Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004

Canberra ACT
26 June 2004

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major Australian Government entities as part of the audits of their financial statements in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004.*

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

Yours sincerely

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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AUDITING FOR AUSTRALIA

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

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Abbreviations

AAO	Administrative Arrangement Orders
AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
AFP	Australian Federal Police
AGD	Attorney-General's Department
AGPS	Australian Government Public Sector
ANAO	Australian National Audit Office
APS	Australian Public Service
ASIC	Australian Securities and Investment Commission
ASX	Australian Stock Exchange
ATO	Australian Taxation Office
ATSIS	Aboriginal and Torres Strait Islander Services
AuASB	Auditing and Assurance Standards Board
AUS	Australian Auditing Standard
BPG	Better Practice Guide
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CEIs	Chief Executive Instructions
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CLERP	*Corporate Law Economic Reform Program*
CobiT	Control Objectives for Information and Related Technology
CSA	Control Self Assessment
CSIRO	Commonwealth Scientific and Industrial Research Organisation
Customs	Australian Customs Service
DAFF	Department of Agriculture, Fisheries and Forestry

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Defence	Department of Defence
DEST	Department of Education, Science and Training
DEWR	Department of Employment and Workplace Relations
DFAT	Department of Foreign Affairs and Trade
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DITR	Department of Industry, Tourism and Resources
DoCITA	Department of Communications, Information Technology and the Arts
DEH	Department of the Environment and Heritage
DoFA	Department of Finance and Administration
DoHA	Department of Health and Ageing
DVA	Department of Veterans' Affairs
FaCS	Department of Family and Community Services
FBO	Final Budget Outcome
Finance	Department of Finance and Administration
FMA Act	*Financial Management and Accountability Act 1997*
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
FTE	Full Time Equivalent
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
HIC	Health Insurance Commission
HRMIS	Human Resources Management Information System
ICT	Information and Communication Technology
IFRS	International Financial Reporting Standards
IT	Information Technology
KPI	Key Performance Indicator
OHS	Occupational Health and Safety

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PBS	Portfolio Budget Statements
PM&C	Department of the Prime Minister and Cabinet
PSM	Commonwealth Protective Security Manual
RBA	Reserve Bank of Australia
Treasury	Department of the Treasury

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Foreword

This report, which follows the ANAO interim audit work up to the beginning of April 2004, describes the effectiveness of systems and processes that major Australian Government Public Sector (AGPS) entities have implemented for statutory financial reporting to Parliament. These same systems are used for the preparation of the monthly financial reports, that inform Chief Executives on entity performance and provide an important basis for management decisions and accountability. In addition, data from these same systems is transmitted to the Department of Finance and Administration and used as a basis for consolidation, analysis, and whole of government decision-making, as well as reporting. The external audit of the statutory reporting process is one of the few mechanisms available to the Parliament to validate that the systems and processes used for government decision-making, are effective.

ANAO audit findings this year, again indicate that there remain fundamental financial management issues that need to be addressed in the AGPS. Entities need to continue to build risk awareness; strengthen business practices and systems of authorisation; enhance financial reporting and analysis; and integrate financial and non-financial information, as part of the development of performance measurement frameworks. This report provides greater context and information on control issues than has been done in prior years, reflecting greater concern and interest in the control environments of entities and the need for greater assurance.

Corporate governance continues to be a major focus of private and public sector corporate reform. To support this effort across the AGPS, the Australian National Audit Office (ANAO) published a Better Practice Guide (BPG) entitled 'Public Sector Governance' in July 2003. The BPG is designed to assist AGPS entities to improve their governance framework, processes and practices. Good public sector governance is important to provide adequate accountability to agencies' many stakeholders, including tax payers, and to encourage performance improvement, while satisfying control and compliance requirements. Recent business support and performance audits continue to show that many entities do not understand fully the legal obligations set by Parliament over entity operations. Through the use of financial statement audits, targeted performance audits and BPGs, the ANAO looks to focus entity attention on, among other things, important legal process shortcomings and provide general guidance for solutions.

In recent times, the Australian community has seen the collapse of a number of different corporate enterprises both internationally and domestically. I have reported previously, that enterprise collapses often raise questions over the soundness of business practices. As self-regulation has given way to a more

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prescriptive regime, there is in my view, an equally valid need for quality and timely financial reporting both within the private and Australian Government sectors. It is fair to say that, along with all important financial data released in capital markets, which also includes Government financial information, there is an imperative for its release to be timely.

Against this background, the Government has moved its financial reporting deadlines to align 'audit cleared' information with the production of its Final Budget Outcome (FBO). The FBO is released in August of each year and that document represents the Government's economic stewardship report to the Australian Parliament. However, there is a policy issue relating to accounting treatments that needs to be clarified for public sector reporting purposes.

The preparation of AGPS financial statements is based on a materiality principle which is well understood in financial reporting. Put simply, it means that the respective entity accounting representations are designed to be accurate (for primary financial balances) within prescribed materiality levels. This is contrasted with the FBO which has no defined materiality threshold.

The financial statement reports and the FBO should logically be based on the same fundamental materiality construct for public understanding and confidence. If they are not, the differences should at least be clearly articulated for more understandable and accurate public sector reporting. However, in the Australian Government sector, this is not yet the case. The resolution of this issue is fundamental to Parliamentary and public understanding of government financial reporting and associated assurance.

I would like to again acknowledge the professionalism and commitment of my staff in undertaking the audit work that culminated in this report. I also record our appreciation for the cooperation of chief finance officers (CFOs) and other relevant entity staff for their input into aspects of this report. Their combined efforts have enabled the tabling of this report for the information of the Parliament in a timely manner.

P.J.Barrett

Auditor-General

26 June 2004

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Summary

Introduction

1. This report updates the ANAO's ongoing assessment of audit findings relating to major entity internal control structures, including governance arrangements, information systems, and control procedures through to March 2004. The findings summarised in this report arose from the interim phase of the financial statement audits of major Australian Government Public Sector (AGPS) entities for 2003–2004. Examinations of such issues are designed to assess the reliance that can be placed on control structures to produce complete, accurate and valid information for financial reporting purposes.

2. This year's report also considers a number of strategic issues which are important in the continuing evolution of better practice financial management practices in the AGPS (Chapter 1).

3. Consistent with past ANAO practice, a second report will be issued in December 2004 following completion of the financial statement audits of entities for 2003–2004. The ANAO will also report, at that time, on any additional operational and financial management issues arising out of the final audits and their relationship to internal control structures, including risk management and fraud control.

4. This report also provides a summary of the financial, accounting, and Information Technology (IT) control processes adopted by entities. It includes an update of the broader corporate governance issues that impact on financial management and reporting. Prior year audit findings outlined in *ANAO Audit Reports* No.61 of 2002–2003[1] and No.22 of 2003–2004[2], noted that continued progress was achieved in the financial year ended 30 June 2003 in resolving internal control and financial reporting issues raised in previous years. It was also concluded, however, that improvements were still required in most entities to assist the understanding of accrual accounting, the timeliness and consistency of financial reporting, the analysis of costs and overheads, and the performance measurement processes and analyses.

5. Audit findings have been classified into three groups:

- the entities' internal control environment;

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[1] ANAO Audit Report No.61 of 2002–03 *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003*.

[2] ANAO Audit Report No.22 of 2003–04, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2003*.

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- the Information Technology (IT) systems; and

- the specific control procedures over significant business and accounting processes.

Internal control environment

6.   As part of the financial statement audit process, the ANAO assesses whether an entity's internal control environment comprises measures that contribute positively to sound corporate governance. The measures should mitigate identified risks and reflect the specific governance requirements of each entity.

7.   Prior year reports noted that improvements were required by some entities in a number of control areas. Entities generally acknowledged that enhancements were necessary in areas such as:

- increased risk awareness assessment and better management, including the use of performance management tools such as data metrics to monitor trends in risk and its treatment;

- enhancing the quality and presentation of monthly financial reporting;

- integrating financial and non-financial data as part of the development of credible performance measurement assessment frameworks; and

- improving the capacity of internal audit functions to deliver a blend of compliance, performance, and risk-based audit services.

8.   ANAO audit observations this year indicate that progress has been achieved across most entities in the above areas. However, in some cases, further progress and refinement are still required. This is particularly the case in respect of expanding the level of reporting of non-financial performance measures.

9.   In addition, the review of the underlying causes of corporate failures that occurred in Australia and overseas in recent times has continued to increase the focus on sound corporate governance within the AGPS. Of significance, is the need for continual diligence with conformance issues together with heightened awareness of the need for continuous improvement in performance management.

Information technology systems

10.   The Australian Government has a significant investment in information and communications technology (ICT). The Consolidated Financial Statements

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of the Australian Government, for the financial year ended 30 June 2003, report an investment cost of $5.85 billion.

11. As indicated previously, new technologies have also introduced increased complexity, greater speed, interconnectivity and dependence on information systems within the IT environment. Implementation of technology provides the scope for improved productivity and better service delivery, but it also can involve substantial costs and increased risks.

Control procedures

12. An entity's system of internal control includes the procedures established to provide reasonable assurance that operational and administrative objectives and goals are achieved. Internal control procedures, within significant operational and accounting processes and financial systems, are examined as part of the audit of an entity's financial statements.

13. Overall, the results of the interim audits of entities reviewed in this report indicate that the effectiveness of control procedures over business and accounting processes was consistent with that of the prior year. Some entities continue to experience difficulty with a number of control processes specific to their operations covering, for example, segregation of duties and inappropriate delegations, procedures to ensure the completeness and accuracy of the recording of transactions, and reconciliation of asset registers. A number of entities could also improve the quality of documentation with regard to accounting estimates.

Key findings

14. The ANAO rates its findings according to a risk scale. Audit findings which pose a significant business or financial risk to the entity and which must be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate business or financial risk are rated as 'B'. These should be addressed within the next 12 months. Findings that are procedural in nature, or reflect relatively minor administrative shortcomings, are rated as 'C'. The timing of action on these findings is at the discretion of the entity.

15. The following results and analysis do not include Defence because the interim audit is not yet complete. With Defence, however, there is detailed commentary in Chapter five and, in the main, issues raised this year are likely to be of the same magnitude as in prior years. Overall, the results of audit activity over the past year indicate that control procedures over business and accounting processes have generally been maintained at a reasonable level with only moderate variation. This is demonstrated by:

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- the number of entities with 'A' category audit issues, remain constant at one in 2003–2004 and 2002–2003;

- the total number of 'B' category audit issues across all entities increased from 68 in 2002–2003 to 98 in 2003–2004;

- seven entities reported an improvement in the number of 'B' category audit issues; 10 entities showed a deterioration in their position, with five entities remaining in the same position; and

- the number of entities with no category 'A' or 'B' audit issues remained at three in 2002–2003 and 2003–2004.

16.   A summary of 'A' and 'B' category audit findings by entity is outlined in Table 2 of Appendix 2.

The ANAO's 2003–2004 audit cycle

17.   Under section 57 of the *Financial Management Act* (FMA Act) for entities, and under clause 3, part 2 of Schedule 1 of the *Commonwealth Authorities and Companies Act 1997* (CAC Act) for Commonwealth Authorities, the Auditor-General is required to report each year to the relevant Minister, on whether the entity's financial statements have been prepared in accordance with the Finance Minister's Orders (FMOs) and whether they give a true and fair view of the matters required by those Orders.

18.   This report presents the cumulative audit results and analysis of audit planning, risk assessments, interim testing and consideration of business and corporate governance arrangements in major AGPS entities as at 31 March 2004. The results of this analysis and interim testing are outlined in the following chapters. All ANAO findings have been reported in detail; discussed with entities' management; and reported in summary to the relevant Minister(s).

19.   The final phase of most audits will be completed in the April to August 2004 period and will be reported to Parliament in December 2004.

Report timing

20.   The purpose and timing of this report specifically recognises the increased responsibility being placed on entities to maintain an effective control structure as part of good corporate governance. The ANAO continues to be committed to the timely reporting of significant matters to assist the Parliament in its oversight of the financial aspects of public administration. The ANAO expects to report the results of the final audits to the Parliament in December 2004, as noted earlier.

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Structure of the report

21. *Chapter 1* presents an overview of important issues facing entities and the Australian Government in relation to financial management policies, procedures, and reporting. These issues are likely to have an important impact in the future on the control structures and financial management practices of the APS.

22. *Chapter 2* provides a summary of major issues relating to the internal control environments of Australian Government entities examined.

23. *Chapter 3* provides a summary of the major issues relating to the audit of information systems focussing on the control issues associated with the planning, management and operation of the IT environment, with particular focus on information security and business continuity management practices.

24. *Chapter 4* provides a summary of the controls over financial systems and processes from a financial statement audit perspective, for each of the Australian Government entities examined.

25. *Chapter 5* outlines the results of internal control structure, business and accounting processes and systems examinations, for each of the Australian Government entities covered, as part of the audits of their financial statements.

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1. Issues Affecting the Australian Government Public Sector

Background

1.1   The focus of reforms in the Australian Government Public Sector (AGPS) over many years has supported the establishment of a performance culture supported by clear lines of accountability. Successive governments have had as an objective, the goal of changing the focus of the public sector towards a more business orientated approach, supported by a rigorous and transparent performance culture, to produce required results.

1.2   Since 2001, the ANAO has provided comment on important elements of the Government's financial reform agenda in its reports to Parliament. Significant issues discussed included commentary on the AGPS's financial framework as applied to accrual budgeting and reporting. Previous reports also included discussion related to performance management issues resulting from the adoption of the outcomes and outputs budgeting and reporting framework.

1.3   Last year's Controls Report[3] centred on the objective of the financial framework to enhance the performance and accountability of the AGPS. We emphasised the need to develop sound financial systems, internal budgeting and reporting arrangements so that managers have access to important information that properly reflects the full cost of their operations. The report also indicated that effective management decision-making is largely reliant on the provision of concise information from these systems and their associated reports.

1.4   This year's report expands further on some of these issues and introduces other contemporary matters to provide a more informative picture of the situation of major entities.

1.5   The AGPS is constantly changing and evolving to meet growing public expectations. To keep pace with these expectations, the Government has introduced initiatives through both legislation and policy reform. As a result, there are a number of contemporary issues that are impacting on the Australian Government's governance arrangements and external reporting processes, which include:

●   corporate governance;

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[3]   Audit report No.61 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ended 30 June 2003*.

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- joined–up or collaborative Government arrangements;

- asset and liability management issues;

- departmental and administered items;

- adopting of Australian equivalents to International Financial Reporting Standards;

- convergence of Australian Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS);

- convergence of Australian Auditing Standards with international standards on auditing; and

- increasingly compressed reporting timetables for Australian Government entities.

1.6 This chapter of the report provides commentary on the impacts of the reform programs and contemporary issues on both the Australian Government and the ANAO. However, before so doing, the following is indicative of the financial statement auditing issues for fiscal 2004.

Financial statement audit position—related to compliance and conformance issues

1.7 The ANAO's audit focus is directed at the significant risk, control, and related management issues within operating and accounting processes and the financial system that supports the financial reporting processes of AGPS entities.

1.8 As part of the financial statement audit process, the ANAO assesses whether an entity's internal control environment comprises measures that contribute positively to sound corporate governance. The measures should mitigate identified risks and reflect the specific identified requirements of each entity.

1.9 The audit process for the current year has identified a number of matters, which indicate that entities within the Australian Government are yet to fully complete the Government's financial reform agenda. Not only have many entities not progressed to the stage where they are fully utilising financial information to maximise performance, it is evident that there are still issues relating to compliance, both in regards to accounting standards and other legislative requirements, that need to be addressed.

1.10 Concerns have been raised with regard to the establishment and maintenance of effective controls over the entity's financial and business processes. For example, recent audit reports on information technology (IT)

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systems, financial delegations and fraud have identified a number of issues demanding attention. These issues go to the core of, and are fundamental to, a sustainable operating model and are critical to the compliance requirements of the AGPS.

1.11   The use of IT within government entities has become increasingly significant in recent years, particularly following the greater dependence on the internet and organisational intranets, with a range of government services now provided directly to the public online. As a result, there is increasing dependence on information and the IT systems that support these services, as well as increasing vulnerabilities and threats that have to be managed effectively.

1.12   The result of the IT audit for fiscal 2004 indicated that, while generally entities have improved their practices, further progress needs to be made for most entities to reach a maturity level that is considered appropriate. In particular, improvement needs to occur with regard to security controls to restrict access to authorised personnel, thus reducing the possibility that unauthorised access can be gained to confidential information or that unauthorised changes can be made to programs or data.

1.13   Late 2003–2004, the ANAO produced an audit report on the use and management of human resource information systems (HRIS). That report concluded that, 'a lack of financial and operational data on the capital and annual costs of the systems meant that the organisations were unable to measure the cost effectiveness of the investment in their HRIS. In addition, the growth of shadow systems not only added to the IT costs but also detracted from the original HRIS capability rationale.'[4]

1.14   The ANAO has recently focussed on the issue of legislative compliance, which is the cornerstone of parliamentary control. The ANAO's audit report No.22 on the audit of financial statements of Australian Government entities for the period ended 30 June 2003, found that nine AGPS entities had not maintained proper accounts and records. As a consequence they had contravened section 48 of the FMA Act.

1.15   In this instance, monies were recorded as utilised from Special Accounts that did not have a valid appropriation by law. Investigation revealed that the entities had used funds from an alternative valid appropriation. However, each entity's accounts and records were inadequate, as they had recorded transactions against the incorrect appropriation.

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[4]   Audit Report No.49 2003–04, *The Use and Management of HRIS in the Australian Public Service*, Canberra.

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1.16 Maintaining proper accounts and records for the revenues and expenditures to a Special Account is essential for the proper management of appropriations. This, in turn, enables entities to meet the requirement that money will only be expended for the purpose for which they are appropriated and that the limit on any appropriation will not be exceeded.

1.17 As part of its 2004 audit program, the ANAO is examining legislative compliance issues in relation to the record–keeping and disclosure requirements for Special Appropriations.

1.18 Extreme care is the accepted rule in accounting for public funds. Section 83 of the Constitution states 'No money shall be drawn from the Treasury except under appropriation made by law.' To give effect to the Constitution, funds are appropriated by Parliament via a number of mechanisms, one of which is by Special Appropriation.

1.19 Early indications in regard to Special Appropriations, are that a number of AGPS entities have not complied with the Government's financial reporting requirements. As a consequence, similar to the Special Account issue above, these entities may have breached section 48 of the FMA Act.

1.20 When the extent of this issue has been fully evaluated, it will be reported separately as part of the ANAO's performance audit program.

1.21 Another example of legislative non-compliance was addressed in the ANAO audit report on financial delegations, which found that, 'financial delegations were not always being managed in accordance with relevant legislation.'[5] In particular, the requirement to document the approval of spending proposals, was not being adhered to in the majority of instances.

1.22 Finally, in May 2002, revised Commonwealth Fraud Control Guidelines[6] (the Guidelines) containing significant changes from the previous Commonwealth Fraud Control policy were released. As a consequence, the ANAO decided to conduct another survey for fraud control arrangements in place across AGPS entities against the Guidelines (a similar survey was undertaken in 1999).

1.23 The fraud control survey[7] found that fraud risk assessments had been undertaken by most entities. However, only 69 per cent of respondents had undertaken such a risk assessment in the preceding two years, as required by

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[5] Audit Report No.42 2003–04, *Financial Delegations for the Expenditure of Public Monies in FMA Agencies*, Canberra.

[6] Fraud Control Guidelines issued by the Minister for justice and Customs, under regulation 19 of the *Financial Management and Accountability Regulations 1997*.

[7] Audit Report No.14 2003–04, *Survey of Fraud Control Arrangement in APS Agencies.*

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the Guidelines. The report on the survey makes the observation that the absence of regular assessment could result in entities not identifying emerging fraud risks in a timely manner.

1.24   The ANAO's analysis of a sample of fraud control plans identified a number of weaknesses, such as plans not being based on recent assessments, plans not addressing the risks identified by the risk assessment, and responsibility not being allocated for the development, review or implementation of plans.

1.25   Of particular concern for sound administration and adequate controls, was that approximately 43 per cent of entities that had reported having experienced fraud in the previous two years also advised that they did not have any form of fraud control management information system.

1.26   The changing public sector financial environment has necessitated an increased focus on the control structures that facilitate Chief Executive Officers (CEOs) meeting their responsibilities under the FMA Act or Boards under the CAC Act. However, there is a need to encourage genuine culture change for there to be a significant improvement in AGPS entities regarding compliance and performance issues.

1.27   This cultural change will only come about when entities recognise and acknowledge the fundamental imperative of prudent financial management as part of the AGPS ethos. There is a necessity for an elevation of the use of financial management standards in an organisation. This will allow a clear alignment between strategic policy decisions and resultant financial impacts flowing from those decisions. The Chief Financial Officers (CFOs) have a critical part to play in this elevation and their roles need to be promoted and accepted as such.

Corporate governance

1.28   Corporate governance in Australia has been predominately self-regulated, as compared to the more prescriptive approach taken by the United States. This prescriptive approach has been reinforced in the United States, with the recent introduction of their *Sarbanes-Oxley Act of 2002*. However, due to several high-profile corporate failures[8], new legislation is being considered to further regulate and strengthen the Australian framework.

1.29   Since 1997, Australia has been engaged in a Corporate Law Economic Reform Program (CLERP).

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[8]   HIH Insurance Ltd, One Tel Ltd, Harris Scarfe Pty Ltd and Ansett Ltd.

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1.30 The ninth instalment in this program, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (referred to as CLERP 9) was introduced to the Australian Parliament for consideration in December 2003.

1.31 CLERP 9 is designed to enhance audit regulation and the general corporate disclosure framework, and introduces a number of important policy changes.

1.32 In a corporate legislative context, CLERP 9 contains similar requirements to those in the Australian Stock Exchange (ASX) principles for listed entities. These requirements do not extend to the majority of the Australian Government's entities. However, they do reflect better practice in this area.

1.33 In regard to the private sector, it is fair to say that CEOs have been, and CFOs are now being, held personally accountable for external financial reporting. For example, the ASX released in March 2003, its 'Principles of Good Corporate Governance and Best Practice Recommendations', defining 10 principles and 28 related recommendations. Principle 4 calls for CEOs and CFOs to attest to the truth and fairness of the company's financial statements. While these attestations are not made publicly, they are made to the Board of Directors. Emphasis is placed on assurance that adequate systems and controls are in place to enable them to sign the reports and financial audits with confidence.

1.34 Principle 7 of the ASX principles is to recognise and manage risk. The ASX makes the recommendation that Company boards establish a sound system of risk oversight/management and control and calls for the Managing Director and the CFO to certify to the Board that:

- the integrity of financial statements is founded on a sound system of risk management, internal compliance and control which implements the policies adopted by the board; and

- the company's risk management, internal control and compliance system is operating efficiently and effectively in all material aspects.

1.35 In the AGPS context, the Department of Finance and Administration (Finance) has issued guidelines that go some way in resolving this accountability issue, in that it has outlined the responsibilities of the CFO and has recommended that, along with the CEO, the CFO should also sign the financial statements.[9] But, in the ANAO's opinion, this needs to move beyond

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[9]   The Role of the CFO—Guidance for Commonwealth Entities, April 2003.

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just the financial reporting mechanism for proper assurance, internally and externally.

1.36 Against the above background, as CEOs are to be held personally accountable for external financial reporting, they need to be actively involved in the financial reporting process and aware of the value of executive information and business intelligence systems. It is through the utilisation of these systems that they will be able to align organisational activities and issues with the related financial impacts. These systems can then be used to demonstrate the successful, or otherwise, implementation of CEO decisions both from the perspectives of policy adherence and sound effective action. The financial reporting framework should not be accorded low priority as it facilitates the integration of both the strategic and operational issues in an overall financial context.

1.37 Complementing the financial reporting process is the need to have an effective risk management strategy and control environment in place. AGPS entities must continually refine their risk management requirements by having a dynamic framework in place to actively manage their changing risk profile.

1.38 The basis for the risk framework is the establishment of internal controls designed to ensure that activities and transactions accord with established criteria. Periodic risk assessments must be undertaken to evaluate the internal and external factors that likely to impact on the entity. Actions need to be taken to manage both insurable and non-insurable risk. Such actions must be executed in a timely manner. Systems must also be capable of allowing the identification, extraction and communication of information in a timely manner. Finally, the controls must be continually monitored and reviewed to determine whether they are adhered to, and are effective.

1.39 The approach being suggested, closely aligns with the model for internal control defined by the USA Committee of Sponsoring Organisations of the Treadway Commission (COSO), which offers an integrated framework categorising internal control into five inter-related components. These are highlighted in Figure 1.1.

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Figure 1.1

Inter-related Components of an Internal Control Model

OPERATION FINANCIAL REPORTING COMPLIANCE

UNIT A UNIT B ACTIVITY 1 ACTIVITY 2

MONITORING

INFORMATION & COMMUNICATION

CONTROL ACTIVITIES

RISK ASSESSMENT

CONTROL ENVIRONMENT
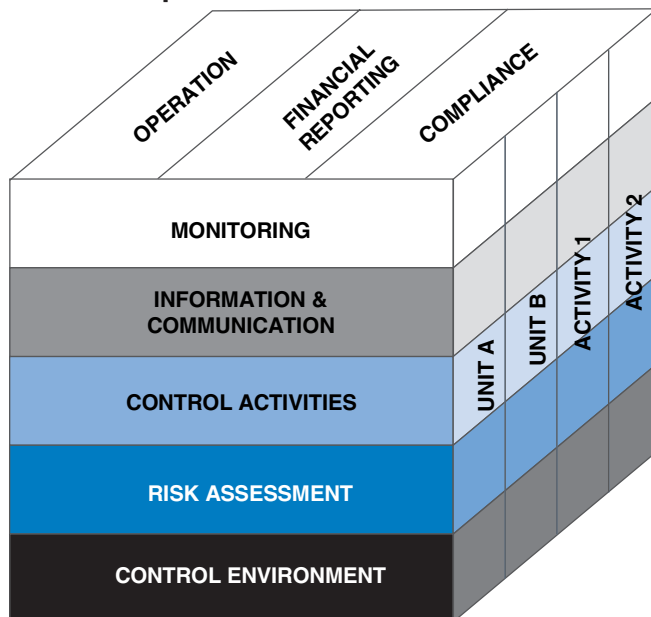
Source: Insurance Facts and Figures 2004, PriceWaterhouse Coopers, 2004, p. 19.

1.40   It is fundamental that risk management should be seen as an integral part of the management culture. The culture creates the 'behavioural standards'. Identified risk needs to be continually monitored and actively managed against those standards.

1.41   Ensuring there is an appropriate governance structure in place, for strategic and operational policy performance and, in particular, for risk management and the control environment, is integral to the AGPS's culture of performance management and to the achievement of government objectives.

Joined–up government arrangements

1.42   To meet growing public expectation, AGPS entities' reporting requirements extend beyond compliance with accounting and legislative rules. The provision of robust performance information is now the expected norm. As the environment, in which the AGPS entities operate, is necessarily, becoming more complex, the challenge to provide performance and accountability information also increases.

1.43   For example, in many cases, to ensure effective and efficient delivery of the outcomes set by Government it is necessary to join together with other entities, both within and external to the Government. These joined–up

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arrangements bring with them additional challenges regarding accountability and performance measurement.

1.44 The term 'joined-up government' can also be used to describe the AGPS working in a 'Whole of Government' way. The latter has recently been expressed in the following manner:

> Whole of Government denotes public service agencies working across portfolio boundaries to achieve a shared goal and an integrated government response to particular issues. Approaches can be formal and informal. They can focus on policy development, program management and service delivery.[10]

1.45 The challenge continues to be to find improved and more efficient ways to deliver results.

1.46 There are numerous arrangements in the Australian Government for the delivery of services. Whilst individual entity heads are accountable under the FMA Act and the CAC Act, governance arrangements will, to some extent, be found in the entity which delivers the services on behalf of the 'accountable' entity.

1.47 Whilst there are numerous benefits of these joined-up arrangements, they also bring about fundamental issues relating to governance and accountability requirements. Further, there are some practical matters that need to be resolved for these joined-up arrangements to be fully effective. For example, performance measures between entities need to be closer aligned to allow improved analysis and program evaluation. Similarly, care needs to be taken to ensure that information can be shared easily, as entities can have different types of financial and other information systems.

1.48 Where joined-up arrangements exist, clarity with regard to the outcomes, performance, responsibilities and accountability is required. Memorandums of understanding, contracts and Business Partnership agreements are examples of formal arrangements between these entities that endeavour to clarify these matters. In addition, where significant joined-up arrangements exist, the ANAO is required to determine and assess the adequacy of the accountability mechanisms in the separate entities included in the joined-up arrangement.

Asset and liability management issues

1.49 Prudent financial management is a fundamental tenet of all business activity. The AGPS is no different to any other sector of the economy in this regard. In this context, it should be noted that the Government has formulated

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[10] Management Advisory Committee 2004 'Connecting Government—Whole of Government Reforms to Australia's Priority Challenges', Commonwealth of Australia, Canberra.

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a policy that is concerned with the elimination of intergenerational inequities. Avoidance of intergenerational inequities is government policy and reflected in the *Charter of Budget Honesty Act 1998.* This Act requires the Government to apply the principles of sound fiscal management, including ensuring that '…its policy decisions have regard to their financial effects on future generations'.[11] Furthermore, the Government is required to 'manage financial risks faced by the AGPS prudently…'.[12] These risks are defined to include:

- risks arising from excessive net debt; and

- risks arising from the management of assets and liabilities.

1.50 This focus is further reinforced by the requirement for the Australian Government to publicly release and table an intergenerational report every five years.[13] The content of that report includes information for the assessment of the '…long term sustainability of current Government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change'.[14] The Government publicly released and tabled an intergenerational report as part of the Budget Papers for the 2002–2003 Federal Budget.

1.51 Balance sheet management is a recognised financial tool in the prudential management of entities' resources. The fundamental rationale is that its use provides a clear measure of both the current and long term financial perspectives resulting from the adoption of sound organisational policy and related management strategies.

1.52 There are a number of significant issues affecting 'balance sheet management' in the AGPS. For example, it is necessary to ensure that there is the capacity to meet capital requirements and liabilities such as employee entitlements, when they fall due. Unfortunately, the ANAO's audit evidence would tend to confirm a study carried out under the auspices of CPA Australia which found that:

> There is very little evidence that agencies are actively managing the balance sheet.[15]

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[11] Section 5(1)(e) of the *Charter of Budget Honesty Act 1998*.

[12] Section 5(1)(a) of the *Charter of Budget Honesty Act 1998*.

[13] Section 20 of the *Charter of Budget Honesty Act 1998*.

[14] Section 21 of the *Charter of Budget Honesty Act 1998*.

[15] CPA Australia 2003 'Study the Balance—Effective Balance Sheet Management in the Public Sector' Melbourne, p. 5.

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1.53 Current Australian Government policy is to fully fund entities' operating expenses. By way of illustration, the Government currently provides appropriation funding for depreciation and amortisation expenses incurred, as non-current assets are consumed over a period of time. Appropriation funding is provided for these expenses to ensure that the entity can maintain its operating capacity by replacing assets it consumes, from funding that matches this consumption over time. Similarly, employee entitlements accruing in-year are fully funded in each year to ensure that entities have the capacity to meet those liabilities when they fall due.

1.54 The debate here is not about 'the policy' to fund all expenses in the year they are incurred, rather the concern is related to the possible diversion of funds, intended for capital replacement and liability extinguishment when they fall due, to other purposes. Diversion of these funds to other purposes can have the effect of circumventing the Government's intentions and priorities, resulting in the need to appropriate duplicate funding some time in the future.

1.55 To keep faith with the Government's imperative, and given the scale of asset replacement and liability management issues, CEOs need to align very clearly their entities' respective asset and liability positions so that any duplication in funding does not arise. In essence, the risk should remain with the agency and not with the budget.

Departmental and administered items

1.56 Administered items include revenues, expenses, assets and liabilities that the Government controls, but which an agency manages on the Government's behalf. They include: grants, subsidies, benefit payments and transfers to other levels of government; taxes, fees, fines and excise; public debt and related interest; and loans to other governments and related interest. Such resources may be used to produce outputs by third party organisations.

1.57 Departmental appropriations are largely disbursed to meet employment costs and supplies relating to rental of premises, leasing of IT equipment, administrative costs, contractors' and consultants' costs and other services.

1.58 An emerging issue within the AGPS is that of the classification of administered and departmental financial activity and the appropriate accountability by entities in managing administered items.

1.59 In an accounting context, the distinction between administered and departmental items appears, on the face of it, to be reasonably straightforward. Australian Accounting Standard (AAS) 29 *Financial Reporting by Government Departments* requires disclosure of administered items separately to other financial information about the department. The standard notes that, while the

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department does not control administered items, disclosure of information about them is required in the general-purpose financial reports because:

> …that information may be relevant to performance assessments, including assessments of accountability.[16]

1.60   For the purposes of AAS 29, financial statement items recognised in the general purpose financial reports of government departments are only those that the department controls. Such items are termed 'departmental' items. These are distinguished from tax revenues, user charges, fines and fees, transfer of funds to eligible beneficiaries (e.g. social security payments), etc which are administered by the department on behalf of the government. This latter group is termed 'administered' items.

1.61   The following excerpt from the Finance Minister's Orders (FMOs), shows that it is a requirement of the FMOs that amounts are reported in ex-post financial statements in the same manner as they are funded[17]:

> …where an amount is explicitly described by an Act (including an annual appropriation Act) as being 'departmental' or 'administered', it will be classified, for the purposes of accrual reporting of the entity, as described in the Act.

1.62   If the appropriation does not align to the requirements of AAS29 for administered items (or vice versa), there is a disconnect between the legal form (appropriation by Parliament in the Budget papers) and the substance (assessment of control under the accounting framework). Ideally, this should always be one and the same. For instance, the notion of control in the accounting standards emphasises a substance test. This is based on whether, in reality, the department exercises significant influence (control) over the critical management decisions of the funding and whether the department utilises the funding to meet its own objectives. Such matters should ideally align to whether or not the entity is managing the function on behalf of the Government, which are:

> …related to activities governed by eligibility rules and conditions established by the government or Parliament such as grants, subsidies and benefit payments.[18]

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[16]   CPA Australia Members' Handbook 2002, AAS 29 Financial Reporting by Government Departments, para 6.3.12.

[17]   Clause 2B.2 of the Financial Management and Accountability (Financial Statements for reporting periods ending on or after 30 June 2004) Orders.

[18]   Senator the Honourable N Minchin, 'Agency Resourcing 2004–05 (Including Appropriation (Parliamentary Departments) Bill (No.1) 2004–05, Appropriation Bill (No.1) 2004–05, Appropriation Bill (No.2) 2004–05)', 2004–05 Budget Paper No. 4, Canberra, 11 May 2004, p. 4.

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1.63   Changes in classification between departmental and administered from one year to the next when little has seemingly changed in the management of the functions can create unnecessary stakeholder uncertainty in determining accountability. If we take as a given that the previous classifications, as departmental, were correct, then the only apparent justification for the reclassification is that the appropriation by the Parliament, administered under law in form, subordinates all other considerations.

1.64   In summary, the issue is that there is a legal requirement to account for these items in a specific way, which has the potential to conflict with the existing accounting rules. Until, and unless, there is an alignment between the legal requirements and the accounting rules there will continue to be an accountability tension.

1.65   The boundaries between these items, which a department clearly does not control and those that a department does control, are becoming blurred. The result is that the accounting classification of administered and departmental items, as they have been appropriated, will further confuse the situation which was originally intended to be explained.

1.66   This blurring of the boundaries potentially has more wide-ranging implications for accountability and transparency for individual entities. Current FMO requirements for the disclosure of administered items are much less than that for departmental items. If a trend develops where, through the appropriation process, there is a consistent change in classification from departmental to administered, less information will be available, resulting in a reduction in accountability and transparency.

Adopting Australian equivalents to International Financial Reporting Standards

1.67   Adoption of Australian equivalents to International Financial Reporting Standards (IFRSs) will bring about a number of changes for all Australian entities, including those in the public sector.

1.68   The impact of these new standards will differ from entity to entity, depending on their specific business and related financial statements. It is difficult to identify significant 'global' issues that will affect all public sector entities. Each entity will need to individually review the changes that will arise and assess how these changes will impact upon them individually.

1.69   A key implementation issue is to ensure that there is an appropriate plan in place for doing so. This plan should include:

- a structured methodology for identifying which issues will impact the organisation and how they will be resolved; and

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- a communication strategy for ensuring the entity's progress is being regularly reported to the Audit Committee, and to those staff within the organisation who need to be aware of operational implications of the changes required.

1.70　An important aspect to be considered in the entity's implementation plan is the requirement for international standards to be applied in a retrospective manner. This is a requirement of the pending standard AASB 1 *First Time Adoption of Australian Equivalents to International Financial Reporting Standards.*

1.71　This standard requires entities to prepare two sets of financial statements for the balance date before the first internationally compliant statements are published. One set needs to be compliant with current AASs for publication as normal. The second set needs to be compliant with the Australian equivalents to IFRSs and will not be published immediately. These statements will instead form the comparative data for the following year's financial statements.

1.72　Table 1.1 outlines the deadlines imposed by AASB 1.

Table 1.1

Key Dates and Events

Balance Dates	Key Dates and Events				
				Full reporting under harmonised standards	
	Prepare Opening Balance Sheet	Start collecting comparative data	Full year comparative data figures	Half year reporting period ending	Annual reporting period ending
31 Dec	31/12/03	1/1/04	31/12/04	30/6/05	31/12/05
31 March	31/3/04	1/4/04	31/3/05	30/9/05	31/3/06
30 June	30/6/04	1/7/04	30/6/05	31/12/05	30/6/06
30 Sept	30/9/04	1/10/04	30/9/05	31/3/06	30/9/06

Source:　ANAO assessment, April 2004.

1.73　Financial reports for 2003–2004 will be the first to disclose the impact of the transition to new standards. Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards* requires narrative disclosure in the 2003–2004 financial report of:

- how the transition to Australian equivalents to IFRSs is being managed; and

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- key expected differences in accounting policies arising from the adoption of the Australian equivalents to IFRSs.

1.74 In their 2004–2005 financial report, entities will also be required to disclose any known or reliably estimable information about the impacts on the financial report, had it been prepared using the Australian equivalents to IFRSs.

Preparedness for adoption of IFRSs

1.75 The ANAO recently conducted a survey of IFRS readiness of 24 large Australian Government entities. This survey showed that the Australian Government's progress towards implementation of these new standards varies greatly across large entities.

1.76 Whilst it was a positive sign that all 24 entities were aware of the deadlines for the implementation of Australian equivalents of IFRSs, there were some aspects that needed to be addressed. These included:

- 13 of 24 entities surveyed did not have an IFRS or equivalent project team or Steering Team that incorporated functions across finance, operations, IT, strategy and client relations; and

- 10 of 24 entities surveyed did not have a staff training strategy in place.

1.77 The ANAO is seen as a source of advice during this time of change. However, we have to be careful of our independence and the integrity of our auditing. Nevertheless, the ANAO does endeavour to identify where it can add value. For example, we have produced a comprehensive guide[19], to assist our audit teams and AGPS entities in the transition to the new IFRS.

1.78 As well as publishing the usual ANAO annual *AMODEL Illustrative Accounts* and quarterly newsletter *Opinions*, the ANAO is presenting 'additional' client seminars to provide information to assist entities through this period of change.

1.79 Technical sessions are presented regularly to ANAO staff to ensure they have a thorough understanding of the changes that the new standards will bring, which are then used in the entity audits.

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[19] Comparison Between Pre-2005 Australian Standards and Australian Equivalents of International Financial Reporting Standards, June 2004, which is included in our internal web site.

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Convergence of Australian GAAP and GFS

1.80 Another change to accounting requirements will come from the potential convergence of Australian Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS).

1.81 In 2002–2003, the Financial Reporting Council set the following broad strategic direction for the Australian Accounting Standards Board in relation to the GAAP/GFS convergence project[20]:

> With regard to public sector reporting, the Board should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting. The objective should be to achieve an AAS for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

1.82 The Board has an ambitious timetable to harmonise Australian GAAP and GFS, with an exposure draft which was scheduled for release in June 2004 for application of the new standard in 2005–2006[21]. The timing of the exposure draft will depend upon resolution of technical differences identified between the two frameworks.

1.83 Some of the technical differences identified to date rely upon the adoption of Australian equivalents to IFRSs for resolution, as their treatments align GAAP with GFS. This means the timing of convergence between GAAP and GFS will be, in part, reliant on the timing of adoption of these standards.

1.84 The process of harmonising GFS and GAAP in part, also, relies upon the early adoption of the solutions identified by the International Accounting Standards Board's Reporting Comprehensive Income Project. The outcome is arguably problematic, as the Board has delayed the progress of this particular project until after the completion of its 2005 Project, and has not currently scheduled a completion date.

Impact of convergence of Australian GAAP and GFS

1.85 The timing of these projects raises another challenge for the public sector, as the implementation of Australian equivalents to IFRSs may coincide with work required by public sector entities as a result of harmonisation of GAAP and GFS.

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[20] GAAP/GFS *Convergence: Implementing the FRC Strategic Direction*, published at <www.aasb.com.au>, amended 18 December 2003.

[21] ibid.

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1.86 Should these projects have coinciding implementation timetables, there will be a need for public sector entities to carefully factor this into implementation plans and communication strategies, particularly for the staff involved, including systems changes.

Convergence of Australian Auditing Standards with international standards on auditing

1.87 The Auditing and Assurance Standards Board (AuASB) has a long-standing policy of convergence and harmonisation with International Standards on Auditing. The AuASB uses international standards as the basis for its corresponding Australian standards.

1.88 It is the policy of the AuASB, in moving forward, that compliance with Australian Auditing Standards (AUS) will also constitute compliance with International Standards on Auditing. It is anticipated that this goal should be met by the start of 2005, through ongoing revisions of both international and Australian standards.

1.89 The ANAO is reviewing exposure drafts of proposed auditing standards as they are released, to provide comments upon the proposed content and identify any potential impacts on ANAO's policies and operations.

Impact of convergence with international auditing standards

1.90 To date, the ANAO review has shown that the proposed standards contain elements that are more prescriptive than current requirements in AUSs. These changes are likely to result in additional work for Australian auditors to ensure full compliance with the new standards.

1.91 An example can be found in the proposed revision of International Standard on Auditing ISA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*. The exposure draft has an overall prescriptive approach, which reduces the auditor's ability to exercise professional judgment. This is particularly apparent where the same procedures are mandated regardless of the assessed risk of fraud in relation to improper revenue recognition or management override of controls.

1.92 If this more prescriptive approach is extended to other auditing standards, it will increase the mandatory requirements on auditors. As the ANAO adopts these standards, there will be internal implications that will go beyond formalisation. For example, the change, is likely to have a significant impact upon the ANAO's resourcing requirements as the Australian Government's financial reporting timetable continues to compress.

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Increasingly compressed reporting timetable for Australian Government entities

1.93 The *Charter of Budget Honesty Act 1998* requires Australian Government entities to provide financial information within tight timetables to the Department of Finance and Administration (Finance) to facilitate the preparation of the Consolidated Financial Statements and Final Budget Outcome each year.

1.94 In 2002, these deadlines were further tightened after the publication of *Estimates Memorandum 2002/13 Budget Estimates and Framework Review—Recommendations*. The latter had been endorsed by a Cabinet decision.

1.95 Amongst others, one of Finance's goals is to provide the Parliament with the Final Budget Outcome (FBO) Report within 45 days of the end of the financial year. To achieve this, Finance is proposing to incrementally tighten the reporting timetable for Australian Government entities, as summarised in table 1.2. Audit cleared financial information is an important part of FBO production. That said, however, it should be emphasised that signed audited financial statements serve statutory reporting purposes.

Table 1.2

Summary of current and future financial reporting timetables

Financial year ending	Audit clearance required from ANAO of financial information of larger entities	Final Budget Outcome Report provided to Parliament
June 30, 2004	July 30, 2004	August 20, 2004
June 30, 2005	July 20, 2005	August 14, 2005

Source: ANAO's assessment of Estimates Memorandum 2002/13 Budget Estimates and Framework Review—Recommendations

1.96 The challenges with this tightening timetable lie with both entities and the ANAO to obtain reasonable assurance that the required information is made available to Finance when required, without a reduction in the quality of that information.

Impact of compressed reporting timetable

1.97 Australian Government entities face further challenges in meeting the compliance reporting regime. In addition to managing the impacts of new accounting standards and, potentially, convergence between Australian GAAP and GFS, entities are required to comply with tightening reporting timetables, as indicated above.

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1.98 This additional requirement impacts upon the workload, pressures and resources of entities and of the ANAO, which has been recognised in the recent budget.

1.99 The ANAO and many entities are putting strategies in place to facilitate audit clearance of financial information within tightening reporting timetables, without diminishing the quality of the audit work performed. The ANAO has engaged with entities to:

- agree timetables for the provision of auditable financial information;

- where appropriate, undertake an early year end closure of the financial statements; and

- highlight processes that can be improved to facilitate the timely provision of auditable financial information.

Conclusion

1.100 The Australian Government is actively seeking to advance its financial management practices with the implementation of reforms aimed at improving the timing and quality of financial information.

1.101 These reforms, which redefine governance arrangements, external reporting and auditing requirements, will have a significant impact on the ANAO and all Australian Government reporting entities.

1.102 The legal and reporting framework for AGPS entities is extensive and in some cases, quite complex. AGPS entities need to maintain conformance with stipulated legal and reporting requirements. To achieve this end, it is essential that the relevant staff at the operational, policy and strategic levels, not only understand, but also undertake, their responsibilities in a manner which ensures that they comply with the framework.

1.103 The audits for fiscal 2004 again highlight that there are a number of instances where conformance with legal and reporting requirements has not been attained. Until there is further improvement in this area, there will continue to be ongoing audit consequences. It is noteworthy that, for the past few years, there have been substantial audit qualifications with major AGPS entities' financial statements which have a direct impact at the whole of government consolidated accounts level. Currently, unless significant change is effected, this position undermines assurance and is therefore a challenge to all concerned to remediate as soon as possible.

1.104 A further performance challenge going forward, however, extends beyond entities meeting legal and reporting requirements. The issue also concerns the effective use of financial information for management decision-making. Advancements in this respect would increase the performance of

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AGPS entities in the delivery of their outputs and thus better contribute to the effective and efficient achievement of the Government's identified program outcomes.

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2.   Internal Control Environment

Introduction

2.1   The CEOs of AGPS organisations are required under the FMA Act, and the CAC Act, to manage the affairs of entities in a manner that promotes effective, efficient and ethical use of AGPS resources. This necessitates the development and implementation of effective corporate governance arrangements. These encompass such elements as business planning and risk management, accountability and conformance mechanisms, and performance monitoring and review, as well as transparent reporting. In particular, the FMA Act identifies: the audit committee; the fraud control plan; and risk management practices as key components of the corporate governance arrangements. The CAC Act identifies the need for risk management practices and an audit committee as essential elements of an entity's financial management framework.

2.2   Each CEO, or Board, is responsible for the design and maintenance of an adequate internal control structure to enable the above legislative requirements to be met. An effective internal control environment assists management in the orderly and efficient conduct of its business. Within such a framework, the internal control environment directly influences the way business and operations are undertaken in every entity. This requires the internal control environment to be carefully reviewed as part of the audit process when assessing the risk of material error in financial systems and reports.

2.3   The Assurance Audit Services and the Business Support area of the ANAO take a coordinated approach to testing the internal control environment. The Business Support Audits (designated as performance audits) are targeted at routine administrative processes such as delegations for expenditure of public monies and property management. These audits typically highlight areas for improvement in the control environment, which are normally incorporated into financial statement audit (FSA) test programs, particularly where the financial statement impact is significant.

2.4   Each year, under the financial statement mandate, the ANAO is required to examine the control environment in each reporting entity. This is supplemented by in-depth performance audits of administrative processes that are important, but not critical, to the financial statement opinion. Their value is primarily associated with improvement to public administration, which is a major element of the ANAO's objectives.

2.5   The ANAO's Performance Audit Assurance Group systematically incorporates consideration of an entity's control environment in its audits,

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together with a consideration of the financial context. For example, consideration of the operation of special accounts provided benefits to entities directly as well as to the financial statement audit process, by highlighting a general lack of awareness of the legal operating rules and associated disclosures. These types of audits supplement financial statement processes in a positive manner but are not fundamental to the audit opinion.

Elements which contribute to financial statement assurance

2.6 In conducting audits of an entity's financial statements, the ANAO focuses on specific elements of the internal control environment. In doing this, the ANAO establishes whether the environment in place comprises elements that contribute positively to the internal control structure, and minimises both financial and non-financial risks to the entity. This judgement has a major influence on the way the audit is conducted, as well as on the amount of audit work needed to form the audit opinion. These elements include:

(a) **senior executive group arrangements**, and whether they meet regularly, focussing attention on the outputs and outcomes that need to be achieved, including the strategic directions, business planning, control framework, financial results and operational imperatives;

(b) **an audit committee**, and whether it reviews the financial statements and meets at least quarterly, addressing issues such as internal audit planning and results, risk assessment and the control environment relating to business and accounting processes and financial systems;

(c) **an internal audit function**, and whether it is independent of management through reporting directly to the CEO and/or the chair of the audit committee, and works with appropriate skill and objectivity to an approved internal audit plan addressing management concerns, compliance with policies and procedures, business and financial risks;

(d) **a risk management plan and a fraud control plan**, which are current and whether they identify inherent risks, controls which mitigate those risks and any further actions which may be required;

(e) **systems of authorisation, recording and procedures** to ensure that transactions are processed, recorded and accounted for correctly;

(f) **sound organisational business practices** to ensure that operations are efficient, effective and measurable;

(g) **financial and accounting skills commensurate with responsibilities** and the complexity of business operations; and

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(h)   **a financial reporting regime** which prepares monthly analyses, including comparison of actual results to budget, variance analysis and relevant commentary.

2.7   The on-going performance and effectiveness of these measures is important to the level of assurance that entities and the ANAO require for financial statement reporting purposes.

Results summary

2.8   The Department of Defence (Defence) has well publicised financial management problems. Some of these problems flow from the control environment including important issues with Defence's books and records. These are detailed in Chapter five of this report and in recent ANAO performance audits. For the purposes of general commentary on the control environment in this Chapter across material entities in the Australian Government, Defence has not been included on the basis that its results would distort the general analysis.

2.9   The cross entity results of the audit testing of control structures, in summary for the major entities, excluding Defence, examined in this report and detailed in Chapter five, are as follows.

Senior executive group arrangements

2.10   It is important to consider the legislative responsibilities of CEOs operating under the FMA Act and Boards under the CAC Act and the distinctions between the two, when assessing the appropriateness of measures taken to govern entities operating under these Acts.

2.11   In general, Departmental Secretaries, as CEOs of FMA agencies, are governed by Part 7 of the FMA Act which gives them responsibility for the overall management of the Agency. The CEOs of CAC Act bodies, on the other hand, share responsibility for governance, and must work to, and in conjunction with, a Board of Directors or similar governing bodies.

2.12   A critical aspect of the internal control environment is the leadership and performance of CEOs within these different management structures.

2.13   At the financial management and reporting level, the senior executive groups/Boards of Directors must ensure financial and audit issues are properly planned, executed, controlled and monitored.

Findings

2.14   Consistent with last year's results, CEOs of all entities covered by this report have established management boards or senior executive leadership committees to plan and monitor strategic direction and performance. In

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addition, these senior executive committees are often supported by sub-committees such as the finance committee, IT committee, or security committee to focus on specific issues and projects. The CEOs were regularly briefed on significant audit and/or accounting issues.

2.15 Most entities have produced a formal Corporate Plan or strategy document, which articulates how each entity perceives its environment and primary role, and which also outlines the broad strategic course of the organisation being charted by the CEOs and senior executive groups.

2.16 The ANAO noted that CEOs, and senior executive groups, continue to give appropriate priority to financial, accounting and audit matters.

2.17 In noting progress from the previous period, most entities now incorporate some monitoring of their operating performance against key non-financial measures. The ANAO considers the development and reporting of key performance measures across the non-financial, as well as financial, areas of their operations, are a crucial support mechanism for informed decision-making and evidence of achievement of corporate strategies.

Audit committees

2.18 Effective audit committees improve communication and coordination between management and internal as well as external audit. This strengthens internal control frameworks and structures to assist CEOs and boards to meet their statutory and fiduciary duties.

2.19 An audit committee's strength is its demonstrated independence and power to seek explanations and information, as well as its understanding of the various accountability relationships and their impact, particularly on financial performance. In particular, it can ensure that accepted audit recommendations are monitored and properly actioned, which greatly improves both internal and external audit effectiveness.

Findings

2.20 Overall, entities generally have audit committees that assist the CEO, any governing bodies, and executive management to foster and maintain an appropriate control culture. Audit committee effectiveness is facilitated by regular examination of their role and charter. This is particularly so in respect of risk assessment, security and better practice financial management and reporting. With one exception, all entity audit committees reviewed their roles and charters and assessed their own performance. This allows for audit committees to sharpen their focus on processes that facilitate their role, such as quality and reliability of reports, the closure rate of action on audit recommendations and timeliness of financial reports.

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2.21 ANAO senior audit staff attend audit committee meetings as observers. In this 'observer' role, the ANAO presents financial and performance audit strategies, audit findings and recommendations.

2.22 Of the 23 entities reviewed this year, only one does not have an independent non-executive member with specialised skills and knowledge who can bring a broader perspective to corporate governance issues. The appointment of independent non-executive members to audit committees is considered by the ANAO to constitute better practice. Independence and objectivity are further strengthened with the appointment of an independent chair. Of the 23 entities examined, five currently have an independent chair.

2.23 Audit committees now regularly and formally monitor the implementation status of internal/external audit recommendations. In addition, many entities via the audit committee, review all Auditor-General reports for general applicability; identify matters that affect the entity; and address the recommendations made. In this way, improvement opportunities identified in one entity can be considered and potentially implemented across all Australian Government entities in a relatively short time frame.

Internal audit function

2.24 Assurance over the accurate and consistent operation of the organisation's controls, program administration and functions has historically been the domain of the internal audit function. However, the function is evolving from that of an assessor of compliance with internal and external requirements, to an assessor of the quality, efficiency, effectiveness and ethics of business operations, thereby positioning itself as a strategic partner of the organisation's executive management. This shift in focus has occurred to match the heightened profile of corporate governance, including accountability and transparency requirements that are an integral part of business environments today. This means that internal audit needs to adopt a risk-based, goal-oriented and forward-thinking approach when developing its charter and a strategic audit work program, so that it adequately addresses the needs and concerns of executive management.

2.25 In order to successfully undertake its program of audit work, the internal audit function needs to be adequately resourced by a mix of skilled risk, accountancy and business practitioners. It needs to be proactive in researching business trends, issues and better practices. Internal auditors can also expect to play a key role in educating and coaching the entity's staff in ethical business practices, risk management practices and the appropriate application of internal procedures and controls as part of a sound financial framework.

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2.26   The function needs to carefully manage the tension between reviewing and promoting organisational priorities and activities, and the act of establishing and implementing these, to ensure the function's independence and objectivity. The function must also have a high level of quality control and communication standards to demonstrate the integrity and relevance of its work. These issues are further explored in a forthcoming Business Support Audit report titled *Management of the Internal Audit Function.*

2.27   The internal audit function has been largely outsourced to external accounting firms because of the difficulties in recruiting and retaining the necessary skills 'in-house'. The majority of the 23 entities examined for this report have outsourced the internal audit function.

Findings

2.28   The ANAO found that all entities have an internal audit annual plan and strategy in place and that the majority align with reasonable risk assessments. Most internal audit work plans address the key business and financial risks independently identified in the ANAO audit strategy. At the time of this report, most audit committees were of the view that the internal audit work programs were progressing satisfactorily against the approved annual work program. Almost all entities recognised the value of risk weighting their recommendations—thereby facilitating the prioritisation of limited resources. The processes and definitions used to make this categorisation varied, being influenced primarily by size and complexity of business operations. Across the 23 entities considered in this report, there are at least 552 high priority recommendations, from a total of at least 1 448 recommendations. This is a broad indication of well-targeted audit programs and a culture that accepts the need for continuous improvement.

2.29   A deficiency, noted last year, related to the lack of formal procedures in place to assess whether the internal audit function delivers an effective, efficient, and value for money service. This deficiency has been addressed by most entities, with the majority of entities examined in this report undertaking a formal performance review of internal audit.

2.30   In respect of compliance and control issues, the ANAO continues to note that, for the most part, entities have reasonably effective and independent internal audit functions, which contribute positively to providing assurance on the key systems, processes and financial statements of entities. Nevertheless, the on-going focus on broader corporate governance issues means that most entities will need to reassess, continually, their internal audit capabilities.

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Risk management plans

2.31   Risk assessment is widely accepted as a key business process, and the ongoing management of risk is accepted as best practice at an entity strategic level, as well as a means of improving operational performance.

2.32   Managing risk embraces both the minimisation of the impact of exposures, as well as the positive acceptance of risk as a part of the process of using opportunities to create more productive use of resources.

2.33   The development and maturing of modern risk management in the AGPS is largely a late 1990s and early 2000s response to the establishment of Australian Standard AS/NZS 4360 in 1995, which was updated in 1999.

2.34   A measure of the maturity of risk management in the AGPS is the extent to which entities have embraced organisation-wide risk management, sometimes known as enterprise risk management, and integrated it with their strategic objectives and operational culture.

Findings

2.35   In 2003, Comcover undertook its annual benchmarking study of Comcover fund members. This study examined ten key performance indicators for risk management. Comcover concluded that the results of the study indicated that entities were well progressed in developing, and implementing, risk management frameworks. It also concluded that some entities had also performed well in areas such as training, communication, and monitoring and review.[22]

2.36   The study identified that the greatest opportunity for improvement related to areas such as insurance risk transfer, use of resources and measuring performance. Entities' practices in these areas were generally rated as basic or evolving (which placed them at the lower end of a five point scale). These areas were also identified as needing improvement in the ANAO Audit Report No.3, 2003–2004 on the *Management of Risk and Insurance.*[23]

2.37   Audit Report No.3 of 2003–2004 found that organisations were only beginning to understand the nexus between risk management and insurance. The link between Occupational Health and Safety (OHS) and risk management was better understood than the link between general insurance and risk management. Organisations were generally too reliant on the general insurance provider (Comcover) to provide advice on appropriate types of insurance including levels of cover and deductibles. As a result, entities have

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[22]   The results of the benchmarking study are discussed in *Australian Government Risk Manager,* Issue no. 16, Summer 2004.

[23]   ANAO Audit Report No.3 of 2003–2004, *Management of Risk and Insurance*.

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generally not sought to obtain insurance based on their risk profile and tolerance.

2.38 The way forward for organisations in this important area is to:

- improve risk management and insurance frameworks by articulating, and documenting, the links between risk management and insurance, and their links with other strategic documents and process;

- review the level of resources dedicated to risk management and insurance including the: adequacy of administrative support; implementing or improving existing databases; and the use of external consultants to supplement internal resources; and

- in line with any Comcover guidance, review risk management and insurance frameworks to enhance or develop reporting, monitoring and review requirements to assess both the performance of, and compliance with, the frameworks. This should include the development of standard reporting templates and an adequate set of key performance indicators (KPI).

Fraud control plans

2.39 The Attorney-General released the updated Fraud Control Guidelines[24] (the Guidelines) in May 2002 outlining principles for fraud control within the Australian Government and set national minimum standards to assist entities in carrying out their responsibilities to combat fraud against their programs. The importance of entities establishing effective fraud control arrangements is recognised in section 45 of the FMA Act, where CEOs are responsible for the implementation of a fraud control plan and for reporting to portfolio ministers on fraud control within their entity.

2.40 Further explanation of the responsibility for preventing and detecting fraud is provided in AUS 210, *The Auditor's Responsibility to consider Fraud and Error in an Audit of a Financial Report.*[25] This standard states:

> The primary responsibility for the prevention and detection of fraud and error rests both with those charged with the governance and the management of an entity.

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[24] Fraud Control Guidelines Issued by the Minister for Justice and Customs, under Regulation 19 of the Financial Management and Accountability Regulations 1997, May 2002.

[25] Australian Auditing Standard AUS 210, The Auditor's Responsibility to Consider Fraud and Error in an Audit of A Financial Report, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, January 2002, para 10.

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2.41 As with risk management plans, fraud control plans need to be regularly reviewed and updated when significant changes to roles or functions occur, to reflect the current fraud risk and control environment for the entity.

Findings

2.42 Fraud control planning is now well-established following issuance of the *Commonwealth's Interim Ministerial Direction on Fraud Control*[26] and the *Fraud Control Guidelines*[27]. Despite this, a number of entities across the AGPS are still not complying with the fraud directions nor the Guidelines. This places those entities at greater risk of fraud. Actions undertaken by most entities include:

- bi-annual reviews of fraud risk assessments and fraud control plans by audit committees;

- articulating fraud control planning in Chief Executive's Instructions (CEIs);

- inclusion of fraud awareness topics in induction courses and the development and running of fraud training courses; and

- listing of fraud control plans on entity intranet sites.

2.43 Some larger entities have also established fraud control sub-committees to manage fraud control performance by groups/states measured against fraud control action plans. Fraud control plans in some larger entities are also integrated with other related documents, for example, integrity plans incorporating codes of ethics and conduct.

2.44 Following the release of the Guidelines[28] by the Attorney-General in 2002, the ANAO conducted a second survey of fraud control arrangements. This survey, which had a 99% response rate, found that there had been a significant improvement in fraud control arrangements since the 1999 ANAO fraud survey of AGPS entities. However, there were still a number of entities that needed to improve to meet the minimum standards established by the Attorney-General in 2002. The forthcoming ANAO *Better Practice Guide on Fraud Control* will provide guidance to help entities in this area. Key areas identified by the survey for improvement or further development are:

- the use of a consistent definition of fraud—50% of respondents were not using the current definition. This impacts on the ability to draw accurate data for benchmarking and comparative analysis across the Australian Government;

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[26] Interim Ministerial Directions on Fraud Control, 1994, op.cit.

[27] Fraud Control Guidelines, May 2002, op.cit.

[28] Fraud Control Guidelines, May 2002, op.cit

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- keeping fraud control plans current in accordance with the requirement for two yearly updates, or more often if there is a significant restructure—31% of respondents did not have a current fraud control plan; and

- collating fraud control activity and results in a systematic way—most entities did not have a management information system that supported regular insightful analysis about potential fraud and its prevention/detection.

2.45 The Attorney-General's Department collects fraud information from entities subject to the Guidelines. The information is collated and a Fraud Annual Report provided to Government to facilitate analysis of fraud trends and future policy development. Analysis of unaudited data provided to the Attorney-General's Department for the year ended 30 June 2003 found:

- there was more than 16 000 cases of alleged fraud investigated with more than 3 000 convictions; and

- as this was the first year of reporting under the Guidelines, not all entities were able to provide detailed information on the financial impact of fraud and associated information on loss and recovery rate.

Systems of authorisation, recording and procedures

2.46 Each CEO is responsible for the design and maintenance of a business model that delivers results whilst ensuring that resources are applied in a way that promotes efficient, effective and ethical use.

2.47 Against the background of the shift by the AGPS from central agency control to a framework of devolved authority in early 1998, entities were required to reassess and to update their systems of authorisation, policies and procedures. Principal amongst these were entities' CEIs which reflect the powers delegated to management by Chief Executives under the FMA Act.

2.48 The payment of accounts for goods and services is a significant business process that requires an effective control structure to achieve the required outcomes. A key component of an effective control structure in the payment of accounts process is a formalised system for the delegation of authority. This must be complemented by clear guidance, instructions and awareness raising of attendant responsibilities.

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2.49 The ANAO business support audit *Financial Delegations for the Expenditure of Public Monies in FMA Agencies,*[29] assessed whether financial delegations associated with the expenditure of public monies were determined, applied and managed in accordance with applicable legislation, Government policy and applicable internal controls across five medium sized entities.

2.50 Formal and well documented systems of authorisation, recording and procedures are necessary to ensure that transactions are processed, recorded and accounted for in accordance with the directives of the responsible governing body and/or CEO and other positions with delegated or statutory authority.

2.51 One mechanism by which management can assure itself of the adequacy of controls over key processes is through the use of Control Self–Assessment (CSA). CSA is an approach that can take many different forms but typically requires individual business units to document, evaluate and regularly assess key controls at the transaction, process and system level. With the increased emphasis on the effectiveness of internal controls flowing from the United States *Sarbanes-Oxley Act of 2000* some international companies are looking to CSA as an important tool of validation. In addition, the operation of the Australian Stock Exchange's (ASX) corporate governance best practice recommendation 7.2 calls for CEOs and CFOs to state to the board in writing that:

> the integrity of the financial statements are founded on a sound system of risk management and internal compliance and control and that the risk management and control system is operating efficiently and effectively in all material respects.[30]

2.52 In the general government sector, there is no direct impact associated with the ASX recommendations. However, the same imperative for strong controls and risk management exists and is widely accepted across the AGPS.

Findings

2.53 The results of ANAO audit work indicate that systems of authorisation, recording and procedures are reasonably understood and formally established in most entities. The focus is now on achieving consistent conformance with these systems and procedures. To this end, the ANAO found that all entities

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[29] ANAO Audit Report No.42 of 2003–2004, *Business Support Process Audit, Financial Delegations for the Expenditure of Public Moneys in FMA Agencies.*

[30] ASX Corporate Governance Council 2003—Principles of Good Corporate Governance and Best Practice Recommendations, March 2003.

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had formal communication processes to address policies and procedures that support staff familiarity with requirements.

2.54 The majority of entities have reviewed and updated their CEI documentation to ensure they remain relevant and efficient. Areas that require on-going assessment and refinement include:

- completing and approving control checks over operational and key accounting processes; and

- reconciling and validating data transferred between operational systems and financial management information systems.

2.55 Authorisation of reconciliation processes and compliance with approved procedures remain an important focus of management and of the audit process. Continuous vigilance in these areas is a key supporting approach necessary for the data integrity of all entities.

2.56 The ANAO business support audit of financial delegations concluded that, generally, entities had developed adequate control structures for the application of financial delegations for the expenditure of public monies. However, the ANAO noted that financial delegations were not always being managed in accordance with relevant legislation. In particular, the requirement to document the approval of a spending proposal was not being strictly adhered to. As well, the statutory power for entering into contracts, agreements and arrangements was incorrectly referenced in some entities.

2.57 In addition, the ANAO found that the number of approvals being granted by inappropriate delegates was higher than expected, given that financial delegations are a routine and well established control.

2.58 The ANAO also identified a number of opportunities for significant improvement in the control structures in entities, including the need for:

- policy documents to be amended to provide an interpretation of the legislation relevant to the entity;

- the nature and monetary limits of the delegation to be detailed in the instruments of delegation;

- the relevant risks and controls in the fraud risk assessment to be identified and assessed; and

- FMIS' controls to be reviewed so that they support the overall control structure.[31]

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[31] ANAO Audit Report No.42, *Financial Delegations for the Expenditure of Public Monies in FMA Agencies,* op.cit. p. 11.

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2.59 CSA, as a mechanism for ensuring the adequacy of controls, has not been broadly adopted across the AGPS. This is because, in part, there is no explicit requirement for reporting on internal controls internally to a CEO, or via the annual report to Parliament.

2.60 Some entities, such as DVA, have found CSA to be a useful component of their overall assurance infrastructure. In DVA, samples of payments to Veterans are selected on a statistical basis and are reviewed in depth. If error rates are higher than a pre-set threshold, internal audit is engaged to perform an ad hoc audit. This promotes ownership of financial and operational risk and controls and, importantly, facilitates timely remedial action if required.

Sound organisational business practices

2.61 Entities continue to face the challenges of reviewing their respective resource allocation judgments and processes to demonstrate that their outcomes/outputs are properly met. This needs to be supported by considered performance reporting to Parliament.

2.62 The Senate Finance and Public Administration Legislation Committee, in its November 2000 report on the *Format of the Portfolio Budget Statements*, commented that:

> Reporting on performance is a cornerstone of the accountability framework. Taxpayers and their parliamentary representatives have a right to feel confident that their dollars are not being wasted but used prudently by public sector entities to deliver outcomes equitably, efficiently and cost-effectively.[32]

2.63 In order to achieve this outcome, entities continue to adopt more 'business-oriented' practices. This has resulted in a continued move towards refining the approach to the assessment of efficiency and effectiveness of individual areas within entities through the budgeting and reporting process. The ANAO has indicated in last year's corresponding report, and it is worth re-iterating here, that this approach includes:

- providing management with incisive data metrics which demonstrate the efficiency and effectiveness of resource allocation decisions;

- having a stronger focus on the improvement of service delivery, as well as on asset and liability management issues;

- comprehensive review of entity performance through strategic, operating and financial reporting processes;

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[32] The Parliament of the Commonwealth of Australia, Senate Finance and Public Administration Legislation Committee, *The Format of Portfolio Budget Statements, Third Report*, Canberra, 9 November 2000 p. 37 para 4.57.

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- increased consideration of the impact of the financial information on the strategic and business planning processes;

- greater focus on the internal budgeting process to ensure the full costs of each aspect of an entities' operations are fully identified and able to be allocated and reported; and

- assessing the contestability of service delivery and considering development of partnership, or alliance, arrangements with suppliers.

2.64 This approach allows for comprehensive annual reporting to Parliament, supported by comparative analysis for appropriate accountability.

2.65 Against the background of increased emphasis on more business-orientated approaches, entities need to maintain conformance with legal and ministerial requirements. The legal framework for entities is extensive and in some cases, quite complex.

2.66 The legal framework, in which Australian Government entities operate, needs to be well understood by the relevant staff at the operational, policy and strategic levels. The major pieces of legislation and other aspects that impact on public sector governance in the Australian Government are shown in figure 2.1.

Figure 2.1

Legal elements affecting governance in the Australian Government sector
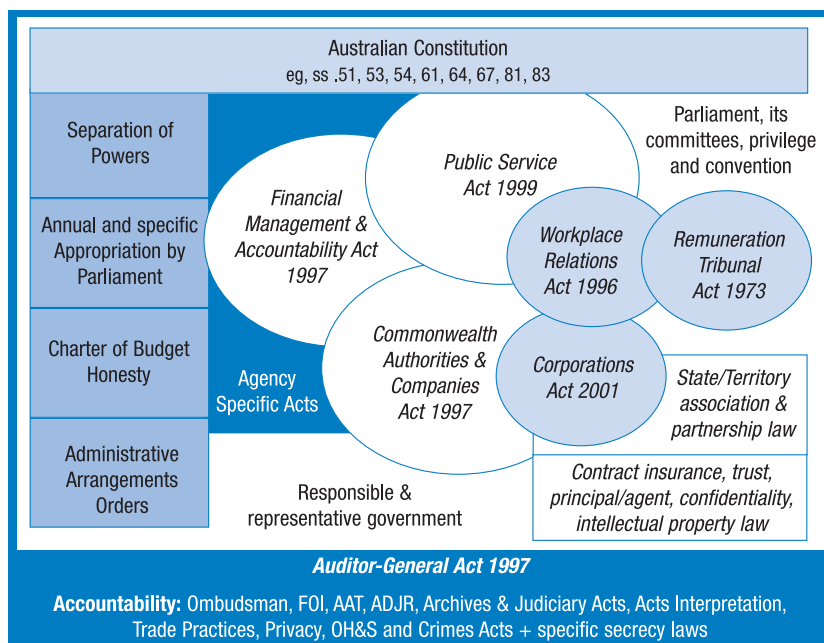
Source: Department of Finance and Administration

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2.67   The ANAO endeavours, particularly through business support audits, to regularly incorporate examination of the legal elements of business operations into its work program. Recent performance audits in the areas of compliance with particular pieces of legislation, consider whether processes are in accordance with relevant legislation; and whether they are effectively managed and accurately reported through financial statements.

2.68   For example, the objectives of the ANAO business support audit on *Compensation Payments and Debt Relief in Special Circumstances*[33] were, amongst other things, to:

- assess whether the management of claims for compensation and debt relief were in accordance with legislative requirements and guidelines; and

- determine whether the associated administrative policies and procedures provided for the effective management and reporting of claims made under those mechanisms.

Findings

2.69   ANAO analysis of performance reporting in a sample of Australian Government portfolio budget statements and annual reports[34] found that:

- generally, outputs and outcomes were well specified and identified the products and services to be delivered;

- entities had linked results reported in the annual report to commitments made in the PBS;

- there was little or no performance information on the individual contributions of other entities where there were shared outcomes. As the practice of 'joined-up government' becomes more widespread, it will be particularly important, for meeting accountability requirements that there are valid performance measures reported to Parliament;

- entities did not always have suitable performance measures relating to quality or effectiveness;

- improvements were needed in relation to reporting on the efficiency of operations and the use of targets or other bases for comparison; and

- entities needed to provide more analysis of performance.

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[33]   ANAO Audit Report No.35 2003–2004 Business Support Process Audit, *Compensation Payments and Debt Relief in Special Circumstances,* Canberra, 24 March 2004, p. 32.

[34]   ANAO Audit Report No.11 2003–2004, *Annual Performance Reporting*, Canberra, 4 November 2003, p. 10.

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2.70   More broadly, at the outcome and output levels, all entities have successfully implemented and refined systems that accurately report the high level cost of providing a service. This has been validated by the financial statement audit process and is reported in the notes to the accounts.

2.71   In terms of legal compliance, the ANAO examination of five FMA entities that reported Act of Grace, Compensation for Detriment caused by Defective Administration (CDDA) payments, and/or waivers of debt[35] concluded that there was a need to improve certain aspects of particular compensatory mechanisms and the overall coordination of all the arrangements. In particular, the ANAO considered that:

- a broad explanatory framework, or set of guidelines, should be developed for the increased awareness in managing, actioning and reporting of ex gratia payments; and

- record-keeping systems and practices for both management and accountability purposes could be improved.

2.72   The ANAO also concluded that the reporting of act of grace and CDDA payments and waivers of debt in some entity financial statements was not always complete and accurate. As well there was a need for better monitoring by management.

Financial and accounting skills commensurate with responsibilities

2.73   The financial function plays a pivotal role in supporting the operations of an entity. The primary objective of the finance function is to provide accounting services and financial information in a low cost, accurate and timely manner. Adequate financial and accounting skills, commensurate with the size and complexity of an entity's operations, are also an essential component of a successful and robust internal control environment. In addition to the capacity to process and account for financial information, implement and manage financial systems, and produce accrual and cash based financial reports, an entity should also possess adequate financial and accounting skills to enable it to:

- develop financial plans and business models which reflect the strategic directions of an entity;

- exercise sound financial judgement on business and operational issues; and

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[35]   ANAO Audit Report No.35 2003–2004, op. cit. p. 17.

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- inject costing, financial and activity analysis relating to financial and operational performance into the management of the entity.

2.74 A practical appreciation of these issues is important for all staff given the need to understand and contain costs; provide sound budget estimates to the Department of Finance and Administration; obtain value for money on contracts for services; and ensure program expenditures are utilised in the most efficient and effective way.

Findings

2.75 Entities are continuing to develop their financial and operational, analysis and forecasting capabilities consistent with the prior year's result. The continuing tight employment market for people with appropriate skills has meant that most entities are still experiencing relatively high turnover of key financial staff which has made the development of financial skills around their individual business plans and strategic directions more difficult. As a consequence, a number of entities continue, in varying degrees, to be dependent upon the use of short and medium term contractors and/or consultants, particularly in relation to the preparation of their annual financial statements. Entities must continue to ensure that they:

- enhance their financial knowledge and analysis/modelling skills consistent with changes in their operational issues and strategic directions; and

- manage their financial and accounting skills knowledge base to ensure there is not undue on-going reliance on contractors and consultants without appropriate longer term management and/or service agreements in place.

2.76 Further progress for most entities will remain uncertain, as staff turnover in financial and operating positions and reliance on contractors and consultants, continue to prevail. Notwithstanding the volatility in the accounting area, the ANAO considers that most entities have sufficient accounting skills to perform routine processes effectively. In a working environment with high staff turnover, increasing complexity and tighter deadlines, it is fundamental for the CFO and Senior Executive staff to be well trained and experienced in matters pertaining to financial management.

Financial reporting

2.77 Better practice financial management involves producing regular, that is, at least monthly, internal management reports for decision-making which are meaningful, timely and relevant. Better examples of internal financial reporting include a summary snapshot outlining overall performance and

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following this with a set of accrual based financial reports encompassing statements of financial performance and position and cash flow statements presenting comparative analysis, and explanations of variances. These should also be accompanied by relevant notes, or commentary, including, where appropriate, graphical presentation.[36]

2.78   This form of management reporting is considered fundamental in enabling CEOs and senior management to meet their responsibilities under the FMA and CAC Acts to ensure resources are expended effectively, efficiently and ethically.

2.79   The preparation of comprehensive financial reports, together with meaningful analysis on a monthly basis, is also considered important in regard to monitoring the accuracy of an entity's financial reports and annual financial statements.

Findings

2.80   Over the past year, entities have continued to expand and refine their levels of financial reporting. In meeting accountability requirements to the Parliament, each entity is required to table an annual report that informs the reader about its performance. The foundation for agency accountability and transparency is the statement of measures and targets in the Portfolio Budget Statements (PBS), with the results provided in the annual report about 17 months later.

2.81   Under Senate Order 25[37], the annual reports of departments and entities stand referred to legislation committees in accordance with a resolution of the Senate. Each of the legislation committees is required to report on their review of the annual reports. In this way, Parliament makes a considered assessment of agency performance. This assessment needs to be facilitated by performance measures which are accurate, coherent and appropriately analysed.

2.82   The ANAO notes that, notwithstanding the improvements made during the last few years, some entities continue to have difficulty in preparing their monthly financial reports on a full accrual basis.

2.83   This issue is particularly pertinent in light of the much shorter reporting timeframes, which have been introduced in respect of year-end

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[36]   Management Advisory Board, Beyond Bean Counting, Effective Financial Management in the APS—1998 & Beyond, Canberra, 1997, p. 57.

[37]   25(2)(6) p. 25 of Standing Order and the Order of the Senate, February 2004.

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reporting by 2005 as part of the Department of Finance and Administration's 'Budget Estimates and Framework Review'[38], referred to earlier.

2.84 In most cases, the ANAO considers that further financial reporting improvement is necessary, particularly with respect to improved financial analysis and commentary to assist CEOs, executives and staff with financial responsibilities to adequately monitor financial and operating performance. For example, many entities do not report at output or outcome level on a monthly basis. Improvements in this area would deliver more detailed understanding of the entity's performance and, from a financial perspective, allow relevant managers/executives to gain improved knowledge as to:

• how resources are being utilised across major activities;

• the cost impact of large expense items such as IT and their relationships to key business operations; and

• the carrying values of assets and amounts of liabilities, and whether asset replacement strategies and liability reduction programs and revenue arrangements are appropriate.

2.85 In 2003–2004, all material entities are required to prepare financial statements with relevant supporting information to allow for audit clearance by 30 July. All non-material entities are expected to provide audit cleared financial statements by 30 August. Most entities are doing a 'trial run' of financial statement preparation late in the financial year to identify potential issues and facilitate the year-end process.

2.86 Financial statements are prepared on a materiality principle. That is, a degree of uncertainty is acceptable so long as it does not compromise decision-making and users are not mislead. Each year the ANAO sets an audit planning materiality for each entity audit; that is, an upper bound for uncertainty beyond which error is not acceptable. Each entity should also set its own tolerance for error in the monthly and yearly financial statements. The majority of entities in this report use the ANAO materiality as their de-facto tolerance for error in the monthly and yearly financial statements.

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[38] Budget Estimates and Framework Review—Department of Finance and Department of the Treasury Joint Review–Canberra 2002. Recommendation 2.

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Conclusion

2.87   This year's report indicates that the AGPS is still in a 'consolidation phase' which is required to enhance entity stewardship.

2.88   ANAO audit findings this year, again indicate that there remain fundamental financial management issues that need to be addressed in the AGPS. Entities need to continue to build risk awareness; strengthen business practices and systems of authorisation; enhance financial reporting and analysis; and integrate financial and non-financial information, as part of the development of performance measurement frameworks.

2.89   Progress against key financial performance elements indicates that entities need to improve their understanding of performance, not only from a financial perspective but also from a whole of organisation standpoint. Integral to this understanding, are the revenue allocation and cost attribution models that need to be considered together with the impact of expenditure decisions and their relationship to key organisational operations. Given the quantums of expenditure incurred with programs and liability management issues, critical financial data analysis and familiarisation will be an essential success factor for AGPS senior management, in the discharge of their stewardship role.

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3.   Information Systems

Introduction

3.1   The Australian Government has a significant and growing investment in information and communication technology (ICT). The continued focus on ICT as a key enabler has contributed to information technology (IT) and supporting systems becoming critical components of important business processes within government entities. In addition, new technologies have also introduced increased complexity, speed, interconnectivity and dependence on information systems within the IT environment, which can involve substantial costs and risks, but also improved productivity.

3.2   Entities need to establish appropriate governance practices to ensure the deployment of ICT meets corporate goals through increased productivity, within a cost effective, prudent control environment.

IT process methodology

3.3   IT governance practices, including the IT control environment, are reviewed as part of the financial statement audits of entities to determine the extent of reliance that can be placed on them. Although the ANAO's financial statement audits tend to focus on IT rather than ICT, IT governance processes equally apply to ICT.

3.4   The ANAO's IT audit methodology has adopted an approach using maturity models based upon the Control Objectives for Information and related Technology (CobiT).[39]   CobiT is a framework of internationally accepted better practice standards that assists with the assessment of key aspects of an IT environment. This assessment forms a functional guide to the settings of audit risk and the extent of specific audit testing to be undertaken.

3.5   This audit methodology is premised on gaining an understanding of an entity's important business processes, and then evaluating the risks and controls of an entity's use of information technology to support these processes. As part of the audit methodology, the effectiveness of key IT controls, that have direct or important effects on the processing of financial information, are evaluated and reported on.

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[39]   The IT Governance Institute and the Information Systems Audit and Control Foundation have jointly developed CobiT; refer to <www.isaca.org> for more information.

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3.6   Figure 3.1 below describes the IT process methodology used by the ANAO. As part of each audit, sub-processes are documented according to this model to ensure that a sound understanding of IT processes is obtained. From this understanding, identified controls are then tested to confirm they are operating effectively.

Figure 3.1

ANAO's CobiT based IT process methodology
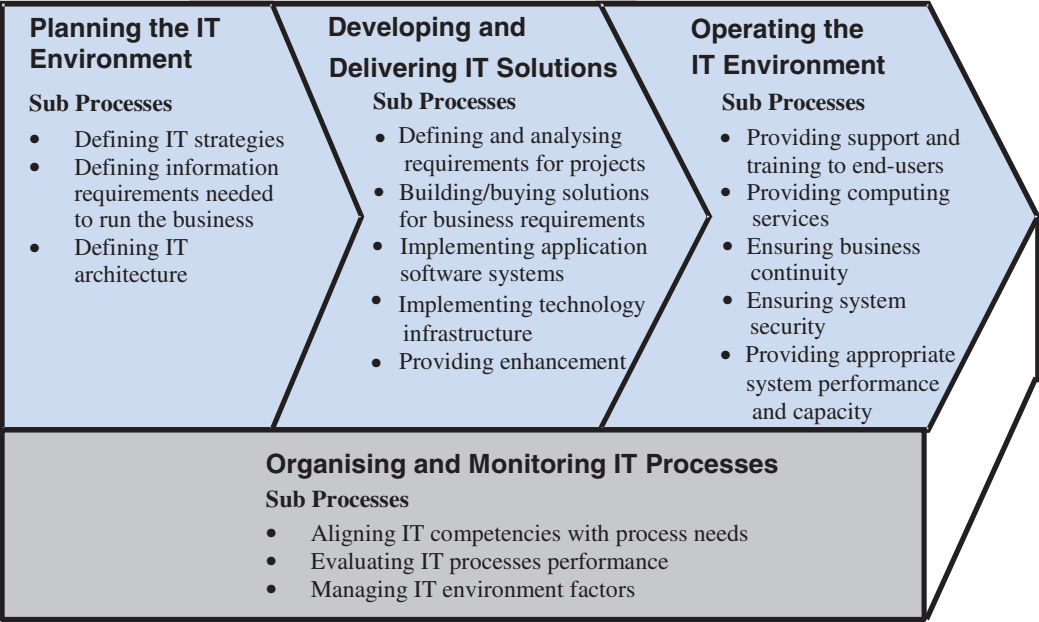
Source: ANAO Financial Statement IT Audit Methodology

3.7   To evaluate how entities are performing against the ANAO CobiT based approach, maturity-rating categories have been developed to provide a benchmark for evaluating each IT sub-process. Table 3.1 below provides an overview, including a high-level generic description, of the rating categories.

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Table 3.1

CobiT based maturity rating categories and descriptions

Category	Detailed Description
Non-existent	There is a complete lack of any recognisable process.
Initial/Ad-hoc	No standardised processes, but there are ad-hoc approaches. The entity recognises that issues exist and need to be addressed. Management is reactive in addressing any issues.
Repeatable but Intuitive	There is global awareness of issues. Processes are developed where they are repeatable and some of them begin to be monitored. There is no formal training and the communication on standard procedures and responsibilities is left to the individual. There is high reliance on the knowledge of individuals and errors are therefore likely.
Defined Process	Systems and procedures have been standardised, documented, communicated and implemented. Training and application of standards is up to the individual. The need to act is understood and accepted. Most processes are monitored against some metrics and deviations are acted upon mostly through individual initiative.
Managed and Measurable	There is full understanding of the issues at all levels. Responsibilities are clear and process ownership is established. A completed set of policies, procedures and standards have been developed, maintained and communicated and is a composite of internal best practices.
Optimised	There is an advanced and forward-looking understanding of issues and solutions. Processes have been refined to a level of external best practice, based on results of continuous improvements and maturity modelling with other organisations.

Explanatory Notes:	Assigned CobiT ratings given within this report are based only upon assessment of systems related to the ANAO financial statement audits (i.e. revenue and payment systems). Any assessment that incorporates a broader whole of entity perspective, which includes non-financial business processes, could result in a different rating.

Source: CobiT Management Guidelines, released by the COBIT Steering Committee and the IT Governance Institute, July 2000.

3.8   Progression through the rating categories means that IT processes are aligning more with the entity's organisational goals. This enables the entity to maximise benefits from its IT investment decisions, through deploying IT resources more effectively and through managing IT risks more appropriately.

3.9   In the public sector environment, the *Defined Process* maturity rating is the minimum baseline, assuming appropriate IT governance arrangements are in place. There are exceptions. For example, Government policy on information security requires security to be managed effectively, which indicates a *Managed and Measurable* rating may be more appropriate. In addition, for large entities that make strategic use of IT (i.e. not for accounting purposes alone), a *Managed and Measurable* maturity rating may be more appropriate, indicating there is full understanding of the issues at all levels and metrics have been established to measure results.

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Audit focus

3.10　The ANAO focused audit attention on those areas identified last year as lagging in maturity, specifically, information security and business continuity management practices, to determine the progress that has been made, and to highlight opportunities for further improvement. The change management practices were not reviewed, following the good results in 2002–2003.

3.11　The financial systems of those entities that have implemented the SAP application were also reviewed. SAP was selected, as it is the most prevalent financial management information system in use within the Australian Government, with 17 of the 24 entities listed in this report having this system implemented. The review focused primarily on the security and control of SAP to test whether the implementation and operation of the SAP system produces reliable, accurate and complete financial information which can be relied upon for financial statement and reporting purposes.

3.12　In addition, the ANAO performed a more in-depth analysis of the information security and business continuity management practices for five larger entities (the extended testing group) which were selected last year, namely, the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and the Health Insurance Commission. This is described in detail in Appendix one.

Overall summary assessment

3.13　The following commentary details the results of IT interim audit testing of major entities (as set out in Chapter five) for the period 1 July 2003 to 31 March 2004. It provides an overall conclusion as to where entities are rated for information security and business continuity management practices and, where applicable, SAP security and control.

3.14　Figure 3.2 below provides a view of the maturity of information security and business continuity practices across all entities referred to in this report. Overall, most entities have attained a *Defined Process* rating for information security management, with 20 of the 24 entities achieving this level. This reflects a 17% improvement since the 2002–2003 audit cycle. Two entities have not achieved a *Defined Process* rating and will need to enhance their security plans, procedures and service levels.

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Figure 3.2

Maturity of information security and business continuity management practices across entities
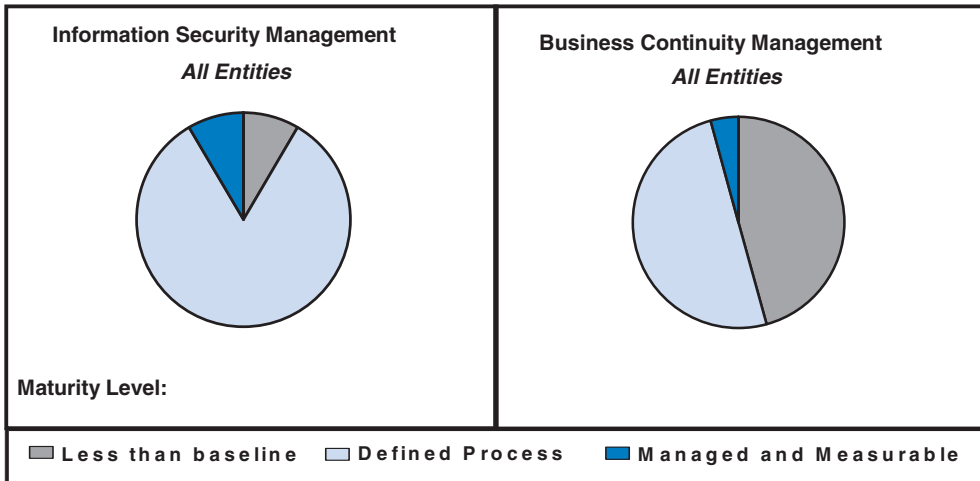
Source: ANAO analysis of entities' IT control environment.

3.15   While most entities achieved a *Defined Process* rating for information security management, only two achieved the higher rating of *Managed and Measurable*. Going forward, most entities should consider improving their information security management processes in order to move to a higher rating. This may be necessary in order to ensure that entities are in a position to comply with various government security standards and guidelines.

3.16   For business continuity management, just over half the entities attained a *Defined Process* rating, representing a 30% improvement since the 2002–2003 audit cycle. This reflects the significant progress most entities have made towards the development of effective business continuity and disaster recovery plans in recognition of the increased risk of potential disruption to service delivery. Those entities that have not yet achieved a *Defined Process* rating will need to continue to work on the business continuity improvements outlined later in this report.

3.17   Outsourcing of the IT infrastructure has strengthened the security arrangements for most entities in the areas of logical and physical security, as well as security reporting. However, the ANAO found that outsourcing did not have as significant an influence on the improvement of the entities' business continuity management practices.

3.18   In respect of the implementation and operation of the SAP financial application, areas requiring improvement include access controls over the SAP system and security administration functions, as well as the accounts payable function. Entities should consider strengthening the robustness of controls

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around their security and accounts payable arrangements to enable adequate segregation of duties and prevent access to incompatible functions. It is acknowledged that, in some cases, entities have implemented compensating manual detective controls to mitigate the risks in these areas.

Information security

3.19 Sound information security management provides entities with assurance that their processes, systems and information are protected from unauthorised access and manipulation. This enhances an entity's confidence that its business transactions are valid, accurate and complete and can be relied on for decision-making purposes. It also mitigates the risk of an entity's confidential information being exposed to unauthorised access.

3.20 The need for information security management is becoming increasingly more important, due to the higher degree of dependence on ICT for service delivery, communication and networking. The increasing use of the Internet, and electronic commerce to process business transactions, and the interconnectivity of these with entity systems, are creating greater risks to potential external threats such as computer viruses and hackers. It is therefore important that entities have effective information security processes in place, with supporting security governance arrangements, to ensure that they are well placed to deal with any security issue that may arise. This will require robust controls over the IT processes that safeguard information against unauthorised use, disclosure, modification, damage or loss.

3.21 Similar to the 2002–2003 audit cycle, the ANAO focused on reviewing the IT processes underpinning information security management. Specifically, the areas covered included:

- IT security policies;

- roles and responsibilities;

- security awareness;

- IT security audits;

- system access procedures;

- system security measures;

- system monitoring and investigation; and

- remote access.

3.22 The ANAO also reviewed logical security over key financial systems, with a particular emphasis on those entities that have implemented SAP as

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their key financial system. The results of this review are covered in more detail under the section Financial Management Information Systems.

Findings

3.23 Approximately 84% of the 24 entities examined have attained a *Defined Process* rating for their management of information security, with 8% attaining a higher rating of *Managed and Measurable*. This is a significant improvement from last year when only 67% of entities attained a *Defined Process* rating. This result highlights that there is a general trend towards improving information security management within the Australian Government. There is increased recognition of the greater importance being given to information security, due to a heightened risk from changes in the technological and geopolitical environment.

3.24 Given the growing importance of information security, entities should be moving towards attaining a *Managed and Measurable* rating. The requirements of the Commonwealth Protective Security Manual (PSM), Australian Communications-Electronic Security Instruction 33 (ACSI 33) and ISO/IEC 17799 Information technology—Code of practice for information security management are consistent with the need for entities to move towards such a rating. These requirements support the need to safeguard official resources and look to limit the opportunity for the unauthorised release of official information that is damaging to the public interest.

3.25 Figure 3.3 below shows how entities performed against the individual maturity indicators for the *Defined Process* rating. Areas of strength were in relation to:

- ensuring executive responsibility for information security is clearly identified;

- information security policy has been established and approved by executive management;

- information security procedures are defined and fit within an entity's security policy; and

- information security incidents are reported.

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Figure 3.3

Information security management maturity indicators—*Defined Process*
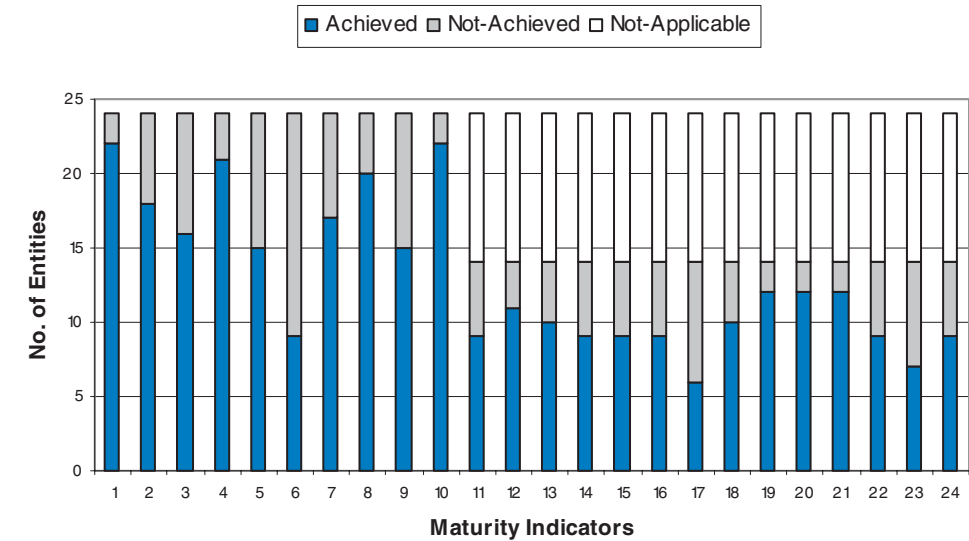
Maturity Indicators:

1.	Executive responsibility for information security is clearly identified within the Entity.
2.	Operational responsibility for information security planning, training and management are clearly defined and assigned within the Entity.
3.	Specific security risks to the Entity are understood, including business impact.
4.	An information security policy has been established and approved by executive management.
5.	A current information security plan exists.
6.	Key business applications handling sensitive information have their own information security plan.
7.	Security awareness exists and is promoted by executive management.
8.	Information security procedures are defined and fit within the Entity's security policy governance.
9.	Information security reporting is IT focused, rather than business focused.
10.	Information security incidents are reported.

Outsourcing Contracts address:

11.	Entity's information security requirements.
12.	The general policy on information security.
13.	How the legal requirements are to be met.
14.	How the integrity and confidentiality of the Entity's business assets are to be maintained and tested.
15.	Access control agreements.
16.	The right to monitor, and revoke, user activity.
17.	User and administrator training.

18. Controls for protection from malicious software.

19. Arrangements for reporting, notification and investigation of security breaches and incidents.

20. Physical and logical controls for access to the Entity's sensitive business information.

21. Levels of physical security to be provided.

22. Security responsibilities of all parties.

23. Service levels agreed for security.

24. The right to audit contractual security responsibilities.

Source: ANAO defined maturity indicators based on CobiT and assessment of entities.

3.26   Areas where significant improvement opportunities were identified relate to:

- establishment of security plans for key business applications which handle sensitive information;

- establishment of a current information security plan; and

- information security reporting is IT focused, rather than business focused.

3.27   Similar to the 2002–2003 audit cycle, outsourcing of the IT infrastructure appeared to have a strong influence on improving the entities information security management arrangements. Those maturity indicators that were mostly achieved by entities in relation to outsourced contractual arrangements included physical and logical controls for access to entity's sensitive business information, and arrangements for reporting, notification and investigation of security breaches and incidents.

3.28   Most entities do not have an information security plan for each of their application systems. Most of the extended testing group have an opportunity to improve their practices by ensuring their information security procedures are defined and fit within the entity's security policy. As well, in relation to the outsourced IT providers, the group needs to ensure that agreed service levels for security are in place.

3.29   Of the extended testing group, one entity attained a *Repeatable but Intuitive* rating for their information security management practices. This entity will need to improve their practices to ensure that, at a minimum, they attain a *Defined Process* rating. Overall, extended testing group entities could continue to improve the maturity of their practices by ensuring:

- key business applications handling sensitive information have their own security plan;

- information security procedures are defined and fit in with the entity's security policy governance structure; and

- establishing agreed levels for security in outsourced arrangements.

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3.30 Individual summary assessments for information security management practices for the extended testing group entities are provided in Appendix one.

Business continuity management

3.31 An important aspect of an entity's risk management strategy is an assessment of the likelihood of continued availability of service delivery and information, and the likely impact on the entity if the service is no longer available. The outcome of such an assessment requires entities to develop business continuity arrangements for those areas considered necessary to maintain business operations. The objective of business continuity management is to ensure the availability of all key business resources required to support critical business processes in the event that normal operating activities are affected by a disaster or other event.

3.32 The ANAO has again this year focused on reviewing business continuity management practices within Australian Government entities including:

- business continuity plans and processes that ensure business operations would continue to operate in the event of a disaster, until such time as the system is re-instated; and

- the disaster recovery plan and processes that ensure the IT systems are re-instated to a satisfactory operating level.

Findings

3.33 Over half the entities reviewed attained a *Defined Process*, or higher rating, for their business continuity management practices. This is a significant improvement on last year's results, where most entities scored a lower rating of *Repeatable but Intuitive*. Overall, the other entities have achieved a more mature business continuity management arrangement than the majority of the extended testing group. Only one entity, in the extended testing group, achieved a higher rating than *Defined Process*.

3.34 Figure 3.4 below shows how entities rated against the individual maturity indicators for the *Defined Process* rating. Most entities have clearly identified executive responsibility for business continuity planning and disaster recovery. However, for some entities, executive management has communicated the need for a continuous service and has obtained computer equipment that provides a high level of availability.

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Figure 3.4

Business continuity management maturity indicators—*Defined Process*.
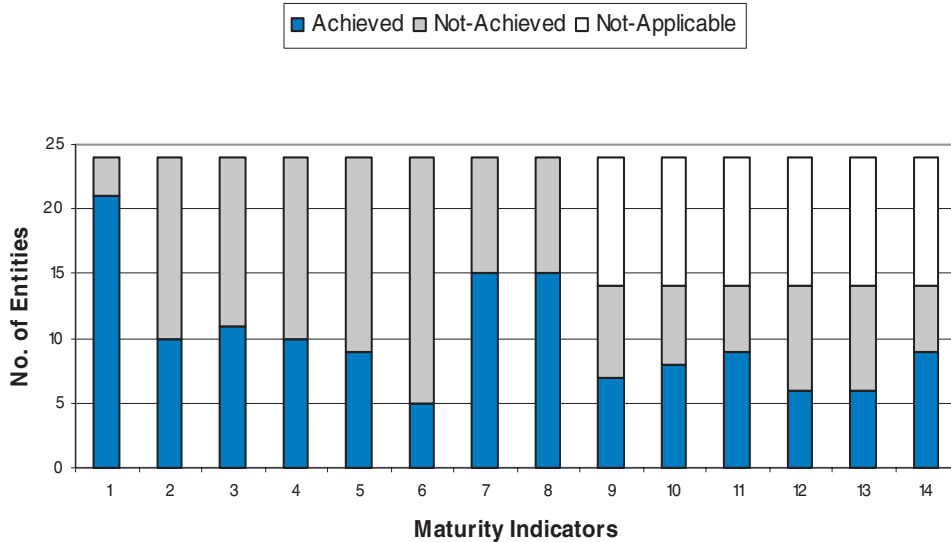
Maturity Indicators:

1. Executive responsibility for business continuity planning and disaster recovery is clearly identified within the Entity.
2. Operational responsibility for business continuity and disaster recovery planning, training, testing, activating and coordinating the plans are clearly defined and assigned within the Entity.
3. Specific risks to the Entity are understood, including likelihood and business impact.
4. A Business Continuity Plan including a Disaster Recovery Plan exists and is consistent with agreed business objectives and priorities.
5. The Disaster Recovery Plan is documented and based on the Entity's critical systems and business impact.
6. There is periodic reporting of business continuity and disaster recovery plans where individuals take the initiative for following Government policy, the appropriate standards and for receiving training.
7. Executive management communicates consistently the need for continuous service.
8. High-availability service and equipment components and service redundancy are being applied as required.

Outsourcing Contracts address:

9. Entity's risk of disaster or security failures, identifies business impact and business priorities for service availability.
10. Entity's business continuity and disaster recovery requirements.
11. Disaster recovery responsibilities of all parties involved in outsourcing, including subcontractors.
12. How the availability of services are to be maintained in the event of disaster or security failure.
13. Service levels agreed for disaster recovery/contingency planning.
14. The right to audit contractual business continuity and disaster recovery responsibilities or to have those audits carried out by a third party.

Source: ANAO defined maturity indicators based on CobiT and assessment of entities.

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3.35 Most entities need to develop periodic reporting on business continuity and disaster recovery for management purposes. Outsourced contracts need to be improved to outline how the availability of service is to be maintained in the event of a disaster. In addition, service levels need to be agreed with outsourcing providers in regards to disaster recovery and contingency planning. This should involve identifying the entity's risk of disaster, business impact and business priorities for service availability.

3.36 Most entities do not document their disaster recovery plans based on the entity's critical systems and business impact. As well, most still do not have a business continuity and disaster recovery plan that is consistent with agreed business objectives and priorities. In addition, operating responsibility for business continuity and disaster recovery planning, training, testing, activating and co-ordinating the plans has not been clearly defined and assigned.

3.37 The maturity of business continuity management processes was not consistent across the extended testing group and other entities. In general, other entities have improved their business continuity and disaster recovery plans, while the extended testing group remained relatively static in this respect.

3.38 Outsourcing of IT infrastructure did not have a strong influence on improving the entities' business continuity management practices. In most cases, disaster recovery plans developed by the outsourcer are in place. However, in many cases, these had not been adequately tailored to the entity's particular business requirements.

3.39 Most entities can improve their business continuity management maturity rating by:

- undertaking a risk assessment to identify all specific corporate and IT risks threatening business continuity;

- establishing a business continuity plan and disaster recovery plan to meet corporate objectives and priorities;

- establishing a disaster recovery plan that includes all of the entity's critical sites, infrastructure and applications, their recovery priority, maximum acceptable outage, estimated time to recover, and costing for implementation;

- assigning operational responsibility for training, testing, activating and coordinating business continuity management plans;

- reviewing and testing business continuity and disaster recovery plans regularly;

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- within cluster outsourced contract arrangements, ensuring the appropriate prioritisation of their IT environment relative to other entities;

- specifying services levels required during a disaster scenario in relevant outsourcing (and/or third party suppliers) contracts; and

- management of the IT outsourcer's (and/or third party suppliers) disaster recovery contractual obligations.

3.40 Individual summary assessments for business continuity management practices for the extended testing group entities are provided in Appendix one.

Financial management information systems

3.41 As part of the financial statement audit, the ANAO reviews the robustness of the controls within the entity's financial management information system (FMIS) to gain assurance over the reliability, accuracy and completeness of the financial information. As part of this process, an understanding is obtained over the financial processes with a view to identifying and testing the key controls against a normative model to identify and assess any control weaknesses. This approach was used to review the financial and business systems of Australian Government entities where controls reliance is required.

3.42 This year, the ANAO focused on reviewing those entities that had implemented SAP as their FMIS with the view of providing a commentary on the implementation and operation of SAP within the Australian Government. Of the 24 major entities reported on, 17 of these entities use SAP. This illustrates the marked extent to which SAP is being used within the Australian Government.

3.43 The review of SAP within the entities concentrated on examining the SAP security arrangements, including segregation of duties. It practically focused on the Basis (SAP's security and configuration module) and accounts payable modules. This was supplemented in some entities with the use of data analysis techniques that involved extracting financial data from the entity's financial system and analysing this data to assist in testing the entity's key controls.

Findings

SAP environment

3.44 The ANAO examined 15 of the 17 entities that have implemented SAP as their FMIS. The other two entities were not examined, as the SAP system for one of the entities was not considered its major financial system. The other entity was undertaking an internal review of SAP at the time of the audit. Of

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the entities examined, 14 have implemented recent versions of SAP ranging from version 4.0b or higher. The majority of entities are running their SAP systems on a Windows NT operating environment with the Sun operating system being the second most commonly used. Oracle is the most common database system being used. All entities have implemented separate development, test and production environments to enable changes to be made to their SAP system in a controlled environment.

3.45   SAP is made up of approximately 17 modules. Of these, the Basis module is required by all entities to provide the security and configuration for SAP. Apart from Basis, the most used modules are:

- Controlling;

- Financial Accounting;

- Materials Management; and

- Asset Accounting.

3.46   The Treasury module is also used by a number of entities, followed closely by the Human Resource module for those entities that are using SAP to manage their human resources and payroll functions.

3.47   Most entities have between two to six clients on their SAP system. A 'client' is the highest level within a SAP organisation and usually represents the entire organisation. Any number of company codes can be set up within a client. A 'company' is the smallest organisational unit in SAP for which a complete self-contained set of accounts can be developed. Most entities had between nine to 12 companies, although one entity had 63 companies. Additional companies are set up to facilitate separate statutory reporting (which will assist in the consolidation of various business operations), enable access to individual company codes to be restricted, and provide an FMIS service for smaller entities. However, it appears that some entities may have established an excessive number of clients and companies. This will be an area for further ANAO investigation in the future.

3.48   All entities had systems interfacing with SAP, ranging anywhere from one interface to 13 interfaces. Given the importance of data transfers across such interfaces, it is critical that entities ensure that business systems that interface with SAP are adequately controlled.

Security policies and procedures

3.49   Separate SAP specific security policies have been developed for half of the entities examined. A separate security administration function has been developed for nearly all entities. All entities had appointed a SAP security administrator, ranging from one to five administrators depending on the size

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of the entity, with the most common being two. Ideally, to ensure adequate segregation of duties between security administration functions, three security roles should be defined, these being user administrator, authorisation administrator and activation administrator. Where segregation is not possible, a measure of control can be achieved by undertaking an independent review of reports of changes to profiles and authorisations. Of the entities examined, only four had been identified as implementing the ideal segregation of system administrator roles. As a consequence, most entities face an unnecessary increased risk of fraud and data corruption.

3.50 Most entities had system administrators who could grant themselves access to inappropriate transactions. In this situation, it is important that these entities undertake regular formal reviews of all security maintenance and/or transactions accessed by the security administrator to ensure all activities are appropriate.

3.51 All entities examined had formal user access procedures established for new or changed access requests to their SAP system. Most entities had adequate termination procedures in place to de-activate a user from the system if he/she leaves the entity. The majority of entities examined had system administrators with access to incompatible functions, again making it important that these privileged users' activities are regularly reviewed.

SAP configuration

3.52 For those entities examined, it was not possible to make changes to customise the SAP configuration in the production environment. In relation to password management, most entities had six or more character length passwords. Only one entity was below the minimum industry standard with a three character length password. Most entities allowed 28 to 30 days before forcing the user password to be changed. However, one entity allowed users to retain passwords indefinitely. This increases the risk of unauthorised access, as user passwords may become more widely known after a long period of time. Some entities have implemented additional restrictions by not allowing selected common words to be used as passwords.

3.53 For most entities, the number of times a user can enter an incorrect password before the system terminates the user session is three. Automatic unlocking of users who have had their passwords disabled due to login failures is not allowed for most entities. For nearly half the entities examined, the number of minutes before automatically disconnecting inactive users from a session on the SAP system was 30 minutes. The remaining entities ranged from 45 minutes to 1 hour 20 minutes.

3.54 Table logging provides an ability to automatically record and subsequently monitor system activity. However, logging of SAP system tables

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have been turned off for most entities due to the large amount of system resources required. In the absence of table logging, entities need to review sensitive tables and relevant reports to ensure unauthorised activity is detected and managed.

Super user IDs

3.55 Access to the SAP system is controlled through the use of user IDs. There are several powerful user IDs, specifically SAP* and DDIC. SAP* allows unrestricted access to SAP. DDIC is used to change system installation parameters. SAP* and DDIC are delivered with a well-known default password.

3.56 The ANAO reviewed these super user IDs to determine how well these ID's are protected from unauthorised use. We identified that almost all entities had implemented adequate protection over these super user IDs. Although most entities have changed their SAP standard passwords, three entities were found to have default SAP passwords still active. Only one entity has developed a profile that will allow users to have the equivalent of super user access to SAP.

Privileged profiles

3.57 Profiles consist of authorisations that provide users with access to the SAP system. There are a number of SAP predefined profiles, which provide powerful privileges. A number of these more important profiles were examined to ensure they were appropriately restricted, the results of which are detailed in the following table.

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Table 3.2

Privileged Profiles—Results of review

Profile	Description	Finding
SAP_ALL	This profile allows users to perform all functions within the SAP system and is especially powerful. SAP recommends that this profile should not be granted to any users in the production environment.	Most entities allowed access to this profile, generally ranging from 1 to 5 users for each entity. However, nearly half the entities examined only allowed two users to have access to this profile. The users, who have this profile, are usually the system administrators for SAP. Two entities have 11 users with access to this profile, which is considered excessive. While the majority of entities have not used this profile to process financial transactions, four entities were identified that had users using this profile to process financial transactions.
SAP_NEW	This profile provides general access to any new profiles and authorisations that are included in a new release of SAP and, hence, may provide access to inappropriate functions. It is also suggested that this profile should not be allocated to any users in the production environment.	The majority of entities examined are using this profile ranging from 1 to 11 users for each entity. Of the 15 entities examined, 10 entities have only 2 users or less that have access to this profile.
S_A.SYSTEM	This profile is designed for the central system administrator and contains all authorisations to undertake SAP system functions.	Most entities have not allowed users to have access to the S_A.SYSTEM profile, with only 3 entities having an excessive number of users (3 to 5) with access to the profile.

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Profile	Description	Finding
S_A.ADMIN	This profile is for the system administrator who is responsible for overseeing system operations. It contains all the BASIS authorisations (except the authority to modify users in group 'Super'), standard profiles as well as access to the development environment.	Almost all entities do not allow access to the S_A.ADMIN profile. Only one entity has allowed 11 users to have access, which is considered excessive.
S_A.CUSTOMIZ	This profile is for users working with SAP customising menu and contains all authorisations for the BASIS activities in the customising menu.	Most entities do not allow access to the S_A.CUSTOMIZ profile, with only two entities allowing access. However, one of these entities has allowed 11 users access.
S_A.DEVELOP	This profile is for developers working in the development environment and allows access to most functions but excludes authorisations for system administration and for user/authorisation maintenance. Therefore this profile should not be used in the production environment.	Two entities have allowed users to have access to this profile. One entity has 12 users who have this profile.

Source: ANAO from SAP Documentation.

Access to SAP Tables

3.58 Tables can be allocated to table classes, such as system tables, security tables and control tables. This provides the capability for appropriate authorised users to maintain each class. If tables are not assigned to a table class, any individual user authorised for table maintenance may add, change or delete entries in any table. The majority of the entities reviewed had assigned their tables to an appropriate authorisation class. However, as reported previously, table logging has not been turned on in the majority of entities. The number of users within each entity who have the ability to control table access range from three to 4 152 users. The majority of these entities have fewer than 76 users. However, two entities had 1 074 and 4 152 users respectively, which is considered excessive.

Change Management

3.59 Of the entities examined, half had configured their system to prevent changes being made in the production environment. Most entities had defined

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their SAP systems to link with SAP's change control system and have also configured their systems to ensure that program ownership is not transferred between systems. The Change and Transport System (CTS) within SAP (CTS is a tool that helps to organise development activities within SAP and then transport the changes between the SAP environments) has been implemented correctly for most entities. Entities are able to transport SAP programs, or to apply SAP patches and transport the changes, in a controlled manner.

Accounts payable

3.60   A vendor master file contains information about the entity's vendors, including name and address, terms of payment and payment information e.g. vendor bank account. A vendor master record must be established for each vendor from whom the entity purchases goods and services. A review of accounts payable identified that a significant amount of users have access to make changes to the vendor master file. The number of users within each entity ranges from three to 49 with the majority having fewer than 25 users. A large number can also post invoices or payments.

3.61   Eight entities were examined to determine the number of potential duplicate vendors. Of these, the majority had significant potential duplicate vendors in their systems, ranging from zero to 4 470 for each entity. A large number of duplicate vendors increases the risk of duplicate payments being made and highlights the need for more robust procedures over the creation of new vendors. Data analysis techniques used on five entities identified significant potential duplicate invoices for two of these entities. Potential duplicates will be further investigated.

3.62   Eight entities were examined to determine whether users who had access to purchasing and receiving also had access to post and update vendor invoices. Of these, the majority had users with this level of access, with two entities having 63 and 36 users respectively. Of these eight entities, half also had users that had access to disbursement processing which is generally not compatible with their duties. In particular, one entity had as many as 140 users with such access. These eight entities have an increased exposure to fraud.

3.63   Information was obtained from five entities on the percentage of invoices that are initiated by purchase orders. In the majority of entities examined, purchase order initiated invoices in 5% to 14% of cases. As a corollary, 86% to 95% of invoices are paid without an approved purchase order. Without utilising purchase orders, entities may not be able to budget accurately for their expenditure and may not be in a position to know what their commitments are at any point in time.

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Summary

3.64   Most of the entities examined had configured their SAP systems in accordance with best practice and had controlled access to most of the powerful standard SAP profiles. Overall, the main areas of potential weakness relates to the access given to the SAP system/security administrators who, for most entities, have access to incompatible functions and transactions. Some of these administrators have used this access to process financial transactions. In this situation, entities must put in place a compensating control that entails the manual review and monitoring of the activities of these users. In addition, most entities are not logging any changes or amendments to key system tables. Therefore entities also need to review sensitive tables and relevant reports to ensure changes are monitored.

3.65   In relation to accounts payable, a significant number of users have been given access to create vendors. Weaknesses have also been identified in relation to segregation of duties within the accounts payable function. It is suggested that this area be closely reviewed and monitored by entities.

3.66   Most entities could improve the security over their SAP system by:

- reviewing the number of clients and companies to ensure they are kept to a minimum;

- ensuring adequate security policies and procedures have been developed for SAP;

- ensuring the system/security administration function is properly segregated;

- logging of changes to sensitive or critical tables; and

- configuring the SAP system to prevent changes being made in the production environment.

3.67   Most entities could improve their accounts payable process by:

- reviewing the number of users who can create new vendors and ensure that the procedures for vendor creation incorporates a mandatory check for existing vendors;

- reviewing the vendor master file and reducing the number of duplicate vendors and bank account numbers;

- reviewing the segregation of duties over the accounts payable function with the aim of segregating the purchasing and payment functions; and

- utilising purchase orders for payment processing, wherever practical.

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Emerging issues

3.68   Over the next couple of years, there will be a number of emerging issues and challenges facing the ICT environment that will have an impact on IT governance and the maturity of an entity's IT processes. Of particular note, is the increasing demand to provide more integrated and interactive information and services in order to improve the performance and management of government services. This has necessitated a move towards e-Government to provide more responsive, comprehensive and integrated government operations and service delivery.

3.69   The IT processes and systems within entities will need to be transformed to adopt and respond to new technologies and to enable entities to work together to ensure that their individual systems are compatible and can be linked both internally and externally. The adoption of these new technologies, such as the use of wireless technology, will introduce a whole new range of information security and business continuity issues and concerns. Each entity's system development management will need to plan for future compatibility, interconnectivity and upgrades.

3.70   Recently, an inquiry by the JCPAA[40] identified weaknesses in the areas of physical security over IT equipment, and highlighted the need to develop and implement practicable standards for the protection of information against access by unauthorised persons, or for unauthorised purposes. Of particular concern to the JCPAA, was the security of information held by providers of tendered services. The Committee recommended the development and implementation of standards to address this issue.

3.71   Information security and business continuity issues and concerns within contract management will become more critical, as entities move away from utilising one outsourcing provider to using a number of IT business partners to provide a range of IT services. Australian Government entities will also need to implement effective data storage practices to support future access to data in the face of rapidly changing technology. This will entail the need for government electronic records to be subject to comprehensive and tested business continuity and disaster recovery plans.

Future IT audit focus

3.72   The ANAO will continue to focus on information security and business continuity management. While entities have generally improved the maturity of their practices, further progress needs to be made for most entities to reach a

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[40] JCPAA, Report 399, *2004 Inquiry into the Management and Integrity of Electronic Information in the Commonwealth*, Canberra, March.

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maturity level that is considered appropriate. The security and contract management issues, recently identified by the JCPAA, highlight the need for entities to further improve their information security arrangements. This is even more critical with the move towards e-Government.

3.73 Over the next year, the ANAO will be undertaking further data analysis of entities' FMIS systems covering general ledger, purchase to pay cycle, asset accounting as well as reviewing system configuration. A suite of data analysis tools is being developed to focus on SAP. This could eventually be expanded to include other FMIS and HR systems, depending on audit procedures and resource availability.

3.74 Identification and testing of key controls will continue to be the main audit focus, but it is intended that this will be supplemented with increased data analysis. The latter will provide additional detail as to the extent of any exposure or error that may be occurring within systems due to control breakdowns. This information could be used to obtain an overall understanding of the general health of an entity's FMIS system by comparison across the Australian Government. This analysis will eventually result in a more informed decision as to the cost and benefits of implementing various controls.

Conclusion

3.75 In general, improvements have been made over the year for both the information security and business continuity management practices. Most entities attained a *Defined Process* rating for their information security management practices. Although there were some entities below the baseline, there were also a number of entities above the baseline. Going forward, most entities should investigate improving their practices with a view to obtaining a *Managed and Measurable* rating for information security management where this is justified. The extent to which entities move towards this rating will depend on the nature of the entities' operations and the importance of information security management in service delivery. While mindful of Government requirements for security, a risk versus cost of control approach should be adopted as part of this process.

3.76 A significant number of entities still have business continuity management practices below the *Defined Process* rating, the minimum baseline. These entities will need to improve the maturity of their practices in order to ensure the continued availability of service delivery and business information.

3.77 The overall maturity of practices did vary between the extended testing group, and all other entities for information security and business continuity

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management. The achievement of specific information security and business continuity management maturity indicators also varied between these groups.

3.78   In relation to SAP, satisfactory results were obtained in the area of SAP configuration. However, for half the entities reviewed, a lack of documentation of SAP security polices and procedures was identified. Most entities also had weaknesses in relation to security administration and table logging. In relation to the accounts payable function, further improvement is required over payment processing, particularly in the area of vendor creation and segregation of functions. For some entities, these weaknesses have necessitated the implementation of compensating manual controls to mitigate any risks.

3.79   During the development of information security and business continuity management processes, entities need to consider the legislative and/or government policy requirements for establishing controls, and where there is discretion, the cost of developing and maintaining a control versus the risk of not having that control. Such considerations also apply to the implementation and maintenance of financial systems.

3.80   In order for entities to ensure that they have an adequate level of control, they need to perform a risk assessment of their processes and systems. This assessment forms the basis for deciding what level of risk is acceptable by an entity, and the level of control required to reduce the risk to an acceptable level. This aspect will need to be considered when entities are considering moving to a higher maturity rating for their IT processes, or are considering the adoption of more robust controls over their FMIS.

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4. Control Procedures

Introduction

4.1   An entity's system of internal control includes the procedures established to provide reasonable assurance that operational and administrative objectives and goals are achieved. Internal control procedures within significant operational and accounting processes and financial systems are assessed as part of the audit of an entity's financial statements. In most entities, key areas covered in the interim phase of the audit include:

- appropriations and other revenues;

- payment of expenses;

- employment and related costs;

- cash management; and

- asset management.

4.2   Another accounting process which requires management's attention is the development of accounting estimates. With compressing reporting timeframes, this is an area that needs to be examined before the final phase of the audit. The ANAO reviews management's processes for ensuring that accounting estimates are adequately derived and documented. Commentary on administered accounting estimates is also included in this chapter.

4.3   Due to joined-up government arrangements, many of the reporting entity's systems of internal control are no longer contained solely within the reporting entity. The ANAO increasingly finds itself reviewing internal control frameworks within multiple organisations, including non-government entities (these entities are referred to as the service entity) to enable it to report on the financial statements of the reporting entity. The interim phases of the audit also includes review of service entity arrangements in accordance with AUS 404 *Audit Implications Relating to Entities Using a Service Entity.*

4.4   The final phase of the audit will build on the interim audit results, through follow-on procedures, and a more extensive focus on the verification of asset and liability balances, and statutory reporting disclosures.

Results summary

4.5   The following results and analysis do not include Defence because the interim audit is not yet complete. With Defence, however, there is detailed commentary in Chapter five and, in the main, issues raised this year are likely to be of the same magnitude as in prior years.

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4.6   Overall, the results of the interim audits of entities reviewed in this report indicate that the effectiveness of control procedures over business and accounting processes have generally been maintained at a reasonable level with only moderate variation. This is demonstrated by:

- the number of entities with 'A' category audit issues, remain at just one in 2003–2004 and 2002–2003;

- the total number of 'A' category audit issues, also remained constant at one in 2003–2004 and 2002–2003;

- the number of entities with no category 'A' or 'B' audit issues remained at three in 2003–2004 and 2002–2003;

- the total number of 'B' category audit issues across all entities, increased from 68 in 2002–2003 to 98 in 2003–2004; and

- seven entities reported an improvement in the number of 'B' category audit issues; 10 entities showed a deterioration in their position, with five entities remaining in the same position.

4.7   A summary of the results of interim audit testing for the major entities for the period 1 July 2003 to 31 March 2004, is set out in Chapter five.

4.8   Commentary on entities' control procedures over key financial categories follows. In all cases, entities concerned have agreed to improve their processes.

Appropriations and other revenues

4.9   Appropriations, both departmental and administered, represent the primary source of revenue for most entities. There are entities which also collect significant revenues in the form of taxation, excise and administered levies. Moderate amounts of other revenues are also generated from the sale of goods and services and from interest earned from cash funds on deposit.

4.10   In 2002–2003 the Consolidated Financial Statements reported total taxation revenues of $161.97 billion and total non-taxation revenues of $48 billion.

Issues

4.11   The ANAO's testing disclosed that control frameworks in entities, relating to the collection, receipt and management of appropriations, levies and other revenues, have improved marginally over the past year. Weaknesses noted in the current year relate to controls over the recognition of revenues and management of recoveries. As in prior years, control weaknesses over the

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timely completion and/or review of reconciliation processes for revenue accounts have also been noted.

4.12 Entities where control issues relating to revenues or related issues have been observed include:

- Australian Taxation Office;

- Department of the Environment and Heritage;

- Department of Veterans' Affairs; and

- Health Insurance Commission.

4.13 Details of the particular issues for each entity are outlined in Chapter five.

Payment of expenses

4.14 Departmental appropriations are largely disbursed to meet employment costs and supplies relating to rental of premises, leasing of IT equipment, administrative costs, contractors and consultants costs and other services. Most entities also disburse administered funds on behalf of the Government on items such as grants, subsidies, benefits, levies and other similar forms of financial assistance.

4.15 Reconciliation processes, segregation of duties, appropriate delegations and access controls, combined with other measures, provide an effective means of ensuring that payments are valid and accurately recorded, and that funds are not mismanaged or subject to material fraud.

4.16 In 2002–2003, the Consolidated Financial Statements reported total cost of goods and services (excluding employee benefits) of $47.85 billion, total subsidies, benefits and grants, of $119.43 billion, and borrowing cost expenses of $8.04 billion.

Issues

4.17 For most entities, payment processes are routine and well established. The ANAO's interim testing has disclosed that payment control frameworks are generally effective, with entities sustaining their control framework over the past year. Individual entities continue to have weaknesses over payment processes, which are specific to their operations, covering issues such as:

- appropriate delegations;

- appropriate segregation of duties;

- compliance processes over the issuance of refunds;

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- controls to prevent duplicate payments;

- monitoring of payments under service delivery agreements;

- preparation of purchase orders;

- procedures to ensure the completeness and accuracy of the recording of transactions; and

- special account reconciliation processes.

4.18   A number of these matters were noted as control issues in last year's corresponding report.

4.19   Entities, where control issues relating to control over payments or related issues have been noted, include:

- Aboriginal and Torres Strait Islander Services;

- Australian Taxation Office;

- Centrelink;

- Department of Agriculture, Fisheries and Forestry;

- Department of Family and Community Services;

- Department of Veterans' Affairs; and

- Health Insurance Commission.

4.20   Details of the particular issues for each entity are outlined in Chapter five.

Employment and related costs

4.21   Employment and related entitlements normally represent the largest departmental expenditure item or running cost. In many instances, personnel costs form one of the larger liabilities entities will need to meet, in particular, the accumulated recreation and long service leave provision balances.

4.22   In 2002–2003, the Consolidated Financial Statements reported $31.03 billion for employment and related costs.

4.23   Given the significance of salaries as an expense item, and that the nature of entitlement calculations make them inherently prone to human error, entities need to have adequate control mechanisms in place to capture and process employee data and payments. Those entities that do not have an integrated FMIS and HRMIS, require a reconciliation process which ensures fortnightly payroll amounts are accurately recorded. In addition, key controls should include approval and review processes.

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Issues

4.24   FMISs and HRMISs, including those contracted to external providers, have been assessed as generally effective. However, individual entities were found to have issues such as:

- inaccuracies in individual employee entitlement balances;

- untimely clearance of significant balances in payroll clearing accounts;

- non-compliance with FMA Amendments Order 2001 (No.2) regarding the transfer of employee leave entitlements; and

- untimely review of payroll reports.

4.25   Entities where control issues relating to employment costs or related issues have been noted include:

- Aboriginal and Torres Strait Islander Services;

- Department of Agriculture, Fisheries and Forestry;

- Department of the Environment and Heritage;

- Department of Family and Community Services; and

- Health Insurance Commission.

4.26   Details of the particular issues for each entity are outlined in Chapter five.

Cash management

4.27   Departmental appropriations are regularly deposited in entities' bank accounts. Each entity needs to ensure they have the necessary liquidity to meet their commitments as they fall due, in accordance with Finance's 'just in time' appropriation drawdown regime. Entities establish and manage their own bank accounts and payment arrangements. In this environment, it is essential that adequate management processes are in place to track fund transfers and safeguard assets. A key control for management is the bank reconciliation.

4.28   Cash management processes are integrally linked to the management of appropriations and receipts and also to the payment of employment and suppliers costs.

4.29   In 2002–2003, the Consolidated Financial Statements reported cash totaling $3.98 billion.

Issues

4.30   Control weaknesses identified this year generally related to:

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- timely completion, including clearance of reconciling items, and review of bank and system reconciliations;

- disclosure of cash;

- proper authority levels approving the investment of surplus funds;

- safe custody of public money;

- segregation of duties; and

- debtor management.

4.31 Entities where control issues relating to cash management or related issues have been noted include:

- Australian Taxation Office;

- Department of Education, Science and Training;

- Department of Family and Community Services; and

- Department of Immigration, and Multicultural and Indigenous Affairs.

4.32 Details of the particular issues for each entity are outlined in Chapter five.

Asset management

4.33 As mentioned in the corresponding previous year's report, asset management, particularly in relation to the maintenance of reliable asset registers, has been an issue for attention and raised consistently by the ANAO, particularly in relation to:

- poor documentation relating to asset acquisitions and disposals and such transactions not being recorded in a timely manner;

- completed capital work in progress not being capitalised upon completion;

- assets on hand not being recorded on the asset register;

- asset registers not being regularly reconciled to financial systems; and

- lack of an appropriate process for the capitalisation of internally developed software.

4.34 In 2002–2003, the Consolidated Financial Statements reported total non-financial assets excluding inventories and other non-financial assets of $94.16 billion.

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Issues

4.35   Entities, where control issues relating to asset management or related issues have been noted, include:

•   Australian Federal Police;

•   Australian Taxation Office;

•   Department of the Environment and Heritage; and

•   Health Insurance Commission.

4.36   Details of the particular issues for each entity are outlined in Chapter five.

Service entities—Joined-up government

4.37   Joined-up, or collaborative government arrangements include service entity arrangements, as defined in AUS 404. This auditing standard defines a service entity as:

> …an entity that provides services to the user to record, process, execute transactions, maintain related accountability for these transactions, or any combination thereof …transactions that affect the financial report of the user flow through an internal control structure, which is, at least in part, legally, physically and operationally separate from the user.[41]

4.38   Although joined-up government arrangements exist in some form in most government entities, not all arrangements directly impact on the reporting entity's accountability for financial statement purposes. A number of arrangements include the provision of non-financial services where the ANAO, for the financial statement audit, would only examine controls, in the reporting entity, over the payment of related expenses.

4.39   Service entity arrangements in Australian Government entities range from payroll processing to the payment of significant benefit payments and the collection of significant administered revenues. A majority of the entities included in this report have service entity arrangements in place, which require the ANAO to understand the control framework established over the service entity arrangement; and may also require the examination of controls in place in both the reporting entity and the service entity.

4.40   Indicative figures show that $15.93 billion of assets, $2.6 billion of liabilities, $83.74 billion of expenses, and $1.71 billion of revenues, included in

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[41]   Australian Auditing Standard AUS 404 *Audit Implications Relating to Entities Using a Service Entity*, February 1999.

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the financial statements of these entities, are at least partly processed, or derived, from business and accounting systems of the service entity.

4.41 Fundamental elements of the risk management process require the reporting entity to identify, analyse and treat risks resulting from the service entity arrangement. The ANAO has found that a majority of the reporting entities have incorporated the risk assessment and analysis processes in their overall strategic risk management processes. However, some entities undertake a specific assessment at the inception of the arrangement, which is updated as circumstances change. The latter is considered better practice.

4.42 The ANAO observed that the majority of entities had a current formal agreement in place covering the service entity arrangements. The ANAO notes that some of these agreements could be improved by the inclusion of specific requirements for the service entity to maintain an appropriate control framework and the provision of a detailed report which advises on the reliability of that framework.

4.43 Entities, where control issues relating to service entity arrangements or related issues have been noted, include:

- Aboriginal and Torres Strait Islander Services;

- Australian Taxation Office;

- Department of Agriculture, Fisheries and Forestry;

- Department of Health and Ageing; and

- Health Insurance Commission.

Processes for accounting estimates

4.44 A significant portion of the Australian Government's administered balance sheet (and administered expenditure and revenue) is comprised of numbers derived through accounting estimation. The balance sheet of the Consolidated Financial Statements, by definition, includes the consolidated estimates of all Australian Government entities. For the material entities included in this report, these figures show that at least $6.89 billion of assets, $76.29 billion of liabilities, $42.35 billion of revenue and $29.74 billion of expenditure were derived by accounting estimates in 2002–2003.

4.45 AUS 516 *Audit of Accounting Estimates* defines:

> an accounting estimate as an approximation of the amount of an item in the absence of a precise means of measurement.[42]

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42   Australian Auditing Standard AUS516 Audit of Accounting Estimates, October 1995.

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4.46   A number of the accounting estimates included in the balance sheet of the Consolidated Financial Statements are complex and are also sensitive to changes in the underlying assumptions. By their nature, accounting estimates are approximations that may need revision as additional information becomes known[43]. For example, the accounting estimate for the unfunded superannuation liability reported for the Public Sector Superannuation Scheme (PSS) and the Commonwealth Superannuation Scheme (CSS) in Finance's financial statements at 30 June 2002, was subsequently revised in the 2002–2003 financial reporting period. The revision increased the original unfunded superannuation liability by $4.6 billion. This revision was primarily attributable to changed assumptions. The single most significant increase to the unfunded superannuation liability was the changed assumption for retrenchments. Other changed assumptions included improved levels of mortality and a higher proportion of members selecting the PSS for their retirement benefits.

4.47   Specialists with the appropriate skills and knowledge are required to produce accounting estimates, which are sufficiently reliable for inclusion in entity financial statements. The ANAO has found that a small number of entities have specialist areas, which develop models to produce their accounting estimate(s). A small number of entities also produce their own accounting estimates based on models developed by an actuary. However, the majority of entities employ specialist actuaries to annually produce the estimates required for financial management and reporting.

4.48   Even when a specialist is employed to determine an accounting estimate, there can be significant uncertainty in the accounting estimate. In 2002–2003, the ANAO issued audit reports containing an emphasis of matter with regard to the inherent uncertainty associated with accounting estimates in the following entities:

- Department of Health and Ageing;

- Department of Treasury; and

- Health Insurance Commission.

4.49   While the preparation and presentation of information in the financial statements is the responsibility of the CEO or entity equivalent, where this information is prepared by an actuary the ANAO must review that work in accordance with AUS 524 *The Auditor's Use of the Work of the Actuary and the Actuary's Use of the Work of the Auditor in Connection with the Preparation and Audit of a Financial Report.*

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[43]   Australian Auditing Standard AAS36 Statement of Financial Position, October 1999.

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4.50 Although management does not have the same expertise as an actuary, the review and approval of material accounting estimates by management is considered a fundamental practice in the preparation of reliable financial statements.

4.51 A number of entities have implemented analysis of accounting estimates to post estimate actual data to provide a measure of accuracy of the estimate. This is also considered better practice.

4.52 Adequate documentation of the relevant model, together with management's review and formal approval, is considered better practice by the ANAO. This review should include, but not be limited to, endorsement of the appropriateness of the model used for the estimate, verification of data utilised, and consideration of any subsequent events that may impact on the estimate. A number of entities could improve the level of documentation and formal review processes with regard to accounting estimates.

Conclusion

4.53 The ANAO has observed a similar position to that of last year with the control frameworks covering the routine accounting processes listed in paragraph 4.1.

4.54 Control frameworks over service entity arrangements are still developing in a small number of entities.

4.55 The entity focus on reviewing significant accounting estimates could be improved in accordance with earlier suggestions.

4.56 The ANAO noted that most entities have improved the consistent application of reconciliation procedures, in response to the corresponding prior year recommendations.

4.57 Many Australian Government entities have significant in-house software developments capitalised in their balance sheets. In previous reports, the ANAO has commented on the issues surrounding the appropriate distinction between capitalised and operating expenditures in relation to internally developed software. This will be an ongoing area of focus as the distinction forms a key principle in the pending Standard AASB 138 *Intangible Assets*. The criteria for the capitalisation of internally developed software are outlined in this pending Standard and Finance Brief 17 *Adoption of International Accounting Standards*.

4.58 These are areas that the ANAO will continue to review to assess improvements over the coming year.

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5. Results of the Examinations of Control Structures—by Major Entity

Introduction

5.1   This part of the report summarises the results of examinations of internal control structures of major individual Australian Government entities as part of the interim audits of their financial statements for the year ending 30 June 2004. These entities primarily comprise the portfolio departments that manage the majority of the Australian Government's financial activities and operate the more significant, and complex, financial systems. The Department of Transport and Regional Services is not included in this report. Audit results were not available in time for their inclusion.

5.2   The ANAO's audits of Australian Government authorities, companies and subsidiaries are performed on a continuous basis. They are structured to meet Board commitments, as well as the Australian Government reporting deadline of 30 July 2004. The results of the audits of these bodies will also be included in the Auditor-General's Report on the *Audits of Financial Statements of Australian Government Entities*, expected to be tabled in December 2004.

5.3   The summary of each major entity's interim audit results contains:

* introductory commentary regarding its business operations;

* identification of its key business and financial statement risks;

* comments on selective corporate governance arrangements;

* a summary of its financial reporting capability;

* the audit results, including reference to the more significant issues identified covering general audit procedures, IT processes, IT security and business resumption planning; and

* an overall conclusion.

5.4   In respect to the business and financial statement risks, these were identified and reported to each entity as part of the planning phase of each audit. They represent the ANAO's assessment of the key factors that give rise to the potential for material misstatement in the financial statements. The ANAO's work during the interim phase of the audit, which is the basis of this report, focuses on steps taken by entities to manage those risks with potential impacts on the financial statements.

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5.5   Issues arising from audit activity are rated in accordance with the seriousness of the particular matter. The rating, which is included in ANAO interim reporting to entities, indicates, to the respective entity, the priority it needs to give to remedial action. As indicated earlier in this report, the ratings are defined as follows:

A: those matters that pose significant business or financial risk to the entity and must be addressed as a matter of urgency;

B: control weaknesses which pose moderate business or financial risk to the entity or matters referred to management in the past which have not been addressed satisfactorily; and

C: matters that are procedural in nature or minor administrative shortcomings.

5.6   Significant category 'B' or 'C' issues remaining unresolved at the time of the next audit may, depending on the seriousness of the issue, be given a higher rating.

5.7   This part of the report discusses the more significant matters identified ('A' and 'B' category issues) in separate sections for each entity. Individual tables for each entity track progress on matters raised from our audits of the 30 June 2004 financial statements.

5.8   A summary of 'A' rated issues by entity is outlined in Table 1 of Appendix 2.

5.9   Table 2 of Appendix 2 provides the number of 'A' and 'B' issues included for each entity as at 31 March 2003 and 31 March 2004.

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Attorney-General's Department

Business operations

5.10   The Attorney-General's Department (AGD) is the central policy and coordinating element of the Attorney-General's portfolio and plays a key role in serving the people of Australia by providing essential expert support to the Government in the maintenance and improvement of Australia's system of law and justice. AGD deliver legislative policy and advice and other services (eg. administration of legislation, coordinating national security, implementing Australian Government policy on family law, management of Emergency Management Australia, responsibility for the provision of administrative support to Royal Commissions under the administrative arrangements order and legal aid).

5.11   There were no significant changes to the business and operational environment of the AGD in 2003–2004.

5.12   The AGD's appropriation funding for the year ending 30 June 2004 comprises:

- Special appropriations–$88.40 million;

- Administered appropriations–$259.92 million;

- Output appropriations–$152.39 million;

- Previous years' outputs–$5.15 million; and

- Departmental equity injection–$0.25 million.

5.13   The AGD's average staffing level is 758 (FTE).

Key business and financial statement risks

5.14   In order to manage its key business risks, the AGD addresses key issues relating to the timely and efficient delivery of advice and other services and its reputation and relationship with its business partners.

5.15   The ANAO's assessment of the risk of material misstatement in AGD's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- changes to reporting requirements resulting from amendments to accounting standards and the FMOs;

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- prior year audit findings, particularly those noted in relation to the following:

    – reconciliation of administered appropriations and special accounts to CAMM and the general ledger;

    – the quality control procedures over the financial statements preparation process; and

    – the delivery of draft financial statements for audit on a timely basis; and

- the fact that a new team will be preparing the AGD's 2003–2004 financial statements.

Corporate governance

5.16 The ANAO's audit approach considers the AGD's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the AGD's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which assist on financial assurance include:

- an executive board that meets weekly and has a formal biannual corporate governance process;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on internal controls, management of financial risks, review of financial reports, control of financial, assets and regulatory compliance;

- a monthly financial reporting regime;

- an internal assurance branch which has a planned risk based audit coverage of the AGD's activities; and

- a fraud control plan, which is regularly monitored/reviewed.

Financial reporting

5.17 The AGD has developed financial reporting processes that include monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows. The reports provide actual versus budget information on both an accrual and a cash basis. In addition, the CFO's team has a good appreciation of the development of financial budgets, the plans and modelling associated with the AGD's strategic objectives, and the production of accrual based financial information and reports.

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Audit results

5.18   The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.1

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position at March 2004
A	0	0	0	0	0	0
B	1	0	1	1	1	1
Total	**1**	**0**	**1**	**1**	**1**	**1**

Source: ANAO

Audit issues

5.19   The ANAO highlighted the following issue that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

SAP and Aurion system user access

5.20   Deficiencies in the administration and review of user access to the AGD's SAP and Aurion systems are currently being addressed by the AGD. In addition, it was noted that the AGD has not yet developed security plans for SAP and Aurion. The ANAO was advised that a System Security Plan will be developed, implemented and maintained for each computer system that is used to store, or process, official information.

Conclusion

5.21   The AGD's management has responded positively to the ANAO's issue and the associated recommendation. The AGD has commenced action to address aspects of the issue identified by the ANAO during the 2003–2004 interim audit.

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Australian Customs Services

Business operations

5.22 The Australian Customs Service (Customs) is responsible for providing effective border management that, with minimal disruption to legitimate trade and travel, prevents illegal movement across the Australian border; raises revenue; and provides trade statistics.

5.23 Given the heightened awareness of national security, Customs has contributed to Australia's counter-terrorism capabilities, while continuing cooperative border protection measures and enhancing maritime surveillance and response capabilities. Customs has an on-going responsibility for the assessment and, where appropriate, the collection, of the Goods and Services Tax (GST) on imported goods—Wine Equalisation Tax (WET) and Luxury Car Tax (LCT). Customs also administers the Tourist Refund Scheme and a range of compliance activity, in conjunction with the Australian Taxation Office, in relation to the GST, WET and LCT for both imported and exported goods.

5.24 Customs' major project during the year has been the implementation of the Cargo Management Re-engineering Project. This has resulted in the allocation of a significant amount of Customs resources for this project.

5.25 Customs' appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$799 million;

- estimated administered revenue–$ 5.76 billion; and

- administered expenses–$0.25 million.

5.26 Customs' average staffing level for 2003–2004 is 4 685 (FTE) across Australia.

Key business and financial statement risks

5.27 In order to manage its business risks, Customs addresses key issues associated with:

- safeguarding Australian borders, including contributing to counter-terrorism capabilities;

- the assessment and collection of Australian Government revenue;

- the protection of the community against illegal importation and the dumping of goods into Australia;

- the fight against illicit drugs and other quarantine risks;

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- the operation of detection programs to identify non-compliance with legislative requirements for revenue leakages.

5.28 In managing these business risks, disciplined management and operational policies, practices, and procedures are required over revenue protection and law enforcement, compliance and regulatory standards, including quality assurance programs. Central to this framework is a comprehensive resource infrastructure including trained staff supported by specialist assets and information systems.

5.29 Key business issues for the current year include the:

- phased implementation of the cargo management re-engineering system that will replace the existing sea and air cargo automation systems and its impact on revenue;

- implementation of the Compliance Assurance Strategy developed in October 2003;

- implementation of measures for Australia's response to quarantine risks and terrorism;

- collection and reporting of customs revenues, including difficulties associated with import duties, self assessment, and complicated legislation; and

- control over the changing nature of complex IT systems, processes and databases, including electronic commerce related activities.

5.30 The ANAO's assessment of the risk of material misstatement in Custom's 2003–2004 financial statements is moderate. The financial statement audit focused on the material financial reporting risks flowing from the following key issues:

- adequacy of compliance programs and their impact on revenue;

- asset management;

- debt management;

- accounting for employee entitlements;

- the financial statement close process and the adequacy of documentation of the audit trail; and

- the new tighter reporting deadlines for completion of the financial statements.

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Corporate governance

5.31   Customs continues to have in place measures that contribute to sound corporate governance and to financial statement assurance. These arrangements include:

- an audit committee that meets at least quarterly and focuses on internal and risk management issues;

- an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;

- a structured framework for incorporating risk management into the broader management and business processes including the development of a Fraud Control Plan;

- a Compliance Assurance Strategy that aims to better align Customs' changing priorities and business practices and provides assurance on the integrity of revenue management activities;

- a number of financial management improvement projects to facilitate the financial statement preparation and audit process that has been aligned with the new organisation structure and business practices; and

- a sound monthly reporting regime to the executive.

5.32   These measures also contributed to the reliability of systems of internal control and compliance with accounting and financial policies.

5.33   Customs has a strong culture in performing its mandatory role as a regulatory agency and has adopted risk management techniques to help ensure compliance of its regulations by clients. Customs is also aware of the changing risks associated with its business re-engineering process and has considered the various strategies and treatment types to mitigate those risks.

Financial reporting

5.34   Customs has a sound financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas and regions. Monthly reports are produced promptly and seek to explain variances from budget or expected outcomes and detail any areas that are of interest to the executive.

Audit results

5.35   The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

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Table 5.2

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	2	1	1	0	0	1
Total	**2**	**1**	**1**	**0**	**0**	**1**

Source: ANAO

Audit issues

5.36   The results of the interim audit work reflect further improvements in Customs' control environment since last year. These improvements include a pro-active approach to implementing necessary policies and procedures, and strengthening current controls.

5.37   However, the audit noted that there remains scope for improvement in the review of QSP Financials' audit logs.

QSP financials audit logs

5.38   No reviews are performed of the audit logs produced by QSP Financials. Regular reviews of system logs, or IT security reports, would assist Customs in detecting and responding to unauthorised access and security breaches.

Conclusion

5.39   Customs has improved its internal control structure by taking remedial action on audit issues raised in the previous year relating to its quality assurance programs over audits conducted under the Compliance Audit Assurance Strategy.

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Australian Federal Police

Business operations

5.40 The Australian Federal Police (AFP) was established to protect Australia's national interests from crime domestically and overseas. The AFP is Australia's international law enforcement and policing representative, and the chief source of advice to the Australian Government on policing issues. AFP priorities are set through ministerial direction. Its areas of focus include handling special references from government, and combating:

- organised crime;

- transnational crime;

- money laundering;

- major fraud;

- illicit drug trafficking; and

- E-crime.

5.41 The scope of AFP operations includes working closely with other Australian and international law enforcement bodies to enhance safety and security in Australia and to provide a secure regional and global environment.

5.42 AFP also provides protection services to dignitaries and crucial witnesses, and community and policing services to the people of the Australian Capital Territory, Jervis Bay, and of external territories such as Norfolk Island and Christmas Island.

5.43 AFP is implementing a new organisational structure in 2004 which is designed to improve operational results, as well as accountability, by providing a clear national focus on its key activities and functions.

5.44 Incremental implementation of the new structure has commenced and is expected to be completed by 1 July 2004.

5.45 The AFP's appropriation funding for the price of outputs in 2003–2004 is $557.67 million. The AFP does not have any administered revenues and expenses.

5.46 AFP's average staffing level for 2003–2004 is 4 691 (FTE).

Key business and financial statement risks

5.47 In order to manage its key business risks, the AFP addresses issues relating to:

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- the timely and efficient delivery of outputs;

- coordinating with international and national crime authorities;

- reliability of delivery of services;

- community satisfaction with services provided;

- responsiveness to increased financial management and accounting responsibilities including Corporate Governance;

- IT security particularly with emergence of e-crime;

- security of evidence, exhibits and witnesses;

- inaccurate, or untimely, policy advice;

- terrorism threat;

- the alignment of resource strategy and AFP's strategy to achieve required outcomes and deliver outputs; and

- international operations including adequate peacekeeping and international services.

5.48 The ANAO's assessment of the risk of material misstatement in AFP's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- financial statement preparation process including month end processes;

- reporting of asset balances;

- compressed financial reporting timetable that could impact markedly on the financial statement close process; and

- increased financial expenditure associated with International Operations.

Corporate governance

5.49 The ANAO's audit approach considers the AFP's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the AFP's strategies, the ANAO focused on the key initiatives in place to meet the AFP's objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

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- a corporate plan which outlines broad strategic directions and is supported by operational plans which detail activities and performance information;

- an executive board that meets once every three months to review operational performance against indicators as well as financial performance and budgetary control;

- a committee framework including an audit committee. The audit committee meets once every three months and focuses attention on IT security and internal controls, management of business, operational and financial risks;

- an internal audit branch that has an internal audit plan which addresses key business and financial risks relevant to AFP's activities;

- a risk management plan which identifies the risks at divisional level to inform divisional managers of the risks they are required to manage; and

- a fraud control and anti-corruption plan, which identifies physical security, personnel security, and IT and information security as the major risks confronting the AFP.

Financial reporting

5.50 AFP produces regular financial reports for its Finance Committee. These reports are well designed and include insightful commentary on the financial data.

Audit results

5.51 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

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Table 5.3

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	1	0	4	1	1	4
Total	**1**	**0**	**4**	**1**	**1**	**4**

Source: ANAO

Audit issues

5.52   The ANAO's review confirmed that the AFP has strong controls over its cash management and expenditure processes and that cost centre management of expenditure against budget provides satisfactory management assurance on outlays. The ANAO has provided a number of recommendations relating to the management of assets and recognises that the AFP has independently moved to address a number of management and control issues in this area. Four issues of moderate control risk, including three prior year issues, were raised for management consideration.

Software capitalisation

5.53   The AFP has not applied appropriate processes to ensure that the capitalisation of expenditure relates only to increased functionality and enhancement to in-house developed software.

Incomplete asset policy

5.54   The AFP is still in the process of finalising its asset management policies and practices. These policies and practices cover gaps identified by the ANAO, in the prior year, relating to depreciation rates, asset reconciliations, useful life of assets, and acquisition and disposal of assets.

Control over upload of data

5.55   The ANAO found that there were inadequate controls over the 'bulk' upload of asset revaluations and in the mapping of assets to asset classes. The latter activity was undertaken to rectify an issue reported in the prior year. The process has resulted in a degradation of confidence over data integrity and the introduction of incorrect posting of balances to the asset subsidiary ledger and the general ledger.

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SAP—User access management

5.56 The AFP has a number of users with a high level of privileged access to the financial system SAP. A review process has been implemented to address this issue as a result of prior year audit recommendations. This review does not cover all of the instances of access and it does not yet address all risks.

Conclusion

5.57 Progress has been achieved in strengthening the control environment. However, further improvements are necessary, particularly in relation to the management of IT security and the management of assets. The AFP has accepted the ANAO's issues and is in the process of implementing a number of its recommendations.

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Australian Securities and Investment Commission

Business operations

5.58 The Australian Securities and Investments Commission (ASIC) is an independent government body that enforces company and financial services laws to protect consumers, investors and creditors.

5.59 The Commission was established under the *Australian Securities and Investments Commission Act 2001,* which requires that ASIC:

- upholds the law uniformly, effectively and quickly;

- promotes confident and informed participation by investors and consumers in the financial system;

- makes information about companies and other bodies available to the public; and

- improves the performance of the financial system and the entities within it.

5.60 In performing its functions ASIC works closely with other financial, consumer and law enforcement bodies in Australia and internationally.

5.61 ASIC's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$200 million;

- estimated administered revenue–$495 million; and

- administered expenses–$39 million.

5.62 ASIC's average staffing level for 2003–2004 is 1 530 (FTE) across Australia.

Key business and financial statement risks

5.63 In order to manage its key business, ASIC addresses issues relating to:

- investigation of fraud and misconduct, and its capacity to act;

- regulation of financial advice and retail financial products;

- market supervision, adequacy of financial reporting, and guidance to industry on financial services reform, cross border regulation and corporate finance policies;

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- identification of compliance issues affecting consumers, and the implementation of consumer policy and education projects;

- interaction with international law enforcement entities and co-ordination of regional offices throughout Australia; and

- the maintenance of Australia's company database, and assessment and prosecution of *Corporations Act 2001* breaches.

5.64 The ANAO's assessment of the risk of material misstatement in ASIC's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- financial statement preparation processes to enable reporting by 30 July 2004; and

- impact of the Corporations Law Economic Reform Program changes on the operations of the business and administered transactions.

Corporate governance

5.65 The ANAO's audit approach considers ASIC's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing ASIC's strategies, the ANAO focuses on the key initiatives in place to meet ASIC's objectives and management of the business risk associated with those initiatives. Measures which assist with financial assurance include:

- an executive board that meets at least monthly to consider and set goals and strategies, including ASIC's strategic plan and directorate business plans; reviews operational, financial and audit committee reports; and discusses issues affecting human resources, governance and delegations;

- a corporate plan which outlines strategic directions and is supported by directorate business plans that detail activities and performance targets;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, ANAO audit activities, and fraud control planning;

- a detailed monthly financial reporting regime;

- an internal audit function which examines ASIC's activities, addressing compliance, business and financial risks; and

- a fraud control plan.

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Financial reporting

5.66 ASIC produces full accrual monthly financial reports which provide detailed information on revenues, expenses and commentary on the variances of actual results to budgeted figures. Included with these reports are cashflow statements, information on staffing resources, capital expenditure, administered data, and the level and ageing of outstanding administered debt. These reports are distributed to the Commissioners and Executive Directors of each directorate.

Audit results

5.67 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.4

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	1	1	0	0	2	2
Total	**1**	**1**	**0**	**0**	**2**	**2**

Source: ANAO

Audit issues

5.68 The ANAO highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Change control management and segregation of duties

5.69 The segregation of incompatible duties for staff within the IT function is a fundamental financial and operational control. A review of ASIC's change management procedures in the development of some of their in-house programs or systems highlighted that staff with development functions have direct access to alter, or modify, the system in the production environment, thereby exposing ASIC to the risk of unauthorised changes to the programs or systems.

IT security

5.70 ASIC's security policies and procedures could be improved. Issues highlighted include an out-of-date IT Security Policy, no IT security plans for

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certain key IT systems, and a lack of ongoing security awareness training within the organisation.

Conclusion

5.71 ASIC's management has responded positively to the ANAO's issues and associated recommendations. ASIC has already taken action to address aspects of the deficiencies identified by the ANAO.

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Australian Taxation Office

Business operations

5.72 The Australian Taxation Office (ATO) is the Australian Government's principal revenue management agency. The ATO's role is to manage and shape tax, excise and superannuation systems that fund services for Australians, giving effect to the Government's social and economic policy.

5.73 Recently, the ATO's activities have been guided by two key objectives—delivering improved revenue and compliance results, while making people's experience with the revenue system easier, cheaper and more personalised. These key objectives have been addressed through groups of activities; operations, compliance, information technology, and people and location. In addition, a new group of activities, corporate change program, has been introduced this year to address the initiative to improve client interaction with the tax system.

5.74 The ATO's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$2.3 billion;

- estimated administered revenue–$197 billion; and

- administered expenses–$6.6 billion.

5.75 The ATO's average staffing level for 2003–2004 is 20 750 (FTE) across Australia.

Key business and financial statement risks

5.76 In order to manage its key business risks, the ATO addresses issues relating to:

- tax administration covering tax reform and corresponding legislative changes—for easier, cheaper and more personalised revenue system;

- self-assessment and voluntary compliance in collection and reporting of taxation revenues;

- complexity and dynamics of the IT environment in relation to developing and managing internal systems and on-line processing by taxpayers;

- workforce planning challenges balancing resources between public support, revenue collection and compliance activities; and

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- maintaining community confidence.

5.77 The ANAO's assessment of the risk of material misstatement in the ATO's 2003–2004 financial statements is high. Key issues for the current year include:

- ATO administered financial statement preparation process which is complex; uses data from a number of business systems; and requires significant estimation to be made to a number of items;

- the requirement to have fully supported reconciliations associated with the ATO business systems and financial management information system; and

- compliance with legislative requirements, both in tax administration and financial statements preparation and presentation.

Corporate governance

5.78 The ANAO's audit approach considers the ATO's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing the ATO's strategies, the ANAO focused on the key initiatives put in place by the ATO to meet its objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- a strategic statement and plan that provide an overview of the ATO directions for the future, including corporate outcomes and performance measures. The ATO delivers on the strategic statement through a comprehensive planning process based on the ATO's corporate priorities;

- an executive board that meets at least monthly and has a formal biannual corporate governance assurance process;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on risk assessment, fraud control and internal and external audit activities;

- a monthly financial reporting regime;

- an internal assurance branch that has a planned risk based coverage of the ATO's activities; and

- fraud control plans and risk assessment plans.

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Financial reporting

5.79 The ATO management reporting process includes internal financial reports prepared for distribution and discussion at monthly executive meetings. These reports include overall analysis of expenditure, in the year to date, under each sub-plan, operating performance of business lines, cash and capital positions, budget changes, and workforce information. In addition, the monthly reports include a statement of financial position, statement of financial performance and cash flows for departmental items.

5.80 For the administered position, a formal report is prepared for the executive meeting at the end of each month analysing the status of various revenue items. The report focuses on cash collection and analysis of actual collection for the month against expectation. While the ATO's financial statements are prepared on a full accrual basis using the Economic Transaction Method, the administered operations are managed and monitored on a monthly basis using the Taxation Liability Method which is a modified cash accounting approach.

Audit results

5.81 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.5

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	1	1	1	1	1	1
B	5	1	12	6	3	9
Total	6	2	13	7	4	10

Source: ANAO

Audit issues

5.82 The ATO continues to address key elements of the general control environment, notably business continuity and disaster recover planning and security. Control weaknesses identified in previous audits on high risk areas are currently being addressed.

5.83 The ANAO review found that significant deficiencies remain in the financial statements close process. In addition, nine moderate control risks issues were identified for management attention.

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Preparation of administered financial statements ('A' category finding)

5.84 The 2002–2003 administered financial statements were derived via a complex group of spreadsheets with inadequate supporting documentation. The $5.558 billion of audit adjustments in 2002–2003 to the administered financial statements highlighted the need for an improved preparation process and better quality assurance. The ATO has commenced a project that is intended to deliver a direct connection, for both cash and accruals, between its financial management information system and business systems, in addition to developing an administered financial reporting tool. This project, however, has not progressed in accordance with the proposed timetable.

5.85 In October 2003, as an intermediary step, the ATO developed a new spreadsheet to derive the 2003–2004 financial statements. At March 2004, the new spreadsheet did not reconcile to the old version. This raises an issue regarding the depth of ATO finance staff's understanding of the business systems and processes that input to the financial statements. The ATO could not demonstrate that a robust financial statement collation mechanism would be in place to support the reporting of administered balances. The ATO is not expecting to meet the 30 July 2004 deadline for the provision of audit cleared administered financial statement balances to DoFA.

Administered cash reconciliation

5.86 Improvements have been made by the ATO in reconciling the financial management information systems to cash components in the business systems. The ATO needs to maintain effective and timely completion of consolidated reconciliation of receipts, refunds, client and control accounts, and pursue appropriate treatment of any discrepancies resulting from these reconciliations.

Management of special accounts and assets held in trust

5.87 The ATO needs to clear significant balances carried forward from prior years in its special account for Other Trust Monies and the assets held in trust in the Comcare account. In addition, the ATO needs to manage and reconcile subsidiary records for these accounts and the account relating to the Superannuation Holding Reserve.

Certificate of compliance relating to payment of public money

5.88 The ATO needs to prioritise implementation of the revised certificate of compliance process in order to obtain adequate assurance that key processing controls are in operation in relation to payments of public money. The ATO is currently relying on other compensating controls to mitigate risk of inappropriate payments.

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Management of debt recorded by the unfunded defined benefit scheme super funds

5.89 The ATO issues superannuation surcharge assessments to all members of Unfunded Defined Benefit (UDB) superannuation funds. For those assessments that are deferred, the super funds are required to maintain a surcharge debt account for each member, collect the surcharge, and remit collections to the ATO. In 2002–2003, the ATO advised that action would be taken by the ATO to appropriately manage these UDB debts. The ATO needs to improve management of these debts and give priority to clear up discrepancies of its records and the records of the related super funds.

Service level agreements

5.90 The ATO provides services to, and receives services from, a number of Australian Government entities as required by legislation and has contractual relationships with a number of organisations to provide and support the delivery of its functions. To help ensure the effective management of these arrangements, the ATO needs to give priority to establishing, or updating, agreements between the ATO and the other organisations.

Payment of family tax benefit

5.91 The ATO needs to clarify the legislative requirements relating to the reporting of the family tax benefit and ensure that the disclosure is in accordance with the legislation and the FMOs.

Costing of internally generated software

5.92 The integrity of the process supporting the costing of the internally generated software needs to be improved by establishing a formalised mandatory process for time recording and approval of timesheets for all ATO staff deployed on IT development projects. In addition, the costing model for internally generated software requires further refinement.

Revenue recognition points

5.93 In order to ensure a consistent approach for all types of revenue, the ANAO recommended last year that the ATO undertake a comprehensive review of the revenue recognition points used for the Economic Transaction Method revenue in the annual financial statements and document the results of the review for future reference. This is currently in progress.

Change management

5.94 During 2002–2003, the ANAO noted that the IT change management and documentation processes, related to the Instalment Processing System and the Fringe Benefit Tax system, had not been undertaken in accordance with the established process. This issue is currently being actioned.

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Conclusion

5.95 The ATO is in the process of addressing the ANAO's issues and associated recommendations. Action is progressing on aspects of the deficiencies identified by the ANAO.

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Aboriginal and Torres Strait Islander Services

Business operations

5.96 The role of the Aboriginal and Torres Strait Islander Services (ATSIS) is to provide policy/advocacy support to the elected representatives of Indigenous Australians within the Aboriginal and Torres Strait Islander Commission (ATSIC) and to administer a range of Australian Government programs for the Aboriginal and Torres Strait Islander people, according to the policies and priorities set by ATSIC.

5.97 ATSIS was established on 1 July 2003 and was created out of the administrative arm of ATSIC in accordance with an Administrative Arrangements Order, dated 28 May 2003. Prior to 30 June 2003, ATSIC comprised the Board, the Regional Councils and a statutory authority in which staff were employed under the *Public Service Act 1999*, and operated under the *Aboriginal and Torres Strait Islander Act 1989*.

5.98 The Board and Regional Councils of ATSIC set directions and make broad decisions as to how the budget appropriated to ATSIS could be distributed. Funding decisions are taken by the staff of ATSIS, under the delegation of its CEO, in accordance with policies determined by the Board and Regional Councils.

5.99 The Government announced, on 15 April 2004, that ATSIS would cease to exist from 1 July 2004, with its programs being distributed to mainstream entities.

5.100 ATSIS' appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$171.4 million;

- estimated administered revenue–$19.41 million; and

- administered expenses–$967.41 million.

5.101 ATSIS' average staffing level for 2003–2004 is 1 175 (FTE) across Australia.

Key business and financial statement risks

5.102 In order to manage its key business risks, ATSIS has sought to address issues relating to:

- ensuring adequate delivery of government policies by managing its resource capacity and reliance on third parties;

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- managing and meeting stakeholder expectations and priorities over economic and socio-economic initiatives for the indigenous community;

- managing the complexity and dynamics of the IT environment to ensure service delivery;

- maintaining community confidence in the organisation to deliver policies and services to the aboriginal community; and

- managing workforce planning challenges in maintaining service delivery and staff morale as a result of the initial restructure of ATSIC and the transfer of functions to ATSIS and the subsequent proposed transfer of its program to mainstream entities.

5.103 The ANAO's assessment of the risk of material misstatement in ATSIS's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- the shortened financial reporting timeframe;

- the impact of the establishment of ATSIS on the financial statement preparation process and the resolution of the treatment and transfer of certain assets and liabilities from ATSIC to ATSIS; and

- reporting and statutory implications associated with the cessation of ATSIS at 1 July 2004.

Corporate governance

5.104 The ANAO's audit approach considers ATSIS' goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing ATSIS' strategies, the ANAO focused on the key initiatives in place to meet ATSIS' objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- an executive corporate leadership group comprising the executive, group managers and the director of communications that meets at least monthly;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on risk assessments, fraud control and internal and external audit activities;

- a monthly financial reporting regime;

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- an internal assurance branch that has a planned risk based coverage of ATSIS' activities;

- an ethics committee including the CEO, General Manager Corporate, General Counsel, Director of Office of Evaluation and Audit which follows up and address allegations and suspicions of fraud; and

- a fraud control plan.

Financial reporting

5.105 ATSIS has implemented a monthly reporting process with reports analysing performance against both financial and non-financial key performance indicators (KPIs) by region, program and output. However, reporting processes could be enhanced with the inclusion of full balance sheets and increased reporting against non-financial and non-input based KPIs, thereby increasing the focus on achievement of outcome/output qualitative objectives.

Audit results

5.106 The following table provides a summary of the status of the 2003–2004 audit issues raised by the ANAO.

Table 5.6

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	N/A	N/A	N/A	N/A	0	0
B	N/A	N/A	N/A	N/A	10	10
Total	**N/A***	**N/A***	**N/A***	**N/A***	**10**	**10**

Source: ANAO

(note: ATSIS was established on 1 July 2003; therefore there are no outstanding issues from the prior year)

Audit issues

5.107 The audit highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Cash at agents

5.108 A review of loan management within ATSIS identified several loan advances to agents for disbursement that were outstanding over 90 days.

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Failure to record disbursements by agents in a timely manner delays recognition of the loan receivables, thereby increasing the risk that interest is incorrectly calculated and payments are made in arrears. Further the retention of funds at agents for extended periods reduces the efficiency of cash usage.

Grant administration

5.109 A review of grant administration identified several deficiencies that diminish the ability of ATSIS to actively manage grant recipients and identify potential risks on a timely basis, including:

- the timely submission, assessment and review of Periodic Financial Information and Activity Performance Information Reports, used for the ongoing monitoring and performance assessment of grant recipients; and

- discrepancies between monitoring activities determined through risk assessment and those contained within the Letter of Offer for the grant, and/or the actual monitoring activities performed.

Grant acquittals

5.110 Acquittal documentation from grant recipients is important in ensuring grant funding is appropriately accounted for and that the agreed objectives for which the funding was provided have been achieved. A review of grant acquittals identified several issues in relation to the performance and timely review of grant acquittals. Concerns were also raised over the significant level of grant acquittals that were yet to be received and assessed.

Recipient Created Tax Invoices (RCTI)

5.111 ATSIS Grant Procedures stipulate that, where a Grantee is registered for GST, a written agreement is to be signed by both parties allowing ATSIS to issue RCTIs for grant releases. ANAO identified several occurrences whereby the RCTI agreement had not been signed by an ATSIS officer. The failure of either party to sign the RCTI agreement is in contravention of ATSIS procedures and potentially limits the authority of the organisation to claim the input tax credit for funds released.

Leave processing

5.112 A review of employee entitlements and leave processing identified a significant backlog in all types of leave processing and numerous instances of leave being taken prior to the application and/or approval dates. These issues raise concerns as to the completeness and accuracy of leave records and the quality of data provided to the Government Actuary.

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Leave transfers

5.113 Under the *Financial Management & Accountability Orders 1997*, monies owed in relation to leave entitlements for employee transfers must be paid to the receiving agency within 30 days of on-going employment with that agency. ANAO identified that ATSIS has breached this requirement in relation to both transfers in, and out of, the organisation.

HR process monitoring

5.114 The review of payroll and leave processing, including the reconciliation process, within ATSIS, identified deficiencies in operating controls in relation to the monitoring of processes to ensure the completeness and timeliness of processing. ANAO also identified a lack of a formal reconciliation of the physical salaries bank account to the FMIS.

Salary overpayments

5.115 A review of the management of salary overpayments highlighted deficiencies in the monitoring and recovery of overpayments. This review identified that no clear lines of responsibilities exist for the monitoring and recording of salary overpayments. Further, there is currently no systematic process within ATSIS to ensure that recovery of these debts is being actively pursued, as required by section 47 of the FMA Act.

Removal of redundant users

5.116 A review of IT security conducted within ATSIS highlighted deficiencies in the removal of redundant users from the network. It was identified that the procedures for the disabling and termination of users from the network were not being consistently adhered to. Further to this, distinct inadequacies in the timely removal of access privileges were also identified.

Access to SAP* Super user profile

5.117 ATSIS' FMIS contains default profiles, which provide unrestricted access to the FMIS environment. It is considered better practice to change the default names of these accounts to reduce the risk of unauthorised users making access attempts. It was identified that several unauthorised access attempts had been made to these default profiles. The ANAO made a recommendation that ATSIS review the management of these default profiles and rename these accounts to reduce unauthorised access attempts.

Conclusion

5.118 ATSIS' management has generally responded positively to the ANAO's recommendations. ATSIS has already taken action to address aspects of the deficiencies identified by the ANAO.

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Centrelink

Business operations

5.119   Centrelink is an autonomous statutory authority, established under the *Commonwealth Services Delivery Agency Act 1997*, and is part of the Family and Community Services portfolio. It is the principal service delivery organisation within the portfolio and is also responsible for linking the various Australian Government welfare services. Centrelink's customers include retired people, families, sole parents, unemployed people, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, indigenous people and people from diverse cultural and linguistic backgrounds. Centrelink operates under purchaser/provider arrangements and obtains the majority of its funding through business partnership arrangements, on a fee for service basis, with client entities that purchase Centrelink's services.

5.120   There have been no significant changes to the business and operational environment within Centrelink for 2003–2004.

5.121   Centrelink's price of outputs for the year ending 30 June 2004 is $2.14 billion.

5.122   Centrelink's average staffing level for 2003–2004 is 24 251 (FTE) across an extensive Australia-wide customer service centre network.

Key business and financial statement risks

5.123   In order to manage its key business risks, Centrelink addresses issues relating to:

- voluntary disclosure;
- service delivery;
- complexity and dynamics of IT environment;
- welfare reform; and
- managing key external relationships.

5.124   The current framework requiring voluntary disclosure by customers heightens the risks associated with ensuring accurate payment and assessment of personal benefits. Centrelink needs to ensure that appropriate controls and strategies are in place to mitigate this risk to the extent possible and encourage timely disclosure by customers.

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5.125 The ANAO's assessment of the risk of material misstatement in Centrelink's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- business assurance framework;

- complex IT systems;

- integrity of benefit payments;

- valuation of internally developed software;

- measurement of unearned revenue;

- accounts payable; and

- accrued expenses.

Corporate governance

5.126 The ANAO's audit approach considers Centrelink's goals, priorities, objectives, and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing Centrelink's strategies, the ANAO focused on the key initiatives in place to meet Centrelink's objectives and management of the business risk associated with those initiatives. Measures which assist in financial assurance include:

- a Board of Management that determines the organisational strategy and provides guidance and oversight to senior management in the delivery of Centrelink's service charter. The Board also reviews overall business strategies, plans and significant policies to ensure that Centrelink fulfils its obligation to client entities and other stakeholders;

- an Audit and Risk Committee of the Board, chaired by an independent member, which ensures Centrelink operates with appropriate financial management and complies with established internal controls by reviewing specific matters that arise from the audit process. The Audit and Risk Committee meets at least five times a year and focuses attention on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes, audit planning and reporting;

- a five-year corporate and business strategy that is supported by a national business plan that details how the strategies outlined will be achieved. This provides the basis for a range of other plans within the organisation;

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- a comprehensive monthly financial reporting regime;

- an internal audit function undertakes a program of audits covering the main aspects of Centrelink's business. The Centrelink internal assurance plan is reviewed and approved by the Board of Management for the ensuing year;

- a fraud control action plan that addresses fraud associated with welfare payments (payment fraud), benefits as a result of information held by Centrelink (information fraud) and Centrelink's assets, financial and human resources (administrative fraud);

- up-to-date Chief Executive Instructions (CEIs) that provide the framework for Centrelink's financial operations. These CEIs are currently being reviewed in order to provide even more detailed guidelines to staff;

- a review and monitoring framework, which includes an assessment and compliance review of benefit payments; and

- the implementation of the Centrelink and Department of Family and Community Services (FaCS) Business Assurance Framework (BAF). Stage One of the BAF is considered by Centrelink and FaCS to be the implementation of the revised rolling random sample surveys (RSS), which measure benefit payment accuracy and correctness. The revised RSS, which are performed quarterly, have been operational since 1 July 2002. Centrelink and FaCS are refining their views on the type and quantity of information which could usefully flow from the RSS. Continued improvement in relation to the use of the RSS data should be seen once additional quarters of data are available for analysis.

Financial reporting

5.127 Centrelink has a monthly financial reporting regime, which includes comparison with budget estimates, variance analysis, key statistics and the integration of non-financial performance information. All reports are prepared on a full accrual basis. The Business Analysis and Reporting Team prepare financial analysis and commentary and National Managers and Team Leaders receive this report on a monthly basis and must provide commentary for variances between budgets and actual. In addition, Centrelink utilises a balanced scorecard to report on progress against key performance indicators.

Audit results

5.128 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

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Table 5.7

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	5	0	5	5	5	5
Total	**5**	**0**	**5**	**5**	**5**	**5**

Source: ANAO

Audit issues

5.129 The audit highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Inappropriate use of manual request to pay forms

5.130 Centrelink needs to tighten controls around the use of Manual Request to Pay (RTP) forms. The use of these RTP forms by-passes the automated FMIS's purchasing controls and makes it difficult for Centrelink to ensure appropriate delegates have approved all purchases, increasing the risk that unapproved purchases may be processed.

Payment discrepancy resolution

5.131 Centrelink needs to improve the monitoring controls over the System Support Groups' resolution procedures. System Support Groups review records which are produced as exceptions from the payment reconciliation process. If these monitoring controls are not strengthened, there is an increased risk of financial loss through inappropriate payments made to Centrelink customers not being identified, or not being recovered, in a timely manner.

Mainframe security monitoring

5.132 There are a number of areas related to mainframe security that do not have formal monitoring controls to detect inappropriate access. Further, policies and procedures for the monitoring of mainframe security have not been formally documented. Without comprehensive security monitoring procedures, there is an increased risk of inappropriate access remaining undetected.

Inappropriate access to benefit payments data

5.133 Centrelink needs to review some systems-based resource rules that permit inappropriate 'write access' to a certain personal benefit payment file.

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This file is the source file for the generation of payment allocations and payment delivery processes for personal benefits. As a result, it is a critical file that requires a high level of security protection. Inadequate access controls increase the risk of data integrity issues through unauthorised changes to benefit payment data.

Financial management information system access

5.134   A number of staff have inappropriate access to develop program and configuration changes in the FMIS, and subsequently migrate these system changes from development into the 'live' environment. Some of these staff also have the ability to create transactions in the 'live' environment. As system development, change migration and transaction processing are conflicting functions, there is a risk that unauthorised changes could be made to the 'live' system and transaction information.

Conclusion

5.135   Centrelink has made progress in strengthening its control environment. However, issues have been highlighted which should be addressed within a reasonable timeframe. Centrelink continues to focus on the outstanding issues and work towards the timely resolution of these matters to further strengthen their control environment.

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Commonwealth Scientific and Industrial Research Organisation

Business operations

5.136 The Commonwealth Scientific and Industrial Research Organisation (CSIRO) has the primary functions of:

- carrying out scientific research to assist Australian industry and to further the interests of the Australian community, as well as, to contribute to national and international objectives and responsibilities of the Australian Government; and

- encouraging and facilitating the application and use of the results of its own, or any other scientific research.

5.137 CSIRO also has secondary functions including international scientific liaison, training of research workers, publication of research results and dissemination of information about science and technology.

5.138 CSIRO's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$909.05 million;

- total outcomes appropriation–$568.65 million.

5.139 CSIRO's average staffing level for 2003–2004 is 6 118 (FTE) across Australia.

Key business risks and financial statement risks

5.140 In order to manage its key business risks, CSIRO addresses issues relating to:

- the continuity of science excellence—the risk that some perceive a decline in the science excellence of CSIRO;

- research selection—the risk that some perceive a lack of rigour in CSIRO's investment decision-making process;

- contestability—the risk that one size fits all approach is adopted to facilitate the distribution of scarce resources across the National Innovation System;

- the governance of associated entities—the risk that governance controls over associated entities established to transfer technology to the market are not effective; and

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- the impact of current and future regulation—the risk that existing or future regulation impacts adversely upon the research undertaken by CSIRO.

5.141 The ANAO's assessment of the risk of material misstatement in CSIRO's 2003–2004 financial statements is low. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- financial and legal requirements relating to CSIRO controlled companies;

- contingent liabilities and assets;

- trust accounting;

- valuation of investments and equity accounting;

- work in progress and deferred revenue;

- project management; and

- output reporting.

Corporate governance

5.142 CSIRO has continued to strengthen its control structure to respond better to business and financial risks. CSIRO has an enterprise risk management plan and action plans (including an update of the fraud control plan) to address the risks identified. To support these plans, CSIRO has:

- a Board made up of external members as well as the Chief Executive which meets on a regular basis to review the operation of CSIRO;

- an Executive Team, Executive Management Council and Group Executives who all meet regularly to monitor operational issues as well as the financial performance of activities at varying organisational levels;

- its own management arrangements in place in each division with committees to monitor divisional activities;

- financial reports prepared at various organisational levels depending on the intended forum;

- an audit committee which meets at least four times a year, focusing on risk management and the control environment, particularly relating to financial systems, accounting processes, audit planning and reporting. The committee is comprised of board members being a sub-committee of the board with members of CSIRO's executive team attending at the

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request of the committee. The audit committee regularly reviews performance and monitors achievements against audit plans; and

• an internal audit strategy and annual plan which, within available resources, addresses key financial and business risks based on management priorities. The annual plan is presented to the audit committee for approval; and performance is reviewed quarterly against the approved plan.

Financial reporting

5.143 CSIRO has an extensive monthly reporting program which incorporates both financial and non-financial indicators for reporting through to the Board, Executive Team and Group Executives. A monthly close process that supports an understanding of CSIRO's financial position underpins this reporting.

5.144 CSIRO is involved in a broad range of activities and, as a result, there is a continuing requirement to ensure that the financial reporting systems meet internal reporting requirements and external reporting responsibilities for both CSIRO, as a whole, and individual Research Divisions. The CSIRO financial reporting framework is currently effective in meeting these needs.

Audit results

5.145 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.8

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	0	0	3	3	3	3
Total	**0**	**0**	**3**	**3**	**3**	**3**

Source: ANAO

Audit issues

5.146 The ANAO review confirmed that CSIRO has a generally effective financial control framework to support the overall management of revenue and expenditure. Strong cost centre management, at the Research, Divisional

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and Corporate levels, supports this control framework. Three issues of moderate control risk were identified for management consideration.

Divisional financial management and accounting

5.147   The ANAO found that, in one division (of a total of twenty), the absence of effective controls over the management and posting of financial transactions meant that the records did not provide the division with satisfactory base data. As a result, the division's financial reporting was not sufficient to enable it to monitor effectively the progress or expenditure on individual projects, or the level of external revenue received. The reporting of the Division's financial performance (at the project level) and its overall net equity position, was inaccurate. In summary, at the time of the audit there was considerable uncertainty regarding the financial position of the division.

Risk management framework and IT security policy

5.148   The ANAO found that the currency of the IT security policy, standards and procedures, needed to be improved across the organisation. In addition, the IT risk management framework has not yet been formalised to include a set of standard IT risk assessments and an analysis of the IT security impact.

Business continuity planning

5.149   CSIRO does not have current and comprehensive policies and plans in place to address the exposure to risk related to the continued operation of CSIRO's business. In the absence of a formalised Business Continuity Plan and Business Impact Analysis, CSIRO is exposed to an increased risk of not being able to recover effectively and provide essential services in a timely manner, should a disaster occur.

Conclusion

5.150   CSIRO's management has responded positively to the ANAO's recommendations. CSIRO has already taken action to address aspects of the recommendations suggested by the ANAO.

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Department of Agriculture, Fisheries and Forestry

Business operations

5.151 The Department of Agriculture, Fisheries & Forestry (DAFF) is the primary policy formulation and advisory body to the Government on Australian agriculture, food, fisheries and forestry issues. DAFF's mission is 'increasing the profitability, competitiveness and sustainability of Australian agricultural, fisheries, forestry and food industries and enhancing the natural resource base to achieve greater natural wealth and stronger rural and regional communities'. DAFF is also responsible for quarantine, export inspection and certification and food safety standards activities.

5.152 There has been no significant change to the business and operational environment within DAFF.

5.153 DAFF's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$286.21 million;

- estimated administered revenue–$595.81 million; and

- administered expenses–$1.81 billion.

5.154 DAFF's average staffing level for 2003–2004 is 3 756 (FTE) across Australia.

Key business and financial statement risks

5.155 In order to manage its key business risks, DAFF addresses issues relating to:

- provision of assistance to rural industries and management of structural change;

- management of stakeholder relations for natural resource policy and programs;

- protection of Australian agriculture and the environment from foreign pests and diseases;

- maintenance of Australia's agricultural exporters disease free reputation internationally; and

- provision of timely and quality policy advice on rapidly evolving issues such as biotechnology.

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5.156   The ANAO's assessment of the risk of material misstatement in DAFF's 2003–2004 financial statements is moderate. Key issues for the current year include:

- transfer of quarantine inspection service staff from State Governments;

- devolved financial responsibility to Business Units;

- Financial Reform (Budget Estimates Framework Review) and shorter reporting deadline; and

- appropriation compliance.

Corporate governance

5.157   The ANAO's audit approach considers DAFF's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing DAFF's strategies, the ANAO focused on the key initiatives in place to meet DAFF's objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- an Executive Board that meets monthly and provides leadership to business units on administrative and operational aspects. It also takes an active role in reviewing and monitoring DAFF's financial performance;

- a governance Committee framework including an audit committee. The audit committee meets at least bi-monthly and focuses attention on risk management, effectiveness of the control environment and improving reliability of internal and external reporting;

- a Finance Sub-Committee that meets at least bi-monthly and oversees the production of the financial statements;

- a monthly financial reporting regime;

- an internal assurance branch that has a planned risk based coverage of DAFF's activities; and

- an up-to-date fraud control plan covering the period 2003-2005. The Fraud Control Plan provides a high level overview of systems to prevent, control and monitor fraud.

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Financial reporting

5.158   DAFF has a monthly reporting regime that includes comparison of actual results against budget and analysis of variances for each business unit and individual administered programs, together with forecasts for the remainder of the year. Some financial analysis is performed on departmental assets and liabilities.

Audit results

5.159   The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.9

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	4	0	4	3	2	3
Total	4	0	4	3	2	3

Source: ANAO

Audit issues

5.160   The ANAO highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Processing of personal benefits through Centrelink- follow-up on prior year issue

5.161   DAFF engages Centrelink to deliver personal benefits programs on its behalf. The ANAO reported some deficiencies, in the prior year, arising in the monitoring and reporting of personal benefits payments processed by Centrelink. This issue remains outstanding in the current year. DAFF advised that they are working closely with Centrelink on developing relevant protocols to remedy this issue.

Unrecorded prior employment service

5.162   The ANAO highlighted instances where employees had potential prior service with eligible AGPS, State and Local government entities that was unrecorded in the DAFF's Human Resources System. It is important that prior service is systematically assessed and accurately recorded in the Human Resources System on a timely basis to ensure that there is not a significant

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understatement of employee provisions in the financial statements. The ANAO recommended that DAFF commit to a project to review the risk of incomplete records including quantifying the impact of unrecorded prior service on the financial statements balances. While DAFF agreed there is a potential liability, it held the view that such an amount would not be material.

Accounts payable processes

5.163   DAFF's vendor database had a number of multiple records of vendors created since the implementation of the financial management system. In addition, the process of raising purchase orders was not always in accordance with DAFF's internal requirements. These shortcomings in the accounts payable processes could increase the risk of duplicate payments being made to suppliers and could facilitate the processing of subsequent fraudulent payments.

Conclusion

5.164   DAFF continues to actively identify and address control deficiencies and to progress its financial reporting. DAFF's management has responded positively to the majority of the ANAO issues.

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Department of Communications, Information Technology and the Arts

Business operations

5.165 The Department of Communications, Information Technology and the Arts (DoCITA) provides strategic advice and professional support to the government on a wide range of policy areas including the arts, cultural development, broadcasting and online regulation, information and communications technology, intellectual property, sport and telecommunications.

5.166 DoCITA also administers legislation, regulations, grants and incentives to industry and the wider community, and supports advisory councils and committees.

5.167 DoCITA's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$127.36 million;

- estimated administered revenue–$75.35 million; and

- administered expenses–$523.06 million.

5.168 DoCITA's average staffing level for 2003–2004 is 584 (FTE) across Australia.

Key business and financial statement risks

5.169 In order to manage its key business risks, DoCITA addresses issues relating to:

- policy advice—the ability of DoCITA to deliver the government's or minister's agenda when providing policy advice;

- program delivery—the delivery of the government's, and/or minister's agenda when delivering programs;

- corporate governance—the establishment of corporate governance arrangements, including an effective accountability framework, to provide the executive and minister with assurances that effective business management is occurring;

- contract management—the management of its contractual arrangements with its key service providers in a way that allows the effective and efficient delivery of services; and

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- resource management—the ability to deliver agreed outputs and outcomes is dependant on the ability to recruit, maintain and develop an appropriate skill base.

5.170 The ANAO's assessment of the risk of material misstatement in DoCITA's 2003–2004 financial statements is low. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- reduced reporting timetable;

- financial statement preparation;

- management and reporting of special accounts;

- accrual calculations; and

- the IT control environment.

Corporate governance

5.171 DoCITA has continued to strengthen its control structure to respond better to business and financial risks. DoCITA has developed a risk management plan and action plans (including an update of the fraud control plan) to address the risks identified. To support these plans DoCITA has:

- an Executive Management Group (EMG) which meets regularly to advise the Secretary on operational issues and to monitor the financial performance of DoCITA's programs;

- financial reports which are submitted to the Secretary and the EMG;

- an Audit, Risk and Evaluation Committee which meets at least quarterly, focusing on risk management and the control environment, particularly relating to financial systems, accounting processes, audit planning and reporting. An external member has been appointed to the committee. The committee regularly reviews performance and monitors achievements against audit plans; and

- an internal audit strategy and plan which, within available resources, addresses key financial and business risks based on management priorities. The annual plan is presented to the audit committee for approval and performance is reviewed quarterly against the approved plan.

Financial reporting

5.172 DoCITA continues to make improvements in the quality and presentation of financial data and reporting available to the Secretary,

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executive and business areas. Improvements in the quality of financial reporting are expected to continue in the year ahead as DoCITA has been able to strengthen the resources in the Corporate Finance area. In addition, end of month processes have been tightened for its business and accrual accounting processes through providing greater assistance to staff in the operational areas of DoCITA. These factors should contribute to DoCITA meeting the tighter financial reporting timetable for 2003–2004 and also alleviate some of the problems experienced in previous financial years associated with the preparation of the financial statements.

Audit results

5.173 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.10

Status of audit issues raised by ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	7	4	3	2	1	2
Total	**7**	**4**	**3**	**2**	**1**	**2**

Source: ANAO

Audit issues

5.174 The ANAO found that the control framework supporting financial management was generally satisfactory, with DoCITA continuing to enhance its control structures and address audit issues reported in prior periods. One new issue and one prior year issue of moderate control risk are discussed below.

IT aspects–privileged to FMIS access

5.175 The ANAO found that a number of system administration staff had been provided with access to all system functions of DoCITA's financial management system. This privileged access increases the risk to the integrity of system data and programs. The ANAO recommended that DoCITA adopt normal practice which is to prohibit or severely limit the granting of such privileged access to circumstances where operational imperatives provide no other alternative, and to actively monitor and review this function.

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System upgrade control environment (prior year issue)

5.176 The ANAO found that DoCITA did not ensure that all changes to key financial systems are subject to a formal process to consider the risks involved and to ensure appropriate testing regimes, including user acceptance testing and sign off, are performed. As a result, there are occasions where changes to the operating system or production data occur directly into production, rather than being migrated through an appropriate test environment.

Conclusion

5.177 DoCITA's management has responded positively to the ANAO's issues and associated recommendations. DoCITA has already taken action to address aspects of the deficiencies identified by the ANAO.

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Department of Defence

Business operations

5.178 The Department of Defence (Defence) is responsible for the defence of Australia and its national interest. Defence's business is focussed on the delivery of the following outputs:

- command of operations;

- navy capability;

- army capability;

- air force capability;

- strategic policy;

- intelligence; and

- superannuation and housing support services for current and retired defence personnel.

5.179 Defence's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$ 14.58 billion;

- estimated administered revenue–$ 935 million; and

- administered expenses–$ 2.23 billion.

5.180 Defence's average staffing level for 2003–2004 is estimated at 91 411, comprising permanent forces of 52 312, total reserves of 20 710, and total civilian staff of 18 389.

Key business and financial statement risks

5.181 In order to manage its key business risks, Defence addresses issues relating to:

- the adequacy of administrative processes and controls to provide appropriate assurance over information produced for operational activities, financial reporting and other decision-making purposes;

- the ability to allocate resources efficiently and effectively, including dealing with change management, administrative processes, data ownership and asset procurement and management;

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- organisational systems and the accuracy and integrity of data records, in relation to current and future business operations;

- contract/project management including the ability to have efficiently and effectively delivered, or enhanced, current and future service levels, as a result of sound contract and project management;

- the ability to recruit and retain adequately skilled staff to achieve current and future business objectives; and

- the increased visibility of current and future issues and decisions.

5.182 The ANAO's assessment of the risk of material misstatement in Defences' 2003–2004 financial statements is high. Following on from last year, key issues for the current year include:

- prior year qualifications across a broad range of financial statement items;

- the adequacy of the corporate governance framework and the effective use of resources available to remediate system and data integrity issues within key management information systems used to record and manage; (i) inventory and repairable items balances, (ii) personnel payments and balances, (iii) supplier related transactions, and (iv) departmental assets and transactions;

- appropriate corporate support and reporting frameworks for management decision-making purposes; and

- effective asset management, including asset recognition and write-downs, assets under construction, inventory valuation and related transactions.

Corporate governance

5.183 As part of the audit planning process, the ANAO has undertaken a high level review of the Corporate Governance framework and resultant procedures and processes in place within Defence. The results of the review impact the necessary audit procedures to be completed by the ANAO.

5.184 Defence has an audit committee that meets on a monthly basis. The Audit Committee has two independent external members, including the chair of the committee. Separately, in 2003–2004, the Secretary established the Financial Statements Project Board (FSPB), comprising the top level of the Defence Executive, including the Chiefs and the Vice-Chief of the three forces. The FSPB is chaired by the Secretary with the CFO as the Deputy Chair. The FSPB, in their periodic meetings, review all actions and plans to address Defence's financial management issues. The ANAO has subsequently seen

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evidence of an extensive increase in activity focussed on addressing issues across Defence as a whole. However, the ANAO considers that the effectiveness of the actions adopted are being eroded by the continuing limitations in key systems and the associated data quality and maintenance issues and an apparent inability to rectify or remediate the problems within a short timeframe.

Defence Materiel Organisation as a Prescribed Agency

5.185   Following the Defence Procurement Review, which was chaired by Mr. Malcolm Kinnaird, the Australian Government announced on 18 September 2003 its intention to establish the Defence Materiel Organisation (DMO) as a prescribed agency under the FMA Act. Although not formalised, this process is expected to occur from 1 July 2005.

5.186   While the financial details, *inter alia*, are still being developed, it is clear that there will be a significant impact on the operations and management of Defence as a whole. As a prescribed agency, DMO will be required to establish its own books and records and prepare separate financial statements for audit. Consequently, any underlying issues remaining in Defence's operational and financial systems may result in the inaccurate transfer of information. Moreover, if audit qualifications still exist within the Department at the time of 'de-merging' DMO from Defence, these could be transferred to the new entity, either directly or via bureau service provision arrangements that will be put in place. This could mean that the opening balance sheet of the new entity would inherit an audit qualification(s), compromising the effective commencement of the new agency. Therefore, record-keeping issues need to be resolved so that the relationship between DMO and Defence is accurately reflected in the financial statements; is observed to be at arms length; is credible; and supports capability and sustainability outcomes.

5.187   While plans are progressing, sufficient allocations of capable resources must be made to adequately assess the needs of the two entities flowing from the organisational split. This will include corporate services arrangements, financial and management accounting regimes and bureau and contract service provisions. In addition, it is noteworthy that the management of the 'de-merger', and its attendant accounting and operational issues, will coincide with Defence's implementation of International Financial Reporting Standards, while Defence continues to work to resolve the numerous, and significant internal and external audit findings.

Financial reporting

5.188   Monthly financial reporting packages, which are compiled by the CFO Group from a variety of sources, continue to be refined, such as their analytical

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content, based on feedback from the Defence Committee and the Audit Committee. However, these packages are not comprehensively accurate as many of the issues identified in the financial statement reporting process will, by their very nature, also impact the monthly financial reporting program.

5.189 Defence recently conducted a 'hard-close' process for end-March 2004 as a means to further refine its financial statement close processes. The exercise was considered a valuable input to assist in:

- the preparation of the year-end financial statements; and

- determining those aspects of the financial statements to self-qualify as necessary. In addition, the hard-close introduced a formal Quality Assurance sign-off process that should enhance accountability and ownership over financial data in the future.

5.190 However, the outcome of the hard-close was that only a small portion of the Defence's balance sheet was, in management's view, of a sufficient quality to be endorsed by management and be subject to audit. This outcome re-emphasises that significant improvement is still required in terms of completeness, quality and timeliness of financial information to prepare Defence's financial statements. Greater corporate support, reliable systems, and adequate controls will be necessary across Defence to provide adequate 'hard-close' and traditional year-end reporting processes in future years. This is required for both management and audit.

5.191 The production of reliable financial statements is a by-product of good governance, reliable information systems, and an effective internal control environment. In Defence, the continuing completion of financial statements well after the required reporting deadline, *inter alia*, indicates that the production of accurate Defence wide financial reports supported by robust evidentiary standards does not occur on a timely basis. Defence remains in an on-going cycle of undertaking remediation processes and utilising additional 'work-arounds' to fulfil its 30 June 2003–2004 reporting requirements.

5.192 Due to the scale of problems being noted in the Defence financial systems and controls, a considerable amount of resources are being applied to the assessment, correction and substantiation of financial data. The over-run and non-completion of these processes inevitably causes a delay in the financial statement completion. In recognition of these issues, the CFO Group has commenced several longer term projects covering financial management processes and system architecture. However, to the extent possible, Defence will need to bring forward remediation processes that support the completion of the financial statements to allow time for considered assessment and audit before the Government's reporting deadline.

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Other findings

5.193 In addition, the audit highlighted other issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements:

- Budget and Output Reporting Information System (BORIS)–Security Administration and program change control; and

- security monitoring of the various platforms hosted by the Defence Computing Bureau.

Defence advise that they have recently addressed ANAO concerns in relation to BORIS.

Audit results

Table 5.11

Status of audit issues raised by ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	10	3	13	TBD*	TBD*	TBD*
B	29	2	38	TBD*	TBD*	TBD*
Total	**39**	**5**	**51**	**TBD***	**TBD***	**TBD***

Source: ANAO. * To be determined–the interim audit is not yet complete.

5.194 The above table includes a summary of the 2002–2003 Closing Report issues that was agreed at the time with Defence management. The CFO Group has prepared a scorecard to monitor progress against these findings, which identifies some issues as being resolved, or expected to be resolved by the end of the financial year. However, recent ANAO audit work has identified additional issues that are being discussed with Defence.

Audit issues

5.195 In 2002–2003, the IT and manual controls over the then operating version of Standard Defence Supply System (SDSS) were not found to be adequate to protect the integrity of pricing data (for example, users of the system were able to overwrite information in the price field/s). This issue continues in 2003–2004. In conjunction with the SDSS Remediation Strategy (see below), Defence established a project team to review the inventory pricing strategy and address the reported issues. The ANAO will monitor the progress of these issues and report the results in our year-end report.

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5.196 Similarly, the inadequacy of controls within, and around SDSS, resulted in significant uncertainty about an asset category known as Repairable Items (RIs). There remain problems with respect to data integrity over quantities, shortcomings with key business processes, and significant gaps in the collective evidentiary support for the recorded balance. Specifically, issues have been identified around the controls and management, including software deficiencies, of accounts known as Supply Customer Accounts utilised to manage RIs and Inventory in SDSS V4. The ANAO will monitor the progress of these issues and report the results in our year-end report.

SDSS—Inventory and Asset Management System

5.197 SDSS, which is the inventory and asset management system, was upgraded to SDSS V4 on 28 July 2003, after significant delays. The upgrade was aimed to provide improved financial functionality including reporting, tighter controls over the maintenance of data integrity and the processing of transactions, and to improve reconciliation ability. Subsequent to the upgrade, and following poor system performance and user acceptance, Defence identified shortfalls in SDSS V4 in the following key areas:

- data quality;

- system performance;

- financial capability gaps;

- software defects; and

- business process compliance.

5.198 Significantly, the overall quality of data residing within SDSS remains in question. The ANAO has also questioned whether data integrity has further deteriorated as a result of wide-ranging system performance problems and user-acceptance issues, which followed the upgrade. Defence has established a significant remediation project of SDSS V4 to address the above deficiencies, with progress being reported to the Defence Committee on a periodic basis. The remediation strategy includes progressive project milestones through to June 2005.

5.199 Currently, significant limitations exist regarding the capability of SDSS V4 to produce adequate financial reports. As a result, additional work-arounds are required, such as Structured Query Language (SQL) techniques, to extract data from SDSS for posting to ROMAN (the Defence General-Ledger) and internal reporting purposes. The SQLs cannot, however, replace fully developed and tested reports, which are crucial to the long-term use and integrity of the system. In the interim, Defence will need to demonstrate that the SQLs are run from a stable database environment. Moreover, the

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techniques used by management to the end of April, appear to have resulted in anomalies that required their reversal from ROMAN, and a re-upload of the financial year's data at the end of May via a separate SQL. Furthermore, the planned suite of financial reports, once implemented, will only be able to adequately query historical information—once data fields are established and information is entered into the system. The ANAO will monitor the progress of the various issues pertaining to SDSS V4 and report the results in our year-end report.

Explosive Ordnance

5.200 In 2002–2003, significant issues remained regarding the valuation of Explosive Ordnance (EO) on the COMSARM system due to a lack of supporting documentation. Defence and the ANAO were unable to obtain sufficient assurance over a significant proportion of the reported balance. Following the 2002–2003 audit qualification, substantial work has been carried out by Defence to compile relevant supporting documentation. However, it would be premature, at this stage, to expect the completely satisfactory resolution of this qualification for the 2003–2004 financial statements.

5.201 In addition, the results from an ANAO stocktake of EO, undertaken as part of the 2003–2004 financial statements audit, noted a discrepancy in an item of significance during the stocktake. Defence management, following a review by Management Audit Branch, subsequently reported that the items were 'located'. However, from a control perspective there remains a concern as to why it took an unacceptable period of time to locate the items in question.

Personnel Leave Remediation

5.202 The 2002–2003 ANAO audit report contained a Limitation-of-Scope finding regarding ADF leave provisions due to:

- sufficient supporting documentation not being available; and

- unacceptable rates of error where documentation did exist. This was mainly due to inadequate controls and processes within Defence's military personnel systems, and the capture of source documentation.

5.203 In addition, system and process issues have been identified which may also affect the recording and reporting of civilian leave balances.

5.204 Consequently, Defence is undertaking a wide-ranging Military leave remediation program. This process has involved:

- analysing previous audit results;

- conducting error queries, manual and system;

- providing a means for employees to review their own leave records;

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- introducing system changes to remove the scope for generating new errors;

- revising existing policies and procedures; and

- complementing existing training packages with an on-line training module for leave records management.

5.205 Despite this on-going remediation program, Defence has communicated an expectation to 'self-qualify' this item in 2003–2004, with the objective of resolving this issue by 30 June 2005.

5.206 Due to the Limitation-of-Scope within ANAO's 2002–2003 audit report regarding military leave provisions, the Executive Remuneration note (containing information pertaining to civilian and Military leave provisions), which is 'material by nature' in disclosure with the FMOs, could not be reliably certified. Hence a separate Limitation-of-Scope applied to the Executive Remuneration note in respect of any accrual effects arising from the Military leave balances. During the 2003–2004 period, Defence has actively pursued the resolution of this matter by reviewing all appropriate source documentation. However, despite considerable ANAO involvement, the issue has still not been resolved.

Defence's Personnel Systems: PMKeyS and ADFPAY

5.207 The ANAO's evaluation of the internal controls surrounding payments and balances within the PMKeyS and ADFPAY systems is that they are not yet sufficient to ensure the accuracy of all payments and balances within the system. Whilst some progress has been made, there remains a number of outstanding issues which were raised in 2002–2003. These issues include:

- access controls—ongoing issues exist over users being granted inappropriate access within PMKeyS and ADFPAY; and

- segregation of duties—there remains a number of personnel who can perform incompatible functions within the personnel process.

Defence's General Ledger System: ROMAN

5.208 The ANAO has undertaken a review of the ROMAN (SAP R/3) system controls that impact on the reliability of the information provided by Defence. A number of issues identified in 2002–2003 have been progressed or resolved. Further work, however, is required in the following areas to ensure an effective control environment is established and maintained. For example:

- 'Purchase-to-pay'—there remain concerns across the 'purchase-to-pay' control framework, which will require additional audit work prior to the ANAO being able to rely on the validity of data residing within the system; and

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- security administration—ongoing issues exist within the 'security administration' and 'change control' procedures, which have the ability to directly impact the integrity of data and affect the ANAO's planned audit reliance.

5.209 In addition, a number of other issues were noted last year that continue to impact on the integrity of the data within ROMAN. These include data ownership and reliability of feeder systems and processes, which must be dealt with to provide management with the assurance over the financial information and, subsequently, the ability to effectively direct resource allocation. All data integrity issues from feeder systems, as well as internally derived issues, will impact the information used by management.

Depreciation

5.210 During 2003–2004, Defence identified potential errors in the depreciation calculation, which were uploaded into the current financial management information system (ROMAN). Defence has calculated an error, relating to the Corporate Services and Infrastructure Group, which affects prior years' figures, being an overstatement in excess of $280 million. Defence has also investigated a potential error in the depreciation calculation for items relating to the Defence Materiel Organisation (DMO). The ANAO will review these issues as part of the 30 June audit and report the results in our year-end report.

Qualification

5.211 The 2002–2003 audit report on Defence's financial statements was qualified on the basis of five Limitations-of-Scope; that is, there was a limit over the ANAO's ability to conclude on some components of the accounts due to inadequacies in Defence's current systems and processes. In their statement accompanying the financial statements, the Secretary and the CFO noted these limitations.

5.212 An audit opinion was unable to be formed on General Stores and Explosive Ordnance (EO) Inventory ($610 million and $1.2 billion respectively of the total $3.83 billion) and Repairable Items (RI's) ($550 million of the total $2.54 billion), which is reported within SME. In addition, Australian Defence Force (ADF) annual leave and long service leave provisions ($732 million of the total $1.07 billion), and subsequently Executive Remuneration disclosures, were also qualified. There was also an item reported under the heading of 'Other Statutory Matters' in the audit report, where Defence breached section 48 of the FMA Act in relation to Special Accounts.

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5.213 In 2003–2004, the Secretary and the FSPB have generated significant activity in regard to the specific remediation of the issues, including an emphasis on addressing the Executive Remuneration qualification. While the final outcome of these activities should provide wide-ranging benefits over the long term, it is not expected that they would all be fully completed prior to the signing of the 2003–2004 financial statements.

Conclusion

5.214 Due to the lack of detective and preventative controls surrounding the core systems of Defence, the ANAO continues to place limited reliance on those controls and is adopting a predominantly substantive audit approach to obtain assurance over the reported balances for 2003–2004, involving a significant increase in audit resources applied to the audit.

5.215 At this stage of the financial year, there has been little completed remediation, or agreement, on the resolution of key audit issues noted in 2002-2003. However, significant work by Defence is continuing, and is currently being analysed and reviewed by the ANAO. As well, further issues have been noted by both Defence and the ANAO, which are being assessed and will require management action prior to the year-end. The current impetus, which has been sponsored by the Secretary and the CFO, individually and via the FSPB, is fundamental in continuing the achievements to date. This is a pressing imperative in order to achieve the remediation, cultural and structural change necessary to support the required Defence outputs in the current financial reporting environment.

5.216 The system and process issues being noted during the financial statements audit are wide-ranging in their breadth and depth. Many of the issues arise from both legacy systems and process issues, and the effectiveness of current systems and processes to deal with the attendant reporting environment. Significant resources are applied by Defence to implement 'work-arounds' to deal with known deficiencies. However, many of the issues are now straddling a broad cross-section of the financial statements. Any further implications are being assessed and will be reported in our year-end report.

5.217 The ANAO will continue to support the Department's commitment and efforts to increase confidence in its financial statements. In particular, the ANAO supports the establishment of the FSPB and the continued effort from the audit committee. However, it is essential that the Project Board include increased emphasis on the timely execution and the integrity of the financial statements and the quality of the key account reconciliations.

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Department of Education, Science and Training

Business operations

5.218 The Department of Education, Science and Training (DEST) provides advice to the government and administers programs to achieve the Australian Government's objectives for education, science and training. For 2003–2004, DEST's objectives are to ensure that:

- individuals achieve high quality foundation skills and learning outcomes from schools and other providers;

- individuals achieve relevant skills and learning outcomes from post-school education and training; and

- Australia has a strong science, research and innovation capacity and is engaged internationally on science, education and training to advance our social development and economic growth.

5.219 DEST's key business processes relate to the:

- administration of grant payments for infrastructure, education and training and research;

- delivery of services, which provide access to education and training assistance;

- joint administration of the Higher Education Contribution Scheme (HECS) in conjunction with the Australian Taxation Office (ATO); and

- provision of expert advice and analysis to the Government.

5.220 Questacon became a group of DEST on 1 July 2004. Previously, Questacon was part of the Communications, Information Technology and the Arts Portfolio. There have been no further significant changes to the business and operational environment of DEST during 2003–2004.

5.221 DEST's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$259.24 million;

- estimated administered revenue–$ 14.78 billion; and

- administered expenses–$ 14.29 billion.

5.222 DEST's average staffing level for 2003–2004 is 1 701 (FTE) across Australia.

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Key business risks and financial statement risks

5.223 In order to manage its key business risks, DEST addresses issues relating to:

- the Minister's reputation and trust;

- the Secretary's accountability;

- on-line service delivery e.g. risk of a breach of security;

- legislative changes;

- provision of timely and effective policy advice;

- ensuring an adequate framework for the management of service providers exists;

- human resource management including workforce planning;

- financial management and reporting;

- performance management and measurement;

- procurement and contract management; and

- service delivery–ability to provide new and/or existing services that are timely and of a high standard.

5.224 The ANAO's assessment of the risk of material misstatement in DEST's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- inappropriate recognition of liabilities and commitments for calendar year grants;

- the adequacy of systems and processes to allocate costs against agreed goods and services (outputs) and resulting benefits (outcomes);

- payments to educational institutions;

- reliance on third-party information e.g. ATO (HECS), Centrelink (Student Financial Supplement Scheme, Abstudy and Assistance for Isolated Children), actuaries and Universities;

- reconciliations between business systems and FMISs; and

- consolidation of Questacon's financial information.

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Corporate governance

5.225 The ANAO's audit approach considers DEST's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing DEST's strategies, the ANAO focused on the key initiatives in place to meet DEST's objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- DEST's progress in meeting its goals and objectives are measured and monitored by the Corporate Leadership Group (CLG). The CLG monitor financial and non-financial performance and review monthly financial management reports;

- a Corporate Committee has been established to oversight the corporate governance of DEST;

- DEST's corporate direction as outlined in the corporate plan, with short-term priorities being assessed on an annual basis and reflected in the business plans of each work unit;

- a strategic risk management plan and risk assessment process developed by the Procurement, Assurance and Legal Group. The plan takes into account the high priority risks and risk minimisation strategies identified by all groups and links the critical success factors set down in the corporate plan;

- the Audit and Business Assurance Committee (ABAC) which meets quarterly and actively focuses on internal and external audit as well as compliance analysis, fraud, risk management, continuity management and IT. All audit reports and audit plans are approved by the ABAC, based on their assessment of risk and coverage required;

- a monthly financial reporting regime;

- an internal audit plan that addresses key business risks and covers all programs administered by DEST; and

- a fraud control plan.

Financial reporting

5.226 DEST has in place a financial reporting regime that includes comparison with budget estimates, variance analysis and associated commentary. Financial reports are prepared on a full accrual basis, and include cash flow statements. The monthly financial reports together with a brief commentary on key variances are distributed to members of the CLG on a

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monthly basis. The results and information contained in the reports are utilised by the CLG when making decisions.

5.227 Group administration units separately monitor actual performance against budget on an on-going basis. The analysis is reviewed by group managers who attend the CLG meetings. The Finance Branch also performs a review of actual expenses compared to budget, for all groups and state offices. The results, including ratio and trend analysis, are reported to the CLG on a monthly basis.

Audit results

5.228 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.12

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	2	1	2	2	2	2
Total	2	1	2	2	2	2

Source: ANAO

Audit issues

5.229 The ANAO highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Untimely clearance of administered bank reconciling items

5.230 A number of reconciling items, including prior year items, in DEST's administered bank reconciliation had not been cleared in a timely manner. The net balance was not material to the financial statements.

Disaster recovery planning

5.231 DEST's department wide disaster recovery plan (DRP) had not been finalised at the end of March 2004. In addition, at this time, DEST's new division, Questacon, did not have a current business continuity plan or DRP.

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Conclusion

5.232 DEST's management has responded positively to the ANAO's issues and associated recommendations. DEST has already taken action to address the deficiencies identified by the ANAO.

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Department of Employment and Workplace Relations

Business operations

5.233 The aims of the Department of Employment and Workplace Relations (DEWR) are to maximise the ability of unemployed Australians to find work—particularly those that face most severe barriers to work; and support strong employment growth and the improved productive performance of enterprises in Australia. DEWR's most significant business process is the management of contracts associated with the employment program.

5.234 DEWR contributes to the achievement of two government outcomes, namely:

- an effectively functioning labour market; and

- higher productivity, higher paid workplaces.

5.235 DEWR's appropriation funding for the year ending 30 June 2004 covers:

- price of outputs–$442.46 million; and

- administered appropriations–$1.38 billion.

5.236 DEWR's average staffing level for 2003–2004 is 2 251 (FTE) across Australia.

Key business and financial statement risks

5.237 In order to manage its business risks, DEWR must address key issues relating to:

- contract management—in delivering employment programs, DEWR relies on contractors and other government entities. A strong contract management framework must be in place to ensure the delivery of a range of programmes. Previous audit coverage has found the contract management framework, as it relates to financial reporting, to be generally sound. Critical elements include legal and probity issues associated with tender selection, contract management and performance monitoring. This is particularly relevant in 2003–2004 with the commencement of the third Employment Services Contract;

- policy advice and analysis—policy advice given by DEWR to its ministers and other stakeholders must be accurate, timely and relevant;

- program administration and output delivery—DEWR's ongoing relationships with its varied stakeholders is extremely important. These

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relationships must be managed effectively to ensure government outcomes are achieved and its external accountability obligations are satisfied;

- downturn in the economy—the demand for DEWR's services may increase with a downturn in the economy. DEWR monitors relevant labour market factors and the level and quality of employment services;

- IT systems and policy changes—DEWR is heavily dependent on the effectiveness and integrity of IT systems for program delivery. DEWR must manage its critical IT systems to ensure they meet the changing needs of DEWR and provide accurate and timely information. Significant changes to DEWR's IT systems occurred in the latter part of 2002–2003 and in the current financial year as a result of the implementation of the Job Network Active Participation Model; and

- increased financial management responsibilities and accountability requirements, including a compressed reporting timeframe.

5.238 The ANAO's assessment of the risk of material misstatement in DEWR's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- reporting of administered and departmental items against their correct classifications;

- contract management arrangements;

- reporting financial outcomes and outputs;

- asset management;

- general IT and IT application controls;

- payment of accounts and collection of revenue;

- key reconciliation processes; and

- changes to financial reporting requirements.

Corporate governance

5.239 DEWR continues to have in place elements which contribute to sound corporate governance and, in particular, to financial statement assurance. Measures which impact positively on financial statement assurance include:

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- a corporate planning framework, which has a strategic risk assessment process covering the main areas of business, including the assessment of group and state business plans and the allocation of resources;

- executive/management arrangements charged with monitoring business planning processes, monthly evaluations of key performance indicators, budgets and other financial and non-financial measures;

- a committee framework that includes: a management board and supporting subcommittees including, people and leadership, audit, remuneration, ethics and the IT subcommittee;

- a strong financial management process that provides informative monthly reports;

- a review and monitoring framework, including a strategic internal audit plan and an annual internal audit work plan approved by the Audit Subcommittee and endorsed by the Secretary and Management Board; and

- a fraud control plan, which is incorporated with DEWR's integrity plan 2003–2005. All major business areas conduct fraud risk assessments, which contribute to the development of fraud control action plans. The fraud control action plans, together with mandatory coverage required by the fraud control policy of the Australian Government, form DEWR's integrity plan.

Financial reporting

5.240 DEWR has implemented a strong and timely financial management process with monthly reports to managers within five days of month end. The reports provide actual performance against budget information on an accrual basis allowing management to assess the financial position and operating performance of DEWR. The reports are supplemented with a balanced scorecard reporting system, which reports against a range of financial and non-financial indicators, including client, business and people management needs and goals.

Audit results

5.241 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

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Table 5.13

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	5	5	0	0	2	2
Total	5	5	0	0	2	2

Source: ANAO

Audit issues

5.242   The ANAO highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

Contract management controls

5.243   The audit approach for administered 'Outcome One' expenditure focused on a combination of detailed IT testing of the Integrated Employment System (IES) controls and key contract management controls. Controls over expenditure were found to be generally effective. Due to the scheduling of contract management and program assurance work for the latter part of the financial year, it was not possible to confirm some important contract management controls were operating effectively at the time of the interim audit.

5.244   The successful completion of the scheduled contract monitoring program and program assurance work, together with timely validation work programmed by Internal Audit prior to 30 June 2004, is critical, to providing the level of assurance required over Outcome One expenditure to be reported in the Department's 2003–2004 financial statements, and in meeting its advanced financial reporting timetable.

IT security systems certification and security

5.245   Controls over other accounting and financial processes were found to be generally sound. Two risk containment recommendations were made relating to the information technology environment. The first related the need to maintain adequate documentation on an agreed set of controls (automated and manual), identified as controlling the payment process, which are updated and formally approved for each system rebuild. A recommendation was also made to improve access controls over staff with IES administrator roles so that access by users was only granted on a needs basis and that access logs were formally reviewed on a regular basis.

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Conclusion

5.246 DEWR continues to strengthen its internal control structure. Subject to the successful validation of Outcome One contract monitoring work, the Department should be in a sound position to produce reliable information for its annual financial statements. DEWR has agreed to implement all of the ANAO recommendations and has advised that the necessary action has been commenced.

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Department of the Environment and Heritage

Business operations

5.247 The Department of the Environment and Heritage (DEH) consists of two autonomous units involved in the following operations as follows:

- *Environment Australia* (EA)—The Environment outcome's objectives are the provision of advice on and implementation of policies and programs for the protection and conservation of the environment. This includes assistance to the Australian community to appreciate and conserve Australia's natural and cultural (indigenous and historic) heritage places for present and future generations.

- *Australian Antarctic Division (AAD)*—The Antarctic outcome's objectives are the pursuit of Australia's Antarctic interests involving the protection of the Antarctic environment and the conduct of scientific research in the Antarctic, sub-Antarctic and the Southern Ocean. The AAD also promotes Australia's interests within the Antarctic Treaty System and administers the Australian Antarctic Territory, Heard Island and McDonald Islands.

5.248 Due to the implementation of the Environment and Heritage Legislation Amendment Act 2003, the Australian Heritage Council Act 2003 and the Australian Heritage Council (Consequential and Transitional Provisions) Act 2003, the Australian Heritage Commission (AHC) has been decommissioned, from 31 December 2003. The AHC's operations have been transferred to the Heritage Division of the department, effective 1 January 2004.

5.249 DEH's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$246.45 million;

- estimated administered revenue–$8.11 million; and

- administered expenses–$263.00 million.

5.250 DEH's average staffing level for 2003–2004 is 1 226 (FTE) across Australia.

Key business and financial statement risks

5.251 In order to manage its key business risks, the department addresses issues relating to:

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Environment outcome

- increased financial management responsibilities and accountability;

- public interest in activities;

- implementation and administration of Environment legislation;

- policy advice and analysis; and

- IT Control Environment (SAP 4.6 upgrade).

Antarctic outcome

- increased financial management responsibilities and accountability; and

- unique and changing nature of operations.

5.252 The ANAO's assessment of the risk of material misstatement in DEH's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

Environment outcome

- changes to financial/regulatory requirements;

- restructuring of the department and integration of the AHC with DEH from 1 January 2004;

- compressed reporting timetable;

- revaluation of assets at fair value; and

- grants administration.

Antarctic outcome

- changes to financial/regulatory requirements;

- the absence of full accrual based accounting and reporting; and

- prior year control weaknesses including asset management.

Corporate governance

5.253 The ANAO's audit approach considers DEH's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing DEH's strategies, the ANAO focused on the key initiatives in place to meet DEH's objectives and management of the business risk associated with those initiatives. Measures which assist with financial assurance include:

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- a senior executive committee which meets weekly to evaluate and determine DEH's strategic direction, financial planning and operational results;

- a committee framework including an audit committee. The audit committee meets at least quarterly and focuses attention on matters relating to internal audit, evaluation, fraud control, risk assessment and financial reporting;

- the executive and operational areas are provided with financial information on a monthly basis in relation to DEH's financial position and operating performance. The reports provide results by outcome on an actuals versus budgeted expenditure and revenue;

- a monthly reporting regime;

- a documented risk management strategy (currently under review) which identifies and treats medium and high rated exposures; and

- a fraud control plan and publication of fraud control arrangements and guidelines included on DEH's intranet.

Financial reporting

5.254 The executive and operational areas are provided with financial information in relation to DEH's financial position and operational performance on a monthly basis. The reports provide results by outcome on a budget versus actual basis. In addition, the executive is also provided with reports on cash management practices.

Audit results

5.255 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

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Table 5.14

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
Environment Outcome						
A	0	0	0	0	0	0
B	1	1	1	0	1	2
Total	1	1	1	0	1	2
Antarctic Outcome						
A	0	0	0	0	0	0
B	1	1	1	1	2	2
Total	1	1	1	1	2	2
Department of the Environment and Heritage (combined total)						
A	0	0	0	0	0	0
B	2	2	2	1	3	4
Total	2	2	2	1	3	4

Source: ANAO

Audit issues

5.256   The ANAO highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

Environment outcome

Payroll clearing account

5.257   A prior year issue relating to the untimely clearance of two payroll clearing accounts had not been rectified at March 2004. The combined balance of these accounts is significant, but not material, to the financial statements.

Accounts payable

5.258   Control exposures were noted in relation to the number of users who had access to create or change vendor master records and/or access to a range of accounts payable transactions. Recommendations were made to minimise the possibility of unauthorised access and to monitor users.

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Antarctic outcome

Insurance claims receivable

5.259 The AAD is to implement a process to review the certainty of the recoverability of their insurance claims receivable, to determine whether the AASB requirements for recognition of this asset have been met.

Capital works in progress

5.260 The AAD's program of review of capital work in progress to identify projects due for completion needs to be strengthened to assist with the timely transfer of capital work in progress to fixed assets upon commissioning.

Conclusion

5.261 DEH's management has responded positively to the ANAO's issues and recommendations. Both the Environment and Antarctic Outcomes of DEH have continued to strengthen their internal control structures and should be in a sound position to produce reliable information for DEH's annual financial statements.

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Department of Family and Community Services

Business operations

5.262 The Department of Family and Community Services (FaCS) is the principal policy formulation and advising body within the Family and Community Services portfolio. According to ministerial requirements and within the relevant legislative framework, FaCS is responsible for income support, housing policy, community support, child care services and family issues, including family payments, child support and family relationships. As well as families, FaCS focuses on groups with differing needs, such as young people and students, people living in rural and remote areas, Aboriginal and Torres Strait Islander peoples, and people from diverse cultural and linguistic backgrounds.

5.263 There have been no significant changes to the business and operational environment within FaCS.

5.264 FaCS' appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$2.48 billion;

- estimated administered revenue–$1.09 billion; and

- administered expenses–$60.93 billion.

5.265 FaCS' average staffing level for 2003–2004 is 4 645 (FTE) across Australia.

Key business and financial statement risks

5.266 In order to manage its key business risks, FaCS addresses issues relating to:

- the integrity of outcomes and outlays;

- the provision of quality and timely policy advice;

- the adequate management of service providers and other stakeholders;

- compliance with legislative requirements;

- human resource management; and

- the continuity of business, including knowledge management.

5.267 The ANAO's assessment of the risk of material misstatement in FaCS' 2003–2004 financial statements is moderate to high. The financial statement

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audit will focus on the material financial reporting risks flowing from the following key issues:

- personal benefit expenditure;

- personal benefit debt and provision for doubtful debts;

- child support revenues, expenses, and debt management;

- grants administration;

- Student Financial Supplement Scheme; and

- month end financial statement reporting processes.

Corporate governance

5.268 The ANAO's audit approach considers FaCS' goals, priorities, objectives, and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing FaCS' strategies, the ANAO focused on the key initiatives in place to meet FaCS'objectives and management of the business risk associated with those initiatives. Measures which assist in financial assurance include:

- an executive board that meets at least monthly and has a formal biannual corporate governance process. The executive board takes an active interest in the financial operations of FaCS and receives monthly detailed reports from the Chief Financial Officer, who is a board member;

- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes, audit planning, and reporting;

- a monthly financial reporting regime;

- an internal assurance branch that has a planned risk based coverage of the department's activities;

- a fraud control plan that covers the period 1 July 2002 to 30 June 2004. The fraud control plan outlines the functional activity, risk event, risk rating and strategies/treatment required and the timing to complete any treatment action and responsibility. The fraud risk assessment is updated every two years in the form of a survey that is sent to all FaCS branches; and

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- the implementation of the Centrelink and Department of Family and Community Services (FaCS) Business Assurance Framework (BAF). Stage One of the BAF is considered by Centrelink and FaCS to be the implementation of the revised rolling random sample surveys (RSS), which measure benefit payment accuracy and correctness. The revised RSS, which are performed quarterly, have been operational since 1 July 2002. Centrelink and FaCS are refining their views on the type and quantity of information which could usefully flow from the RSS. Continued improvement in relation to the use of the RSS data should be seen once additional quarters of data are available for analysis.

Financial reporting

5.269 FaCS has an effective and strong financial reporting regime in operation. The current regime includes monthly accrual reporting to the Board on actual results against budget, including an analysis of any variances, percentage of year to date budget utilised, and a performance scorecard, in relation to departmental financials. The performance scorecard incorporates both financial and non-financial measures of FaCS' current financial position. The ANAO have recommended some areas where reporting of administered financial information to the Board could be strengthened.

Audit results

5.270 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.15

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	6	3	3	2	7	8
Total	6	3	3	2	7	8

Source: ANAO

Audit issues

5.271 The ANAO highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

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HRMIS privileged access reviews

5.272 FaCS has determined that, to appropriately manage the risks associated with privileged access to the HRMIS, actual usage of the privileged access should be independently reviewed on a monthly basis. During the audit, it was noted that these reviews had not been performed for the period November 2003 to February 2004. FaCS has since rectified this deficiency.

Comcare trust account

5.273 FaCS needs to review its processes relating to the transfer of funds between the Comcare Trust Account and departmental bank accounts to ensure compliance with the legal requirements of the Trust. In addition, FaCS needs to identify the source and reason for a significant amount in the Comcare Trust Account which relates to activity prior to 30 June 2001. Finally, the balance of the Comcare Trust Account is currently included within the Departmental accounts, when the nature of a trust requires that it be recorded and disclosed separately.

Administered payments reconciliations

5.274 The audit highlighted a number of reconciling items in the administered child support payment accounts reconciliations. A large number of these items have been carried over from as early as July 1999. These items need to be reviewed and any outstanding issues resolved in a timely fashion.

Cash receipts

5.275 The Child Support Agency (CSA) is part of FaCS. However, it operates on separate systems and processes. CSA needs to review their cash and cheque receipting process. A number of issues were highlighted during the audit, including a lack of segregation of duties and insufficient access controls around the cheque register.

Commonwealth State Housing Agreement Grants

5.276 FaCS needs to strengthen the controls around the spreadsheet used to calculate and monitor grant payments under the Commonwealth State Housing Agreement. The ANAO identified several issues relating to access and cell protection controls in this spreadsheet, and the reconciliation process between the spreadsheet and the financial management information system.

Transfer of leave entitlements

5.277 When employees are promoted or transferred between Australian Government Agencies or Authorities, FMA Amendment Order 2001 (No.2) requires an amount in respect of the accrued annual and long service leave be transferred with the employee, within thirty days of the transfer. At the time of

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audit, CSA was yet to pay a significant amount of leave entitlement monies to receiving entities where staff had transferred.

Employee report review

5.278 CSA payroll processing is outsourced to the ATO. The monitoring of reports received by CSA from the ATO is therefore essential, as it is CSA's main visibility over the processing performed. The audit highlighted a number of occasions where CSA was not ensuring these reports were reviewed in a timely manner.

IT security

5.279 A prior year issue relating to the review and monitoring of IT access logs, particularly in relation to privileged accounts, is currently being addressed by FaCS and is expected to be resolved shortly.

Conclusion

5.280 FaCS has acknowledged all issues and initiated corrective action to ensure all ANAO recommendations are addressed. FaCS should focus on the outstanding issues and work towards the timely resolution of these matters, to further strengthen their control environment.

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Department of Finance and Administration

Business operations

5.281 The role of the Department of Finance and Administration (Finance) is to assist the Government achieve its objectives by providing policy advice and services. Finance accomplishes this by contributing to three key outcomes:

- sustainable government finances;

- improved and more efficient government operations; and

- an efficiently functioning parliament.

5.282 Finance's operations are diverse, ranging from budget preparation and managing a large property portfolio, to providing cars and drivers for Senators and Members of Parliament.

5.283 Finance has continuing outsourced arrangements in place for the provision of human resource management, Australian Government financial reporting, internal audit, office services, IT services, property portfolio management, and Comcover's client services.

5.284 Finance's appropriation funding for the year ending 30 June 2004 covers:

- its price of outputs–$397.61 million, $148.70 million of which is funded by appropriations; and

- administered appropriations–$4.8 billion.

5.285 Finance's budgeted average staffing level for 2003–2004 is 871 (FTE).

Key business and financial statement risks

5.286 In order to manage its business risks, Finance addresses key issues relating to:

- appropriateness and rigidity of the Australian Government's financial management framework;

- appropriateness and accuracy of advice provided to Ministers, Members of Parliament and departments;

- valuation of superannuation liabilities administered on behalf of the Australian Government;

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- valuation of insurance liabilities administered on behalf of the Australian Government and the appropriateness of asset cover and reinsurance policies;

- valuation of the Australian Government's domestic property portfolio and adequacy of asset management procedures;

- validity and accuracy of entitlements paid to parliamentarians and their staff; and

- appropriateness of contract management procedures over outsourced arrangements for the provision of human resource management, Australian Government financial reporting, internal audit, office services, IT services, property portfolio management and Comcover's client services.

5.287 The ANAO's assessment of the risk of material misstatement in Finance's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- accounting for the actuarial assessment of the public sector unfunded superannuation liability;

- accounting for asset management; and

- reliability of valuations provided from third parties for assets and liabilities, particularly for Comcover.

Corporate governance

5.288 Finance has in place structures and processes that contribute to effective corporate governance and, in particular, to gaining assurance over the financial statement process. Specific processes assisting Finance in achieving this assurance include the following:

- annual internal audit work program approved by the audit committee;

- business planning and budget process;

- defining policy and procedures to operate within legal and social requirements;

- establishing control and accountability systems;

- regular updating of the audit committee charter;

- 'Finance Managers' committee and fortnightly meetings with Finance's Chief Financial Officer;

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- reviewing, monitoring and evaluating Finance's performance; and

- appropriate risk management, including an established risk management coordination unit.

5.289 These processes are exercised by management and articulated to all staff within Finance.

Financial reporting

5.290 Finance has developed strong financial reporting processes that provide monthly reports on administered and departmental revenues, expenses, assets and liabilities, and cash flow statements. The reports provide actual versus budget information on an accrual basis, allowing management to reliably assess Finance's financial position and operating performance.

5.291 During 2002–2003, Finance managed the 'close the books' process successfully. In order to facilitate meeting of the 30 July 2004 deadline, comprehensive financial statement instructions detailing procedures and a timetable were distributed to appropriate Finance line managers in March 2004. Finance is well placed to meet the reporting timeframe for 2003–2004.

Audit results

5.292 Finance has resolved all financial reporting issues raised by the ANAO in previous years. At this time, there are no issues to report arising from our 2003–2004 financial statement audit.

5.293 The results of the audit to date indicate that Finance has continued to take a pro-active role towards maintaining a strong system of internal controls.

Conclusion

5.294 The ANAO noted continued refinement of corporate governance and control structures in place. In relation to the current audit cycle, based on the work performed to date, the control framework and the internal controls are operating satisfactorily.

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Department of Foreign Affairs and Trade

Business operations

5.295 The Department of Foreign Affairs and Trade (DFAT) is responsible for protecting and advancing Australia's interests internationally by: enhancing international security, national economic and trade performance, and global cooperation; providing consular and passport services to Australian citizens; projecting a positive and accurate image of Australia internationally; promoting public understanding of Australia's foreign and trade policy; and managing overseas property owned by the Australian Government. DFAT provides high-quality advice to the Government across the spectrum of foreign and trade policy issues. It assists the increasing number of Australian travellers and Australians overseas, and projects a positive image of Australia internationally.

5.296 DFAT's outputs which contribute to its four outcomes, are carried out by staff serving at its network of overseas posts as well as in Canberra, in State and Territory capitals and in some regional centres.

5.297 There have been no significant changes to the business and operational environment within the department.

5.298 DFAT's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$798.29 million;

- estimated administered revenue–$197.56 million; and

- administered expenses–$202.43 million.

5.299 DFAT's average staffing level for 2003–2004 is 3 157 (FTE) across Australia and overseas.

Key business and financial statement risks

5.300 In order to manage its key business risks, DFAT addresses issues relating to:

- the delivery of timely and effective policy advice in line with the government's and ministers' agenda;

- maintaining effective relations with other countries and the ability to influence global and regional developments to protect Australia's interests;

- maintaining a secure and effective overseas network;

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- meeting client expectations and demands for consular and passport services, including the requirement to have continued security over passport operations; and

- valuation of the Australian Government's overseas property portfolio and adequacy of asset management procedures.

5.301 In managing these business risks, disciplined governance arrangements and management practices are required over foreign and trade policy and related diplomatic activities. Integral to this are human resource, information technology, financial and corporate management processes and systems that support a large network of overseas posts.

5.302 The ANAO's assessment of the risk of material misstatement in DFAT's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- contract management—particularly in relation to overseas property operations;

- administration of IT function—particularly in regard to transmission and storage of financial data on a worldwide network; and

- monthly financial reporting.

Corporate governance

5.303 The ANAO's audit approach considers DFAT's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing DFAT's strategies, the ANAO focused on the key initiatives in place to meet DFAT's objectives and management of the business risk associated with those initiatives. Measures which assist on financial assurance include:

- an executive committee which oversights the operational performance of divisions; reviews departmental wide issues and monitors financial performance;

- a governance committee framework including an audit committee. The audit committee meets at least quarterly and focuses on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, fraud control and ANAO audit activities;

- a monthly financial reporting regime;

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- an internal assurance section (Note this section is currently reviewing its procedures and coverage to be more based on risk assessments); and

- a fraud control plan.

Financial reporting

5.304 DFAT has maintained a strong focus on continuously improving the quality of its financial information and reporting systems and processes covering an extensive overseas network. Improvements are expected to continue in the quality of financial reporting and analysis as DFAT continues to integrate accrual based financial information into its management and decision making processes.

Audit results

5.305 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.16

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	1	1	0	0	0	0
Total	1	1	0	0	0	0

Source: ANAO

5.306 At this time, there are no issues to report arising from our 2003–2004 financial statement audit. There were no outstanding issues as at August 2003.

Conclusion

5.307 The ANAO noted continued refinement of corporate governance and control structures in place. In relation to the current audit cycle, based on the work performed to date, the control framework and the internal controls are operating satisfactorily.

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Department of Health and Ageing

Business operations

5.308 The Department of Health and Ageing's (DoHA) vision is better health, and healthier ageing, for all Australians through a world class system which:

- meets people's needs, throughout their life;

- is responsive, affordable and sustainable;

- provides accessible, high quality service including preventative, curative, rehabilitative maintenance and palliative care; and

- seeks to prevent disease and promote health.

5.309 DoHA's mission is to make a difference by:

- *looking outwards* to listen and respond to consumers, and engage constructively with professionals, providers, government and industry;

- *looking forwards* to respond effectively to emerging challenges including an ageing population, and improve services and care by strategic planning, benefiting from emerging knowledge and technologies; and

- *looking after* the health and wellbeing of the community, the funds entrusted to DoHA by the Australian people, and the priorities of the Ministerial team and the Government.

5.310 DoHA's vision and mission are to be delivered through outcomes including research, regulation, policy development, program management and partnerships with consumers and stakeholders.

5.311 DoHA's goals are:

- equitable access—improving the delivery of high quality health services for all Australians where and when they need them;

- fostering a healthier community—encouraging healthier living through measures to prevent and reduce the severity of diseases and injury and known health risks;

- broader primary care and better links to community and acute care—integrating care for consumers, through evidence-based care with improved linkages between primary, acute and community care;

- ageing—ensuring choice and access to appropriate community based and residential aged care services for older Australians, support for

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carers and industry, and a whole-of-government approach to the challenges of an ageing Australian population;

• public/private mix—improving choice through strong and viable public and private health sectors, in which people have access to affordable private health care; and

• sustainable health system—responding to emerging pressures, including from new technology and pharmaceuticals, in ways that improve care but contain costs.

5.312 Following a Program Management Review in 2002–2003, DoHA made changes to its management structure. The corporate executive structure has now been in place for over 12 months. The challenge facing DoHA during 2003–2004 is to build on the Program Management Review outcomes to deliver tangible improvements in the way that common activities are managed across the Health and Ageing portfolio.

5.313 The 2003–2004 year has seen a number of key changes to the business and operational environment of DoHA including;

• the announcement that the Health Insurance Commission (HIC) will move to a direct appropriation funding model for its operating requirements in 2004–2005;

• the announcement by the Government to abolish ATSIC, as from 1 July 2004, that will result in a distribution of indigenous programs to a number of Australian Government departments, including DoHA. DoHA will need to develop strategies to address the particular challenges facing DoHA;

• the impact of the revised Medical Indemnity package; and

• payment of an extra $513 million (estimated) to nursing home providers to assist in meeting agreed safety and building standards; and

• funding to purchase additional anti-viral medication late in 2003–2004.

5.314 CRS Australia, Therapeutic Goods Administration (TGA), National Industrial Chemicals Notification and Assessment Scheme (NICNAS), and the Office of the Gene Technology Regulator (OGTR) form key parts of DoHA and its consolidated financial statements.

5.315 DoHA's appropriation funding for the year ending 30 June 2004 comprises:

• price of outputs–$930 million (including amounts paid to HIC);

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- estimated administered revenue–$33.3 billion; and

- estimated administered expenses–$33.4 billion.

5.316 DoHA's average staffing level for 2003–2004 is 5 219 (FTE) across Australia.

Key business and financial statement risks

5.317 In order to manage its key business risks, DoHA focuses on issues relating to:

- addressing pressing health and ageing priorities before, and as, they emerge;

- promoting health, including preventative health measures that contribute to the long term sustainability of the health system;

- the delivery of timely and appropriate health care policy which ensures adequate health services are available to all Australians;

- compliance with grant funding agreements and Australian Government specific health and ageing related legislation;

- management and reporting of the Government's exposure to the Medical Indemnity package;

- management of relationships with key stakeholders such as HIC, DVA, Finance, State & Territory Governments, industry groups, service providers and consumers;

- management of systems and programs relating to delivery of a wide range of services; and

- public perception of DoHA.

5.318 The ANAO's assessment of the risk of material misstatement in DoHA's 2003–2004 financial statements is moderate to high. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- reduced reporting timetable;

- resolution and timeliness of year end accruals emanating from HIC;

- monitoring and reconciliation of funds disbursement with particular note on DoHA's transition to the new funding arrangements for HIC arising from the move to a direct appropriation funding model for HIC during 2004–2005;

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- reporting the Government's liabilities under the medical indemnity initiative;

- complex calculations of payments made to State and Territory Governments, service providers and program recipients;

- compliance with all relevant legislation and agreements by DoHA and recipients; and

- information transfer from feeder systems into the general ledger (FMIS).

Corporate governance

5.319 The ANAO's audit approach considers DoHA's goals, priorities, objectives and strategies, along with the critical success factors DoHA considers are necessary to achieve them. In reviewing the strategies, the ANAO focused on the key initiatives in place to meet the objectives and management of the business risk associated with those initiatives. Measures which assist in building financial assurance include:

- an Executive Committee (chaired by the Secretary) and two sub-committees that together assess the overall performance of DoHA's operations;

- a corporate committee framework including an Audit Committee, Policy Outcome Committee and Business Management Committee. The Audit Committee includes an independent member appointed from outside DoHA and an observer from the ANAO. The Audit Committee meets at least quarterly and focuses attention on internal audit activities, external audit activities and control framework assurances;

- a monthly financial reporting regime;

- the Audit and Fraud Control Branch (AFC) which has primary responsibility for internal scrutiny within DoHA and operates under the broad direction of the Audit Committee. The main goal of AFC is to promote and improve DoHA's corporate governance arrangements, through the conduct of audits and investigations, and the provision of high quality independent assistance and advice;

- a department wide Risk Management Plan (being coordinated by the Business Group) will be provided to the DoHA's Executive for consideration in July 2004, with implementation in the 2004–2005 financial year; and

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- in line with the Government's current Fraud Control Policy, a periodic fraud risk assessment undertaken by DoHA with the most recent assessment presented at the July 2003 audit committee meeting.

Financial reporting

5.320 DoHA produces full accrual monthly management financial reports within six days of the end of each month. DoHA reports comprehensively on its operations, including:

- administered and departmental revenues, expenses, assets, liabilities, cashflows;

- net cost of outputs by Divisions and State & Territory Offices (departmental); and

- outcomes report by programs (administered).

5.321 These are distributed to the Executive and Business Management Committee on a monthly basis. Included with these reports is commentary on DoHA's financial position, including detailed variance analysis.

5.322 The financial reports are supplemented by non-financial reports produced quarterly, but these are not integrated. Non-financial reports are primarily focused on budget initiatives and are reported by Outcome. KPIs are monitored throughout the year at a divisional level and are reported at a corporate level annually. The KPIs are reviewed when each Division prepares its annual business plan.

Audit results

5.323 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.17

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	5	1	5	4	1	2
Total	5	1	5	4	1	2

Source: ANAO

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Audit issues

5.324   The ANAO highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

IT security framework

5.325   The ANAO noted that DoHA has recently updated its IT Security policy. While no formal risk assessment is currently in place, a risk assessment is in progress and will form the basis of further development of the policy. The IT outsourcer is contractually responsible for security operations, including monitoring of the IT environment. However, the ANAO identified the need for DoHA to establish processes or mechanisms to provide assurance that IT security controls at the outsourced facility are effective and meet DoHA's security control objectives. DoHA is adopting a more comprehensive security control reporting regime which is in the process of being agreed with the IT outsourcer. It is expected that regular activity and incident reporting will be provided to DoHA to identify system issues. DoHA intends to supplement this with annual reviews of the IT outsourcer's security framework and associated controls.

Business continuity planning

5.326   As was noted by the ANAO in the prior year, DoHA does not have a formally established department-wide business continuity plan. A proposed business continuity plan has recently been drafted and circulated for comment and will be updated when DoHA's formal risk assessment has been completed. Whilst there is a Disaster Recovery Plan (DRP) for the mainframe, a formal DRP for other platforms has not yet been developed. This exposes DoHA to the potential risk that in a disaster situation critical business processes may be significantly interrupted. DoHA intends to develop a formal crisis management plan to be completed by December 2004.

Conclusion

5.327   DoHA has responded positively to the ANAO's issues and associated recommendations. DoHA has already taken action to address aspects of the deficiencies identified by the ANAO relating to its business continuity planning and IT security framework. In regards to the latter, DoHA has now established a comprehensive reporting regime with a view to identifying security system issues. The reporting regime will be supplemented by annual reviews of the IT outsourcer's security framework and associated controls. DoHA has a good statutory financial reporting framework in place and remains on track for timely completion of its financial statements.

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Department of Immigration and Multicultural and Indigenous Affairs

Business operations

5.328 The Department of Immigration and Multicultural and Indigenous Affairs (DIMIA) is responsible for enriching Australia through the entry and settlement of people, valuing its heritage, citizenship and cultural diversity; and recognising the special place of Indigenous people as its original inhabitants. DIMIA's business is managing the permanent and temporary entry of people into Australia, enforcing immigration law, successfully settling migrants and refugees, promoting the benefits of citizenship and cultural diversity, and working with other portfolio *entities* and government departments to advance the social, economic and cultural interests and status of Indigenous people.

5.329 A standard departmental appropriation funding arrangement was put in place in DIMIA in 2003–2004, replacing the purchasing agreements under which DIMIA operated between 1999 and 2003. DIMIA is to move to a new funding arrangement in 2004–2005, as determined by the recently completed review of DIMIA's business processes and funding arrangements.

5.330 DIMIA's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$845.40 million;

- estimated administered revenue–$474.20 million; and

- administered expenses–$339.45 million.

5.331 DIMIA's average staffing level is 4 557 (FTE) in Australia and overseas.

Key business and financial statement risks

5.332 In order to manage its business risks, DIMIA addresses key issues relating to:

- adequate corporate governance arrangements, including an effective accountability framework;

- the enforcement of immigration law in relation to all classes of visas, and entry and stay conditions;

- appropriate management of contractual arrangements to ensure effective and efficient delivery of services;

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- the prevention of system or information security failures through the management of large and complex IT environment and systems;

- correct issuing of visas to ensure border integrity is not compromised; and

- maximising the economic benefits of migration, tourism and full fee paying international students.

5.333 The ANAO's assessment of the risk of material misstatement in DIMIA's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- continued implementation of the Global Workings Initiative;

- earlier reporting requirement of 31 July 2004;

- SAP finance environment and reconciliations due to issues identified in this area in prior years;

- recognition and accounting for unearned income and accrued revenue; and

- asset revaluations due to fair value requirements in *AASB 1041 Revaluation of Non-current Assets*[44] as the transitional provisions for DIMIA have now ceased.

Corporate governance

5.334 Generally, a corporate governance regime imposes an alignment in the authority, responsibility and accountability within an entity, aspects of which are critical to the preparation of reliable financial statements. Corporate governance arrangements in DIMIA which contribute to financial statement assurance include:

- a management board which meets at least monthly to advise the Secretary on progress against the achievement of key departmental outcomes and related strategic and operational issues, including risk management;

- a finance committee which meets monthly, to assist the management board by providing advice on expenditure and budget allocations;

- an audit and evaluation committee which meets at least quarterly, focusing on risk management and the control environment, particularly

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[44] Australian Accounting Standards Board (AASB) 1041, Revaluation of Non-Current Assets, July 2001.

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relating to financial systems, accounting processes, audit planning and reporting. The committee regularly reviews performance and monitors achievements against internal audit plans;

- a monthly financial reporting regime;

- an internal audit strategy and plan which, within available resources, is based on management priorities; and

- a security steering committee, which meets regularly to develop, set and review information technology and protective security policies and procedures.

5.335 DIMIA is continuing development of a risk management strategy. DIMIA has introduced a risk management toolkit. The development of a formal, strategic risk management plan and the endorsement of the draft Fraud Control Plan will assist in strengthening the risk identification, assessment and prioritisation processes, including the implementation or refinement of controls to minimise risk to an acceptable level.

Financial reporting

5.336 DIMIA has stable and efficient monthly financial reporting processes. Monthly reports are provided to branches and the executive for review and analysis. Improvements are expected to continue in the quality of financial reporting and the level of financial analysis as DIMIA consolidates the level of accrual accounting and its financial management knowledge.

Audit results

5.337 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.18

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues Outstanding at August 2003	Issues resolved prior to March 2004	New Issues to March 2004	Closing Position as at March 2004
A	0	0	1	1	0	0
B	6	3	3	0	9	12
Total	6	3	4	1	9	12

Source: ANAO

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Audit issues

5.338 The ANAO highlighted the following issues that should be addressed to enhance the control environment and the reliability of information contained within the financial statements.

Overarching strategic risk management framework

5.339 DIMIA's devolved structure requires a considered risk management framework. DIMIA has a number of processes in place but could not demonstrate a coordinated strategic risk management structure with satisfactory reporting to management.

Fraud control plan

5.340 In 2002–2003, the ANAO noted that DIMIA did not have an up-to-date fraud control plan. A draft fraud control plan has been produced but has not yet been endorsed.

Overseas Audit and Security Checklist (OASC) and Financial Accountability and Control Tool (FACT) Checklist

5.341 DIMIA's control environment relies on the regular completion and analysis of a series of control self-assessment checklists across State/Territory and overseas offices. The ANAO found that the checklists did not align with the control framework in place. As well, overall results were not formally communicated back to individual offices. In these circumstances the effectiveness of the control self-assessment checklists is reduced and opportunities for process improvements are not maximised.

Safe custody of public money at the Perth Office

5.342 The ANAO found that the security and safe custody of public money needed to be improved. The current processes expose DIMIA to an increased risk of financial loss.

Translating and Interpreting Services (TIS) revenue reconciliation

5.343 There is no formal review of the reconciliation between the TIS revenue system and the financial management information system. In addition, procedures for the reconciliation process, are not documented. The absence of documented procedures may result in loss of corporate knowledge and ineffective controls.

SAP change control procedures

5.344 SAP system changes are not being recorded in a timely manner in the SAP migration database. This may undermine the integrity of the data in the migration database.

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Immigration Records Information System (IRIS)–Security

5.345 DIMIA does not have adequate processes in its onshore offices to obtain assurance that the security controls over IRIS are operating effectively. The ANAO recommended that DIMIA's onshore offices utilise the IRIS security controls self-assessment checklist, currently used by DIMIA in overseas posts.

IRIS system administrator passwords

5.346 Passwords for the IRIS system are issued to offshore posts in advance for the following twelve-month period. DIMIA has advised that it is updating its procedures to include appropriate security arrangements to mitigate risk of unauthorised use of the passwords.

User access

5.347 Two issues identified in 2002–2003 remain unresolved. DIMIA does not perform regular reviews of users with access to its FMIS. In addition, delays in the removal of access from employees who have left DIMIA were observed.

Business continuity management

5.348 In 2002–2003, the ANAO raised concerns regarding the currency of DIMIA's Business Continuity Plans as the last major review of the plans was conducted as part of contingency planning for the year 2000. At March 2004, DIMIA was still developing its Business Continuity Management framework as this project has been more complex than anticipated. In addition, the IT Disaster Recovery Plan, a component of the BCP, has not been developed.

Conclusion

5.349 DIMIA has acknowledged the issues and initiated corrective action to ensure all ANAO recommendations are addressed.

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Department of Industry, Tourism and Resources

Business operations

5.350 The Department of Industry, Tourism and Resources (DITR) is committed to promoting sustainable improvements in living standards for all Australians by working in partnership with business, and other stakeholders, to maintain and facilitate internationally competitive Australian industries. In addition, DITR advises the government on measures to enhance the development of efficient and globally competitive industries, and delivers efficient and effective business programs to assist industry development.

5.351 There have been no significant changes from the previous year to the business and operational environment within DITR. A minor change to the structure of the DITR portfolio occurred in 2003–2004, whereby DITR divested its minority interest in the Australian Technology Group to the Department of Finance and Administration.

5.352 DITR's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$250.66 million;

- estimated administered revenue–$1.21 billion (including ACIS); and

- administered expenses–$1.6 billion.

5.353 DITR's average staffing level for 2003–2004 is estimated at 1 559 (FTE) across Australia.

Key business and financial statement risks

5.354 In order to manage its key business risks, DITR addresses issues relating to:

- the maintenance of adequate processes and controls for the effective administration of grant and innovation programs;

- initiatives for best practice and effective support delivery;

- the timely implementation of system changes required to cater for policy/legislative changes; and

- the retention, and attraction, of staff.

5.355 The ANAO's assessment of the risk of material misstatement in DITR's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

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- administration of grants programs;

- appropriation funding;

- financial statement preparation and close processes; and

- changes to reporting requirements, including changes to the FMOs and the compressed financial statement reporting timetable.

Corporate governance

5.356 The ANAO's audit approach considers DITR's goals, priorities, objectives and, strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing DITR's strategies, the ANAO focused on the key initiatives in place to meet DITR's objectives and management of the business risk associated with those initiatives. Measures which assist in providing financial assurance include:

- an executive board that meets weekly to consider strategic organisational issues;

- monthly monitoring by portfolio managers of both financial and non financial measures of performance;

- a governance committee framework, including an audit committee and a financial statement sub-committee. The audit committee meets quarterly and focuses attention on overseeing DITR's audit, risk management, and fraud control plans and policies. The financial statement sub-committee meets at least monthly during the financial statements preparation and focuses on monitoring the financial statement process and DITR's interaction with external audit;

- a monthly financial reporting regime;

- a Corporate Strategy Group that has a planned risk based coverage of DITR's activities;

- an overall departmental risk management plan and divisional risk plans; and

- a fraud control plan.

Financial reporting

5.357 Continuous improvement initiatives implemented by DITR have resulted in a comprehensive monthly reporting regime. Monthly financial reports are made available to the Executive within 6-10 days of the month end. Improved data collection practices, coupled with improvements stemming

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from the regularity of monthly reporting processes, have seen a distinct improvement in the data quality and the timeliness of month end reporting and the financial statement close process.

Audit results

5.358 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.19

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	3	1	2	2	0	0
Total	3	1	2	2	0	0

Source: ANAO

5.359 DITR has resolved all financial reporting issues previously reported by the ANAO. At this time, there are no issues to report arising from our 2003–2004 financial statement audit.

Conclusion

5.360 Audit noted continued refinement of the control structures in place. In relation to the current audit cycle, based on the work performed to date, DITR's control framework and internal controls are operating satisfactorily.

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Department of the Prime Minister and Cabinet

Business operations

5.361 The Department of the Prime Minister and Cabinet (PM&C) is responsible for providing:

- policy advice and support on economic, industry, infrastructure and environment issues and on the effective operation of the Council of Australian Governments, the peak inter-governmental forum in Australia for policy reforms of national significance and requiring co-operative action;

- policy advice on social and women's issues, as well as administering on behalf of the Government, a number of programmes, including Partnerships Against Domestic Violence and grants to non-government women's organisations;

- policy advice on international issues; and

- policy advice on parliamentary, machinery of government and legal and cultural issues; provision of a range of support services for government operations including coordination of Cabinet and Executive Council business; policy advice on coordination and promotion of national awards and symbols; coordination of government communications and advertising; administration of the Prime Minister's official establishments; and administration of the visits and hospitality program.

5.362 PM&C's business, and operational environment, is predominately consistent with that of prior years, but with the inclusion of additional outputs pertaining to Defence and Security policy support, and the Cabinet Implementation Unit.

5.363 PM&C's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$54.67 million; and

- administered appropriations–$32.25 million.

5.364 PM&C's average staffing level for 2003–2004 is estimated at 392 (FTE).

Key business and financial statement risks

5.365 In order to manage its business risks, PM&C addresses key issues relating to:

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- the delivery of timely and effective policy advice and services in line with the Government's and Prime Minister's agenda;

- coordination of policy advice on a whole of government basis, including identification of emerging issues; and

- maintenance of appropriate security over Cabinet documents and other confidential departmental information.

5.366 The ANAO's assessment of the risk of material misstatement in PM&C's 2003–2004 financial statements is low to moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- special accounts–government communications and advertising;

- accounting for special accounts, special programs and grants;

- contract management; and

- asset management.

Corporate governance

5.367 The ANAO's approach considers PM&C's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing PM&C's strategies, the ANAO focused on the key initiatives in place to meet their objectives, and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- an executive committee which oversees the operational performance of the various divisions; reviews department-wide issues; and monitors financial performance;

- a governance committee framework including an audit committee. The audit committee, which meets quarterly, focuses on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, ANAO audit activities and fraud control;

- a 'contracted in' Internal Audit function that plans and conducts its work based on risk assessments of departmental activities and input from the Audit Committee;

- a monthly reporting regime; and

- a fraud control plan.

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Financial reporting

5.368   PM&C has a stable and efficient transactional financial reporting system. PM&C reports against budget for the various programs and activities, in both summary and detail form, and provides variance analysis. In addition, PM&C is aware of the impending transition to International Financial Reporting Standards (IFRS) and have considered all of the prerequisites for compliance.

Audit results

5.369   The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issue raised to date by the ANAO.

Table 5.20

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at March 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	0	0	0	0	1	1
Total	**0**	**0**	**0**	**0**	**1**	**1**

Source: ANAO

Audit issue

5.370   The audit highlighted the following issue that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

Business continuity planning

5.371   PM&C has progressed business continuity planning across the department, however, as at March 2004, the following steps had not yet been undertaken:

- formulation of business continuity plans for each business area; and

- the regular testing and updating of a business continuity and disaster recovery plan.

Conclusion

5.372   PM&C's management has responded positively to the ANAO issue and recommendation.

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Department of the Treasury

Business operations

5.373   The Department of the Treasury (Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury's mission is to improve the wellbeing of the Australian people, by providing sound and timely advice to the Government, based on objective and thorough analysis of options, and by assisting Treasury ministers in the administration of their responsibilities and in the implementation of government decisions. In carrying out its mission, the Treasury is responsible for the following policy outcomes:

- sound macroeconomic environment;

- effective government spending and taxation arrangements; and

- well functioning markets.

5.374   There have been no significant changes from the previous year to the business and operational environment within the Treasury.

5.375   The Treasury's estimated appropriation funding for the year ending 30 June 2004 (as detailed in the 2003–2004 Treasury Portfolio Additional Estimates Statements and also incorporating the 2003–2004 Treasury Portfolio Supplementary Additional Estimates Statements) comprises:

- price of outputs–$148.49 million;

- administered revenue–$3.49 billion; and

- administered expenses–$1.08 billion.

5.376   The Treasury's average staffing level for 2003–2004 is estimated as 760 (FTE) across Australia (exclusive of the Royal Australian Mint).

Key business and financial statement risks

5.377   In order to manage its key business risks impacting on the financial statements, the Treasury analyses and mitigates risks relating to:

- payment of grants to the States and Territories under the inter-governmental agreement;

- Australian Government investments and the management of the Government's participation within the International Monetary Fund and other international investments;

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- the administration of the Australian Government's HIH Claims Support Program;

- the administration of the Royal Australian Mint in the production of the Australian Government's circulating coin; and

- FOREX management.

5.378 The ANAO's assessment of the risk of material misstatement in the Treasury's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- financial statement preparation processes;

- financial and other regulatory requirements and their application;

- timing of information from consolidated entities;

- FMIS controls and management (including system upgrades);

- internal controls and processes; and

- consolidation processes for business operations.

Corporate governance

5.379 The ANAO's audit approach considers the Treasury's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the Treasury's strategies, the ANAO focused on the key initiatives in place to meet the Treasury's objectives and management of the business risk associated with those initiatives. Measures which assist on financial assurance include:

- an executive board that meets twice a month and has a formal annual corporate planning process;

- a governance committee framework, including an audit committee. The audit committee meets at least eight times a year and focuses attention on corporate governance, internal audit, external audit, fraud and risks faced by the Treasury;

- a monthly financial reporting regime;

- an internal assurance unit that has a planned risk based coverage of the department's activities; and

- a fraud control plan.

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Financial reporting

5.380 The Treasury has a comprehensive monthly reporting process and a detailed quarterly reporting process. The monthly reporting includes a preliminary report being produced and distributed by the fifth day after month end. A report with greater detail is prepared and distributed within two weeks of month end. This report is provided to the management board and outlines the departmental and administered financial position and performance by area or group, a capital management report, a variance review of the Treasury and a quality assurance report.

Audit results

5.381 The following table provides a summary of the status of prior year issues, as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.21

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	1	1	0	0	1	1
Total	**1**	**1**	**0**	**0**	**1**	**1**

Source: ANAO

Audit issues

5.382 The audit highlighted the following issue that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

SAP access management

5.383 During the course of the audit two users were found to have administrator access rights in SAP that allow complete access to all data and functions. There is currently no review of transactions performed by these users. This increases the risk of errors, irregularities or fraud from occurring and not being detected. The Treasury has removed administrator access rights and assigned more appropriate access rights to the users involved.

Conclusion

5.384 The Treasury's management has responded positively to the ANAO's issue and the associated recommendation. The Treasury has already taken action to address the deficiency identified by the ANAO.

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Department of Veterans' Affairs

Business operations

5.385 The Repatriation Commission is responsible, under the *Veterans' Entitlements Act 1986*, for granting pensions, allowances and other benefits; and providing treatment and other services through hospitals and institutions, or community facilities to veterans. The Department of Veterans' Affairs (DVA), in its role of providing administrative support to the Repatriation Commission, delivers its responsibilities by making pension, allowances and other benefit payments to veterans and other entitled persons. DVA also administers the commemoration program and the *Defence Service Homes Act 1918*.

5.386 This year, DVA commenced transition to a new IT architecture to provide more cost-effective use of hardware and software and to establish a new data operating environment. There are indications that the new infrastructure will deliver business benefits and result in improved service to the veteran community.

5.387 DVA's appropriation funding for the year ending 30 June 2004 comprises:

- price of outputs–$278.86 million;

- estimated administered revenue–$2.40 million; and

- administered expenses–$9.71 billion.

5.388 DVA's average staffing level for 2003–2004 is 2 468 (FTE) across Australia.

Key business and financial statement risks

5.389 In order to manage its key business risks, DVA addresses issues relating to:

- the effective management of service level arrangements for the payments of benefits with the Health Insurance Commission, the Department of Health and Ageing and Centrelink;

- decentralised and devolved operations to State Offices, which are managed through quality assurance and monitoring processes;

- continuous changes in veterans' legislation covering the applicability of benefits and levels of benefits to be paid;

- the reliance on external parties to provide information to support entitlements for various government benefit programs;

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- maintenance of a good public profile;

- increased financial management responsibilities and accountability; and

- business risks concerned with the Defence Service Homes Insurance Scheme.

5.390 The ANAO's assessment of the risk of material misstatement in DVA's 2003–2004 financial statements is moderate. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- payments to veterans together with a verification of year-end accrual calculations;

- management of contracts and service level agreements;

- financial reporting reform requirements; and

- key areas of Defence Service Homes Insurance Scheme.

Corporate governance

5.391 The ANAO's audit approach considers DVA's goals, priorities, objectives, and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing DVA's strategies, the ANAO focused on the key initiatives in place to meet DVA's objectives and management of the business risk associated with those initiatives. Measures which assist with financial assurance include:

- an executive management group which meets quarterly to determine and evaluate progress on the agreed strategic directions of DVA. The group is supported by sub-committees that assess the overall performance of DVA's operations through a variety of reporting mechanisms;

- a governance committee framework, including the National Audit and Fraud Committee, which oversees and provides direction to risk management activities and assesses outcomes of external reviews of programs including follow-up actions. The committee also has a monitoring role in relation to the progress of internal audit and ANAO findings and the accounting and financial statements completion process;

- an internal audit team which develops an internal audit strategy and undertakes risk profiling across DVA. DVA's attitude to the internal audit activities is positive which is reflected through their acceptance

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and implementation of a significant portion of the recommendations suggested by the internal audit; and

- a strategic risk management policy which is reviewed every two years. The policy is directly linked to DVA's fraud control activities. A detailed risk assessment is prepared from the strategic risk management policy for each program.

Financial reporting

5.392 Reporting processes implemented by DVA are comprehensive and includes both financial and non-financial information. The Balanced Scorecard report measures performance against cost, quantity, timeliness, quality and outcome. In addition, monthly reports of actual versus budgeted expenditure are distributed for review by each State and Branch Manager and are discussed at a quarterly meeting of the Corporate Resources Committee.

Audit results

5.393 The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.22

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	0	0	0	0
B	4	2	2	0	3	5
Total	4	2	2	0	3	5

Source: ANAO

Audit issues

5.394 The ANAO highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements.

Security plans–follow-up on prior year issue

5.395 IT application security plans provide the organisation with a documented strategy for managing and maintaining access and security to its application programs and data. These plans need to evolve with changes in the operating environment. The ANAO reported, in prior years, that the System Security Plan for the Pension Information Processing System had not been

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updated. This issue remains outstanding in the current year. DVA was reviewing the plan at the time of the audit.

Business recovery plan–follow-up on prior year issue

5.396 Business continuity planning is integral to the provision of uninterrupted availability of all business resources/systems required to support key business processes and ultimately continuous service to customers. In reviewing DVA's business continuity planning processes, the ANAO could not confirm whether a formalised Disaster Prevention Plan, as required in the outsourcing agreement, or any formalised disaster recovery plans for the DVA's IT infrastructure, had been developed and tested. Discussions held between DVA and the ANAO indicated that a number of activities required to complete the plan have been undertaken or were near completion.

Data inconsistencies

5.397 The ANAO performed a review of the quality of the standing database on a number of DVA's pension systems. Data inconsistencies were identified relating to a large number of veterans' records that need further investigation. DVA is progressing with the analysis and is of the view that the exposure to inappropriate payments being made is low.

Management of section 93 recoveries

5.398 Under the *Veterans' Entitlements Act 1986* section 93, where a veteran or a war widow commences litigation against a third party seeking damages or recovery of costs, the Repatriation Commission, on behalf of the Australian Government, can recover, in full, its expenditure on treatment costs from the veteran or war widow. The ANAO reviewed management of section 93 recoveries and found that there were no written procedures issued to cover these recoveries, resulting in inconsistent practices across different States. In the absence of documented procedures, differences in management of debt by DVA could result in under-recovery of Australian Government monies as well as in unrecorded debtors and revenue in the year-end financial statements. DVA plans to have a draft national policy in place before 30 June 2004.

Accounts payable processes

5.399 A number of multiple records of vendors have been created in DVA's financial management system. In addition, the process of raising purchase orders was not always in accordance with DVA's internal requirements. These shortcomings in the accounts payable processes increased the risk of duplicate payments being made to suppliers and could facilitate the processing of subsequent fraudulent payments. DVA advised that a review process has commenced.

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Conclusion

5.400 DVA's management has responded positively to the ANAO's issues and associated recommendations. DVA has already taken action to address aspects of the improvements identified by the ANAO.

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Health Insurance Commission

Business operations

5.401 The Health Insurance Commission (HIC) is the Australian Government statutory authority responsible for delivering national health programs such as Medicare; the Pharmaceutical Benefits Scheme (PBS); the 30 per cent Private Health Insurance Rebate (PHIR); the Australian Childhood Immunisation Register; and the Australian Organ Donor Register on behalf of the Department of Health and Ageing (DoHA). HIC contributes to the quality of health care in Australia through efficient payments and its expertise in health information and electronic business.

5.402 HIC also administers a number of health incentive programs and grant schemes on behalf of DoHA, and processes the payment of benefits for the Department of Veterans' Affairs' (DVA) Treatment Accounts and the Office of Hearing Services. In addition, HIC assists in administering the Family Assistance program for the Department of Family and Community Services.

5.403 HIC processes more than 400 million transactions each year and pays benefits in excess of $16 billion per year. HIC also detects and prevents fraud and inappropriate servicing; provides international consultancy services; and plays a key role in the development of Australia's health payments and information for the future.

5.404 The 2003–2004 year has seen a number of key changes to the business and operational environment of HIC including:

- the announcement that, in 2004–2005, HIC will move to a direct appropriation funding model for its operating requirements for Health related outputs;

- the development of a sustainable funding model for HIC following the completion of an Activity Based Costing Review;

- responsibility for the administration of key elements of the Government's new MedicarePlus initiative;

- responsibility for administering all aspects of the revised Medical Indemnity package;

- continued implementation of the eBusiness and technology improvement program, including the movement to online claim lodgement for PBS and Medicare; and

- the reappointment of IBM GSA for major information system services.

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5.405 HIC's average staffing level for 2003–2004 is 4 665 (FTE) across Australia.

Key business and financial statement risks

5.406 In order to manage its key business risks, HIC addresses issues relating to:

- understanding and meeting customer needs;

- financial resources and the ability to meet contractual obligations and deliver corporate strategies;

- quality of data residing on HIC information systems;

- integrity of the Medicare card;

- performing regulatory responsibilities appropriately;

- the revised Medical Indemnity package;

- business improvement through technology infrastructure and solutions;

- the protection of sensitive information; and

- management of relationships with key stakeholders such as DoHA, DVA and Finance.

5.407 The ANAO's assessment of the risk of material misstatement in HIC's 2003–2004 financial statements is high. The financial statement audit will focus on the material financial reporting risks flowing from the following key issues:

- adequacy of the internal control environment over critical information systems;

- implementation of the medical indemnity and MedicarePlus initiatives;

- funding of new initiatives;

- financial statement preparation;

- accounting for internally developed software;

- reduced reporting timetable;

- year end accrual and provision calculations; and

- asset impairment.

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Corporate governance

5.408 The ANAO's audit approach considers HIC's goals, priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing HIC's strategies, the ANAO focused on the key initiatives in place to meet HIC's objectives and management of the business risk associated with those initiatives. Measures which assist on financial assurance include:

- a Board of Commissioners with predominantly non-executive members;

- monthly meetings of the Board of Commissioners;

- a governance committee framework including an audit committee, Fraud and Service Audit Committee, Business Outcomes Committee, Human Resource Committee and Remuneration Committee. The audit committee meets at least five times throughout the reporting period and focuses attention on achievement of strategic objectives; promotion of accountability to the Minister, Parliament and the community; management performance and internal controls; monitoring the Audit and Risk Assurance Services Branch function; and liaison between senior management, internal audit and external audit;

- a formal strategic plan underpinned by a corporate and divisional and state business plans;

- a monthly financial reporting regime;

- monthly reporting of key performance indicators to monitor performance against objectives;

- a formal risk management framework including a detailed risk management plan which is reviewed and updated by senior management at least quarterly. This is further complemented by risk management disciplines being embedded across all facets of the organisation;

- an internal Audit and Risk Assurance Services Branch function that has a planned risk based coverage of HIC's activities;

- a Program Review Division with responsibility for ensuring the integrity of programs administered by HIC through the prevention, detection and investigation of fraud and abuse; and

- a fraud control policy and plan.

5.409 These activities contributing to corporate governance have been reviewed and assessed as operating satisfactorily to assist HIC meet its

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strategic objectives. Further improvement will, however, be required before the corporate governance framework is considered fully effective in ensuring the achievement of strategic outcomes.

Financial reporting

5.410   The HIC monthly financial reporting process is primarily focussed on reporting actual results against budget/plan. HIC has undertaken a number of new measures to enhance the quality of monthly financial reporting, and continued improvement can be achieved through adding more rigour, discipline and sophistication to the financial management reporting framework. This improvement will embed greater preventative controls within the reporting framework and enhance the quality of financial reporting.

Audit results

5.411   The following table provides a summary of the status of prior year issues as well as the 2003–2004 audit issues raised by the ANAO.

Table 5.23

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2003	Issues resolved prior to August 2003	Issues outstanding as at August 2003	Revised Rating	Issues resolved prior to March 2004	New issues to March 2004	Closing position as at March 2004
A	0	0	1	(1)	0	0	0
B	7	1	15	1	5	10	21
Total	7	1	16	0	5	10	21

Source: ANAO

Audit issues

5.412   The audit highlighted the following issues that should be addressed to support the adequacy of the control environment and the reliability of information contained within the financial statements.

Financial stewardship

5.413   Financial stewardship for the statutory financial report preparation process primarily relates to the prominence and effectiveness of the supervisory function performed by HIC's central Finance division over the statutory financial information framework. The current supervisory activities of HIC's central Finance division require expansion to improve the financial disciplines that underpin the financial statement preparation process. This expansion will improve the governance and accountability culture throughout HIC.

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5.414 The Managing Director's Instructions are the primary reference within HIC to communicate financial and administration requirements. These instructions were last updated in 1999 and given the passage of time, have lost prominence as an important corporate governance tool within HIC.

5.415 The reconciliation of the general ledger to underlying feeder systems, and independent support, are critical control mechanisms over the integrity of information reported within the financial statements. Responsibility for the reconciliation of key accounts within the HIC general ledger is delegated to various areas. The controls over reconciliations are not sufficient to ensure the general ledger reconciliation process is complete and sufficiently robust throughout the entire reporting period.

5.416 The change management structure within HIC does not ensure the complete and timely communication of financial risks to the central Finance division arising out of changes to operational activities. The current structure can result in HIC being reactive in its management of risks that impact upon the financial statements.

5.417 The ANAO communicated serious issues concerning the resourcing of HIC's central Finance division in 2003. HIC has taken steps to bolster its resource capability to address the risks attaching to its statutory financial reporting, management and accountability responsibilities.

Departmental revenue

5.418 At March 2004, there was no central system for managing the revenue that flows from project work undertaken by HIC on behalf of other *entities*. As a result, this element of the revenue base is managed and accounted for in a fragmented manner. The nature of this issue will change beyond 2003–2004, as HIC moves to a direct funding model with Finance for its operating requirements. The ability to defer recognition of revenue in response to phasing issues is no longer available for some activities.

5.419 The current project management reporting information framework is not sufficiently developed to enable rigorous management analysis and review to be completed on a consistent and timely basis. Consequently, the financial outcomes attaching to individual projects and new initiatives are managed on a portfolio basis, rather than at the individual transaction level.

5.420 HIC continued to provide services to external parties in 2003–2004, while the renewal of key agreements with external parties remained outstanding, including schedules to the Strategic Partnership Agreement with the Department of Health and Ageing.

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Medical indemnity

5.421 The introduction of the medical indemnity reform in 2002–2003, combined with further amendments and new initiatives in the 2003–2004 year, has created a number of new statutory, financial reporting and administration risks for HIC. Aspects of the internal control environment over various components of the Medical Indemnity reform package administered by HIC are currently under development and will require further testing and validation throughout 2004–2005 to ensure such risks are mitigated to acceptable levels.

NSW shared business services

5.422 The NSW Shared Business Services central processing function has previously operated with insufficient direction and input from the central Finance division, limiting the effectiveness of the internal control environment and audit process. Significant reengineering of the reporting lines and protocols between the Shared Business Services processing centre and the central Finance division has been recently undertaken to ensure central processing staff are sufficiently cognisant of their role in the management of key statutory financial reporting risks. The 2003–2004 year end process will represent the first opportunity for the NSW central processing staff to demonstrate their capacity to properly manage financial reporting risks under their responsibility.

Business improvement program

5.423 The Business Improvement Program represents the current major operational change initiative within HIC, and is primarily delivered through the development of various eBusiness and technology solutions. The implementation of this program creates several financial reporting risks due to its capital intensive nature, the requirement for major changes to existing process infrastructure, and the 'greenfields' element of proposed solutions. The central Finance division is currently developing a framework for the regular review and management of the financial reporting risks arising from the continued development and rollout of the Business Improvement Program.

Departmental expenditure

5.424 The IBM GSA contract for information system services is HIC's largest business support contract, and is a potential source of misstatement risk in the financial statements due to deficiencies in:

- contract management;

- period end accruals; and

- management reporting of various aspects of the contract.

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5.425 The ANAO does, however, acknowledge recent actions by management to address these concerns and reduce the risk of financial statement misstatement to within accepted tolerances.

Accounting for lease makegood provisions

5.426 The bulk of HIC activities are carried out from leased premises that have property lease agreements containing 'makegood' clauses. Makegood clauses require HIC, as the lessee, to restore the premises to original condition and remove any fit out added by HIC during its tenancy. HIC currently recognise the cost of lease 'makegood' clauses when payments are made rather than at the inception of the lease in accordance with current AASs.

Accounting for long service leave

5.427 HIC long service leave provision is derived from a leave liability report produced by the Aurion payroll software system. A long service leave liability accrual has not been recognised for 579 staff notwithstanding the existence of an obligation. The report does not recognise a liability until an employee completes 261 days of work. HIC staff involved in the management of employee entitlements possess limited knowledge of the report's parameters. In addition, inadequate integrity checks are performed over this report.

Administered financial reporting

5.428 HIC reports a number of significant administered activities within its annual financial statements. Embedded within the declaration made by representatives of HIC that attaches to the annual financial statements, is an assertion about governance and accountability. The statutory reporting framework employed within HIC does not document the same level of financial stewardship and accountability activities normally expected to underpin the administered financial information reported within a public set of annual financial statements. HIC needs to expand its monthly management reporting to support the annual declarations made by HIC.

5.429 HIC is responsible for administering a variety of significant grants and programs to enhance the delivery of medical care through incentives, particularly in regional Australia. Grant and incentive schemes administered by HIC reside on a number of legacy feeder systems that are limited in their ability to generate period end accruals and the quantum of annual expense totals. This lack of functionality decreases the robustness of grant and incentive general ledger information presented within the financial statements.

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Mainframe security

5.430   In previous years, the ANAO has reported significant findings in the control practices and administration of user access over the mainframe environment, where many of HIC's significant business applications reside. HIC has made notable progress in addressing these deficiencies. However, a number of actions still need to be completed, mainly in the area of implementing and adopting role based access control.

Security incident management

5.431   Since the commencement of the current IT outsourcer in 2000, the activity of reviewing IT security reports has not been consistently completed. The ANAO found that no clear policies or procedures have been developed and implemented, and reviews of security reports have not yet commenced. The HIC has indicated that there have been ongoing discussions with the contractor seeking to find an effective approach to security monitoring.

Change management

5.432   A number of deficiencies were identified in the controls over change management. It is recognised that actions have commenced to address these weaknesses through the implementation of a new change management tool for controlling changes in the mainframe environment. Action has also commenced on formalising procedures for managing change documentation.

Business continuity management

5.433   Although the business continuity and disaster recovery plans are yet to be finalised, HIC has made significant progress towards implementing a comprehensive business continuity plan and disaster recovery plan. Some work is still required in completing the documentation, procedures and testing of these plans.

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Conclusion

5.434 Important areas for improvement, such as the IT control environment and the medical indemnity issue, have received significant management attention in the current year but remain as outstanding, together with other issues. Areas for improvement that management will need to address are the lack of robustness concerning the accounting disciplines, systems and statutory reporting framework for Departmental items. This is evident by the majority of findings being Departmental in nature. HIC needs to ensure the risks associated from these exposures are addressed in a timely manner, particularly as HIC moves into a direct funding relationship with Finance in 2004-2005. However, HIC will also need to focus greater efforts on Administered activities. These activities are supported by various legacy systems that will have increasing difficulties in providing the necessary functionality to maintain and measure the arrangements that HIC has as a purchaser and/or provider of services.

Canberra   ACT

26 June 2004

P. J. Barrett

Auditor-General

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Appendix 1: Extended Testing Group Individual Assessments

The ANAO performed a more in-depth analysis of the information security and business continuity management practices for five larger entities (the extended testing group) which were selected last year, namely, the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and the Health Insurance Commission. This is described in detail in this Appendix.

Information Security Management Practices

Individual summary assessments of information security management practices for the extended testing group are detailed below.

Australian Taxation Office

The ATO has a well-developed and evolving security policy framework. A branch exists within the organisation with the role of managing and facilitating IT security policy, training, incident investigation and assurance. Corporate relationships have been developed with corporate protective security functions, outsourcer security roles and key internal system owners. Regular assurance reviews of key IT systems and environments provide influential oversight of security status and establish an appropriate focus on risk mitigation strategies and their implementation.

The ATO increasingly chooses to employ Web-based technologies for transactions with taxpayers. An established process of threat risk assessment and risk management for new information systems provides a level of assurance with regards to issues of security. Risk assessments frequently make use of intrusion testing by external security specialists.

Effective protection against introduction of malicious and disruptive software and external IT attacks is implemented at the ATO via a framework of operating system restrictions, filters on electronic data transfer, host-based detection software and firewalls. Remote access is regulated via dedicated hardware and software, smart cards, protected channels and encryption techniques. Smart cards and hard drive encryption prevent unauthorised access to data on mobile computers.

A centralised 24-hour IT security incident response function is in place, and has links to the Defence Signals Directorate (DSD) security incident reporting system. IT related security breaches are investigated by computer specialists and directed through disciplinary channels with official penalties applied as appropriate.

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Physical security is achieved *via* swipe cards, security guards and electronic keypads for high-security areas. ATO sites and facilities have undergone comprehensive and continuing review in 2003–2004 focusing on access control. Renewed emphasis has been placed on security certification of both ongoing and non-ongoing staff; business units have identified role clearance requirements; and a central database of employee clearance status has been implemented. Briefing and induction sessions, an e-learning security module and banners, enhance a good overall level of organisational security awareness.

The ATO has attained a *Defined Process* rating for their information security practices. Areas for improvement include: establishing a corporate information security plan based on:

- a comprehensive risk analysis;

- clarifying roles and responsibilities for implementation of security; and

- establishing effective strategies and roles for the protection, retention and monitoring of security audit logs.

Centrelink

An overarching IT Security Policy has been implemented which provides the guidelines and boundaries to establish sound security practices. This policy is accessible to all staff, and addresses all key security areas. The policies were developed as a result of identifying the key information processes and related risks, and involved an extensive consultative and review process.

The overall security policy and operational planning is developed centrally. All security policies detailed within the IT Security Policy have been endorsed by the CEO and reflect management commitment to that policy. A Security and Privacy Committee has been established to advise the CEO on matters in relation to the development, implementation and review of security and privacy policy and procedures. The day-to-day management of security related activities is achieved through a process of centralised and localised activities.

Line managers are responsible for ensuring that employees have an appropriate level of security awareness and security clearance for the level of approved information access. Although there is currently no formal training program for staff to increase their awareness of IT security concerns, induction courses are provided that include segments relating to the security of information, basic security awareness standards, the consequences of violating those standards, and appeal rights.

The Centrelink security access management system governs authorisation, monitoring and management of user access to the mainframe systems and

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database. Monitoring procedures over mainframe security requires improvement to ensure access to sensitive files is well controlled. Strong system access procedures are in place through the use of security access passes and electronic access tokens by approved persons. Access is provided on the basis of demonstrated need.

Dial-up access is available and restricts access only to authorised persons. All remote access to Centrelink's computer system must use encryption services.

Overall, Centrelink has attained a *Managed and Measurable* rating for their information security practices. Centrelink is in the process of undertaking a risk assessment of mainframe security to identify critical risk areas that require formal monitoring to ensure user access is appropriate.

Department of Health and Ageing

DoHA has an IT security policy that sets the framework for the establishment of security controls. The IT security policy has recently been updated to comply with government security requirements. While no formal risk assessment is currently in place, a risk assessment is in progress and will form the basis of further development of the policy framework.

Security training is provided at induction courses and the security area has developed other security training courses that are provided on an 'as required' basis. Security related policies and guidelines are located on DoHA's Intranet. Data encryption is required and used for all data that is in-confidence or at a higher security classification. However, not all internal communication links are encrypted. This exposure is being addressed by DoHA with a fully implemented solution due in December 2004.

To obtain access to DoHA's mainframe, midrange or LAN IT environments, potential users are required to complete an approved application form indicating that they understand the conditions of use and will comply with the security policy, which is then forwarded to IBM Global Services for processing. Access to DoHA's IT environments is a necessary prerequisite for access to business applications which have their own system access and approval processes and are monitored by the respective application System Manager/Administrators.

The current procedures for gaining remote access to DoHA's IT environment are documented on the Intranet. Subject to there being a valid business need and appropriate approval, a user can request dial-in access by completing a Dial-In-Access Request Form.

Since the commencement of their contractual arrangements, IBM Global Services has been responsible for security operations, including monitoring, in the IT environments. DoHA is currently in the process of negotiating security

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related service levels and improved security reporting requirements with IBM Global Services.

Overall, DoHA has attained a *Defined Process* rating for its information security management practices. However, the ANAO identified a need for more comprehensive security monitoring of the IT environment. Improvements need to be made through the establishment of a proper risk assessment, which will be used as the basis for updating the IT security policy. DoHA will be establishing mechanisms to provide assurance that IT security controls at IBM Global Services are effective and meet DoHA's security control objectives.

Department of Veterans' Affairs

The IT Security Policy is the core policy document promoting security awareness, processes and solutions within DVA. Responsibility for the maintenance of the IT Security Policy is assigned to the DVA's Information Management Unit—Security and Mainframe Support Section.

The policy clearly articulates the security requirements of the business owners and the users of DVA systems. Business owners are responsible for developing and maintaining security plans, in conjunction with the IT Security Unit, to ensure consistency with the IT Security Policy, identification of application risks and appropriate mitigation strategies.

Security assurance services within DVA include services provided by Internal Audit and the Security and Mainframe Support Section. Work undertaken by these areas has encompassed a number of security/risk management related activities and has lead to improvement in the delivery of IT security within DVA.

DVA's delivery of IT services is outsourced. However, DVA has retained responsibility for security management. This role is managed by the Security and Mainframe Support Section, which administers access to DVA's resources, including by staff of the outsourcing firm. DVA has adequate controls that allow it to detect and analyse security events, as well as the ability to log and take appropriate action. Daily review of system logs by the IT Security Unit has been enhanced through the implementation of new log review software.

DVA has achieved a CobiT rating of *Defined Process* for their information security practices. Areas for improvement include deployment of on-going security awareness programs to both new recruits and existing staff and ensuring that key security plans are updated, reviewed and endorsed on a regular basis.

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Health Insurance Commission

HIC's existing IT Security Policy is in the process of being updated. IT security roles are defined and an organisational Security Steering Committee is established that meets bi-monthly. IT security awareness is undertaken through an induction program for all new staff. In addition, a series of information posters and discussion guides have been distributed for use by managers.

Formalised procedures are in place for the administration of user security and procedures for the creation of new accounts. Changes to existing accounts require a review of the appropriateness of the access required.

In regard to the mainframe, users are granted access through group structures to perform key business processes including; viewing and updating customer information, processing transactions and initiating payments on key business applications. In prior years, the ANAO has brought to HIC's attention significant findings in the administration and control of user access over the mainframe environment. While HIC has made significant progress in addressing these issues, further work is underway to ensure user access is authorised and managed and to fully adopt role-based access. It is intended that, once this is implemented, a program will be established for ongoing cyclical review. As a result of user access deficiencies, mainframe security could not be relied upon for the purposes of the financial statement audit. Consequently, additional substantive test procedures were required to gain financial assurance.

Since the commencement of IBM Global Services as the IT outsourcer in 2000, regular reviews of IT security reports have not been undertaken. HIC has indicated that there have been ongoing discussions with IBM Global Services in seeking to find an effective approach for security monitoring. In addition, although procedures exist in relation to incident security reporting, these need to be formally approved and documented. However, there are periodic IT security reviews undertaken by Internal Audit.

Overall, HIC has attained a *Repeatable but Intuitive*, rating for its information security management practices. Improvements need to be made by continuing to establish defined standard user profiles and functional group structures for each job function and undertaking regular reviews of user access. This includes the development and implementation of policies and procedures to cover the review of IT security incidents within the IT environment. The implementation of these measures will assist HIC in moving towards a *Defined Process* rating.

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Business Continuity Management Practices

Individual summary assessments of business continuity management practices for the extended testing group are detailed below.

Australian Taxation Office

ATO's business continuity management (BCM) framework has improved significantly since last year's report. The BCM framework addresses the main elements of business continuity, namely crisis response, crisis management, and business process recovery.

The business continuity and emergency control structures established are logical, clearly stated in ATO Practice Statements, and consist of a number of layers reflecting organisational and business functions. Executive and operational responsibilities for business continuity planning and disaster recovery have been assigned within the ATO.

Information on business continuity arrangements is collected, assessed and reviewed on a continuous basis by the National Director of Business Continuity. New templates, for consolidation of information, have been developed and are being distributed. Business impact analysis (BIA) has been limited to the Goods and Services Tax with the intention to perform BIAs for all business processes. The ATO needs to continue the momentum over business continuity data collection and process improvement.

ATO's IT infrastructure, applications and telecommunications represent critical business elements. The ATO has disaster recovery arrangements for mainframe, midrange (excluding the Distributed Systems Environment (DSE)) and communications. Testing of existing business continuity and mainframe disaster recovery processes has been successfully completed during the current year. Further testing of the mainframe disaster recovery plan is planned for mid 2004. The ATO still needs to develop, implement and test, disaster recovery arrangements for the DSE.

The ANAO notes that the ATO is currently implementing the IT Infrastructure Library (ITIL) framework. IT Service Continuity Management (ITSCM) is a component of ITIL. Full implementation of the ITSCM component should substantially assist the ATO to improve IT business continuity management.

The ATO has attained a *Defined Process* rating for its business continuity and disaster recovery practices. Continued attention to the collection of business impact information for all identified business processes and the establishment of disaster recovery practices for the DSE are required to improve this rating.

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Centrelink

A formal business continuity emergency framework has been developed which comprises all business continuity plans (BCPs) for area offices, call centres and the national support office. This framework includes an assessment of critical activities, consideration of disaster scenarios, development of crisis plans for specific business areas and regional areas, disaster notification procedures, and responsibilities of management.

The use of a BCP template has enabled the development of standardised plans across Centrelink. Business continuity policies and procedures are communicated throughout the organisation via the Business Continuity and Emergency Management home page, or the Centrelink Intranet.

A business criticality review was conducted in March 2002. The review identified key business processes, the IT systems that support them, and the timeframe for the maximum acceptable outage. The business continuity and emergency framework highlights that BCPs should be maintained and tested on a regular basis. However, a recent Performance Audit Report[45] identified that this has not been the case for all BCPs. In addition, it was noted that the business continuity team has not implemented a formal schedule to ensure that all BCPs are tested, reviewed and updated in a periodic and controlled manner for adequate management assurance.

Disaster recovery plans (DRPs) have been developed for Centrelink's mainframe applications and Infolink (SAP) system. The mainframe DRP consists of two plans. One relates to the data centre and the other to the hardware and operating system. The data centre plan identifies the different types of disasters that may result in a system outage or failure, the activation and escalation procedures and the key individuals to contact. The DRP also includes a schedule of all tests performed between the period October 1997 and March 2002. The ANAO noted, however, that a test had not been conducted since November 2002 and that the plan is currently being reviewed.

The hardware and operating system plan is a contingency procedure that documents the steps required to restore the mainframe operating system in order for IT applications to be restored from backup devices in the event of a disaster. This plan was tested during the current financial year.

The disaster recovery plan for SAP includes the recovery of the SAP production and application servers and identifies the process by which the plan should be escalated once a disaster recovery event has been identified.

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[45] ANAO Report No.9 of 2003–04, *Business Continuity Management and Emergency Management in Centrelink.*

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The plan details the teams that are to be involved in the restoration of SAP in the event of a disaster. This plan has recently been updated and tested.

Overall, Centrelink has achieved a *Managed and Measurable* rating for their business continuity and disaster recovery plans. However, improvements could be made by implementing a schedule to ensure that all BCPs are tested, reviewed and updated on a periodic basis and that regular periodic testing is undertaken on the data centre disaster recovery plan.

Department of Health and Ageing

DoHA does not currently have a formally established department-wide business continuity plan. A proposed BCP has been drafted and circulated for comment. It is understood that the BCP will be updated once the formal risk assessment has been completed, and will draw on the recent business impact analysis. Although management has made steps towards assessing business risks associated with business continuity management, little progress has been made since last year.

DoHA has a formal DRP for the mainframe environment. However, there is no formal DRP for critical systems, such as various payment systems and SAP, or for the midrange and network environments. A formal crisis management plan for handling disaster situations is planned in the forward work program following finalisation of the BCP. The intended development of these plans has been delayed due to the extension of IBM Global Services contract to 2009. As part of this extension, DoHA will shortly be undergoing a hardware replacement of its IT infrastructure across all IT environments that will necessitate a technical review and update of DoHA's continuity and disaster arrangements.

Overall, the DoHA has attained a relatively low *Repeatable but Intuitive* rating for the business continuity management practices. The DoHA will need to ensure that the formal risk assessment is completed as soon as possible to facilitate the development of adequate business continuity and disaster recovery plans.

Department of Veterans' Affairs

DVA's business continuity arrangements consist of a BCP, regional contingency plans, escalation, backup and recovery procedures. The BCP incorporates core requirements including essential services, associated maximum outage periods, IT systems and infrastructure. The essential services have been identified through a business impact analysis.

Responsibility for the maintenance of BCPs and contingency plans is assigned to the Division Head, Corporate Development Division. The BCP was

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previously reviewed, updated and endorsed by Executive Management in November 2002.

Internal and external review of the BCP identified the need to include essential services and changes to the IT environment that had occurred subsequent to November 2002. As a result, a business impact analysis was completed and endorsed by the Executive Management Group. This document provided the basis for updating the list of essential services, which was also endorsed by the Executive Management Group. Contingency plans are currently being reviewed and updated.

DVA is currently documenting the disaster recovery process that will culminate in the development of a DRP. In the absence of a formalised DRP and outsourcer disaster recovery services, there is potential, in the event of disaster, that infrastructure replacement and subsequent data recovery may not be achieved in a timely manner in order to meet the DVA's operating requirements.

DVA has achieved a CobiT rating of *Defined Process* for business continuity planning and *Repeatable but Intuitive* for the disaster recovery process. Improvement opportunities identified within these processes include: update and obtain executive endorsement of the BCP, schedule testing of the BCP, and formalisation of the disaster recovery plan.

Health Insurance Commission

BCPs are being developed for each State Headquarters and National Office division, as well as DRPs in accordance with the ANAO's better practice guide for business continuity management.[46] HIC has made significant progress towards implementing comprehensive business continuity and supporting DRPs.

The BCPs have been developed, reviewed and signed off through the use of a template. However, not all plans are up to date. The process for finalising and maintaining business continuity is currently being established with the recent appointment of a business continuity manager. Individuals within the respective areas that have continuity plans are responsible for their maintenance. Each plan documents the resources required. However, the details within each plan vary and the costing of time and dollars for overcoming the backlog and manual processes during the recovery are yet to be documented. The minimum requirements necessary to perform the business continuity activity have been documented. However, the detail of this information also varies between plans.

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[46] ANAO Better Practice Guide, 2000 *Business Continuity Management—Keeping the wheels in motion*, Canberra.

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A disaster recovery strategy has been developed and tested with IBM Global Services for mainframe services. DRPs are yet to be finalised in the areas of firewall, midrange and distributed services.

Overall, the HIC has attained a relatively low *Repeatable but Intuitive* rating for its business continuity and DRPs. Significant progress has been made in developing the plans. However, the plans are yet to be completed, fully tested and reviewed. It is expected that, once these plans have been developed, HIC will be in a position to attain a *Defined Process* rating.

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Appendix 2: Significant Findings by Major Entity

The following table sets out 'A' rated findings (significant business or financial risks) identified during the interim audit of entities as part of the 2003–2004 financial statement audit cycle.

Table 1

Summary of 'A' category findings

Entity	No. of 'A' findings	Explanatory Comment
Department of Defence	TBD	To be determined. At the time of audit, the resolution of issues remains problematical.
Australian Taxation Office	1	Significant deficiencies have been identified in the ATO's close the books processes and it is anticipated that they will not be able to prepare materially correct administered financial statements by 30 July.

Further details on each of these findings, and on the 'B' rating findings, are included in the individual entity summaries contained in Chapter five of this report. A table summarising the number of 'A' and 'B' findings follows.

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Table 2

'A' and 'B' ratings by entity at 31 March

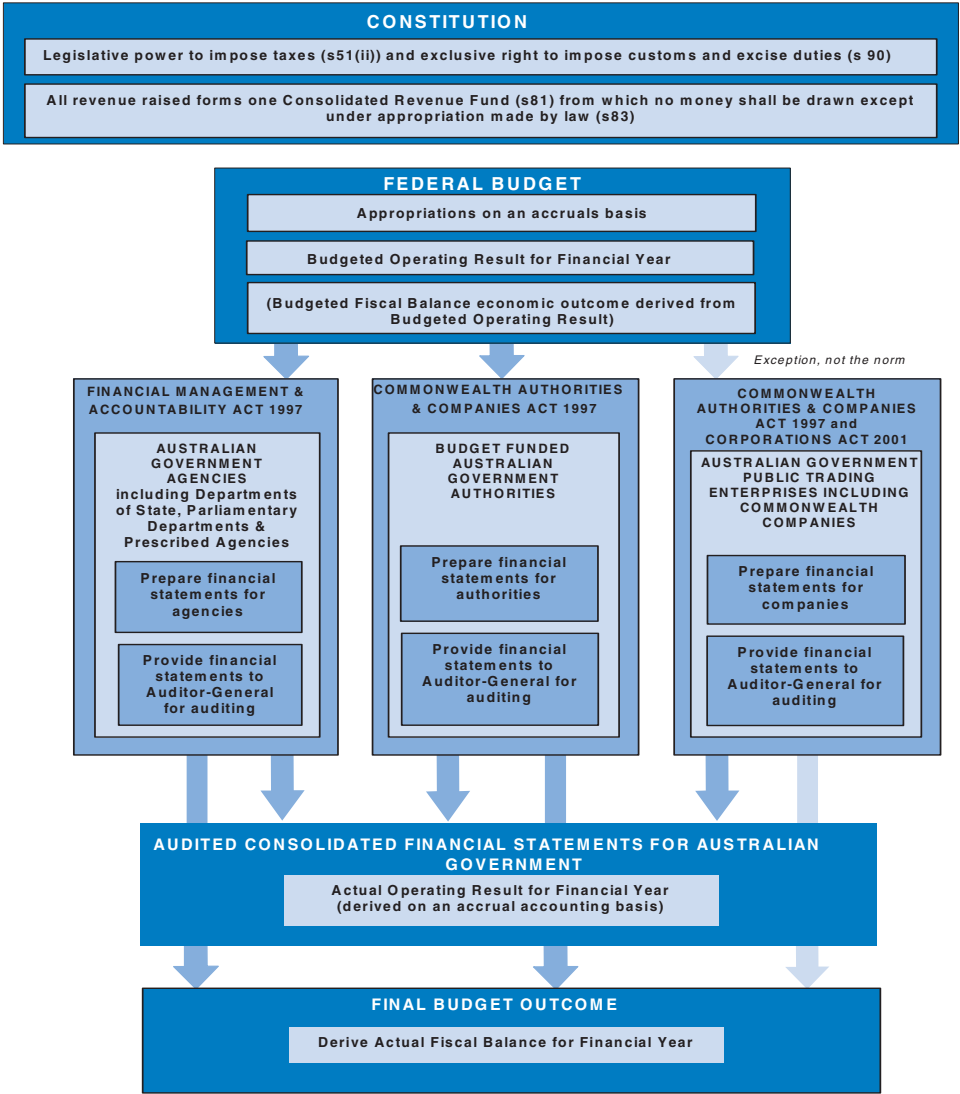| Entity	2004 Rating		2003 Rating	
	A	B	A	B
Aboriginal and Torres Strait Islander Services	0	10	n/a*	n/a*
Attorney-General's Department	0	1	0	1
Australian Customs Service	0	1	0	2
Australian Federal Police	0	4	0	1
Australian Securities and Investment Commission	0	2	0	1
Australian Taxation Office	1	9	1	5
Centrelink	0	5	0	5
Commonwealth Scientific and Industrial Research Organisation	0	3	0	0
Department of Agriculture, Fisheries and Forestry	0	3	0	4
Department of Communications, Information Technology and the Arts	0	2	0	7
Department of Defence	TBD**	TBD**	10	29
Department of Education, Science and Training	0	2	0	2
Department of the Environment and Heritage	0	4	0	2
Department of Employment and Workplace Relations	0	2	0	5
Department of Family and Community Services	0	8	0	6
Department of Finance and Administration	0	0	0	0
Department of Foreign Affairs and Trade	0	0	0	1
Department of Health and Ageing	0	2	0	5
Department of Immigration and Multicultural and Indigenous Affairs	0	12	0	6
Department of Industry, Tourism and Resources	0	0	0	3
Department of the Prime Minister and Cabinet	0	1	0	0
Department of the Treasury	0	1	0	1
Department of Veterans' Affairs	0	5	0	4
Health Insurance Commission	0	21	0	7
Total	**1**	**98**	**11**	**97**

Source: ANAO.

* Note: ATSIS was established on 1 July 2003, therefore there were no issues at 30 June 2003.

** To be determined–the interim audit is not yet complete. As a consequence this table does not include 2003–2004 findings for Defence.

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Appendix 3: The Australian Government Financial Reporting Framework

Framework overview

The Australian Government's financial reporting framework is outlined in the diagram below. Then follows an overview of the financial reporting requirements for the various types of AGPS entities captured by the framework. Finally the audit of the financial statements of these entities is described.

CONSTITUTION

Legislative power to impose taxes (s51(ii)) and exclusive right to impose customs and excise duties (s 90)

All revenue raised forms one Consolidated Revenue Fund (s81) from which no money shall be drawn except under appropriation made by law (s83)

FEDERAL BUDGET

Appropriations on an accruals basis

Budgeted Operating Result for Financial Year

(Budgeted Fiscal Balance economic outcome derived from Budgeted Operating Result)

Exception, not the norm

FINANCIAL MANAGEMENT & ACCOUNTABILITY ACT 1997	COMMONWEALTH AUTHORITIES & COMPANIES ACT 1997	COMMONWEALTH AUTHORITIES & COMPANIES ACT 1997 and CORPORATIONS ACT 2001
AUSTRALIAN GOVERNMENT AGENCIES including Departments of State, Parliamentary Departments & Prescribed Agencies	BUDGET FUNDED AUSTRALIAN GOVERNMENT AUTHORITIES	AUSTRALIAN GOVERNMENT PUBLIC TRADING ENTERPRISES INCLUDING COMMONWEALTH COMPANIES
Prepare financial statements for agencies	Prepare financial statements for authorities	Prepare financial statements for companies
Provide financial statements to Auditor-General for auditing	Provide financial statements to Auditor-General for auditing	Provide financial statements to Auditor-General for auditing

AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR AUSTRALIAN GOVERNMENT

Actual Operating Result for Financial Year (derived on an accrual accounting basis)

FINAL BUDGET OUTCOME

Derive Actual Fiscal Balance for Financial Year

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Australian Government

Section 55 of the FMA Act requires the Finance Minister to prepare annual financial statements for the Australian Government. These financial statements are a general purpose financial report consolidating the financial activities and financial position of all entities, authorities and other entities controlled by the Australian Government.

The financial statements for the year ended 30 June 2003 and the audit report thereon were published on 27 November 2003.[47] The results of the audit were reported to Parliament in the ANAO Report No.22 2003–2004, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2003.*

Australian Government agencies

Australian Government agencies are legally part of the Australian Government and are subject to the provisions of FMA Act. They comprise Departments of State, Parliamentary departments and prescribed agencies.

The FMA Act requires agency Chief Executives to prepare financial statements for their entities in accordance with FMOs. The FMOs include a requirement that the statements comply with accounting standards issued by the Australian Accounting Standards Board.

Australian Government authorities and subsidiaries

The CAC Act refers to 'Commonwealth Authorities' as bodies corporate that hold money on their own account and have been created by the Parliament to perform specific functions. Authorities operate under their own enabling legislation and generally must comply with provisions of the CAC Act.

The CAC Act requires the governing bodies of authorities to prepare financial statements in accordance with the FMOs. Directors must also ensure that subsidiaries prepare financial statements in accordance with the *Corporations Act 2001* (where applicable) and the CAC Act.

Australian Government companies and subsidiaries

Australian Government companies are companies in which the Government has a controlling interest. Australian Government companies operate and prepare financial statements under the *Corporations Act 2001* and provisions of the CAC Act.

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47   Commonwealth Government of Australia, 2003 *Consolidated Financial Statements for the Year Ended 30 June 2003.*

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Directors of an Australian Government company must ensure subsidiaries of the company prepare financial statements in accordance with the *Corporations Act 2001* and the CAC Act.

Other bodies

The ANAO also audits the financial statements of other bodies controlled by the Australian Government or where the Australian Government has significant influence. These consist primarily of trusts or joint ventures entered into by controlled Australian Government bodies.

Audit of Australian Government financial statements

Audit scope

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the truth and fairness of the financial statements and for the records, controls, procedures and organisation that support the preparation of those statements.

The ANAO's independent audits of financial statements are undertaken to form an opinion whether, in all material respects, the statements are true and fair. The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement.

Audit procedures include examination of the entity's records and its control environment, information systems, control procedures and statutory disclosure requirements. Evidence supporting the amounts and other information in the statements is examined on a test basis, and accounting policies and significant accounting estimates are evaluated.

While entity control structures are evaluated as an integral part of the audit process, only those systems and controls, on which it is intended to place reliance for the purpose of determining audit procedures leading to audit opinions on the financial statements, are evaluated in detail. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include a detailed evaluation of systems and internal controls.

The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. An audit conducted in accordance with Australian Auditing Standards is designed to provide reasonable assurance that the financial report, taken as a whole, is free from material misstatement, whether caused by fraud or error.

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The fact that an audit is carried out may act as a deterrent. However, the auditor is not responsible for the prevention of fraud and error. Nevertheless, the new fraud audit standard requires that when planning and performing audit procedures and evaluating and reporting the results thereof, the auditor should consider the risk of material misstatements in the financial report resulting from fraud or error.

The audit report on financial statements

The audit report on the financial statements includes a statement of the auditor's opinion as to whether the statements give a true and fair view of the entity's financial position, the results of its financial operations and its cash flows in accordance with Australian Accounting Standards, and other mandatory financial reporting requirements, and statutory requirements.

If the auditor is not satisfied the financial statements are true and fair, the audit opinion is qualified, with the reasons being indicated. Audit reports may be qualified because of a disagreement between the auditor and management of the entity on the application of accounting standards or other reporting requirements, because the scope of the audit work needed to form an opinion has been limited in some way, or because of a conflict between applicable reporting requirements.

An audit report may contain an 'emphasis of matter' to draw attention to a matter that is relevant to the readers of the financial statements. An 'emphasis of matter' does not qualify the audit opinion being given. In many cases, an 'emphasis of matter' relates to inherent uncertainty about an aspect of the financial statements, where the outcome is contingent upon future events and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

The audit report may also contain details on 'other matters'. Section 57 of the FMA Act requires that, in reporting to Ministers on the financial statements of Agencies, the Auditor-General must not only report on whether the statements have been prepared in accordance with the FMOs and give a true and fair view of matters required by the FMOs but must also state particulars of any contravention by a Chief Executive of section 48 of the FMA Act. In addition, section 57(5) requires the Auditor-General to state when he did not obtain all necessary information and explanations.

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Series Titles

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Administration of the Freedom of Information of Requests

Audit Report No.56 Performance Audit
Management of the Processing of Asylum Seekers

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Management of Protective Security

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Health Insurance Commission

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Intellectual Property Policies and Practices in Commonwealth Agencies

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The Australian Taxation Office's Management of Aggressive Tax Planning
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