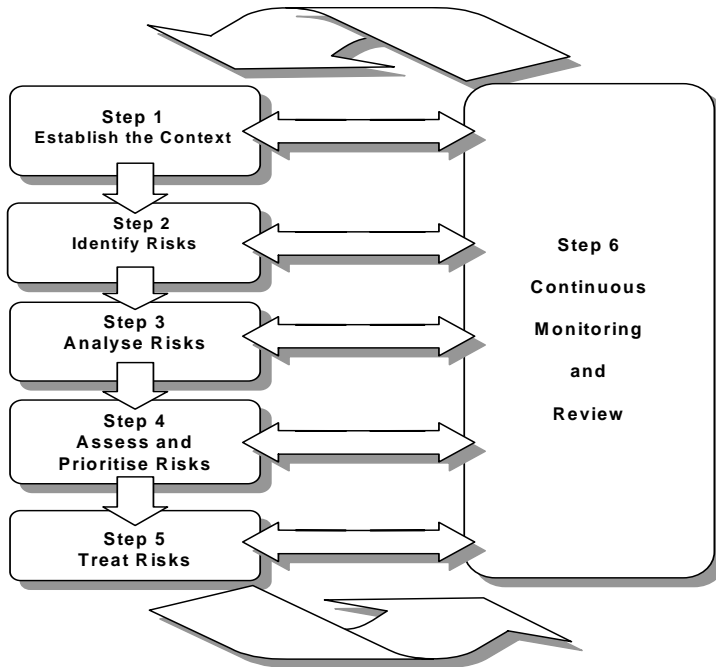
External and internal environment

4.8 Establishing the external and internal environment requires consideration of the factors which impact on the Branch. A major element of this step for the 1996-97 NCIP undertaken by Industry Groups was identifying clients and undertaking extensive analysis of basic industry information (for example, total client revenue responsibility).

This was a time consuming but important task.

Figure 3

The risk management model



4.9 There are several external and internal environmental factors which affect the Branch. External factors include government policies (for example, trade and industry assistance), economic and social factors. Internal ones include organisational goals, strategies and policies (for example, trade facilitation, client service and self assessment).

4.10 As part of establishing the context Industry Groups identified some environmental factors in the 1996-97 NCIP. ACS provided the ANAO with documentation in June 1997 to show how it had

undertaken the process during the initial stages of preparing the 1997-98 NCIP.

4.11 The ANAO noted that Industry Groups made considerable use of external information for monitoring day-to-day changes in the environment in 1996-97 (as discussed in Chapter 6 *Monitor and Review*). However, it was not apparent that such external information was systematically and explicitly considered to assist in establishing the context during the preparation of the NCIP.

4.12 We therefore consider that there is scope for Industry Groups to undertake further systematic and explicit consideration of environmental factors to establish the Branch operating context during the preparation of the NCIP.

Stakeholder analysis

4.13 Stakeholder analysis involves identifying potential stakeholders and understanding their interests and how this affects Branch operations. Such analysis helps to ensure that the agency meets stakeholder needs. Industry Groups have a wide range of stakeholders including industry participants and associations, Federal and State government authorities and international customs and trade bodies.

4.14 The ANAO found that there was only limited explicit

stakeholder analysis undertaken for the 1996-97 NCIP. Most contact with Industry Groups concentrated on problem resolution. ACS advised the ANAO in May 1997 that stakeholder contact was more likely to occur through strategic, formal discussions with industry associations and Commonwealth and State government agencies, often through the National Business Centre network.

4.15 However, with minor exceptions we did not observe that there was structured feedback from the strategic discussions to Industry Groups. Such feedback can be an important element in establishing the Branch context. We noted, however, that one National Business Centre did contact stakeholders in developing the 1996-97 NCIP. This is considered in the better practice illustration below.

Better practice

The Textile, Clothing and Footwear Industry Group approach to Establishing the context

The Textile, Clothing and Footwear (TCF) National Business Centre prepared profile reports for sub-industries such as Furs, Floor Coverings and Clothing.

The profiles concentrated on sub-industry demographics such as industry revenue, concessional tariff rates and commodity classification codes. Some profiles identified government policies and sub-industry stakeholders to help establish the context. Although these did not contain a detailed analysis of this information, the reports provided a sound basis for the TCF National Business Centre and Industry Groups to expand industry knowledge in subsequent risk management cycles.

Risk criteria

4.16 Risk criteria establish the level of risk which the agency is prepared to accept. They also promote comparability and consistency in the output of the risk management process. Criteria assist in determining whether a risk is acceptable and in ranking that risk against other risks. To simplify the decision-making process, risk criteria should be reasonably measurable and operationally focussed.

4.17 At the time of the audit, ACS had not clearly established its risk criteria. However, in preparing the draft 1996 Commercial Services Strategic Risk Profile ACS developed six broad risk criteria. These included issues such as a threat to human life, significant effect on revenue and

a major impact on ACS client service delivery. These criteria form a basis on which ACS should develop more measurable and operationally applicable risk criteria to aid the Branch with decision-making on the acceptability of risks.

Recommendation No.3

4.18 The ANAO recommends that in order to provide a more substantial and comprehensive basis for the risk management process, the Commercial Compliance Branch undertakes a more structured approach to the analysis of the environment and stakeholders and further develops explicit and operationally applicable risk criteria for managing risk.

ACS response

4.19 Agreed. A more comprehensive analysis of the environment and stakeholders has been included in the 1997-98 National Compliance Improvement Plan, specifically within the Commercial Services Risk Profile. Risk criteria are being further developed in the context of the 1998-99 planning process.

Risk identification

4.20 Risk identification is the second step in the risk management process and aims to identify as many potentially significant risks as possible. This process must be comprehensive as unidentified risks cannot be treated and may pose a major threat to the organisation. A structured approach, using outside expertise as necessary, which encourages both conventional and lateral thinking is strongly recommended.

4.21 There are several methods which can be used to assist in the risk identification process. Some which may be used by Industry Groups include:

- 'brainstorming';
- data analysis which helps to ensure that both 'actual' and 'perceived' risks are identified;
- system mapping and process analysis, particularly as a form of gap analysis; and
- check lists once the process has operated for some time and comprehensive lists of risks are available.

4.22 'Brainstorming', the method used by Industry Groups for developing the 1996-97 NCIP, has several benefits and limitations. The primary benefit is that it can be a quick and easy way to identify many potential risks. However, the process is limited by the extent of the knowledge of the people involved and their perceptions (further discussion of the benefits and limitations of types of 'brainstorming' is in Appendix 2). This can result in the identification of a large number of known risks, however, without trained facilitators less obvious risks are less likely to be identified by the group. It is therefore important that, where appropriate, Groups use additional methods, such as those listed above, to identify as many potential risks as possible.

4.23 Part of this stage involves clearly defining what the risk is, what leads to the risk occurring and potential outcomes. Industry Groups provided general

descriptions of the risks within the risk register such as 'sales tax', 'valuation' and 'undeclared production.' The comprehensiveness of the risk analysis would be improved with more precise definition of what the risk is and how it could arise.

Recommendation No.4

4.24 The ANAO recommends that ACS strengthens and diversifies its techniques for risk identification, embracing data analysis and process analysis as well as brainstorming, to ensure that risks are comprehensively identified.

ACS response

4.25 Agreed. Data analysis techniques have been extensively used since the earliest days of the current compliance improvement strategy. The outcome of the data warehouse pilot project, currently in progress, will strengthen the capacity for more diverse techniques to be used.

Risk analysis

4.26 The purpose of the risk analysis step is to estimate the probability (likelihood) and effects (consequences) of a risk event and to combine these to develop an overall risk level. The main methods are control analysis, qualitative analysis, quantitative

analysis or a combination of these.

Control analysis

4.27 Control analysis determines how controls make risks less likely or mitigate their consequences. Controls can include management systems, physical barriers, human systems, commercial and legal controls and computer systems.

4.28 Industry Groups identified some computer controls when compiling the 1996-97 NCIP, however, a systematic analysis of existing controls was not undertaken. Descriptions and assessments of controls contained in the plan tended to be generic (for instance, 'control adequate') and there were no links to documentation describing what the control was, how it worked and how it affected the likelihood and consequence of the particular risk. This meant that it was not clear how Groups had taken into account, as part of their risk analysis, the controls ACS already had in place.

Qualitative analysis

4.29 Qualitative analysis describes the factors which influence the likelihood and consequence of a risk. It is therefore necessary in most risk analysis processes.

4.30 A variety of qualitative information such as material on

the industry and its peak associations was obtained by Industry Groups, however, there were limited examples where this information was systemically analysed to describe factors which influence the likelihood and consequence of a risk. The ANAO observed that the risk analysis process relied heavily on the knowledge of individual officers with little indication of how the information collected had affected the process.

4.31 The ANAO noted that the period in which the initial risk analysis was conducted (February to May 1996) would have limited the scope for a detailed risk analysis process. We consider that ACS could benefit from ensuring that, where cost-effective, a variety of information is collected to obtain a wide range of views on the analysis and that all relevant information is systematically analysed and well-documented. This would provide a corporate memory and enable future risk analyses to draw on the information.

Quantitative analysis

4.32 Quantitative analysis involves the use of numerical data to assist in determining the likelihood and consequence of a risk event occurring. Various quantitative analysis techniques are available, such as probability, variance and sensitivity analysis

of industry trade and treatment result data.

4.33 Industry Groups had access to a large variety of data during the development of the 1996-97 NCIP. However, the short timeframe available, unfamiliarity with analytical techniques and limited computer facilities restricted the ability of Groups to undertake detailed analyses. The ANAO considers that there is scope for Groups to increase their use of quantitative analysis techniques in preparing future NCIPs. This is likely to occur when ACS furthers its use of data analysis software and fully implements its data warehouse facility, which is currently being piloted.

4.34 One type of quantitative analysis which could be adopted by Industry Groups involves sensitivity analysis. Sensitivity (or 'what if') analysis asks how a result will be changed if the original estimates are not achieved or an assumption changes.³² This technique is especially useful in risk management where there is uncertainty about the likelihood or consequence of a risk event occurring. Such a tool would be of considerable benefit in later consideration of risk assessment, prioritisation and possible risk

³² C.T. Horngren, G. Foster, *Cost Accounting a Managerial Emphasis*, Seventh Edition, Prentice Hall, New Jersey, 1991.

treatment. An example is provided in the illustration below.

Risk rating

4.35 After the risk has been considered an estimate of the likelihood and consequence is prepared and an overall risk level is developed. Likelihood and consequence risk measurement scales can greatly assist in defining levels of risk by providing guidance on what the organisation considers to be the differences in risk levels. A risk level matrix combines the scales, providing an overall assessment of the level of risk. To ensure the results of scales for likelihood and consequence are relevant to the risk assessment and prioritisation process (Step 4) it is important that scales be developed with consideration to the risk criteria determined in Step 1:
Establishing the context.

4.36 Consistent measurement scales help to ensure

comparability of risk levels across different parts of the organisation and are critical if risk is to be considered in the resource allocation process. The ANAO found that for the 1996-97 NCIP each Industry Group developed risk measurement scales for likelihood and consequence. Some Groups adopted a three point scale where others used the five point scale in the APS Guidelines. This limited the comparability of risk ratings across Groups. We noted that the five point scale was to be adopted in the 1997-98 NCIP and this should improve comparability of risk levels across Industry Groups.

Illustrative example - sensitivity analysis of Tariff Concession Orders

The example in Table 1 below makes assumptions about the incidence of non-compliance to analyse their possible revenue consequences. It draws on information of the Top 200 clients³³ claims for Tariff Concession Orders (TCOs) in three Industry Groups in the calendar year ending 31 December 1996. TCOs reduce the amount of duty payable and this example examines the probability that TCOs were claimed when they should not have been.

Table 1
Value of Tariff Concession Orders 1996

³³ The top 200 clients by value of goods imported during the period January-December 1996 in each industry.

Probability of incorrectly claimed TCO (per cent)	Industry A \$000	Industry B \$000	Industry C \$000	Total \$000
100.0	11 458	173 222	86 349	271 029
50.0	5 729	86 611	43 174	135 514
25.0	2 864	43 306	21 587	67 757
10.0	1 146	17 322	8 635	27 102
5.0	573	8 661	4 317	13 551
2.5	286	4 331	2 159	6 775
1.5	172	2 598	1 295	4 065

Analysis

The table above illustrates that if the top 200 companies in all the three industries incorrectly claimed all of their TCOs (100 per cent occurrence rate) there is a total of \$271 million revenue at risk (\$11.5 million in Industry A, \$173.2 million in Industry B and \$86.4 million in Industry C). If on the other hand, only 1.5 per cent of companies claimed when they should not have, the split would be \$172 000 in Industry A, \$2.6 million in Industry B and \$1.3 million in Industry C.

It is possible, of course, that occurrence rates for non-compliance with TCOs for each industry may not be uniform. In practice, Industry Groups would have to undertake further investigation to develop estimates of the occurrence rate. For the purposes of illustration, however, the ANAO has chosen some figures arbitrarily and assumed that Industry A, Industry B and Industry C may have 10 per cent, 1.5 per cent and 2.5 per cent occurrence of non-compliance respectively.

This produced revenue at risk figures of \$1.1 million, \$2.6 million and \$2.2 million respectively for these industries. Industry Groups could perform other sorts of sensitivity analysis, for example, by considering different populations. Their analysis could look at a population which excludes the top 200 clients, or only look at clients with a certain number or value of transactions.

4.37 Measurement scales can be either qualitative, quantitative or semi-qualitative. Qualitative measurement scales use words or descriptions to rate risks and require subjective judgment. In contrast, quantitative measurement scales use figures or numbers and provide objectivity by the person rating the risk in the decision-making process. Semi-qualitative scales provide for both description and numbers, and in practice work

best to assist decision-making. If available, quantitative information can be used, however, qualitative description provides discretion in interpreting the measurement scale.

4.38 The proposed 1997-98 NCIP risk measurement scales rely on broad qualitative descriptions with minimal use of quantitative information. The ANAO considers that these can be improved by increasing the

specificity of qualitative descriptions and the use of quantitative information to provide guidance to Industry Groups in measuring risks. Set out in Table 2 and Table 3 below are illustrative semi-qualitative measurement scales prepared by

the ANAO. These would need to be refined to meet the circumstances for ACS and other organisations, but could be a useful starting point for consideration of such rating scales.

Table 2**Likelihood risk measurement scale**

Likelihood		
Rating	Probability range per cent	Qualitative characteristic
Almost certain	80-100	Event expected to occur in most circumstances (e.g. weekly), controls are non-existent
Likely	50-79.9	Event will probably occur in most circumstances (e.g. fortnightly), controls are poorly documented, poorly understood and their appropriateness is not known
Moderate	25-49.9	Event should occur at some time (e.g. monthly), controls are poorly documented, but reasonably well understood and considered to be reasonably appropriate
Unlikely	10-24.9	Event could occur at some time (e.g. half-yearly), controls are reasonably well documented, well understood and considered to be appropriate
Rare	0-9.9	Event would occur only in exceptional circumstances (e.g. yearly), controls are well documented, understood and tested and found to be appropriate and reliable

Table 3**Consequence risk measurement scale**

Consequence		
Rating	Effect range \$	Qualitative characteristic
Extreme	Greater than 5 million	Concentrated national public and political interest, major effects for ACS clients, material loss of integrity for the ACS regulatory system
Very high	1,000,001 - 5 million	Short-term public interest, ministerial and top management intervention, loss of integrity for the ACS regulatory system
Medium	250 001 - 1 million	Isolated public interest, senior management involvement, industry complaints, integrity of the ACS regulatory system undermined
Low	20 001 - 250 000	Local issue, some management involvement, isolated loss of integrity in the ACS regulatory system
Negligible	0-20 000	Affect only a small group of clients, addressed through routine ACS operations, confidence in integrity of the ACS regulatory system

Table 4

Overall assessed risk

	Consequences				
Likelihood	Extreme	Very High	Medium	Low	Negligible
Almost certain	severe	severe	high	major	significant
Likely	severe	high	major	significant	moderate
Moderate	high	major	significant	moderate	low
Unlikely	major	significant	moderate	low	trivial
Rare	significant	moderate	low	trivial	trivial

Key:

Severe risk	Must be managed by senior management with a detailed plan
High risk	Detailed research and management planning required at senior levels
Major risk	Senior management attention is needed
Significant risk	Management responsibility must be specified
Moderate risk	Managed by specific monitoring or response procedures
Low risk	Managed by routine procedures
Trivial risk	Unlikely to need specific application of resources

4.39 It is important that the overall risk level provides sufficient scope for describing the risk and identifying different risk levels to allow an appropriate risk priority to be assigned and risk treatment plans to be developed. The scale of seven risk levels in the APS Guidelines (see Table 4 above) provides a useful distinction between different levels of risk on which to base management decisions. The proposed 1997-98 NCIP adopted the AS/NZS 4360 scale of four risk levels *high*, *significant*, *moderate* and *low*. This scale is

more limited in identifying extremes in risks which may be faced by Industry Groups. The ANAO considers ACS could better define risk levels by adopting the seven risk levels promoted in the APS Guidelines.

4.40 In determining risk levels Industry Groups relied heavily on experience and perceptions of officers. The ANAO found there was limited documentation on how the likelihood and consequence ratings were established. The limitations of this approach were partly

overcome by the review and agreement of ratings by other regions and the NBC, however, there was limited documentation on the review process. We consider that ACS should ensure that all risk rating and review processes remain rigorous and appropriately documented, particularly where amendments occur.

Recommendation No.5

4.41 The ANAO recommends that, in order to better support the structured analysis of risks and consideration of their significance, ACS further develops the use of qualitative and quantitative risk analysis techniques and risk measurement scales.

ACS response

4.42 Agreed. Risk analysis in the Branch has been recently strengthened by the results of the National Compliance Measurement Project, which was finalised in June 1997.

Assessing and prioritising risks

4.43 Risk assessment and prioritisation involves reviewing the risk level developed at Step 3: *Risk analysis*, deciding if the risk is acceptable or unacceptable and then ranking the risk in relation to other risks. This requires a comparison of

likelihoods, consequences and overall risk level with the risk criteria determined in Step 1: *Establish the context*. The APS Guidelines indicate that documentation at this stage should include a list of acceptable risks, in priority order, showing reasons why they are acceptable, together with a list of unacceptable risks.

4.44 The ANAO observed that Industry Groups did not appear to go through a distinct assessment and prioritisation of risks after Step 3: *Risk analysis*. The results of the priority setting process exactly matched the assessment determined in the third step. Risks given an overall risk level of 'high' had 'high' priority and risks rated 'low' had 'low' priority. Although there was no explicit assessment and prioritisation process, we noted that regional Industry Groups reviewed the priorities established and this provided the Groups with some assurance that the priorities were appropriate. We support this review process.

4.45 Industry Groups included the risk priority as a part of the risk register. Although the majority of risks identified in the register were given a priority, where no priority had been given it was not clear why a risk had been accepted or if indeed the risk had actually been accepted. We consider that it is good practice that where a risk is not

allocated a priority or is accepted by Industry Groups the reasons are documented to record and allow review of the decision.

4.46 The ANAO considers that an across-industry assessment and priority setting process should compare risks in Industry Groups against each other to produce a register of risk priorities for the Commercial Services Division. This process is particularly important for *major, high and severe* risks (where the APS Guidelines indicate senior management attention is required) and to assist the Division to focus resources for treatment of those priorities.

4.47 In developing the 1996-97 NCIP each Industry Group undertook its own risk assessment and prioritisation process and produced its priority listing of risks. The ANAO considers that a review across Industry Groups to assess and prioritise *major, high and severe* risks for the Division would assist it to determine the overall risk priorities for the Division. This in turn would contribute to a statement of risks across ACS to inform strategic and resourcing decisions for the agency. This is discussed further in Chapter 8.

Recommendation No.6

4.48 The ANAO *recommends* that, to assist with strategic decision-making, including

resource allocation decisions, the Commercial Services Division undertakes a risk assessment and prioritisation process across Industry Groups and develops an overall risk priority register as part of its Corporate Governance framework.

ACS response

4.49 Agreed. This matter is currently being addressed.

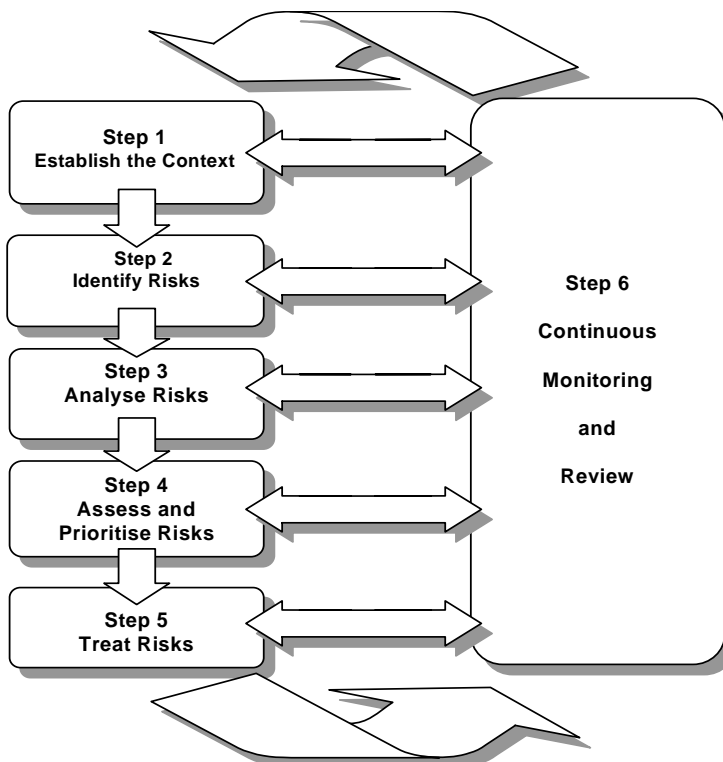
5. Risk Treatment

This chapter discusses the risk treatments available (administrative arrangements, education and enforcement) and their selection. It also considers the identification of clients to receive treatment as part of the 1996-97 National Compliance Improvement Plan.

Introduction

5.1 Step 5: *Risk treatment* in the risk management cycle is depicted in Figure 4 below.

Figure 4
The risk management model



5.2 This step involves evaluating options and implementing treatments for those risks not accepted in Step 4: *Assess and prioritise risks*. In determining risk treatments an agency can choose to:

- avoid the risk by not proceeding with the activity that would generate the risk;
- lessen the risk by reducing either the likelihood or the consequence, or both;
- transfer all or part of the risk by shifting responsibility to another party; or
- accept and retain the risk where the cost of risk treatment is not justified.

5.3 The Branch is primarily responsible for assurance that clients who had transactions with the ACS correctly assessed their revenue liability and complied with relevant requirements. The administration of programs and schemes themselves is the responsibility of other Branches in ACS. For example, delivery of automotive industry assistance or tariff export concessions is the responsibility of the Industry Branch.

5.4 In considering options to treat the risks of non-compliance the ANAO noted that these need not be limited to specific treatments delivered by the Branch. Treatment options can

incorporate administrative arrangements, education and enforcement activities, including those conducted by other areas within ACS. The ANAO considers that although some treatment options may not be the responsibility of the Branch, all options available to ACS should be identified in the NCIP.

Identifying and selecting treatment options

5.5 Several factors should be considered when identifying and selecting treatment options. These include the cost-effectiveness of alternative treatment approaches and the appropriate balance between administrative arrangements, education and enforcement activities.

Cost-effectiveness considerations

5.6 The selection of an appropriate treatment method should involve consideration of the most cost-effective approach. The potential cost and effect of a treatment option should be determined and then various options compared to select those with the best effect for the lowest cost. This does not mean that the lowest cost option will always be selected. Cost-effectiveness considerations involve examining

factors such as the potential extent of treatment results (direct and indirect), the costs of alternative delivery of the treatment and the financial and non-financial implications of alternative risk treatments. For example, a single audit may be less expensive than producing pamphlets to resolve a compliance issue. However, a single audit will only treat one client while distributing pamphlets has a leverage effect that may encourage voluntary compliance among many clients.

5.7 The ANAO found that Industry Groups did not document their consideration of the costs, benefits and potential effectiveness of the risk treatment options while preparing the 1996-97 NCIP. We suggest that ACS incorporates more explicit and transparent cost-effectiveness analysis of treatment options for identified risks including relevant quantitative and/or qualitative costs and benefits.

5.8 The Branch had various sources of information available about the costs of the Commercial Compliance function and results of compliance activities. These included ACS budget and financial systems for expenditure and collections, an Activity Based Costing (ABC) exercise and the Compliance Activity Recording Database (CARD).

5.9 The budget and financial systems recorded actual expenditure and collections whereas the ABC exercise aimed to establish the cost of certain ACS functions such as importing, exporting, refunds and drawbacks. The agency advised that from the ABC initiative it could obtain data at the regional level, by industry group, for overall compliance activity as well as functions, such as excise compliance activity. Although these systems can provide useful data to ACS on the cost of its functions and data for overall compliance activity for an industry group at the regional level, they were not designed to provide information on the cost-effectiveness of risk management activities and particular treatments undertaken by the Branch.

5.10 Information on the cost-effectiveness of individual risk management activities is important to assist Industry Groups to determine which risk treatment methods are the most appropriate. CARD was designed to collect the necessary information on the results and costs of individual compliance treatment activities to enable this analysis. The database provides a foundation for Industry Groups to undertake cost-effectiveness analyses, however, information in the database needs to be accurate to permit appropriate analysis to be undertaken.

5.11 The ANAO found that information on compliance activity costs in CARD could be misleading in two respects: namely, the cost base and the amount of time attributed to activities.

5.12 The cost base in CARD for compliance activities incorporated officers' salary, travel expenditure and 'other' direct costs. It excluded additional staffing costs such as training, superannuation and accommodation, which can represent a significant element of the full cost of an activity.

5.13 The ANAO noted that the Branch had not promulgated a time recording policy which clarified the aspects of staff effort to be recorded and the accuracy required in calculating time spent on activities. We found that staff had inconsistent understandings of what aspects of a compliance activity were to be recorded and the way time calculations were to be made. These different understandings were reflected in regions recording varying levels of time for compliance activities as shown in Figure 5 below.

5.14 In response to our findings that the information in CARD could be misleading, the Branch advised the ANAO that it did not rely on CARD data for any costing information, but used the ABC information which was gathered corporately. We note this comment but reiterate our

observation that CARD has a particular advantage over the corporate ABC data exercise in that it is able to record relevant information on the cost-effectiveness of particular risk management activities. We consider that it would be worthwhile for ACS to have mechanisms to ensure that information contained within CARD is accurate and complete. This would allow the Branch to derive greater benefit from the ACS investment in developing and maintaining CARD.³⁴

Recommendation No.7

5.15 The ANAO *recommends* that to better support the cost-effectiveness analysis of compliance activities by Industry Groups and to assist in the selection of treatment options, the Commercial Compliance Branch puts appropriate mechanisms in place to improve the accuracy of information contained in the Compliance Activity Recording Database.

ACS response

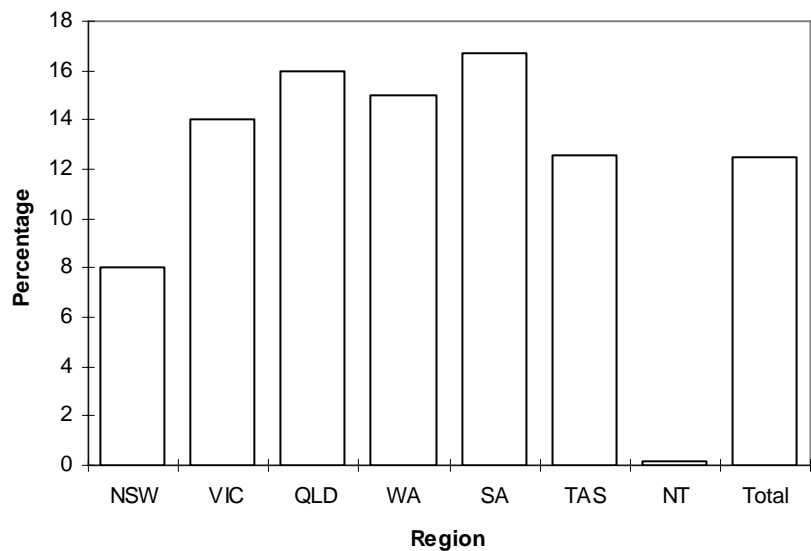
5.16 Agreed. Inconsistencies between regions in relation to the input of data to CARD were recognised prior to the conduct of the efficiency audit. Guidelines

³⁴ The ACS estimated that the cost of developing CARD in 1996 was \$330 000. It also estimated that maintenance over the following three years would cost \$197 000 overall.

have now been produced for the use of CARD which should

ensure greater accuracy and consistency of data input.

Figure 5
Time charged to compliance activities as a percentage of total time available (by region) January 1996-February 1997



Determining the type of treatment

5.17 Selection of the most appropriate treatment from the available range is a central element of the risk management process. The Industry Panel sought to focus ACS treatment of compliance risks using a combination of administrative arrangements, education, and enforcement activities. These are discussed in turn below.

Administrative arrangements

5.18 Administrative arrangements cover all processes

and systems developed by ACS to ensure compliance with its regulatory requirements. The ANAO considers compliance is encouraged by having arrangements that are both easy to comply with and readily show non-compliance.

5.19 Through simplification of legislation and provision of a system which facilitates payment and reporting of excise, for example, ACS aims to promote an administrative framework with which it is easy to comply. At the time of the audit, ACS was preparing draft self assessment

legislative proposals for Ministerial consideration and was introducing a new electronic reporting system for excise payers. We encourage ACS to continue this work.

5.20 The Division formulated a protocol between the Commercial Compliance Branch and policy Branches which have administrative responsibility for policy and legislation. This aimed to strengthen links between the Branches, allowing ACS to identify better and act on suggestions for legislative changes or administrative improvements.

5.21 The ANAO observed, however, that the 1996-97 NCIP had not identified any areas which may require review of administrative arrangements. We consider that there is scope for greater involvement by Industry Groups, in addition to those areas with administrative responsibility, for identifying changes in administrative arrangements as a risk treatment. Any proposed modifications in arrangements should be incorporated in future NCIPs.

Education

5.22 Education of clients can be an effective risk treatment. It can encourage voluntary compliance by enabling clients to have the necessary knowledge and ability to meet obligations. The Industry

Panel recommended that ACS provide client education, advice and support.³⁵

5.23 Pamphlets, business and industry education programs and individual client advice are used for educating clients. Although some education treatment options may be the responsibility of other Branches, the ANAO considers that future NCIPs should incorporate all planned education activities.

5.24 The ANAO noted that in the 1996-97 NCIP, education was not identified frequently as a risk treatment. At the time of our audit, Industry Groups were developing education strategies, although they were not a significant part of the plan. We support these efforts and consider there is scope for Groups, in association with other areas in ACS, to widely use education strategies as cost-effective compliance risk treatments.

5.25 In our view it is important for ACS to establish client needs to help them address their risks of non-compliance. This can be achieved through surveys and market testing of proposed education programs. We observed that a client survey was conducted late in 1996 in the Duty Free Industry Group. It established that clients wanted a

³⁵ Industry Panel on Customs Audit Reforms, op. cit., p13.

manual to provide basic information to store owners and managers about the duty free system and customs and sales tax legislation. At the time of the audit, the manual was in final draft stage. We commend the Duty Free Group for this work and encourage other Groups to adopt this approach.

5.26 It is good practice to undertake post-implementation reviews of risk treatments. These help to determine the effects of treatments and allow lessons learned from the exercise to be applied to other treatment approaches. The ANAO found that the TCF Group intended to undertake a review of its education program for 'Assists'³⁶ in 1997-98. The program started in 1996-97 and involved a client information letter and preparation of articles for several trade magazines. The ANAO encourages all Industry Groups to undertake timely and cost-effective post-implementation reviews of their risk treatment projects.

Enforcement

5.27 Enforcement activities deter non-compliance and promote

ongoing compliance through detecting and applying appropriate sanctions to clients who fail to meet their obligations. The Branch undertakes enforcement activities through a regime of client audits which can result in penalties and prosecutions. In addition, during 1996 ACS developed an industry monitoring regime for three industries. This is discussed in detail in *Monitoring as a risk treatment* below.

5.28 The Branch adopted a corporate approach to company audits that was promulgated in the ACS Company Audit Manual in August 1996. This is a systems based audit methodology and is consistent with contemporary audit approaches. Audits detect areas of non-compliance and make recommendations on client procedures and systems to reduce the likelihood of similar deficiencies in the future.

5.29 The Industry Panel emphasised the need for the Branch to obtain an appropriate balance between client service and enforcement activities. The ANAO considers that client service approaches such as administrative arrangements and education are important as they can cost-effectively contribute to improvements in industry compliance.

5.30 Enforcement activities, particularly audits, can be

³⁶ 'Assists' are goods or services provided by the importer to the supplier which are incorporated into the completed goods and then imported into Australia. In some instances, 'Assists' are dutiable and the value of the completed good should incorporate the value of the assist.

relatively expensive and can have a limited compliance effect in comparison to alternative methods which are able to reach a greater number of clients. However, we appreciate that obtaining a balance between client service (which aligns with principles of facilitation) and enforcement (which aligns with principles of control and regulation) is a matter of judgement which should be informed by performance information on the effectiveness of both methods.

5.31 Our analysis of CARD data showed that between January 1996 and February 1997 audits represented 52 per cent of compliance risk treatment activities undertaken by Industry Groups while research, visits, education and 'other' represented the remainder (as indicated in Figure 6 below). This shows diversity in the types of treatment activities undertaken by the Branch.

5.32 As the primary area in ACS responsible for ensuring voluntary compliance, audits will continue to be an important risk treatment used by the Branch. However, the ANAO considers that by continuously refining the selection process for risk treatment methods Industry Groups may be able to make greater use of client service approaches (such as client education) to maintain and increase industry compliance.

5.33 The selective publication of compliance results, such as is done by the Australian Taxation Office and the Department of Social Security, helps to notify clients of treatment actions and underlying issues in compliance. This may produce a compliance effect for other clients, as well as those who have directly received the treatment. The ANAO noted that limited publicity had been given by ACS to its own audit results. By providing selective information to industry associations and discussing the treatment results with them, ACS may be able to improve voluntary compliance and identify possible underlying issues.

Monitoring as a risk treatment
- industry Key Performance Indicators

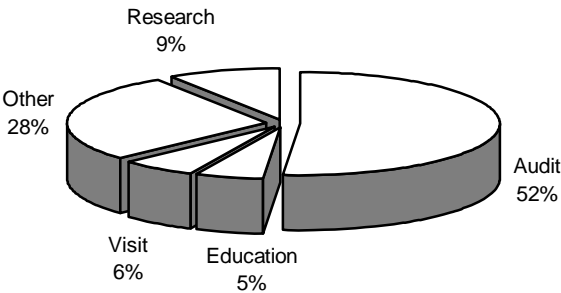
5.34 During 1996 and 1997 ACS, in consultation with industry, gave considerable attention to the ways liability holders in the tobacco, petroleum and alcohol industries should report their liability and what Key Performance Indicators (KPIs) were appropriate for monitoring purposes. The aim was to establish an electronic reporting capability for excise payers and to monitor selected key performance information to obtain broad assurance of compliance. This was to allow ACS to highlight anomalies for further investigation without the

need for intrusive and extensive auditing.

5.35 As a pilot, ACS developed and tested three KPIs for the petroleum industry in 1996-97. These were:

- comparison of duty paid with Budget forecast;
- comparison of deliveries with sales data; and
- charting of deliveries of concessional products.

Figure 6
Compliance activity type as a percentage of total number of recorded compliance activities



Key

Audit	Examination which may range from a simple desk examination of client operations through to a complex examination of client controls
Education	Advice to industry and the public regarding ACS legislative and administrative requirements
Visit	Call to a client's premises to familiarise ACS with the client's operations
Research	Analysis of data to determine or monitor compliance, establish industry or client context, and determine appropriate treatment options
Other	Risk treatments such as leverage exercises, mailouts, review of legislation and policy changes, not elsewhere included

5.36 The results of the trial indicated a high level of compliance in the industry. The ANAO supports the use of KPIs as one tool to monitor the performance of clients and industries on an ongoing basis. We acknowledge the difficulty of

establishing appropriate KPIs for each industry and the considerable work ACS has undertaken. We also consider that the monitoring technique would be particularly useful in industry sectors such as TCF and General Business Industry

Groups to highlight areas for further, specific analysis. The large number of players mean that these industry sectors are not so amenable to individual audit as a means of ensuring compliance.

Recommendation No.8

5.37 The ANAO recommends that to facilitate the selection of suitable risk treatments ACS:

- where appropriate, incorporates explicit cost-effectiveness analysis into its selection process; and
- makes greater use of integrated risk treatment approaches combining administrative arrangements, stakeholder education and enforcement activities.

ACS response

5.38 Agreed. Managers have regard to cost-effectiveness and integrated risk treatments when they are developing and implementing their compliance plans. The compliance activity depicted in Figure 7 (see page 44) demonstrates that integrated risk treatment approaches already form an integral part of the National Compliance Improvement Plan.

The three treatment options working together

5.39 On 28 June 1996 a change in the Tariff Concession Order (TCO) legislation was passed and

came into effect on 15 July of that year. A TCO is an instrument which reduces the rate at which customs duty is payable. The change in legislation reduced the concession offered by TCOs for some goods. Customs brokers were notified of the change through an Australian Customs Notice (ACN) on 5 July 1996 and a COMPILE³⁷ broadcast message (the ACS-Broker e-mail service) three days later.

5.40 The change introduced new Customs Duty rates on TCOs and required ACS to amend codes in COMPILE. Although the new codes were in place and operating, controls to prevent use of the incorrect TCO codes were not implemented until the end of July. As a result, some import entries and payments were incorrectly calculated. A second broadcast message was sent on 17 July informing brokers of the revised codes and requesting them to amend the incorrect entries. A second ACN was then sent to brokers at the start of August which, for a third time, requested brokers to amend incorrect entries and informed them that ACS intended to undertake follow-up audit action. ACS advised the ANAO that penalties were only applied to

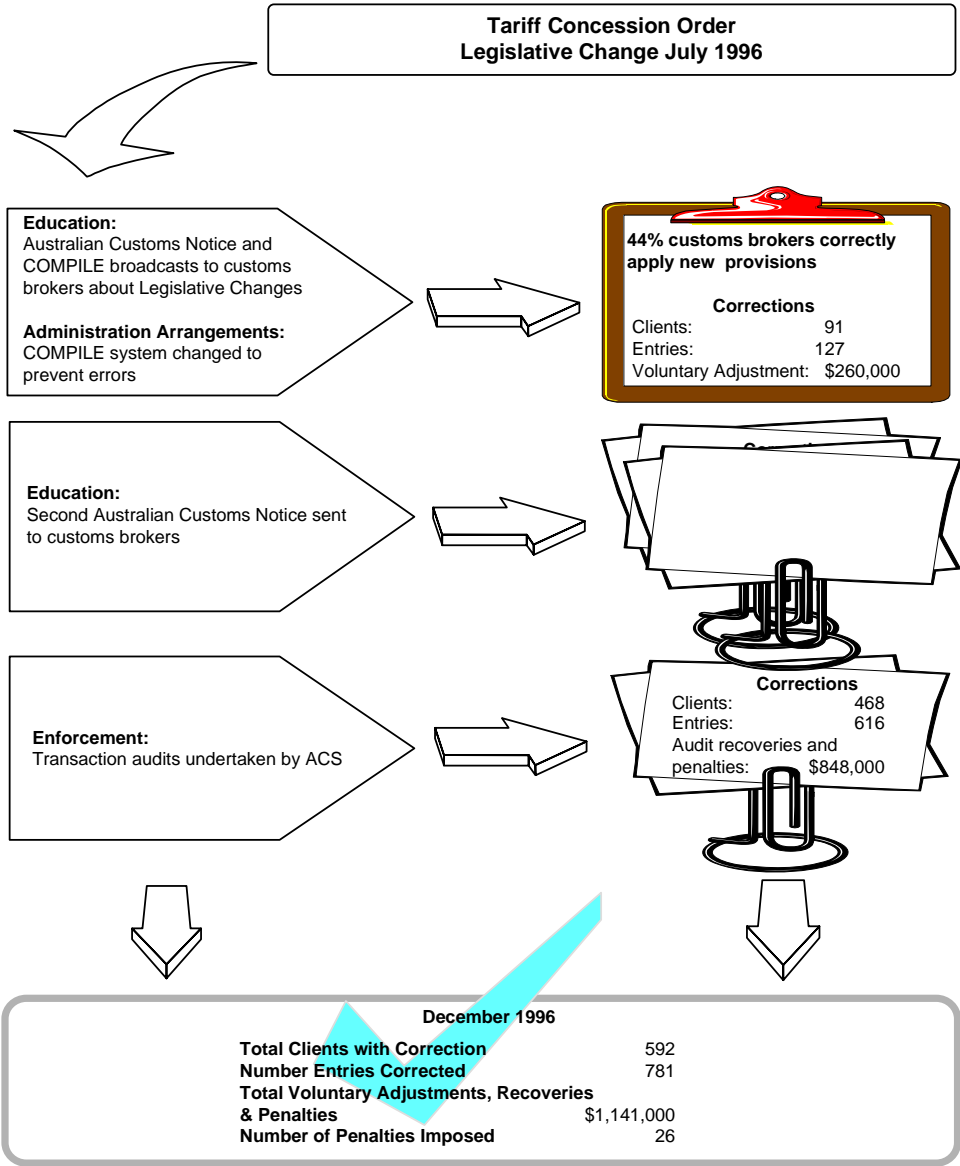
³⁷ COMPILE is the Customs On-line Method of Preparing from Invoices Lodgeable Entries. It allows customs brokers to prepare and lodge electronic entries for imports and excise payments.

imports where the broker had not amended incorrect entries by the end of August.

5.41 Figure 7 below illustrates the treatments applied and the response by companies to those treatments. The ANAO

commends the efforts by ACS to develop an integrated approach and encourages the Branch to use this where appropriate and cost-effective.

Figure 7
The steps to compliance: Tariff Concession Orders



NB Finalisation of penalties and remissions was underway at the time of the ANAO report and figures are subject to change.

Selecting clients for risk treatment

5.42 In order to ensure that identified risks are treated appropriately, Industry Groups should select clients on the basis of risks identified in the 1996-97 NCIP and take into account both the likelihood and consequence of a risk occurring. Profiling is the selection of clients on the basis of risks to produce a targeted treatment program. For example, a profile may be clients falling within the ACS top 50 revenue liability clients for the industry that have claimed more than \$1 million in TCOs within the financial year and have never been subject to audit by ACS.

5.43 Profiling methods vary from manual processes to complex computer programs and in broad terms have four steps:

- generic risk analysis and assessment within each industry group;
- application of the generic risks to clients in the industry group;
- consideration of the client individual characteristics and business risk profile; and
- consideration of previous treatment activities in the population and individual clients.

5.44 The ANAO considers it important that an explicit client

selection process is undertaken, taking into account both the consequence and likelihood of a risk occurring and linking client selection to risks identified in the NCIP. This helps to ensure that attention is focused towards the areas of greatest risk.

5.45 Selecting clients on the basis of both the likelihood and consequence of risks occurring increases the opportunity that non-compliance will be detected. Client selection on this basis encourages efficient and effective resource use. Documenting the consideration of the risks associated with the client enables review of selection processes and encourages continuous improvement.

5.46 The ANAO found the risk registers in the 1996-97 NCIP linked risks and general strategies for treating them but did not explicitly link clients to those risks or strategies. There was little supporting information to show how clients had been selected on the basis of occurrence of the risks listed in the NCIP.

5.47 In most Industry Groups, the majority of clients identified for treatment were among the top 50 clients in terms of ACS revenue responsibility for that industry. This focus provided ACS with assurance that a significant portion of its revenue responsibility was accurately determined. In this regard,

gaining assurance about the group of clients which represent a significant portion of ACS revenue responsibility may be prudent.

5.48 However, the ANAO considers that in selecting clients there is scope for the Branch to explicitly consider the likelihood of the risk occurring in respect of the client. This may provide the Branch with a greater opportunity for detecting non-compliance and thereby improve use of resources. The ANAO found a good example of client selection in the TCF Industry Group, as described in the better practice illustration below.

5.49 A simple manual client profiling system is effective for small numbers of clients. However, the ANAO considers that there are benefits in having an automated client profiling system to provide an ability to regularly assess potentially large portions of the client population, which cannot be readily undertaken by manual processes.

5.50 ACS advised the ANAO during the audit that as a major

corporate priority it was undertaking a data warehouse project to store and retrieve data. With the assistance of separate analytical tools and techniques ACS proposes to use this data to research and develop profiles. We support the development of a cost-effective automated profiling system to assist Industry Groups in the selection of clients for treatment.

Recommendation No.9

5.51 The ANAO *recommends* that to contribute to the appropriate treatment of risks identified in the National Compliance Improvement Plan, Industry Groups profile and explicitly select clients on the basis of risks in the plan, taking into account the likelihood and consequence of those risks occurring at the client level.

ACS response

5.52 Agreed. Client selection is linked to the industry risk registers in the 1997-98 National Compliance Improvement Plan.

Better practice in client selection

- Textile, Clothing and Footwear client profiling

The ANAO considers the TCF Industry Group in NSW developed a sound, simple manual client profiling process for major industry participants. Although the selection process for clients to be included in the treatment program was not described, the process appeared to take account of the individual client profile and showed the link between the selection of clients and risk treatments in three ways:

- identified risks from the industry-level analysis were re-examined for individual clients and a likelihood, consequence and risk level derived for each client;
- detailed risk profiles were developed for selected major clients, covering basic statistics about the business mix, origin of goods and major suppliers; and
- summary risk ratings for each client were considered in relation to the risk profile, the date of the previous audit and the dollar turnover.

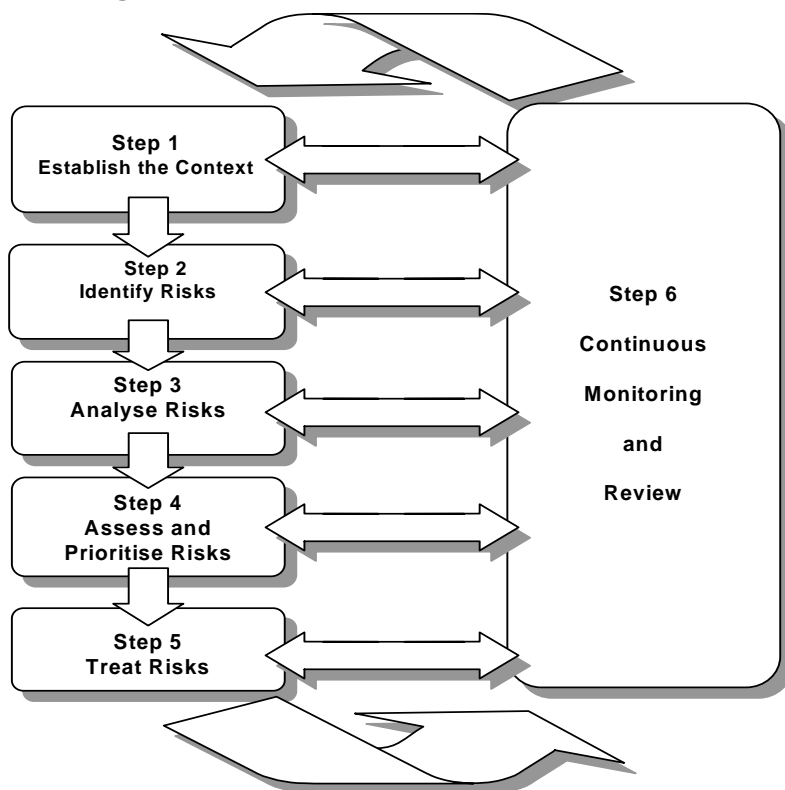
6. Monitoring and Review of Risks

This chapter considers the monitoring and review of risks and the information which assists the Branch undertake this part of the risk management cycle.

Introduction

6.1 Step 6 - *Monitor and review* in the risk management cycle is depicted in Figure 8 below.

Figure 8
The risk management model



6.2. The 'final' step in the risk management process, monitoring and review of risks, involves *continually* re-examining the environment in which the Branch operates. It provides information on how changing circumstances may alter risk priorities and helps to ensure that the ways risks are managed remain valid.³⁸ This step applies on a continuous basis to all the elements of the risk management cycle.

6.3 The APS Guidelines refer to monitoring and review as necessary to:

*...monitor risks, the effectiveness of the plan, strategies and management system that have been set up to control implementation of the risk treatments.*³⁹

The step requires the Branch to review its environment on an ongoing basis to ensure that the activities and risks contained in the NCIP remain relevant in light of the changed environment, check progress against the plan and consider the efficiency and effectiveness of activities undertaken in treating risks.

6.4 To do this effectively the Branch requires information from

both external and internal sources. External sources can provide the Branch with information on changes to the business environment and thereby guide it on the relevance of the NCIP. Internal information sources allow the Branch to monitor progress against the plan and the efficiency and effectiveness of activities undertaken. These information sources are discussed below.

External information sources

6.5 The ANAO found that Industry Groups made considerable use of external information sources for day-to-day monitoring of changes to the business environment. These sources included federal and state government agencies, industry media, industry contacts and international forums.

6.6 Information was used in various ways to build general industry knowledge and undertake comparative data analyses. For example, the TCF and Alcohol Industry Groups used trade journals to monitor developments in the industry and the Petroleum Group obtained publicly available petroleum production data from the Department of Primary Industries and Energy for comparison with

³⁸ Management Advisory Board and the Management Improvement Advisory Committee, *Guidelines for Managing Risk in the Australian Public Service*, Report No.22, AGPS, Canberra, 1996, p34.

³⁹ Management Advisory Board and the Management Improvement Advisory Committee, loc. cit.

information provided by companies to ACS.

6.7 The ANAO found that while Groups used external information sources, their use as part of a risk monitoring process was not explicit. We suggest that changes in the external environment and their possible effect on risks could be better communicated and understood if the Branch explicitly included relevant external information from other government agencies and industry contacts as a part of its monitoring and review processes.

Internal information sources

6.8 Internal information sources can inform the Branch about progress against the NCIP, the efficiency and effectiveness of activities undertaken and how the operations of the Branch affect its environment. The effective management of information about Branch activities requires a system to record, analyse and report information, as discussed below.

Recording information

6.9 As noted in Chapter 5- *Risk treatment*, the Branch had two sources of information about the broad costs and results of its activities on which to base assessments of its efficiency and effectiveness. These were the

Activity Based Costing (ABC) exercise undertaken in 1996-97 and the Compliance Activity Recording Database (CARD). The ABC exercise conducted across the agency aimed to establish the cost of certain ACS functions such as importing, exporting, refunds and drawbacks. Although this exercise provided useful data to the agency on the cost of its functions and ACS advised that from the ABC initiative it could obtain data at the regional level, by industry group, for overall compliance activity, we noted that the exercise was not designed to provide information on the cost-effectiveness of risk management activities undertaken by the Branch. This kind of information was recorded in CARD.

6.10 CARD contained information on the Branch compliance activities including information on the type, cost and result of individual treatment activities. It also provided the opportunity for officers to record general comments about the treatment or client. As the basis for the Branch compliance activity performance information, it is essential that the data contained within CARD be accurate, comprehensive and reliable to ensure that subsequent analyses of the efficiency and effectiveness of treatments undertaken are accurate.

6.11 As stated in Chapter 5, the ANAO considers that information recorded in CARD on the cost and time spent on activities could be misleading. We also consider that the database may not be accurate and complete as some activity records were not entered until the activity was finished and there was no mechanism for ACS to detect missing activity reports. CARD forms an integral part of the management information system in the Branch and is capable of recording valuable information relevant to considerations of the efficiency and effectiveness of Branch activities. Therefore, we consider that it would be worthwhile for ACS to have mechanisms to ensure that information contained within CARD is accurate and complete. (See Recommendation No.7 at paragraph 5.15.)

Analysing information

6.12 The Branch undertook a significant exercise in the first half of 1997 to analyse information about its risk management activities. The objective of the exercise was to develop a statistically valid measure of client revenue compliance. The ANAO considers that ACS is on the right track in moving towards using a statistically-based and reliable method to measure revenue compliance. We encourage ACS to pursue initiatives in this direction.

6.13 CARD provided the Branch with considerable scope to undertake other very useful analyses of compliance activities (such as risk treatments). Such analyses could include, for example, comparisons of activity types, results and costs to explore differences in the efficiency and effectiveness of various treatment options. In addition, activity details, including general comments made by officers in the Industry Groups, could be used to analyse compliance trends, identify possible emerging issues and test relevant assumptions made during the development of the NCIP.

6.14 The ANAO considers that for analysis to be useful, it is important to have a basis for comparison of progress, efficiency and effectiveness. Performance indicators, targets, standards, benchmarks and milestones can provide such a basis. The Branch had three external performance indicators specified in the ACS 1995-96 Annual Report. These are contained in Table 5 below.

6.15 These indicators were quite 'high level' in nature and focussed on the overall achievements by the Branch. The ANAO considers that the Branch would benefit from also adopting more specific, operationally-focussed and measurable performance indicators. Such indicators could assist managers to evaluate the economy, efficiency and

effectiveness of risk management activities, progress against the NCIP and its continued relevance.

Table 5

Commercial Compliance Branch performance indicators⁴⁰

Performance indicator	Result against indicator
Implement the Industry Panel on Customs Audit Reforms recommendations	24 of the 28 recommendations implemented
Optimise compliance coverage in areas of identified risk	approximately 29 per cent of total revenue liability assured through compliance audit activities
Maximise the level of compliance ⁴¹	\$60.6 million in adjustments, incorporating both returns to clients and recoveries from clients by the Branch 121 penalties applied \$240 000 remitted in penalties

Reporting information

6.16 Management reports provide information to management about changes in the business environment and activities undertaken by the Branch. They also provide an opportunity for Industry Groups to communicate to senior management identified changes in risk levels and priorities, their views on the appropriateness of risk treatment plans and progress against the risk treatment plans contained in the NCIP. To be effective, reports must be timely, clear and easy to understand.

6.17 NBCs provided the first reports by Industry Groups to the

National Manager, Commercial Compliance in February 1997. The Branch intends the reports to be provided half-yearly. The first reports reviewed the Groups' activities between July and December 1996. The ANAO noted that there was regular informal feedback between Groups and NBCs and regular formal meetings. We consider that in addition to these opportunities, more frequent formal reporting to the National Manager, Commercial Compliance (perhaps three or four times a year) would provide the Branch with a better opportunity to ensure that the NCIP remains relevant.

⁴⁰ Australian Customs Service, *Annual Report 1995-96*, AGPS, Canberra, 1996, p60-69.

⁴¹ The Branch advised that the results of the compliance measurement exercise would be included as a performance measure in the 1996-97 Annual Report.

6.18 There was a considerable amount of detail on the activities undertaken and issues in the various Industry Groups in the half yearly reports. The Groups primarily used narrative information in the report, concentrating on activities they had undertaken during the period and major issues facing them. The relevance of this information to potential changes in the business environment and risks and the adequacy of treatment measures was sometimes not made apparent.

6.19 We consider that the content and presentation of the reports could be improved to better inform management about changes in the environment, risk levels and priorities, the appropriateness of risk treatment plans and progress against the NCIP. This could be achieved by refining the design and content of reports to better reflect the risk management process, identifying performance information and presenting this information where appropriate, using techniques such as tables and graphs.

Recommendation No.10

6.20 The ANAO *recommends* that to enable the Commercial Compliance Branch to more effectively monitor and review how changing circumstances may alter risk priorities and to ensure the ways in which risks are managed remain relevant, it

enhances its management information framework by developing the systematic use of external and internal information sources and incorporating appropriate performance information.

ACS response

6.21 Agreed. Industry Groups and the Research and Analysis units continually seek additional sources of internal and external information to assist in identifying areas of potential risk. This includes evaluating results of past activities to determine their effect on levels of compliance.

7. Human Resource Management

This chapter highlights the implications for Branch staff of the changes flowing from RACS and the Industry Panel Report. The ANAO commends ACS on the steps that it has taken to improve the skills of staff and recommends some action to help with the continuing transition envisaged.

Introduction

7.1 Previous chapters referred to the significant organisational and operational changes in the Branch in response to RACS in 1993 and the Industry Panel in 1995. These involved a reorganisation of the Branch from functional areas to industry sectors, the establishment of National Business Centres and the development of new corporate manuals for company audits and the improvement of commercial compliance with regulatory requirements.

Implications of the changed approach by the Branch

7.2 The strategies flowing from these major reports have set particular challenges for staff in the Branch. These challenges, in

turn, require staff to have adequate training in risk management, auditing and the relevant industry environment as well as in ACS-specific matters, as explained below.

7.3 Under the new arrangements all staff need to be familiar with risk management concepts and some need to be expert in their application. They also need to be able to apply the current ACS audit methodology, recognising that the approaches to audit activity varied considerably under previous arrangements and were generally not sophisticated.

7.4 A related requirement under these new arrangements is for staff to have an understanding of industry features and dynamics, and to be able to relate this to compliance improvement, risk management and audit activities. At the same time staff need to

retain and keep up-to-date their high level of ACS-specific knowledge (such as tariffs and by-laws).

7.5 The approach adopted by the Branch was to establish the framework and plan for the improvement of skills of existing staff and to maximise the benefit to be gained by placing those staff in areas where they could best contribute to ACS.

Training in the Branch

7.6 The Branch training initiatives sought to address both the short-term and longer-term requirements, spanning exposure to the overarching principles of risk management in the Branch and skills in its 'business', such as knowledge of ACS-specific matters, the industry environment and audit methodology. Of these three elements of operational training in its business, the Branch advised the ANAO that it considered industry knowledge and auditing were the priority areas in which staff skills needed to be enhanced in the short-term. Existing training in ACS-specific matters was to continue.

7.7 Our observations on the training activities and skill needs of Branch staff which became apparent during the audit are discussed below.

Risk management training initiatives

7.8 Training in risk management for Branch staff (and indeed for all ACS staff) was planned to involve three levels:

- Level 0 - an introduction to risk management in a two to three hour session, giving participants an overview of the risk management terminology and a basic awareness of what was contained in the 'risk management cycle';
- Level 1 - a one-day course aimed at staff who need to have a sound understanding of the risk management process applicable to their jobs. This could be undertaken through a workshop based on a case study or a stand alone on-the-job workbook that took the participant through a case study; and
- Level 2 - a formal course and project on the risk management process involving some 100 hours, to provide exposure to risk management at a very detailed level; for example, that required in certain specialist areas such as the Research and Analysis Groups.

7.9 At the time of the audit, staff were undertaking Level 0 and Level 1 courses and the Level 2 course was being developed. ACS risk management training

initiatives were extensive and involved significant resource commitment. We consider that the general direction of the training effort was appropriate.

Industry knowledge

7.10 Branch staff advised the ANAO that industry knowledge development was handled by individual regions, with particular emphasis on the National Business Centres and the relevant Research and Analysis Groups. We found that good work had been done in this regard by the Alcohol Group to identify the structure of, and trends in, its industry. We consider that such efforts are a solid foundation on which to build further industry knowledge and skills of staff.

Auditing, computer assisted audit techniques and information technology auditing

7.11 The challenge for the Branch in regard to auditing is that very few staff have any formal exposure to contemporary auditing practice. The Branch advised that it recognised that there was a significant need to improve staff skill levels in the use of the company audit methodology (incorporating elements of both transaction and systems based auditing) introduced to the Branch in August 1996.

7.12 The Branch approach to delivery of audit training in the short term was to use existing training modules where appropriate and also to seek external assistance. Training and assistance was acquired by the Branch in 1996-97 from a private sector accounting firm to help adoption of improved auditing techniques. This involved the development of a two-day course on auditing based around the new methodology and its provision to Commercial Compliance staff in all regions. In two particular audits where the new methodology was used and where complex information technology (IT) systems were involved, the Branch obtained the assistance of an IT audit expert from a professional firm.

7.13 The ANAO considers that the ACS audit methodology is sound and consistent with contemporary professional auditing approaches. While recognising the need for competent skill levels at the fieldwork stage of an audit, we consider that good skill levels are particularly important at the planning and review stages of an audit. This helps in ensuring that the audit process provides evidence appropriate to meeting the audit objectives and the results of audits are properly interpreted.

7.14 As staff acquire better auditing skills, it will remain

important that the Branch has access on an 'as required' basis to external, expert audit assistance in the next few years. We consider that, further to the interim training and advice provided to audit groups by two of the professional audit firms, the Branch would benefit from establishing an ongoing mechanism for audit managers to have professional assistance to draw on at the planning and review stages of audits. The involvement of external professionals to review Branch audit activity in a peer review process would also assist ACS in determining the extent of its improvement and guide it in assessing particular aspects for further training and staff development.

7.15 The ANAO recognises that successful integration of computer assisted audit techniques (CAATs) and IT audit expertise in the audit process as envisaged in the ACS methodology takes perseverance. The agency has acquired copies of a proprietary CAATs tool to allow staff to undertake data analysis as part of the audit process and also to allow Research and Analysis (R and A) Groups to improve their analyses of in-house data-bases. We observed that the use of CAATs was still at a developmental stage and this tool had not been widely used in audits.

7.16 With increased technical sophistication of commercial entities' systems, it is important that ACS is able to use CAATs effectively. Some staff would benefit from additional training in the use of the available CAATs tool so that this technique is more fully integrated into the planning and conduct of audits.

7.17 The ANAO appreciates that IT audit is both highly specialised and subject to a changing environment. This makes it very difficult for agencies to acquire and maintain up-to-date IT auditing skills in-house. As a way of meeting its particular needs for specialised IT auditing expertise, we suggest that the Branch should consider putting in place a standing arrangement with professional firms to obtain such assistance in those regions where it is required.

Research and Analysis training

7.18 The Commercial Services Division advised the ANAO that training for members of R and A Groups (some of whom were drawn from ACS Intelligence areas) was not a principal focus of the training initiatives delivered so far in the Branch. We noted that while staff from Intelligence areas have investigatory skills, these were not the only skills applicable to R and A Group responsibilities. Other necessary skills include an ability to undertake complex data

analysis and use a variety of research methodologies to develop an understanding of factors which influence commercial compliance risks.

7.19 We found considerable inconsistency in the quality of analytical support provided to the Industry Groups by the R and A Groups. Improvements could be made in the analytical processes, their documentation and the presentation of research results. We also found that the R and A Groups were provided with a CAATs tool to assist data analysis. Although at the time of the audit Central Office had considerable expertise with the use of these tools, their use in the regions was relatively underdeveloped.

7.20 The Level 2 risk management course is specifically tailored to R and A Groups needs and we support this as a means of providing them with a suite of tools to improve their effectiveness and analytical support for Industry Groups.

Commercial Education Program

7.21 The Commercial Education Program (CEP) was a major and ambitious initiative for the Commercial Services Division, designed to put the education of staff on a firm, longer-term footing. In its development phase

during the course of the ANAO audit, it was intended to involve a partnership between an education institution and the ACS, be externally accredited and involve competency-based training. The program was intended to provide three levels of accreditation based upon completion of specified modules.

7.22 At the time of the audit, ACS was in the process of developing competency standards as a foundation for the education program. This process involved ACS undertaking detailed and comprehensive job analyses in the compliance, research and analysis, trade facilitation and industry assistance functions. ACS was establishing common and specialist competencies in these areas and three levels of competencies.

7.23 Following this work, ACS intended to assess the current competencies of existing staff as part of a training needs analysis. It intended to complete its assessment of skill needs against the Commercial Compliance competency standards by mid-August 1997, to be followed by other Branches in the Commercial Services Division. ACS planned to have the first modules of CEP (including units on auditing, accounting, IT and statistics) available by the end of September 1997.

7.24 The ANAO considers that the approach adopted by ACS to the development of the CEP is sound but the benefits of the program will not be available for some time. Therefore, we concluded there was a need for existing skills to be supplemented in the meantime by drawing on skilled staff from external sources.

Staffing structures and levels

7.25 Staffing structures are relevant in discussions of training requirements because the level of skills able to be acquired with new or replacement staff (and their training needs) will depend, in part, on the staffing structure in place in the regions. Industry Groups generally had an Industry Group Manager and several team leaders and members. In addition, some regions had positions for graduate recruits to be trained.

7.26 The ANAO considers that the sophistication of the techniques that staff are required to apply in audits will vary depending on the industry and client involved. For example, audits of large clients in the alcohol and petroleum industries involve complex IT systems. These require different skills to audits performed on small clients which do not have computerised systems.

7.27 In our view, the structure of audit teams would benefit from a mix of levels and expertise which is appropriate to the specific audit task. This means that team structures for particular audits in certain Industry Groups from time to time may require more senior and expert staff than others, especially where staff are expected to plan and undertake reasonably complex systems-based audits. We acknowledge that ACS has adopted a flexible approach in some cases as evident, for example, in the establishment of a team to undertake a particular task in the freight forwarding industry. We consider that the wider adoption of this approach could be beneficial in providing efficient and effective audit risk treatments.

Overall approach

7.28 The ANAO appreciates that in implementing the overall staffing changes as a result of RACS, the agency has tried to match existing staff and job requirements to the maximum extent possible. While such a strategy might be a practical necessity in the short term, it had some limitations. This strategy did not allow the Branch to change its underlying staffing capability significantly and rapidly.

7.29 It is our view that because the current training initiatives will take some years to produce significant change in staff capability, there would be merit in the Branch considering ways to expedite the acquisition of skills. Possible options include selective recruitment of skilled staff, medium-term contract staff, secondments and staff interchanges. We consider that such recruitment at the audit manager and team leader levels would be of significant benefit to the Branch at this stage.

Recommendation No.11

7.30 The ANAO *recommends* that to supplement and expedite the acquisition of specific audit and Information Technology skills ACS:

- continues to use external, professional assistance in these areas and establishes a framework for this assistance to be available in the longer term; and
- considers selective recruitment, secondments and staff interchanges of professional audit managers and team leaders into positions in the Commercial Compliance areas in regional offices to achieve more cost-effective outcomes.

ACS response

7.31 Agreed. Commercial Compliance staff have continual access to the expertise provided by the ACS internal audit contract. Where appropriate, additional external expertise from other sources continues to be used. Additionally, Customs recently launched a recruitment campaign to attract suitably qualified auditors to the Commercial Compliance Branch.

8. The Way Ahead for Risk Management in ACS

This chapter draws together observations and lessons learned from the Commercial Compliance Branch in planning and applying risk management. It also suggests possible ways ACS can build on the progress made in the Branch and Commercial Services Division to secure the benefits that risk management offers for improving management decision-making.

Lessons learnt from introducing risk management to the Commercial Compliance Branch

8.1 As a large, dispersed organisation with diverse and dynamic functions including trade facilitation, enforcement and revenue collection, ACS has major challenges in achieving its stated objective of making risk management an integral part of the planning and management processes at all levels.

8.2 In developing its processes over time, ACS can capitalise on its own considerable experience to date. The ANAO suggests that ACS would benefit from applying the lessons learned in the Branch, discussed in previous chapters. We consider that the key broad lessons apparent from our analysis of the Branch that could be worth applying in other areas of ACS are the:

- benefits of having a process and plan which are explicitly framed against the APS Guidelines;
- advantages of having an organisational structure and human resource management regime to support the dynamic process;
- necessity for an adequate level of supporting documentation for the whole process, to promote the efficiency, effectiveness and accountability of the risk management regime. The use of risk management guides and preformatted documents can support this and can facilitate a structured and comprehensive approach which allows for comparability of results, promotes effective review and update and enhances transparency in decision-making;

- importance of clearly linking the planning processes and linking these, in turn, to relevant documentation; and
- value of developing the skills and knowledge of current staff and engaging specialist expertise, including consultants, to address specific needs.

8.3 The ANAO notes that in refining its processes, ACS can, of course, also capitalise on the experience of agencies such as the Australian Taxation Office and others which are adopting risk management principles.

The corporate infrastructure supporting risk management

8.4 The ANAO found that the ACS Executive Group⁴² gave risk management a high corporate priority and that the organisation refined its risk management processes and developed a solid infrastructure to support risk management corporately. The stated objective in undertaking these tasks was to ensure risk management became an integral part of the planning and management process at all levels

in the organisation.

Achievements included:

- commitment by the ACS Executive Group in May 1995 to a formal process of risk management at the corporate level through the development and implementation of a consistent approach based on AS/NZS 4360 and the APS Guidelines;
- assignment of responsibility for the task of establishing the process throughout ACS to the National Director (Commercial Services);
- establishment of the Risk Management Co-ordination Unit in 1995 to support the corporate introduction of risk management. The Unit was responsible for formulating the corporate risk management policy, model and processes, performance indicators and awareness and training programs; and
- development and issue of a Risk Management Policy in March 1996, based on AS/NZS 4360 and the APS Guidelines. The ANAO considers that the policy was a useful corporate document that emphasised the business necessity for, and practical requirements of, risk management in ACS, as well as the need for all staff to be involved in the management of risk.

⁴² The ACS Executive Group comprised the Chief Executive Officer (CEO), two Deputy CEOs, three National Directors (Border Management, Commercial Services and Business Development and Technology) and the National Manager, Executive Support.

8.5 The ANAO commends ACS, and particularly the implementation team, for the considerable progress made in formulating and implementing elements of the strategic risk framework and providing valuable support to staff.

ACS strategy for the adoption of risk management

8.6 The implementation strategy adopted by ACS in responding to the imperatives of the Industry Panel was to introduce risk management across the agency on a staged basis. In 1995, ACS informed the Customs Advisory Board⁴³ of its organisational risk management strategy and the three phases of the broad project plan in that year. The ACS plan, subsequently endorsed by the Board, involved the development, implementation and integration phases over the three years 1995-96 to 1997-98. In outlining its risk management strategy and clarifying the responsibilities of the implementation team and the business areas, ACS indicated that the development of specific business risk processes and their integration into the functions of the business area would remain

the responsibility of the National and Regional Directors and Managers.

8.7 After processes to introduce formal risk management were commenced in the Branch, the ACS strategy was to focus then on core business areas, in accordance with the recommendations of the Industry Panel. Accordingly, formal risk management processes were initiated in late 1995 in the Border Operations Branch in the Border Management Division and Coastwatch in 1996. At the time of the audit, processes to introduce and implement formal risk management were continuing in those areas.

Obtaining the business benefits of risk management for ACS

Strategic risk management planning and resource allocation

8.8 The ANAO found that ACS made sound progress with the development of the formal processes of risk management, particularly in the Commercial Services Division. We consider that the full business benefits of risk management for ACS will start to be realised when risk management is fully in place in the Division and in other key parts of the agency. Such progress will mean that risk-based planning

⁴³ The Customs Advisory Board (replaced in 1997 by the Ministers Advisory Council on Customs) was established in 1994 to oversee the implementation process of the then Government's decisions in relation to RACS and to make recommendations to the Minister and the Chief Executive Officer on matters of ACS administration.

and operational processes can help to inform higher level decisions on resource allocation.

8.9 A similar view of a possible ultimate benefit of risk management was also expressed by the Chief Executive Officer in the 1995-96 ACS Annual Report. In reflecting on the progress made in developing risk management programs and plans in the commercial and border operational environments he wrote that:

*When fully developed and implemented, they will provide Customs with a framework that will better target our resources and effort.*⁴⁴

8.10 The ANAO noted that ACS had started to consider risk management issues formally in relation to resourcing decisions. In April 1997, the ACS Executive Group endorsed the continuing development of transparent, equitable and flexible resource allocation processes. The endorsement incorporated three themes: improving linkages between corporate planning and resource allocation; making greater use of unit costs and a focus on outputs; and (of particular significance in the context of resource allocation and risk management) bringing together risk management considerations and information

including cost, workload and performance data.⁴⁵ While recognising that this was in the early days of its formal development, we consider that the explicit consideration of the alignment of resourcing (especially staffing) and identified risks was a positive development in the adoption of formal risk management in ACS.

8.11 Senior management in any organisation requires assurance that it has a robust mechanism which allows it to allocate resources between broad areas of current priority and emerging needs. The ANAO appreciates the elements of the ACS corporate planning processes and documentation and their relevance to risk management. These elements are illustrated and discussed in Chapter 3 in respect of the Commercial Services Division. However, we noted that the framework did not provide ACS with a high-level statement of the key risks the organisation faced.

8.12 To better inform senior management's strategic and resourcing decisions and thereby gain the business benefits of risk management, the ANAO considers that it would be beneficial for ACS to have a collective understanding of its major risks. The statement of

⁴⁴ Australian Customs Service, op. cit., p3.

⁴⁵ Executive Group/Regional Directors Meeting Minutes April 1997.

these should be prepared on a consistent basis, to allow senior management to make judgments across the agency as to current and emerging areas of need.

8.13 The statement does not have to be a discrete document, limited to and specifically prepared for this purpose. In our view, a satisfactory document would be one that draws on the risk management plans in key operational areas to highlight areas of major risk to the agency. Providing the risk management processes were done in a broadly consistent way, significant risks could be summarised to inform senior management regarding the best targeting of resources and effort.

When will the business benefits be realised?

8.14 The ANAO noted that ACS adopted a staged approach to the introduction of risk management whereas the Australian Taxation Office adopted a concurrent, agency-wide approach to implementation.⁴⁶ ACS advised that it adopted its staged approach in light of government decisions after RACS and after

considering the cultural changes that were required for its staff.

8.15 We appreciate the practicalities which led ACS to implement a staged approach. We also understand that in implementing this approach, the agency had a strategy to focus on its core business areas first, thereby allowing it to derive the benefits of risk management in its most important activity. The extent to which ACS will be able to derive business gains from effective risk management by improved economy, efficiency and effectiveness and better service delivery will depend on the extent and speed with which the whole organisation comprehensively adopts and applies the principles.

8.16 In January 1996 the Chief Executive Officer endorsed the broad features of the corporate risk management implementation strategy and steps for the remainder of 1995-96. The Executive Group, along with Regional Directors, received information on progress against the implementation strategy on a regular basis.

8.17 The ANAO noted that the adoption and development of risk management in key operational areas was a clear corporate strategic objective in the ACS Corporate Plan.⁴⁷ Risk-based

⁴⁶ See Auditor-General, *Risk Management Australian Taxation Office*, Audit Report No.37 1996-97, AGPS, Canberra, 1997. Note that the ATO adopted an approach that addressed an extensive range of business risks. In contrast, the initial predominant focus of ACS was on compliance risks.

⁴⁷ The ACS Corporate Plan 1996-1999 refers to the adoption of risk management as a key

analyses and information were being developed at the time of the audit in the Commercial Services Division in the course of its application of the formal processes of risk management. We consider that it would be useful for ACS to have these in place across the other major areas of its activities.

8.18 At the time of drafting this report, ACS had not established a clear date by which all operational areas would have consistent and comprehensive risk management plans in place. The ANAO considers that by setting a target date for risk management to be implemented across all operational areas, senior management can communicate to the organisation when they expect rigorous, risk-based information to be available for key corporate decision-making such as resource allocation. This would assist ACS realise the business benefits of risk management in a timely way.

Recommendation No.12

8.19 The ANAO *recommends* that to:

- assist strategic organisational and resourcing decisions by

action for the triennium in a number of Key Result Areas such as Trade Facilitation and Compliance, Travel Facilitation and Compliance, Delivery of Industry Support, Community Protection and Revenue Collection. See Australian Customs Service, *Corporate Plan 1996-1999*, Australian Customs Service, Canberra, 1997.

senior management, ACS prepares a statement summarising the risks facing the agency in its key operational areas; and

- ensure sufficient information for the development of such a statement, ACS sets a realistic medium term target for key operational areas to have consistent risk management plans in place.

ACS response

8.20 Agreed. The ACS strategic risk program is based on the priorities identified by the Review of the Australian Customs Service (the Conroy Review), the ANAO's recommendations for modernisation of the Diesel Fuel Rebate Scheme and the achievement of core business key results.

8.21 Corporate strategic risks will continue to be based on the key result areas. A specific statement of risks associated with key operational areas will be compiled in the next round of corporate planning.

8.22 The current risk management work program specifies that all key operational areas will have standardised their risk management practices in accordance with Customs corporate risk management policy by the end of July 1998.

Canberra ACT
20 October 1997



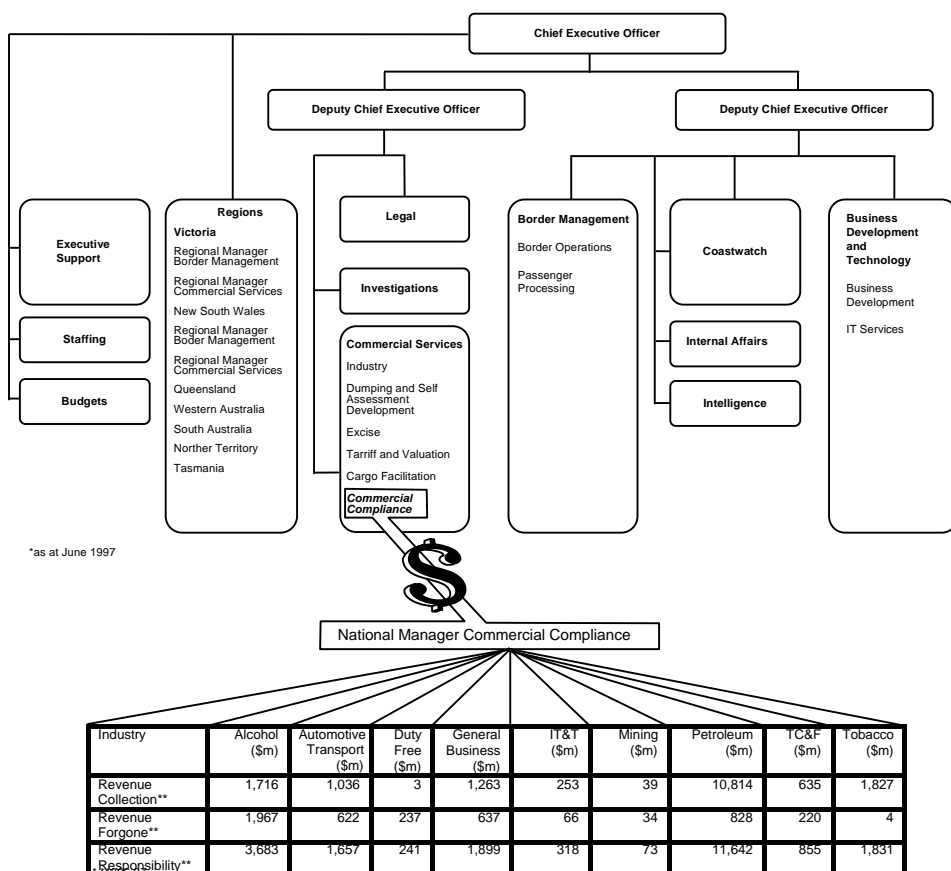
P. J. Barrett
Auditor-General

Part Three

Appendices

Appendix 1

Organisational structure of the Australian Customs Service and operations of the Commercial Compliance Branch



Appendix 2

‘Brainstorming’ to identify potential risks

‘Brainstorming’ can be an effective method of comprehensively identifying potential risks. There are several different approaches which can be adopted to ensure a rigorous process. Each approach has benefits and limitations in terms of effectiveness and practicality. Some key features are set out below.

Benefits and limitations in the various approaches to ‘brainstorming’

Approach	Benefits	Limitations
Individual	Focussed. Detailed knowledge in specific areas.	Thought processes about a risk are limited because one person does not know everything. Only one approach to viewing risk areas and risks.
Team with members drawn from a single discipline	Good knowledge of specific risks. Scope for a variety of approaches. Team co-ordination relatively easy.	Within the discipline, appreciation of ‘non-technical’ issues may be scant. Limited to consideration of risks within the particular discipline. Wider business risks may be missed.
Multi-disciplinary team	Wide range of views and approaches. Wide range of business effects considered.	Facilitation of the group is likely to be required. Some analyses can be general and additional, detailed analyses possibly required.

Appendix 3

Performance Audits in the Australian Customs Service

Set out below are the titles of the reports of the main performance audits by the ANAO in the Australian Customs Service tabled in the Parliament in the past three years.

Audit Report No.20 1995-96
Diesel Fuel Rebate Scheme
Australian Customs Service

Audit Report No.1 1996-97
Passenger Movement Charge
Australian Customs Service

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