

The Auditor-General
Audit Report No.56 2004–2005
Financial Statement Audit

**Interim Phase of the Audit of Financial
Statements of General Government Sector
Entities for the Year Ending 30 June 2005**

Australian National Audit Office

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Canberra ACT
24 June 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major General Government Sector 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 *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2005*.

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

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Abbreviations

AAO	Administrative Arrangement Orders
AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
AEIFRS	Australian equivalents to International Financial Reporting Standards
AFP	Australian Federal Police
AGD	Attorney-General's Department
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
ATSIS	Aboriginal and Torres Strait Islander Services
AUASB	Auditing and Assurance Standards Board
AUS	Australian Auditing Standard
BCM	Business Continuity Management
BCP	Business Continuity Plans
BEFR	Budget Estimates and Framework Review
BPG	Better Practice Guide
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CEIs	Chief Executive's Instructions
CE	Chief Executive
CFO	Chief Finance Officer
CobiT	Control Objectives for Information and Related Technology
CSA	Child Support Agency
CSIRO	Commonwealth Scientific and Industrial Research Organisation
Customs	Australian Customs Service

DAFF	Department of Agriculture, Fisheries and Forestry
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
DoEH	Department of the Environment and Heritage
DoHA	Department of Health and Ageing
DoTARS	Department of Transport and Regional Services
DVA	Department of Veterans' Affairs
FaCS	Department of Family and Community Services
FBO	Final Budget Outcome
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
GGs	General Government Sector
HIC	Health Insurance Commission
HRMIS	Human Resources Management Information System
IFRS	International Financial Reporting Standards
IT	Information Technology
ITC	Information and Communications Technology

JCPAA	Joint Committee of Public Accounts and Audit
PM&C	Department of the Prime Minister and Cabinet
RBA	Reserve Bank of Australia
SAP	An integrated software solution providing a wide range of business functions. Used by a large number of Australian Government entities as their FMIS
Treasury	The Treasury

Foreword

This report outlines the results of the audit of key financial systems and controls in General Government Sector¹ (GGS) entities. The audit coverage undertaken forms an integral part of the audit of the 2004–2005 financial statements of these entities. This report provides a summary of the audit findings as they relate to major revenue and expenditure programmes of Government that underpin the financial statements of individual entities, and which are consolidated into the Australian Government Consolidated Financial Statements. The report provides assurance to Parliament that the systems and processes designed to deliver the major programmes of Government and collect the revenues that sustain those programmes, are operating in a way that can fairly report the associated financial activities to Parliament. It also highlights where these processes have been found to be at risk of material error².

At the entity level, each finding in this report has been formally reported to the Chief Executive and their respective audit committees. In this way, reporting by the Australian National Audit Office (ANAO) acts as a catalyst for improvement and provides a stimulus to management for resolution of issues, where this is warranted. The report also includes a commentary on contemporary issues and developments that impact on public sector management, particularly financial reporting and governance.

One aspect of financial management that impacts significantly on our audit coverage is the expanding use of large IT systems to deliver government programmes that involve substantial benefits and risks, together with increased complexity, greater speed and dependence on the information system itself. Our audit findings indicate that the effectiveness of the management of the key financial IT systems remains uneven and the report identifies that further attention is required in relation to security plans and the management of IT system access. Business continuity management in a range of entities also needs to be further developed to provide assurance that a disruption to business can be adequately managed.

Chief Executives, through executive committees and audit committees, should continue to pay attention to the governance processes used to ensure that key

¹ General Government Sector (GGS) comprises all government departments and other entities that provide largely non-market public services and are funded mainly through taxes and other compulsory levies. This report covers the portfolio departments and other major GGS entities.

² Materiality is defined in Australian Accounting Standard *AASB 1031 Materiality* as information, which if omitted, misstated or not disclosed has the potential to adversely affect the decision about the allocation of scarce resources made by users of the financial report or the discharge of accountability by management or governing body of the entity.

controls are effective and appropriate to meet their statutory and fiduciary responsibilities. This report indicates that the majority of entities have key elements of effective governance frameworks in place. This in turn supports good public administration, especially in view of the range of matters and competing priorities that need to be dealt with by public sector managers often in relatively short timeframes. An effective framework is not, however, sufficient in its own right to ensure an adequate control environment and the veracity of financial reporting. To assist in this area, the ANAO published a further Better Practice Guide (BPG) in its governance series titled 'Public Sector Audit Committees' in February 2005. In producing this Guide, the ANAO recognised that the greater focus on corporate governance committees had increasingly prompted entities to seek practical and up-to-date guidance on their audit committee arrangements.

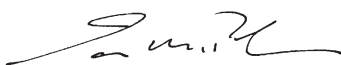
The BPG, amongst other things, highlighted the important role that can be played by audit committees in overseeing and improving, where necessary, legislative compliance across the GGS. Recent ANAO reports have also brought to the attention of the Parliament quite widespread difficulties in implementing and complying with key legislative provisions, particularly in relation to the *Financial Management and Accountability Act 1997* (FMA Act). In light of these difficulties, the scope of financial statement and performance auditing will be expanded to include further consideration of legislative compliance.

While the role of audit committees will be crucial in improving legislative compliance across the GGS ultimately, the responsibility for the maintenance of a compliant framework lies with each Chief Executive. Chief Executives in a modern Australian Public Sector are commonly required to deal with an array of policy, programme and organisational issues. However, it is also important that ongoing attention is devoted to measures to reinforce good governance and effective administration. This has been underlined by the recent decision of the Government that Chief Executives of FMA Act entities must now provide certification relating to the financial management of their organisations with effect from the end of the 2005–2006 financial year.

Public sector financial reporting is increasing in complexity as a result of recent developments in accounting that impact both the public and private sectors. Of particular relevance in 2004–2005 is the requirement for entities to determine the financial systems and reporting implications of adopting the Australian equivalents to International Financial Reporting Standards (AEIFRS) in 2005–2006. The ANAO report *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2005* will detail the progress of AEIFRS implementation in entities. It will also report the final audit results of all entities subject to Australian Government control.

At the whole of government level, the different accounting bases adopted in preparing the Australian Government's budget, the Financial Budget Outcome (FBO) and the Consolidated Financial Statements (CFS) adds complexities to the various reports and can be confusing for many readers. In this regard, harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) is intended to improve the direct comparability of budget statements with reports on the budget outcome, and to allow for better understanding of government finances. Accordingly, it is an important priority to better integrate public sector financial reporting, which has the support of the Australian, State and Territory Governments. The ANAO will play its role in the development of this project by providing feedback on the forthcoming exposure draft of the accounting standard *Financial Reporting of General Government Sectors by Governments* being developed by the Australian Accounting Standards Board.

I would like to 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.



Ian McPhee

Auditor-General

Summary

Summary

Introduction

1. Under section 57 of the *Financial Management and Accountability Act* 1997 (FMA Act) and under clause 3, part 2 of Schedule 1 of the *Commonwealth Authorities and Companies Act* 1997 (CAC Act), the Auditor-General is required to report each year to the relevant Minister, on whether the financial statements of public sector entities 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.
2. This report presents the results of the interim phase of the 2004–2005 financial statement audits. The audits have encompassed a review of governance arrangements related to entities' financial management responsibilities, and an examination of internal control, including information technology system controls for all portfolio departments and other major General Government Sector entities as at 31 March 2005. An examination of such issues is designed to assess the reliance that can be placed on internal controls to produce complete and accurate information for financial reporting purposes. All ANAO findings have been reported to entities and summary reports provided to the relevant Minister(s).
3. The final phase of most audits will be completed in the April to August 2005 period. Consistent with past ANAO practice, a second report will be tabled in Parliament in December 2005 following completion of the financial statement audits of entities for 2004–2005. 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 controls.
4. 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 GGS (Chapter 1).
5. The results of the audit have been arranged into three groups:
 - observations relating to the entities' control environment (Chapter 2);
 - audit findings relating to the audit of information technology systems focusing on information security, business continuity management and SAP financial management information application controls (Chapter 3); and
 - issues arising from the audit of control activities over significant business and accounting processes. (Provided in summary form in Chapter 4 and by Portfolio in Chapter 5).

Control environment

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

7. The ANAO has observed that the large majority of entities have established key elements of a control environment that is designed to provide a sound basis for effective financial management. However, the ANAO has noted that there is still some inconsistent application and execution of better practice approaches, especially in respect of fraud and legal compliance.

Information technology systems controls

8. The Australian Government has a significant and growing investment in information technology to enhance public administration and programme delivery. The Government in 2002–2003 spent an estimated \$4.21 billion on operating and capital expenditure in this area.

9. New technologies have 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.

10. During the course of the interim phase of the 2004–2005 financial statement audits, the ANAO focused on the way entities managed information security and business continuity management. In general, most entities have implemented sound governance in relation to information security management. However, a significant number of entities have yet to adopt comprehensive and tested business continuity management practices. Going forward, entities will need to maintain focus on information security and business continuity due to the continued move towards e-Government and the adoption of new technologies.

11. In addition, the interim phase of the audit has identified that many entities that use the SAP financial management information system are not taking maximum benefit of internal application controls and are placing heavy reliance on weak external controls. These entities need to strengthen user access and security administration functions.

Control activities

12. The results of the interim phase in relation to entities covered in this report indicate that the effectiveness of control activities over business and

accounting processes have generally been maintained at a reasonable level. Although the total numbers of significant audit findings, excluding the Department of Defence, decreased in 2004–2005, the audit findings suggest that entities need to pay attention to the controls underpinning their financial management frameworks, particularly in the areas of IT, FMIS, purchasing and payment of accounts, and policies and procedures. On the other hand, the audit noted fewer control weaknesses in relation to accounting and reporting processes at the operational level.

13. The large number of control weaknesses relating to IT systems controls, such as the management of user and systems access, IT security and change controls, indicates that increased management attention is needed to provide assurance that entities have appropriate IT systems controls in place.

14. The audit findings in relation to such areas as the financial statement preparation process, purchasing, payment of accounts and financial policies and procedures, further emphasises that entities must continue to give attention to fundamental elements of their internal control.

Detailed audit findings

15. 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.

16. Most of the entities had areas that require attention, particularly in relation to financial management framework and IT controls, where performance has been variable. This is demonstrated by the following analysis.

- The number of entities with 'A' category audit issues increased to three in 2004–2005, up from one in 2003–2004.
- The total number of 'A' category audit issues increased to nine in 2004–2005 from one in 2003–2004.
- The number of entities with no category 'A' or 'B' audit issues was six in 2004–2005, up from three in 2003–2004.
- The total number of 'B' category audit issues across all entities, decreased from 87 in 2003–2004 to 64 in 2004–2005, due largely to improved performance by the Health Insurance Commission (HIC).

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

17. A summary of 'A' and 'B' category audit findings by entity is outlined in Appendix 7.

18. This analysis does not include the results of the interim phase of the audits of the Department of Defence or the Department of Human Services (DHS), as these audits were still in progress at the time of preparation of this report. Commentaries on the Defence and DHS audits are included in Chapter 5.

Report timing

19. The purpose and timing of this report specifically recognises the increased responsibility being placed on entities to maintain effective controls 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.

Interim Issues

1. Contemporary Financial Management and Reporting

This chapter covers recent initiatives in entities' working arrangements and associated governance aspects together with developments in the accounting and auditing environment.

Background

1.1 Over the last decade, General Government Sector (GGS) entities have implemented financial management and reporting processes which have supported the move to accrual based budgeting and a performance culture based on the measurement of outputs and outcomes.

1.2 Essentially, the Government has required entities to manage their operations with a stronger focus on results and increased connectivity between entities to enhance the delivery of government programmes. Accompanying this approach, the importance of governance has been emphasised to ensure risks are identified and appropriately managed, robust controls and processes are maintained and comprehensive performance regimes are put in place.

1.3 The implementation of the Government's reform agenda has seen significant changes in the Australian General Government Sector (GGS). Foremost amongst these was the implementation of a range of service delivery reforms including the use of third party providers. At the same time there has been an increasing use of technology for administration and programme delivery providing many benefits, but also increasing the potential for risk.

1.4 Efficient organisations utilise their resources to maximise returns and, at the same time, have a strong focus on adherence to their legal, policy, industrial, human resource and managerial responsibilities and obligations. This has been described as the performance and conformance equation. A robust assurance process that, in the public sector, has regard to the requirements of legislation and government policies facilitates validation of this equation.

1.5 Effective internal controls and robust risk management processes therefore are of continuing importance. The ANAO contributes to more effective governance through its reporting to entities, the Government and Parliament on both the performance of programmes and the systems and resources utilised in their delivery.

Financial statement audit coverage

1.6 Australian auditing standards require that, to render an audit opinion, there is reasonable assurance that the audit will reveal any misstatements aggregating to more than the level of materiality that has been set as acceptable. In planning the audit, the ANAO accepts some small amount of risk that the audit procedures will fail to detect whether the financial statements are materially misstated. This minimal risk is accepted because it is cost-effective to do so. In conducting the audit, however, there are specific audit procedures performed that minimise this risk. These procedures include, for example, undertaking analytical reviews, reviewing the operation of significant internal controls, testing a sample of transactions and account balances and confirming year-end balances with third parties.

1.7 An important component of the ANAO's audit methodology is a sound understanding of an entity's internal controls. This enables the ANAO to make a preliminary assessment of the risk of material error in an entity's financial statements and to plan an audit approach to reduce audit risk to an acceptable level. The ANAO therefore reviews and evaluates an entity's internal controls to assess its capacity to prevent and detect errors in business processes, accounting records and financial reporting systems. The ANAO recognises that the reliability of an entity's business processes, accounting records and financial systems can be enhanced through effective internal controls.

1.8 In response to legal compliance issues being identified in recent performance audits, in our 2003–2004 financial statement audits³ and concerns expressed by Parliamentary committees⁴, the ANAO is expanding its financial statement work programmes to include some high level additional procedures to address specific legislative compliance risks relating to the management of appropriations, public funds and delegations.

Assurance and performance dimensions

1.9 There is a clearly acknowledged performance emphasis in the public sector. Entities will continue to face the challenge of allocating their available resources to deliver on output targets and outcomes. Financial reporting enhancements are necessary to ensure that Chief Executives and executive management are assured about financial and operating performance.

1.10 Two integral elements of the assurance process are the roles that audit committees and internal audit functions perform. Both of these areas have

³ Audit Report No.21 of 2004–05, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*.

⁴ Chapter 7 JCPAA Report 402, *Review of Auditor-General Reports 2003-04: First and Second Quarters*.

been the subject of considerable discussion following recent corporate failures. This discussion has led to greater recognition of the importance of internal assurance mechanisms and sound corporate governance within entities. Significant issues include committee member expertise and the need for independent, objective evaluations of an entity's stewardship, covering performance issues including financial information.

1.11 In the last decade, both in the private and public sectors, there has been significant analysis of entity performance covering strategic, operational, financial and management matters. Stakeholder scrutiny - albeit from the public, and analysts, the media, or the Parliament - has highlighted the expectation of, and the need for, disciplined governance and assurance processes. The clear articulation of these performance measures will be paramount, particularly given the increasing trend towards Australian Government entities working together on programme management and service delivery.

Australian Government entities working together

1.12 As the environment in which the GGS entities operate is becoming more complex and the community's expectations increase, the manner in which entities collaborate in policy development and service delivery needs to reflect a whole-of-government perspective. The challenge to provide appropriate performance and accountability information also increases.

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, programme management and service delivery.⁵

1.13 There are numerous arrangements in the GGS for the delivery of services. Whilst individual entity Chief Executives (CEs) are accountable for performance, governance arrangements will, to some extent, be found in the entity which delivers the services on behalf of the 'accountable' entity. For example, the creation of the Department of Human Services, and its relationship with other key entities (eg. the Health Insurance Commission, Centrelink, the Child Support Agency and CRS Australia) will create particular obligations and require those entities to re-examine the way in which their governance arrangements are structured and the way they work with each other.

⁵ Management Advisory Committee 2004 *'Connecting Government—Whole of Government Reforms to Australia's Priority Challenges'*, Commonwealth of Australia, Canberra.

1.14 While there are numerous benefits of such arrangements, they also bring about issues relating to governance and accountability requirements. There is also a number of practical matters that need to be resolved for these arrangements to be fully effective. For example, performance measures adopted by entities need to be more closely aligned to allow improved analysis and programme 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.

1.15 Where collaborative, or whole-of-government arrangements exist, clarity with regard to the desired outcomes, performance, responsibilities and accountability is required. Memoranda of understanding, contracts and business partnership agreements are examples of formal arrangements between these entities that endeavour to clarify these matters. Where significant collaborative arrangements exist, the ANAO assesses the adequacy of the accountability mechanisms in the separate entities included in the arrangement.

Financial reporting and auditing frameworks

1.16 Previous ANAO reports have outlined developments and issues in the financial reporting and auditing frameworks. They include:

- the convergence, in relation to public sector financial reporting, of Australian Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS);
- the introduction of Australian equivalents to International Financial Reporting Standards (AEIFRS);
- distinguishing between departmental and administered items;
- the implementation of the compressed timetable for annual financial reporting arising from the Budget Estimates and Framework Review (BEFR); and
- the convergence of Australian and international auditing standards.

1.17 These matters are on-going and outlined below is their current status.

Convergence of Australian GAAP and GFS

1.18 The Australian Government publishes two ex-post annual financial reports. The Final Budget Outcome (FBO) report, prepared under section 18 of the *Charter of Budget Honesty Act 1998* (the Charter), presents GGS fiscal outcomes for the financial year. The Consolidated Financial Statements (CFS), prepared under section 55 of the *Financial Management and Accountability Act*

1997 (FMA Act), present the financial results and financial position of the Australian Government as a whole.

1.19 Audit-cleared financial information from material entities assists in the timely production of the FBO report. While the FBO must by law, be released within three months of financial year-end, the Government's target is within 45 calendar days of year-end. The timeframe for preparation and audit clearance of material financial statements that are used in the FBO is being shortened progressively, with a target date of 30 July in 2005 and 20 July in 2006.

1.20 The financial statements of each Australian Government entity are audited by the ANAO. These audited entity statements form the basis for the CFS, which must by law be delivered to the Auditor-General by end of November each year (unless the Minister tables the reason the date is not met). The Auditor-General audits the CFS pursuant to section 56 of the FMA Act.

1.21 The CFS is prepared on an accrual accounting basis in accordance with applicable Australian Accounting Standards (AAS), (including AAS 31 *Financial Reporting by Governments*), other mandatory financial reporting requirements in Australia and statutory requirements.

1.22 Consistent with the requirements of the Charter, the FBO is based on the Australian Bureau of Statistics accrual GFS framework as well as on AAS.

1.23 The Charter also requires that departures from applicable external reporting standards be identified. In this regard, the major differences between the GFS and the AAS treatments of transactions are reconciled and included in the Budget Papers.

1.24 While the CFS is audited, the FBO is not. In this context, and in addressing a 2001 JCPAA Review,⁶ the ANAO confirmed its willingness to audit the FBO⁷ if requested to do so, but this was a matter for the Government and the Parliament to decide.

1.25 If there were such a request, the issue of relevant standards to be used would be central to an audit of the FBO. The 'Budget Estimates and Framework Review - Recommendations',⁸ required the Department of Finance and Administration (Finance) to continue to work towards harmonisation of Australian Generally Accepted Accounting Principles (GAAP) and the GFS

⁶ Australia, Parliament 2001 JCPAA: Review of Accrual Budget Documentation Official Committee Hansard, Canberra.

⁷ ANAO response dated 6 September 2002 to Report 388 *Review of the Accrual Budget Documentation*.

⁸ Estimates Memorandum 2002/13, Department of Finance and Administration, which details the recommendations of the Budget Estimates and Framework Review approved by the Government.

frameworks. The Review proposed that this would be achieved via the development of an Australian accounting standard for government to harmonise the two frameworks.

1.26 In April 2003, the Australian Accounting Standards Board (AASB) was tasked with the following direction from its oversight body, the Financial Reporting Council (FRC):

With regard to public sector reporting, the Board (AASB) 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 Australian accounting standard 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.

1.27 Various proposals for convergence were made to the AASB by Heads of Treasuries to the AASB during 2003. In late 2003, the AASB issued two consultation papers for comment by the GAAP/GFS Convergence Project Advisory Panel. The current status of the project is that an Exposure Draft of the proposed standard *Financial Reporting of General Government Sectors by Government*⁹ is scheduled to be released in mid-2005. The AASB proposes a mandatory operative date for financial periods ending on or after 30 June 2007, with earlier adoption permitted.

1.28 The ANAO supports the initiative, to better integrate public sector financial reporting. Harmonisation of GFS and GAAP is intended to improve comparability of budget statements with reports on the budget outcome and allow for better understanding of government finances.

Australian equivalents to International Financial Reporting Standards

1.29 Public Sector⁹ entities with 30 June balance dates will be required to apply AEIFRS for the first time in their financial statements for 2005–2006. There is a small number of entities with a 31 December balance date whose first application of AEIFRS will be for 2005.

1.30 In their annual financial statements leading up to the introduction of AEIFRS, entities are required to comply with Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting the Australian Equivalents to International Financial Reporting Standards*. In 2003–2004, entities disclosed:

⁹ Public Sector entities include GGS, Public Financial Corporations and Public Non-Financial Corporations.

- an explanation of how the transition to AEIFRS was being managed; and
- a narrative explanation of the key differences in accounting policies that were expected to arise from adopting AEIFRS.

1.31 Thus, for example, the Australian Government's Consolidated Financial Statements for 2003–2004 disclosed expected key differences in accounting policies, including:

- all property plant and equipment assets (other than public access communication assets) being recorded at their fair values in opening balance sheets prepared as at 1 July 2004;
- the capitalisation, as part of a related asset, of the present value of an obligation to decommission the asset and/or restore the site where the obligation qualifies for recognition as a liability;
- the derecognition of any valuation component of the carrying amounts of intangible assets where the valuation was not arrived at by reference to an active market for the intangible;
- the requirement to measure inventory not held for sale at the lower of cost or current replacement cost; and
- the requirement to discount all non-current employee entitlements, including non-current annual leave, to its present value.

1.32 For 2004–2005 financial statements, AASB 1047 requires that the disclosures made in 2003–2004 be updated and, in addition, that there be disclosed:

- any known or reliably estimable information about impacts on the financial statements had they been prepared using AEIFRS; and
- if impacts of the above are not known or reliably estimable, a statement to that effect.

1.33 In order to provide assurance that implementation of AEIFRS is progressing, and to identify any issues that require resolution, the Department of Finance and Administration (Finance) issued Finance Brief 24 *Adoption of AEIFRS - Provision of Information on Implementation* in March 2005. The Finance Brief requests material¹⁰ entities to prepare, and provide to Finance:

¹⁰ Material entities comprise 99% of revenues, expenses, assets and liabilities as determined by the Department of Finance and Administration.

- Opening (1 July 2004) AEIFRS departmental and administered balance sheets and accounting policy notes, by 30 April 2005; and
- 30 June 2005 AEIFRS departmental and administered balance sheets, income statements and statements of changes in equity, by 30 September 2005.

1.34 The target date for the provision of the above information by non-material entities is 31 December 2005.

1.35 Finance requested that the level of detail provided be of auditable quality and be sufficient to meet the requirements of AASB 1047.

1.36 The ANAO has decided, for material entities, that it will audit and issue audit opinions to management on the opening balance sheets in the first instance, and on full year information, in due course. The timing of the delivery of these audit opinions is the subject of agreements between the ANAO and each entity, having regard to the target dates set by Finance. At the date of preparation of this report, audit work on opening balance sheets was continuing.

1.37 The requirement to prepare an opening AEIFRS balance sheet as at 1 July 2004 and full AEIFRS statements for 2004–2005, is the result of the way changes in accounting policy are given effect under AEIFRS. Under existing GAAP, a change of accounting policy is applied from the beginning of the current reporting period, whereas under AEIFRS, accounting policy changes are presented as if they had always applied. Thus the opening balance sheet is the starting point for the application of AEIFRS and the full AEIFRS statements for 2004–2005 will be the basis for reporting comparative figures in the 2005–2006 financial statements.

1.38 Accounting policies must be applied consistently throughout the first statutory annual financial statements prepared under AEIFRS, that is no change in policy is permitted. AEIFRS, to be applied in 2005–2006, were made by the AASB in July 2004, based on a ‘stable platform’ of international standards as at 31 March 2004. As it happens, some changes have since been made to the international standards and hence to AEIFRS. Where given later mandatory application dates, earlier adoption is permitted.

1.39 Decisions on the accounting policies that will be applied by entities in 2005–2006 will largely be determined by the Finance Minister, who will formalise them in Orders for the 2005–2006 financial statements which will be made under both the FMA and CAC Acts. At the date of preparation of this report, draft Orders were in preparation by Finance. Pending the finalisation and release of the Orders, Finance issued a series of Finance Briefs to assist

entities to prepare for the introduction of AEIFRS and setting out the accounting policy choices likely to be made.

1.40 Under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, an entity may avail itself of certain specific exemptions to full retrospectivity in its 2005–2006 financial statements if it first applies AEIFRS by an explicit and unreserved statement of compliance with AEIFRS. If an entity does not, or is unable to, make this statement of compliance, it cannot avail itself of the exemptions and instead full retrospective application of the new standards will be constrained only by the defined criterion of ‘impracticability’.

Distinguishing departmental and administered items

1.41 Issued in 1993, AAS 29, *Financial Reporting by Government Departments* has made a distinction between the financial activities which a department controls (e.g. the employment of staff) and those activities undertaken on behalf of government (e.g. the collection of taxes or the payment of benefits according to legislation). The distinction is made to facilitate accountability according to where the ‘balance of control’ over an activity lies. The distinction is an important element of the Australian Government’s financial framework. In practice, however, difficulty is often experienced in determining whether an item should be classified as departmental or administered.

1.42 The AASB is currently reviewing AAS 29. The distinction between departmental and administered is one of the aspects of the standard which the AASB has foreshadowed may be amended. The AASB is canvassing a number of options, including requiring a government to designate items as departmental or administered by reference to the concept of control in the conceptual framework and having regard to the financial management framework of the government.

1.43 At the same time, Finance has commenced a project to develop criteria to be utilised in the classification of activities as administered or departmental and also intends to review, in consultation with entities, the classification of administered and departmental appropriations.

Developments in Australian Auditing Standards

1.44 Audit Report No 58 2003–2004 *Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year ending 30 June 2004* noted the then Auditing and Assurance Standards Board long-standing policy of harmonisation with International Standards on Auditing (ISAs) and commented on the increasingly prescriptive nature of those Standards.

1.45 Following amendments to legislation made by the *Corporate Law Economic Reform (Audit Reform and Corporate Disclosure) Act 2004*, the Financial Reporting Council (FRC) has been given oversight of Australia's audit standard setting process. Key amendments made by the Act include the reconstitution of the Auditing and Assurance Standards Board (AUASB) as a statutory body under the oversight of the FRC and giving auditing standards the force of law for the purposes of the *Corporations Act 2001*.

1.46 The strategic direction of the AUASB will include the development of Australian Auditing Standards that:

- have a clear public interest focus and are of the highest quality;
- use as a base, as appropriate, the ISAs;
- make such amendments to ISAs as are necessary to conform with the Australian regulatory environment and statutory requirements; and
- incorporate additional requirements based on standards in other national jurisdictions, where appropriate and considered to be in the public interest.

1.47 In addition, the AUASB is required to continue to develop auditing and assurance standards, other than for historical cost financial information, as well as developing guidance and participating in research relevant to its activities.

1.48 The AUASB is currently seeking comments on four exposure drafts for revised ISAs. The content of these exposure drafts and the nature of the strategic direction given to the AUASB strongly suggest that the trend to an increasing number of auditing standards will continue.

1.49 Audits conducted by the ANAO must be in accordance with the auditing standards made by the Auditor-General under section 24 of the *Auditor-General Act 1997*. The ANAO standards have incorporated by reference the standards set by the AUASB.

Reporting timetable

1.50 There has been a recent one-year deferral of the Budget Estimates and Framework Review's (BEFR) delivery targets for material entity financial statements for the financial year ending 30 June 2005. As a result in 2004–2005 entities will again be required to submit their financial statements to Finance by 30 July.

1.51 BEFR target dates for the reporting of material entity financial statements for the financial year ending 30 June 2006 are expected to be:

- 20 July for financial statement submissions to Government;
- 25 July for providing a preliminary accrual budget outcome to Government; and
- 14 August for the Final Budget Outcome Report to Government.

1.52 The deferral will provide entities more time to implement the reporting efficiencies required to meet the revised reporting timeline and the revised reporting framework.

Conclusion

1.53 The last few years have been characterised by a number of important and potentially far-reaching developments in the international and national accounting and auditing environment. Developments such as the convergence of GAAP and GFS and the application of AEIFRS are directly impacting on the current responsibilities of entities and the ANAO as the external auditor. Together with the ongoing complexities of public sector administration, including the imperative for the public sector to take a whole-of-government approach to policy formulation and the delivery of services, it is clear entities need to continue the focus on establishing effective governance and control environments. This includes robust performance regimes.

1.54 There is a worldwide shift towards assurance processes being used as a lead indicator in validating management performance. This follows recent international and national trends and will place greater focus on governance principles in the public sector.

2. Control Environment

This chapter provides a high level overview of the ANAO's observations in relation to some of the key components of an effective control environment, as well as entities' progress in relation to fraud control management. The observations are based on inquiries with management of each entity, observations of processes and a review of key governance documents produced by each entity.

Introduction

2.1 The Chief Executives (CE) of General Government Sector (GGS) entities subject to the FMA Act are required to manage the affairs of entities in a manner that promotes effective, efficient and ethical use of resources. While there is no equivalent legislative provision applying to CAC Act entities, the same general standard could reasonably be expected to apply. This necessitates the development and implementation of effective corporate governance arrangements and internal controls designed to meet the individual circumstances of each entity and to assist in the orderly and efficient conduct of its business and the entity's compliance with applicable legislative requirements.

2.2 A sound understanding of an entity's internal controls is an integral component of the ANAO's financial statement audit. This understanding enables the ANAO to make an assessment of the risk of significant error in an entity's financial statements and to plan an audit approach to reduce audit risk to an acceptable level. The reliability of an entity's business processes, financial systems and records is dependent on effective governance and internal controls.

2.3 One element of internal control is an entity's control environment. Australian Auditing Standard AUS 402 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements* at paragraph 67 states:

The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for effective internal control, providing discipline and structure.

2.4 The control environment directly influences the way business and operations are undertaken in every entity. This requires the control environment to be carefully reviewed as part of the audit process when assessing the risk of material error in financial systems and reports.

2.5 In addition to the control environment, another element of internal control that the ANAO considers is fraud control. Fraud control is an important consideration in the public sector, due to the responsibilities that flow from the management and utilisation of public funds.

2.6 More in-depth performance audits of administrative and management systems and processes that support, but are not always critical to, the audit opinion on the entity's financial statements, supplement the review of the control environment, undertaken as part of the financial statement audit. The primary aim of these audits is to improve public administration, which is a major element of the ANAO's objectives.

2.7 The ANAO's Performance Audit Services Group systematically incorporates consideration of an entity's control environment in its audits, together with a consideration of the financial context. For example, consideration of the operation of special accounts, financial management of special appropriations and investment of public monies provided benefits to entities directly as well as to the financial statement audit process, by highlighting in some cases a lack of awareness of the relevant legal requirements and associated disclosures. These types of audits supplement financial statement processes in a positive manner and the nature and extent of the findings will determine the impact on the audit opinion on the entity's financial statements. Nevertheless in the light of recent performance audits disclosing compliance issues with key aspects of the legislative framework that relate to financial management, the ANAO is expanding its financial statements work programmes to include some high level additional procedures to address specific legislative compliance risks relating to the management of appropriations, public funds and delegations.

Elements which contribute to financial statement assurance

2.8 In conducting an audit of an entity's financial statements, the ANAO focuses on specific elements of the control environment. In doing this, the ANAO establishes whether the environment in place comprises elements that contribute positively to establishing a foundation for effective internal control, and minimises both financial and non-financial risks to the entity. This judgement has a major influence on the way the audit is conducted, including the amount of audit work needed to form the audit opinion. The main elements reviewed are:

- a) **senior executive group arrangements** – including the leadership, control, and performance role of the group and management's philosophy and operating style;

- b) **an audit committee** – including the documented assurance and performance role of the Audit Committee, its use as a forum for communication between management, internal and external auditors and the degree of independence/expertise of the Committee;
- c) **an internal audit function** – including the documented assurance and performance role of the Internal Audit function as an integral component of the system of internal control, independent of management, and the level of outstanding issues raised by Internal Audit;
- d) **fraud control arrangements** – which are current and include measures for the prevention and detection of internal and external fraud and the documentation/implementation of fraud control plans;
- e) **systems of authorisation, recording and procedures** – to ensure that transactions are processed, recorded and accounted for correctly, including the assignment of authority and responsibilities and segregation of duties; and
- f) **a financial performance management regime** – which prepares and reports budgets and monthly analyses, including comparison of actual results to budgets, variance analysis and relevant commentary to ensure that operations are efficient, effective and measurable and moving towards a more results driven culture.

2.9 The on-going performance and effectiveness of these measures can make a significant contribution to the level of assurance that entity management, and in turn the ANAO, require for financial statement reporting purposes.

Overview

2.10 The following commentary provides an overview of the control environment for portfolio departments and other GGS entities. The Department of Defence has not been included in this chapter because the large number of findings requires separate commentary and is described in detail at Chapter 5.

Senior executive group arrangements

2.11 It is important to consider the particular legislative responsibilities of CEs operating under the FMA Act, or under the CAC Act, when assessing the appropriateness of measures taken to govern entities operating under these Acts.

2.12 In general, the responsibilities of CEs of FMA agencies are governed by Part 7 of the FMA Act, which gives them responsibility for the overall management of their agency. The CEs 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 body.

2.13 A critical aspect of the control environment is the leadership and performance of CEs and executive management arrangements within these different management structures, as this has a significant impact on the control consciousness of entities.

Observations

2.14 Consistent with previous findings, overall, entities had appropriate executive and/or management arrangements in place to provide sufficient direction, guidance and control over their organisations. All entities except one had produced a formal Corporate Plan or strategy document, supported by annual business plans at the divisional or branch level that articulate the entity's goals and objectives, to assist in measuring entities' progress in meeting these.

2.15 Consistent with last year's results, all entities covered by this report had established management boards or senior executive committees. All but two of the entities had an executive charter that clarified the respective committee's roles, responsibilities and powers. All the boards or executive committees met regularly in accordance with a calendar of scheduled meetings to plan and monitor strategic direction and performance, often based on a standing agenda of items. However, less than one half had established an annual forward plan or agenda to help ensure that the meetings in the year addressed all the significant issues and responsibilities that require the attention of executive management. This is a better practice that the ANAO considers would benefit all executive committees and should be considered by those that are not following this practice.

2.16 Management committees that focus on functional or topical areas or issues, including financial and accounting matters, generally support all of these boards or senior executive committees. For all entities examined, these management committees had documented terms of reference and in all but one case the value and performance of the management committees was monitored and reviewed by the executive committee or the CE.

2.17 The audit also identified that in all entities there was a code of conduct outlining standards of personal behaviour and requirements for ethical conduct on the part of all staff.

Audit committees

2.18 All entities under the FMA Act and the CAC Act are required to establish audit committees. The ANAO Better Practice Guide on Public Sector Audit Committees issued in February 2005 (the Guide), refers to audit committees 'as a crucial component of corporate governance, fundamental to assisting the Chief Executive/Board to:

- ensure all key controls are operating effectively;
- ensure all key controls are appropriate for achieving corporate goals and objectives; and
- meet their statutory and fiduciary duties.'

2.19 This has been underlined by the recent decision of the Government that Chief Executives of FMA Act entities must now provide certification relating to the financial management of their organisations with effect from the end of the 2005–2006 financial year. It is anticipated that this will further reinforce the need for a strong audit committee.

2.20 An audit committee's strength is its demonstrated independence and authority to seek explanations and information, as well as its understanding of the various accountability relationships and their business impact particularly on risk and controls, and financial performance.

2.21 The key characteristics of better practice¹¹ for audit committees include:

- a good understanding of the audit committee's position in the legal and governance framework;
- clearly defined roles and responsibilities;
- members with relevant personal qualities, skills and experience;
- the ability to maintain effective relationships with key stakeholders;
- the ability and capacity to conduct its affairs efficiently and effectively; and
- a robust and considered process of performance assessment.

2.22 The ANAO audit included a high-level review on the composition and performance of all entities' audit committees having regard to these characteristics.

¹¹ ANAO Better Practice Guide on *Public Sector Audit Committees* issued in February 2005.

Observations

2.23 Although the Guide had only been recently issued, the ANAO noted that audit committees were already considering the guidance provided and the impacts on their operations and effectiveness. Overall, the ANAO found that the entities examined had audit committees that were generally operating effectively and have all or the majority of the characteristics of better practice. However, the ANAO noted that there are opportunities for improvement in relation to the audit committee's role in reviewing the effectiveness of legislative compliance arrangements and business continuity planning arrangements, as discussed below.

2.24 All audit committees examined had charters that clearly articulate the committee's roles and responsibilities. With two exceptions, all audit committees regularly reviewed their charters and assessed their own performance. For the two exceptions, discussions were taking place or proposals being considered to review their charters and consider processes to review their own performance. All except two committees had established annual forward meeting plans, including dates, location and agenda items that covered the responsibilities included in their charters.

2.25 For all entities examined, the ANAO found that the Chief Executive or Board was well informed, on a timely basis, of the audit committee's deliberations and activities. Also, based on observation of senior audit staff attending audit committees as observers, the overall financial literacy of the audit committees was good and meetings were generally well run.

2.26 Audit committees are likely to be more effective if they operate independently of line management. The appointment of one or more independent non-executive members (depending on the size of the committee) to audit committees is one of the most visible and practical ways of demonstrating the independence of the audit committee. Independence and objectivity can be further strengthened with the appointment of an independent chair. Of the entities reviewed this year, only one did not have an independent, non-executive member; however this entity was currently considering adding an independent member to the committee's membership. As well, six of the committees had an independent chair.

2.27 All committees had reviewed the performance of, and resources required by internal audit, and all but three had reviewed the internal audit charter on an annual basis. For the three exceptions, their internal audit function was outsourced and two of the committees reviewed the charter as part of the contract out process and the third committee was planning to review the charter in the near future.

2.28 Audit committees continued to regularly and formally review the issues identified in internal and external audit reports, and monitored the implementation status of report recommendations.

2.29 Audit committees also have an important role to play in reviewing and advising on important components of corporate governance. The ANAO found that for all entities examined, the audit committees were reviewing financial reports and recommending their signing by the CE. All but one of the committees were assessing whether management had in place a current and comprehensive risk management framework, with the one exception having a separate executive committee doing this. Similarly, in all but one entity, the audit committees reviewed fraud control plans, again with the one exception had a separate executive committee performing this role.

2.30 The ANAO found in six of the entities that the audit committees were not reviewing and determining if business continuity planning arrangements were appropriate. For four of these entities, a separate executive committee was reviewing business continuity planning arrangements. However, for the other two entities there was a lack of effective executive review of business continuity planning arrangements.

2.31 The ANAO Better Practice Guide on Audit Committees states ‘reviewing the effectiveness of how an entity is monitoring compliance with relevant laws, regulations and associated government policies is an established function of Audit Committees as part of their oversight of the control environment’. This responsibility includes:

- determining if the entity has considered legal and compliance risks as part of their risk assessments; and
- reviewing the effectiveness of the system for monitoring compliance with relevant laws and regulations.

2.32 The audit found that for some of the entities, the audit committee was not explicitly ensuring that this important function was being performed. In seven of the entities, the responsibility for monitoring legislative compliance was not included in the committee’s audit charter, although this was being reassessed in light of the Better Practice Guide. It should be noted that some entities did have specific committees or functional areas dedicated to monitoring compliance. Also, in a number of cases, the entities saw this responsibility as part of the overall control framework and believed that legislative compliance was being monitored through the review of risk assessments and the review of the results in internal and external audits. Some committees also reported that specific legislative reviews had been recently carried out. Other committees saw this as an issue for line managers.

2.33 In some cases the audit found that no overall responsibility had been assigned to ensure that all legal and compliance risks had been considered and no formal mechanism was in place to ensure legislative compliance was monitored effectively. Without this kind of specific assurance, these entities faced increased organisational risk of non-compliance with relevant laws and regulations.

Internal audit function

2.34 Internal audit is an important tool of executive management that helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes¹². Internal audit supports the audit committee as a key component of the governance framework and is generally responsible for a broad based programme of audits that can range from assessing the quality, economy and efficiency of business activities and controls, to advising on opportunities to harness emerging technologies and improved business practices. Internal audit may also be involved in promoting, educating and coaching the organisation's staff in key principles, procedures and controls.

2.35 Following on from the results of an examination of the internal audit function in the ANAO Business Support Process audit report titled Audit Report No. 3 2004–2005 *Management of Internal Audit in Commonwealth Organisations*, the ANAO focused on the following components of the internal audit function; internal audit charters, performance evaluation, annual plans and audit recommendations.

Observations

2.36 Based on the ANAO's review, it was found that generally internal audit was providing an effective service to the executive management by assisting them in carrying out their governance responsibilities. All entities examined had appropriate internal audit charters that set out the responsibilities, access rights, reporting arrangements and standards of performance of the internal audit function. In all but two cases, the performance of internal audit was regularly evaluated, usually by the audit committee or in other cases by a separate committee or outside body. To receive the most benefit from this function, the ANAO encourages continued attention to this area.

2.37 An annual internal audit plan was developed in all of the entities; however in three cases these plans were not linked to the entity's strategic and

¹² Institute of Internal Auditors, International Standards for the Professional Practice of Internal Auditing, Florida, January 2004 [IIA Standards]. Available: <www.theiia.org>.

operational risks. In one case, the internal audit programme had been compliance driven, but was moving to a risk-based approach. In the other two cases, the entities had not formalised their strategic and operational risks. Once this is done, the ANAO encourages internal audit to ensure the annual plans are based on the entity's identified risks. The ANAO noted that in all but one case the internal audit work programmes were progressing satisfactorily against the approved annual plan timetable.

2.38 Internal audit in almost all entities recognised the value of rating their recommendations by risk or priority. The ANAO noted that the audit committees actively monitored the progress of implementing recommendations.

2.39 The internal audit function had been largely outsourced to accounting firms or co-sourced because of the difficulties in recruiting and retaining the necessary skills 'in-house'. The ANAO review found that the independence of these outsourced groups was assisted by mechanisms to identify and manage potential conflicts of interest.

Fraud control

2.40 The Attorney-General released the updated Commonwealth Fraud Control Guidelines (the Guidelines)¹³ 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 programmes. The importance of entities establishing effective fraud control arrangements is recognised in section 45 of the FMA Act, that specifies CEs are responsible for the implementation of a fraud control plan, and for reporting to portfolio ministers on fraud control within their entity.

2.41 Further explanation of the responsibility for preventing and detecting fraud is provided in Australian Auditing Standard AUS 210 *The Auditor's Responsibility to consider Fraud in an Audit of a Financial Report* which states in paragraph 13:

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

2.42 In August 2004, the ANAO issued a Better Practice Guide on 'Fraud Control in Australian Government Agencies' to support the Guidelines and provide additional information on their implementation to those who have direct responsibility for fraud control in Australian Government entities.

¹³ Fraud Control Guidelines Issued by the Minister for Justice and Customs, under Regulation 19 of the Financial Management and Accountability Regulations 1997, May 2002.

2.43 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.

Observations

2.44 The ANAO found that although fraud control planning is now well established following issuance of the Commonwealth's Interim Ministerial Direction on Fraud Control¹⁴ and the above-mentioned Guidelines, a number of entities were still not complying with all aspects of the fraud directions or the Guidelines.

2.45 The ANAO found that all entities examined had a Fraud Policy Statement issued by the CE containing a definition of fraud consistent with the Guidelines. With a few minor exceptions, these policy statements demonstrated a clearly articulated commitment to fraud control, identified employees' responsibilities and the roles and responsibilities of management, provided assurance of confidentiality with regard to allegations and gave advice on where further information can be found.

2.46 In all but three entities, appropriate awareness raising and training programmes were in place in relation to fraud and fraud control. It was also reported that, in all cases, employees responsible for fraud investigations had undertaken relevant training and held mandatory qualifications.

2.47 The ANAO noted however, some significant weaknesses in fraud control planning and fraud control mechanisms. These included:

- in seven of the entities, the Fraud Control Plans in place, had not been updated in the last 2 years and therefore were not based on current fraud risk assessments;
- where there had been substantial changes in the entity's structure or functions recently (for example, as a result of AAOs), risk assessments and fraud control plans had not been updated in seven of the entities;
- a realistic timetable had not been developed in six of the entities in respect of strategies identified in the Fraud Control Plan, and four entities were not proceeding satisfactorily against their timetables;
- in eight entities, appropriate performance indicators and related targets had not been established in order to monitor the effectiveness of the fraud control plans; and
- in four entities, the Executive or Board did not regularly review fraud control performance.

¹⁴ Interim Ministerial Directions on Fraud Control, 1994, op. cit.

2.48 The Attorney-General's Department collects fraud information from entities subject to the Guidelines. The information is collated and a Fraud Annual Report is provided to Government to facilitate analysis of fraud trends and future policy development. Analysis of unaudited data provided to the Attorney-Generals' Department for the year ended 30 June 2004 found that:

- there was a total of 51 615 allegations of fraud;
- 92% of fraud allegations were investigated following initial evaluation; and
- 4 851 individuals were referred to the Commonwealth Director of Public Prosecutions during 2003–2004.

Systems of authorisation, recording and procedures

2.49 Formal and well documented systems of authorisation, recording and procedures are necessary to help ensure that transactions are processed, recorded and accounted for in accordance with the directives of the responsible governing body and/or CE or other sources of delegated or statutory authority. Principal amongst these are entities' Chief Executive's Instructions (CEIs), which reflect the powers delegated to management by CEs under the FMA Act.

2.50 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.

Observations

2.51 The ANAO found that entities' key controls were reflected in, or addressed by, policies and procedures such as CEIs or their equivalent. All entities examined except one had arrangements in place to ensure the entity's policies and procedures were appropriately reviewed and approved on a regular basis. The large majority of entities had recently reviewed and updated their CEI documentation to ensure it remained relevant and efficient. The audit identified two entities that were operating under CEIs that were significantly outdated.

2.52 The ANAO found that all of the entities except two had education, information and communication processes in place relating to policies and procedures designed to ensure staff were familiar with requirements. In addition, delegations of authority and responsibilities were regularly reviewed and updated.

2.53 To assist entities in assessing whether delegates have correctly exercised their delegations, one suggested better practice is to regularly (at least annually) require the delegates to formally make a signed statement to this effect. The ANAO noted that in less than one-half of the entities that this was done on a formal basis. Where not already in place, entities should consider implementing an individual, annual sign-off by delegates as a more formal control over the exercise of delegations.

Financial performance management

2.54 Better practice financial management involves producing regular, internal management reports for decision-making that are meaningful, timely and relevant. Better examples of internal financial reporting include a summary snapshot outlining overall performance supported by 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 presentations.¹⁵

2.55 This form of management reporting is considered fundamental in enabling CEs and senior management to meet their responsibilities in managing resources effectively, efficiently and ethically.

2.56 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.

Observations

2.57 In most cases, the ANAO found that monthly financial performance reporting was providing financial analysis and commentary to assist CEs, senior executives and staff with financial responsibilities to adequately monitor financial and operating performance.

2.58 In the large majority of the entities examined, there was a committee to oversee the internal budget process. This committee was normally comprised of senior executives and financial managers, or in some cases, this role was assumed by the executive committee. Where no separate budget committee existed, internal budgets were developed by the finance group and Chief Finance Officer (CFO) and taken to the executive for review and approval.

¹⁵ Management Advisory Board, *Beyond Bean Counting, Effective Financial Management in the APS—1998 & Beyond*, Canberra, 1997, p. 57.

2.59 All but two entities had an internal budget policy that was disseminated to managers and staff. To assist in managing the budget preparation and review process, the ANAO found that in all cases there was a dedicated team or identified resources and that the skills of this team or identified resources were considered to be adequate. Also, in all entities, sound quality assurance processes were in place to help ensure the quality of budget bids prior to the consideration by a committee or the CE.

2.60 For all entities management had in place effective processes aligned to ensure timely budget revisions to deal with changes in environment and/or entity priorities during the year. Also, managers were provided with or had access to relevant financial information on a timely basis that was consistent with their stated responsibilities.

2.61 The ANAO found that in all cases, financial performance was on the agenda of an appropriate number of executive meetings during the year and there was discussion on the impact of the financial results on current and future operations. In addition, the financial performance reports to the Executive included commentary on performance, based on information supplied by line managers.

2.62 With two exceptions the financial information provided to the Executive was presented with non-financial operational information so that a balanced view of performance was obtained.

2.63 Budget forecasts were included in the management reports presented to the Executive, for all but four of the entities. In one of these cases, management was working on a system to include forecasts in the reports. In the other three cases, while there was some trend analysis and mid-year review of spending, forecasts were not part of executive reporting. Monitoring performance against budget, particularly the major programmes, is important to ensure the entities have the benefit of the most up-to-date assessments.

Conclusion

2.64 In order for entities to be able to quickly and effectively deal with the challenges they face, as outlined in Chapter 1 of this report, it is essential that they implement effective internal controls.

2.65 There is a substantial body of guidance available to entities to assist them in developing and implementing the key components of an effective control environment, and appropriate fraud control arrangements, including ANAO Better Practice Guides. The ANAO has observed that the large majority of entities have considered this guidance. However, the ANAO has noted that there is still some inconsistent application and execution of better practice approaches, especially in respect of fraud and legal compliance. With the increased national and international focus on corporate governance, continued management attention is still required in this area as an effective framework is not sufficient in its own right to ensure an adequate control environment.

3. Information Technology Systems Controls

This chapter reports on the assessment of IT controls over information security and business continuity management. The chapter also reports on the controls over the SAP financial application for selected entities.

Introduction

3.1 The Australian Government has a significant and growing investment in information and communications technology (ICT) to enhance public administration and programme delivery. In 2002–2003 the Government spent an estimated \$3.11 billion on ICT operating expenditure¹⁶ and \$1.10 billion on ICT capital expenditure.¹⁷ From the 1999–2000 survey of ICT expenditure data, operating expenditure was \$2.05 billion. This represents an increase, over the three-year period, of \$1.06 billion or approximately 52%.¹⁸

3.2 Entities use a range of technologies for information provision, service delivery and administration. The continued focus on ICT as a key enabler has contributed to information technology (IT) and supporting systems becoming critical components of business processes within government entities.

3.3 Because of the criticality and dependence on technology, appropriate governance practices are important to ensure the deployment of technology meets corporate goals through increased productivity, within a cost effective and prudent control environment.

3.4 Information technology has long been considered an integrated business solution that can involve substantial benefits as well as costs. The adoption of new technologies has progressively introduced increased complexity, greater speed, interconnectivity¹⁹ and dependence on information systems. As well as the potential for productivity and efficiency gains, these technologies introduce new risks. Significant amongst these are information security and business continuity.

¹⁶ Year Book Australia 2005, Communications and Information Technology, Government use of Information Technology, Australian Bureau of Statistics, Canberra. ICT operating expenses included: wages and salaries \$836 million, hardware \$515 million, software \$269 million, telecommunication services \$676 million, and contractors/consultants \$811 million.

¹⁷ Year Book Australia 2005, Communications and Information Technology, Government use of Information Technology, Australian Bureau of Statistics, Canberra. ICT capital expenses included hardware \$616 million and software \$485 million.

¹⁸ The range of ICT expenditure data collected in earlier surveys of government expenditure by the ABS was limited. Capital expenditure data was not collected in the 1999–2000 survey.

¹⁹ The ability to link hardware and software, typically from different manufacturers, so that they can communicate.

Audit coverage

3.5 The ANAO financial statement audit methodology is premised on gaining an understanding of an entity's important business processes supporting the development of the financial statements. The methodology, as it relates to IT, evaluates the risks and controls of the entity's use of technology to support these business processes.

3.6 An IT component of the financial statement audit process assesses general controls²⁰ over four key elements of IT management, namely: IT Governance; Development and Implementation of IT Solutions; Delivery of IT Services; and Monitoring and Reporting. These areas are closely aligned to the IT processes contained in Control Objectives for Information and Related Technology (CobiT).²¹

3.7 The emphasis for this chapter is on the assessment of information security and business continuity management (BCM), which were reviewed as part of the general controls audit of the Delivery of IT Services element of IT management. The ANAO also undertook more in-depth reporting of the information security and business continuity practices for five larger entities (the extended reporting group). This group is comprised of: the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and the Health Insurance Commission.

3.8 In addition, the ANAO continued audit focus this year on the system controls of the applications supporting the entities' financial management information system (FMIS), specifically SAP.²² SAP is the most commonly used FMIS amongst the larger entities.²³ Evaluating risks and controls of financial systems provides assurance over the reliability, accuracy and completeness of information for financial statement and management reporting purposes.

²⁰ These relate to the entire IT environment within which application systems are developed, maintained, and operated, and are therefore pertinent to all applications. The objectives of general controls are to ensure the proper development and implementation of systems, and the integrity of program and data files and computer operations.

²¹ CobiT is a framework of internationally accepted better practice standards that assists with the management and assessment of key aspects of an IT environment. It has been developed by the Information Systems Audit and Control Association and the IT Governance Institute: <www.isaca.org>.

²² SAP is an integrated software solution, developed in Germany, that provides support for a wide range of business functions, including both financial and human resource management.

²³ 17 of the 24 entities included in this report have implemented SAP as their financial management information system.

Control assessment

3.9 The following commentary summarises the results of selected components of the IT interim phase of the major entities covered in this report. All findings in relation to IT for each entity are included in Chapter 5 of this report.

3.10 The information security management and business continuity management sections of this chapter provide an overall assessment of entities' information security and business continuity practices. A total of 24 entities were included in these assessments.

3.11 The robustness of the controls within entities' SAP financial systems was also reviewed to gain assurance over the reliability, accuracy and completeness of the financial information derived from these systems. As part of the audit, an understanding was obtained about the financial processes with a view to identifying and evaluating key controls against a better practice model. Seventeen of the 24 entities reviewed in this report had implemented SAP as their FMIS. This chapter reports the results of control assessments using specialised analysis software applied to 10 of these entities.

Assessment method — information security and business continuity management

3.12 To evaluate how entities were performing, ratings were developed to provide a controls baseline.²⁴ These ratings are on a scale of 0 – *Non-existent* to 5 – *Best Practice* and are described in detail at Appendix 1.

3.13 A control rating of 3, being *Established*, is considered by the ANAO to be the minimum standard (or baseline) to be achieved by entities to demonstrate alignment with both acceptable management controls and any public sector standards or guidance.

3.14 Progression through the rating levels indicates that IT processes are better aligned with the entity's organisational goals. This enables the entity to maximise benefits from its IT investment decisions, through the deployment of IT resources more effectively and through the appropriate management of IT risks.

3.15 As in previous years, the ANAO has developed a series of indicators for each rating level for information security and business continuity management. Details of these indicators at the 3 – *Established*, 4 – *Mature* and 5 – *Best Practice* control levels are provided in Appendices 2 and 4 respectively. In order to attain a specific rating, the entity must meet all indicators within

²⁴ A measurement or calculation used as a basis for comparison or to compare performance.

the level. An entity rated below the *Established* control level indicates it has not achieved one or more indicators at the controls baseline.

3.16 Although entities were assessed against the *Established* control level, there are factors that influence the determination of the baseline for individual entities. For example, Government policy on information security²⁵ requires the fulfilment of some indicators at the 4– *Mature* control level. In addition, for large entities that make broader strategic use of IT for programme delivery, a *Mature* level may also be more appropriate for business continuity management, indicating a complete set of policies, procedures and standards had been developed.

Information security management

Summary assessment

3.17 In general, most entities reviewed had adopted sound governance principles in relation to information security management, with roles and responsibilities for IT security being clearly assigned, documented and accepted by key stakeholders. The strength of these principles has been demonstrated in coordinated security processes that provide clear policy articulation and the implementation of robust procedures and practices.

3.18 The lack of a developed and regularly maintained security plan, that is based on ongoing risk assessment and is effectively aligned with the entity's overarching security policy, has been identified as an area of weakness in information security management for some entities. Other areas identified where improvements are required include: security awareness and training; segregation of duties; security reporting; and the management of IT systems access. Of these, access management and its associated functions of granting, revoking and monitoring user access was the area most in need of attention.

Information security focus areas

3.19 The value of information security, both in the private and public sector, is increasingly measured by its contribution to business growth. It is no longer viewed solely as a technology solution for the protection of data and assets. Information security is now regarded as an integrated business solution based on a strategic combination of organisational resources, processes and technology. The key elements of information security management are concerned with the identification of threats and vulnerabilities, and the

²⁵ The Commonwealth Protective Security Manual (PSM) sets out the policies, practices and procedures that provide a protective security environment that is not only fundamental to good business and management practice, but essential for good government. It also lays down the procedures designed to ensure that departments and agencies approach protective security measures in a way that is consistent across government.

development of strategies to mitigate, prevent, and recover from the impact of negative security-related events on business operations.

3.20 Information security not only has the potential to enhance the protection of information, while facilitating proper access to it, but also to enable access in a manner that supports an organisation's strategic objectives. Sound information security management enhances an entity's confidence that its recorded 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.

3.21 For this audit phase, the ANAO focused on reviewing the IT practices and procedures underpinning information security management. The areas reviewed included the following issues as they related to financial applications and associated system components supporting these applications:

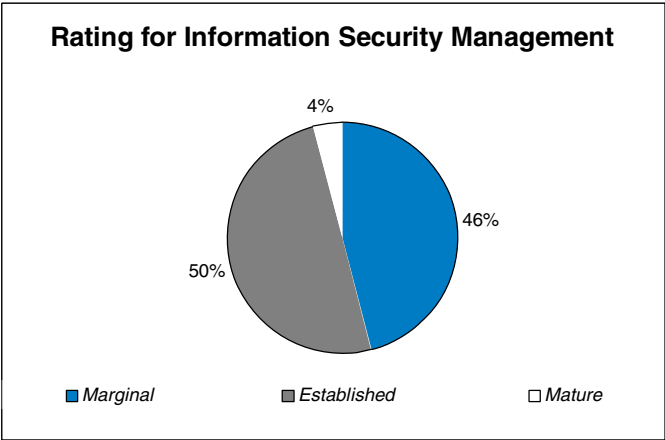
- IT security policies, plans and procedures;
- security roles and responsibilities;
- security awareness and training;
- IT security monitoring, investigation and reporting; and
- system access procedures.

Findings

3.22 As illustrated in Figure 3.1 below, eleven entities (representing 46% of the entities reviewed) had only reached a 2 – *Marginal* control rating for information security management. A *Marginal* rating is below the expected minimum standard and indicates a lack of adherence to acceptable management controls and public sector standards. However, eight of these entities had a high *Marginal* rating (this is demonstrated in Figure 3.2) having failed to meet only one or two of the indicators at the control baseline (*Established*) level. The improvements required by entities noted below the baseline are discussed later in this section.

3.23 54% of entities attained a *Established* or higher rating, with one entity obtaining a *Mature* control rating, indicating that security management practices were documented and endorsed by management, with risk assessment and impact analysis consistently performed.

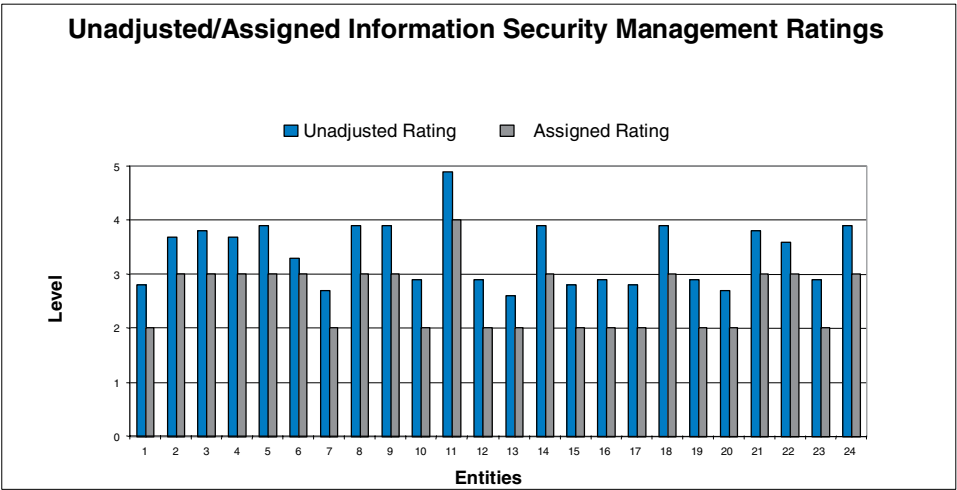
Figure 3.1



Source: ANAO analysis of entities' Information Security Management control environment.

3.24 Figure 3.2 below provides a snapshot of the ratings for information security management across all entities referred to in this chapter. The 'Unadjusted' rating demonstrates the entity's progression toward attaining the next level to that 'Assigned'. The 'Assigned' rating reflects the requirement to meet all indicators in a level in order to advance to a higher rating.

Figure 3.2

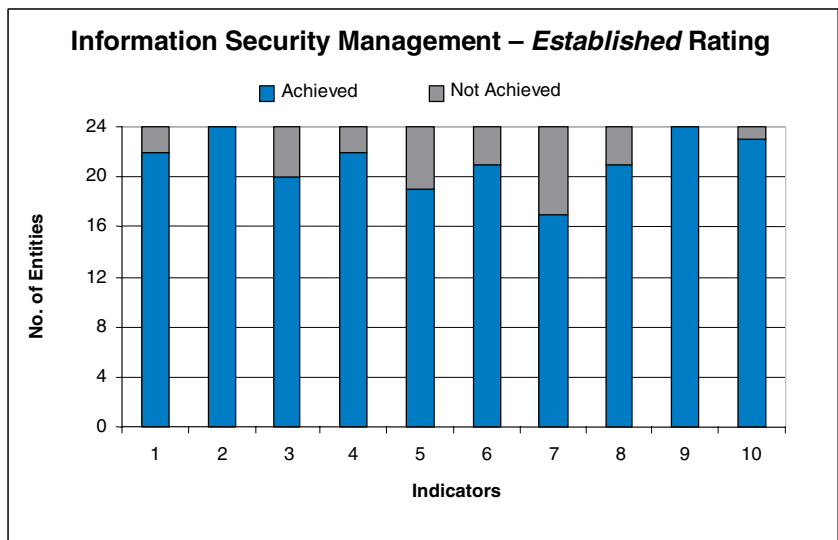


Source: ANAO analysis of entities' Information Security Management control environment.

3.25 The review identified that of the entities obtaining the *Established* control rating, most had implemented more than 75% of the *Mature* control indicators. It was also noted that approximately half of these entities had implemented 75% of indicators at the *Best Practice* control level.

3.26 Figure 3.3 below illustrates how entities performed against the individual indicators for the *Established* control rating (as previously mentioned these indicators are listed in Appendix 2). Areas where improvement opportunities were identified relate to the need for the regular revision of security plans (based on ongoing risk assessment and alignment with security policy), system access restrictions, security awareness and training, and security reporting.

Figure 3.3



Source: ANAO analysis of entities’ Information Security Management control environment.

3.27 The most significant area needing improvement concerns the granting and management of access to IT systems. Limitations in system access security over financial applications were associated with a lack of regular and timely review of user access and audit trails, and the ineffective segregation of duties over key financial functions.

3.28 The principal areas of strength identified for information security management were:

- governance: executive and operational roles and responsibilities for IT security are clearly defined, actively managed and accepted for information security activities; and
- physical access: control of physical access to data computing centres ensures access to facilities is appropriately authorised.

3.29 Analysis of the extended reporting group, summarised in Appendix 3, indicates further improvements in the level of their information security management practices can be achieved by:

- developing individual security plans for key business applications handling sensitive information;
- clearly defining and aligning information security procedures with the entity's security policy; and
- the endorsement by the entity of risk management and current security policy and procedures.

3.30 Of the extended reporting group, one entity was rated at a *Marginal* control level for information security management practices. This entity will need to improve the governance of IT security to attain an *Established* control rating.

Business continuity management

Summary assessment

3.31 In most entities reviewed, management responsibility for business continuity had been identified and assigned, with roles and responsibilities clearly articulated. Business continuity plans (BCPs), where completed, had been based on business impact analysis, with due consideration given to system criticality assessments.

3.32 A significant number of entities still have work to perform to ensure they have developed, implemented, tested and documented comprehensive business continuity plans. While most entities had an appropriate business continuity policy in place, they had yet to complete supporting plans for all critical areas of their business.

Business continuity focus areas

3.33 An important aspect of an entity's governance and risk management strategies is an assessment of the risk to the continued availability of service delivery and information.²⁶ The assessment requires an entity to understand its operating environment, and the constraints and threats that could result in a disruption to services. This process is more commonly referred to as business continuity management but other terminology is sometimes used.

²⁶ The Business Continuity Handbook acknowledges the dual role that risk management and BCM play: *'Risk management and BCM need to be considered part of an integrated whole. BCM should be conducted as one of the required outcomes of the risk management program, whilst the identification, analysis and evaluation of risk continues to be an important step in developing the business continuity plan.'*

HB 221: 2004, Business Continuity Management, Standards Australia/Standards New Zealand, p. 5.

3.34 The outcome of such an assessment requires entities to develop business continuity arrangements for those areas considered necessary for maintaining 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 when normal operating activities are affected by a disaster or disruption event.

3.35 The ANAO concentrated on the following elements of business continuity management:

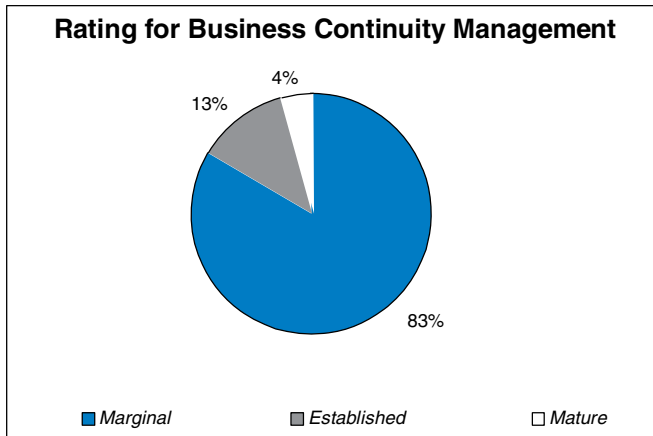
- business continuity policy, and its integration with entity governance and risk management policies;
- business continuity plans and processes as they contribute to the maintenance of business operations in the event of a disruption;
- incident reporting;
- continuity training and awareness; and
- disaster recovery plans (DRP) and processes that enable IT systems to be re-instated to a satisfactory operating level in a timely manner following a disruption event.

Findings

3.36 As illustrated in Figure 3.4 below, only 13% of the entities attained an *Established* control rating in relation to business continuity management, with one of the entities obtaining the *Mature* level. Twenty entities (representing 83% of the entities reviewed) were assessed at a 2 – *Marginal* rating for business continuity management. This is below acceptable management controls and public sector standards. However, nine of these entities had a high *Marginal* rating having failed to meet only one or two of the indicators at the baseline level. The improvements required by entities below the baseline are discussed later in this section.

3.37 ‘The objective of business continuity management is to ensure the uninterrupted availability of all key business resources required to support essential (or critical) business activities.’²⁷ As part of BCM, management needs to prioritise both the business areas and supporting IT systems, and perform a cost benefit analysis based on perceived risks. Not all business functions will require a recovery strategy. The business impact and risk profile will differ across the various Government programmes delivered by entities affecting the criticality of the BCM process but not removing the need for the process to be performed.

²⁷ ANAO, *Business Continuity Management—Keeping the wheels in motion, Guide to Effective Control—January 2000*

Figure 3.4

Source: ANAO analysis of entities' Business Continuity Management control environment.

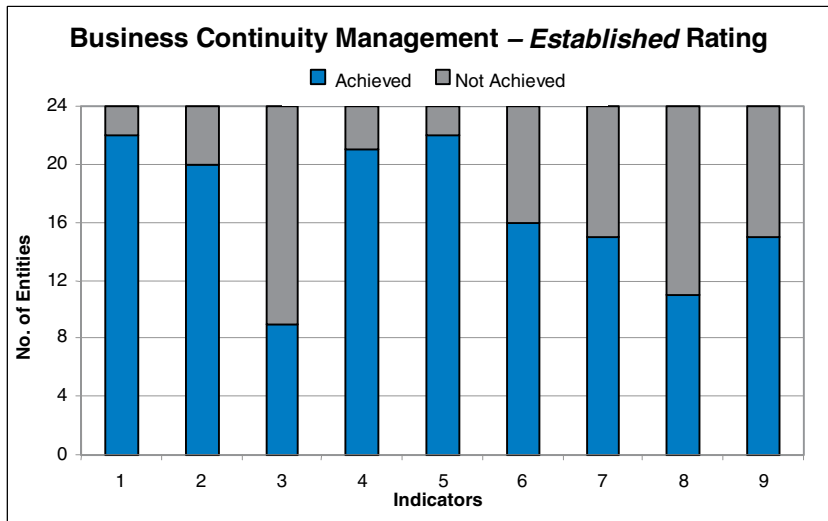
3.38 Figure 3.5 below illustrates how entities rated against the individual indicators for the *Established* control level. General observations made throughout the assessment include:

- most entities, approximately 92%, had clearly identified management responsibility for business continuity planning and disaster recovery;
- in the formulation of the BCPs, 92% of entities had considered IT system components that operate continuously and provide redundancy;
- a high number of entities, 83%, had clearly defined roles and responsibilities for business continuity and disaster recovery planning; and
- 88% of entities had based their BCPs on system criticality²⁸ and business impact assessments.²⁹

²⁸ The importance of IT systems and supporting technology to the maintenance of core business functions and processes.

²⁹ Identifying the various events that could impact the continuity of operations and their financial, human and reputational impact on the organisation.

Figure 3.5



Source: ANAO analysis of entities' Business Continuity Management control environment.

3.39 Entities could improve their business continuity management rating by ensuring:

- business continuity plans have been developed for the entire organisation and are aligned with corporate objectives and priorities;
- appropriate reporting and recording of all business continuity incidents;
- key personnel understand business continuity policy and procedures, and obtain training; and
- periodic BCP testing and reporting of outcomes.

3.40 Analysis of the extended reporting group, summarised in Appendix 5, indicates the need for improvement in predominantly the same areas as has been identified for other entities. Three out of the five entities in this group had only reached the *Marginal* level.

SAP financial management information system

Summary assessment

3.41 In respect of the SAP financial application, weaknesses identified in 2003–2004 had not improved appreciably. Further progress is required over user access, security administration functions, and functions associated with ordering, receipting and payment for goods and services, more commonly referred to as the 'purchase to pay' cycle. Entities should consider

strengthening application controls, in particular by reinforcing the need for clearer segregation of duties.

3.42 The review has identified that full advantage has not been taken of the configurable controls³⁰ available within SAP, necessitating significant reliance on controls external to the system.

3.43 Concerns still exist regarding the lack of regular reviews of user access and audit trails. While many entities document the need for audit trails and subsequent review activities, most entities either fail to undertake this activity or fail to perform the review in a timely manner.

SAP focus areas

3.44 Given the complexity of SAP and the number of entities using the application, the ANAO purchased analysis software³¹ to aid in the review of the system-based configurable controls used by entities. The software assesses the implementation of configurable controls selected by the entity to support business and accounting processes. The assessment also facilitates analysis of the application security.

3.45 The ANAO completed a pilot using the analysis software on the audit of the Department of Transport and Regional Services (DoTARS) in November 2004. The success of the pilot in terms of audit and operational efficiencies for both the ANAO and DoTARS led to a phased rollout of the software across 10 entities using SAP. All other SAP entities continued to be audited using the manual audit programme, but have not been included in this chapter.

3.46 The commentary in this section covers the following entities.

- Australian Federal Police.
- Attorney-General's Department.
- Department of Defence.
- Department of Employment and Workplace Relations.
- Department of Foreign Affairs and Trade.
- Department of Immigration and Multicultural and Indigenous Affairs.
- Department of the Environment and Heritage.
- Department of Transport and Regional Services.
- Health Insurance Commission.
- Treasury.

³⁰ System based 'switches' that can be set by turning them on or off to secure the application against inappropriate processing, based on the organisation's business rules.

³¹ SAP Assure © jabIT Solutions: <www.jabit.com.au>.

3.47 The SAP review for these entities concentrated on examining the SAP ‘purchase to pay’ cycle. It also focused on how the application was configured for application controls and security arrangements. SAP findings reported in this chapter may also equally apply to all entities using SAP as their FMIS.

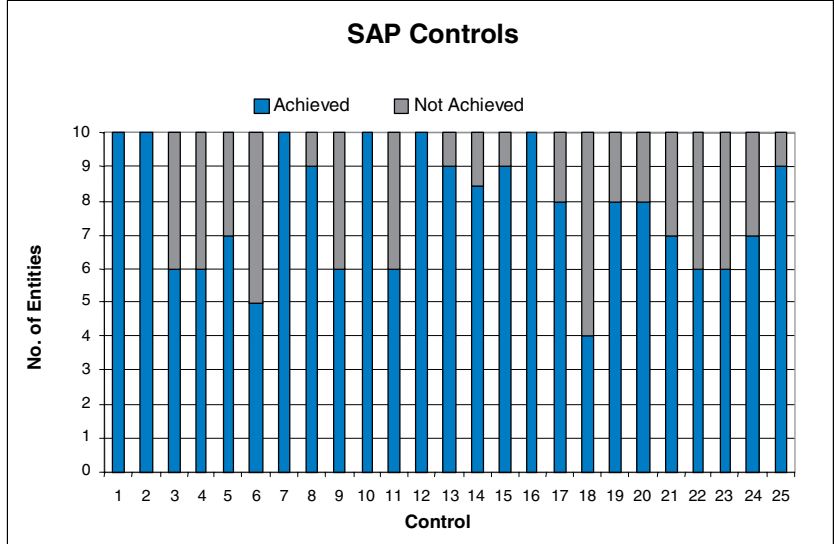
Findings

3.48 In respect to the implementation and operation of the SAP financial application, the issues identified as areas for improvement in 2003–2004 had not improved appreciably. Further progress is required over user access, security administration functions, and the ‘purchase to pay’ cycle.

3.49 General observations from the review identified that standard SAP system-based controls had either not been configured, or had been configured poorly. Poorly configured controls were often at variance to entity’s policy, business requirements and better practice. Entities were therefore heavily reliant on the robustness of controls external to the application to provide the assurance that transactions are valid and are processed accurately and completely.

3.50 Figure 3.6 below illustrates how entities performed against selected individual controls. These controls are described in Appendix 6.

Figure 3.6



Source: ANAO analysis of entities’ SAP control environment.

3.51 Particular areas of concern were the high number of users, both general and administrative, with access to system functionality conflicting with their level of authority or responsibility. While this type of access was often

promoted by the entities as essential to their business process, concerns still existed regarding the ongoing lack of regular review of user access and audit trails. While many entities document in their policy and procedures the necessity of audit trails and subsequent review activities, most entities either failed to undertake this activity or failed to perform the review in a timely manner.

3.52 Entities should consider strengthening the access controls or implementing compensating controls³² over functions within the application that could give rise to potential conflict with the authority of the user to complete such transactions, for example, both approving and paying a purchase order.

3.53 Access to the SAP system is controlled through the use of user IDs and passwords. The ANAO reviewed several powerful user IDs³³ in order to determine how well they were protected from unauthorised use. All entities had implemented adequate control over these user IDs.

3.54 Controls, in addition to security, that required further strengthening included:

- the development of change management policy and comprehensive supporting procedures; and
- segregation of incompatible functions in the development and implementation of system changes.

3.55 Controls over changes to the application were examined. The results of the review indicated that all entities had appropriately tested and approved changes to the SAP application.

Emerging issues

3.56 Continuing technology developments and advancements, together with the ongoing implementation of such technologies by entities, will heighten a number of emerging issues and challenges. The adoption of new technologies will introduce a new range of risk management issues and concerns. Such technologies will also have an impact on IT governance and the reliability 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 management and delivery of government

³² An internal control that reduces the risk of an existing or potential control weakness resulting in errors and omissions.

³³ Specifically SAP* and DDIC. SAP* allows unrestricted access to SAP, while DDIC is used to change system control settings. SAP* and DDIC are delivered with well-known default passwords.

programmes. This has continued the move toward e-Government to provide more responsive, comprehensive and integrated government operations and service delivery.

3.57 One of the Australian Government's key objectives for the information economy is *'to make government an exemplar in the use of ICT to improve citizen engagement, efficiency and effectiveness of service delivery'*.³⁴ This objective translates into a strategic priority to *'raise Australian public sector productivity, collaboration and accessibility through effective use of information, knowledge and ICT'*.³⁵

3.58 The management of IT related risk is a key component of entity governance. Effective IT governance is integral to the success of overall governance by ensuring efficient and effective planning, management and operation of IT processes, IT resources and information. IT governance provides the structure to link and align technology to entity strategies and objectives.

3.59 Entities' IT processes and systems will need to transform to respond to new technologies and to ensure that systems are compatible and integrated, both internally and externally. Each entity's management of systems development will need to plan for future compatibility, interconnectivity and maintenance. Change management³⁶ processes and procedures will also need to adapt to ensure the reliability and integrity of systems, and the information they process, is maintained in a systematic and controlled manner.

3.60 As a consequence of the continued move toward e-Government and the adoption of new technologies for interconnection and interoperability of systems, information security management will become an even more critical issue. As the implementation of new technologies transform the Australian Government, service delivery, contract management, configuration and storage management, as well as business continuity management will also become more important issues to be actively managed.

3.61 During 2004, an inquiry conducted by the Joint Committee of Public Accounts and Audit (JCPAA)³⁷ identified weaknesses in the area of physical

³⁴ Australia's Strategic Framework for the Information Economy 2004–2006, Department of Communications, Information and Technology and the Arts, Canberra, July 2004

³⁵ *ibid.*

³⁶ A systematic approach to dealing with change through defining and implementing procedures and/or technologies.

³⁷ Joint Committee of Public Accounts and Audit, Report 399 Inquiry into the Management and Integrity of Electronic Information in the Commonwealth, Canberra, March 2004.

security³⁸ over IT equipment. This inquiry also highlighted the need to develop and implement practical 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, and in doing so has placed greater onus on entities to better manage security issues.

Future IT audit focus

3.62 The ANAO will continue to review information security and business continuity given that the preservation of an effective security and continuity control framework is a key responsibility for entities. Maintenance of effective security and business continuity arrangements are necessary for the integrity, availability and continued operation of government business.

3.63 Over the next year the ANAO will also continue its evaluation of the security and control of key financial management systems. Analysis will concentrate on general ledger,³⁹ the 'purchase to pay' cycle, and asset management, as well as system security and configuration.

3.64 Identification and testing of key risks and 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 on the extent of any exposure or error that may be occurring within an entity's systems, due to control weaknesses. This data analysis may also be used in benchmarking IT controls to gain an overall understanding of the general health of entity controls by comparison across entities.

Conclusion

3.65 While more than half of the entities attained the *Established* control rating for information security management, indicating compliance with acceptable management controls and public sector standards, almost half also failed to meet this baseline. Given the importance of information security controls to preserving the integrity and confidentiality of information, entities need to improve their practices, in particular those concerning access management. Entities that place a higher importance on information security for service delivery should also assess their current practices with a view to obtaining a *Mature* control rating.

³⁸ Physical protection measures to safeguard organisations facilities, including but not limited to restrictions on entry to premises, tamper-resistant storage and anti-vandal measures.

³⁹ The collection of all individual accounts for a particular business that is used in the preparation of financial statements.

3.66 The audit indicated that more than three-quarters of entities failed to meet the baseline for business continuity management. Most entities need to continue their efforts to establish and maintain business continuity plans across the entire organisation and ensure appropriate training is provided to all relevant personnel. Plans must be regularly tested, with the results documented, and all business continuity incidents recorded and reported. Lessons learned from testing and previous incidents must be incorporated into the review and update processes.

3.67 In order for entities to ensure that they develop and maintain an adequate level of control, they need to perform risk assessments of their processes and systems. These assessments form 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.

3.68 Audit of entities' SAP applications continued to identify areas for improvement of implemented configurable controls. In particular, there are opportunities for entities to strengthen security administration and segregation of functions. Entities also continue to place heavy reliance on external and compensating controls, such as the review of audit trails. These are generally not well managed.

4. Summary of Entities' Control Activities

This chapter provides a summary and comments on the audit issues discussed in detail in Chapter 5 with the exception of Defence.

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 controls over 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 management;
- receivables, revenue and receipts;
- cash management;
- purchasing, payables and payments;
- employment and related costs; and
- asset management.

4.2 During the audit, the ANAO also assesses the overall financial risks to the entity and seeks to obtain added assurance from the entity overall financial management framework and the accounting and financial reporting policies and processes in place. This leads to the identification of broader findings and issues that are not limited to the detailed functional financial and accounting areas listed above.

4.3 An entity's internal controls are delivered, or supported by information technology systems. Accordingly, the interim audit also includes the review and testing of the entity's information technology systems controls that enable the accounting and financial reporting processes to be delivered.

4.4 An accounting process which requires on-going attention is the development of accounting estimates. The ANAO reviews processes for ensuring that accounting estimates are adequately derived and documented.

4.5 The final phase of the audit builds 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.

Key Findings

4.6 Overall, the results of the interim audits of entities reviewed in this report indicated that the effectiveness of controls over business and accounting processes had generally been maintained at a reasonable level. However, most of the entities had areas that required attention, particularly in relation to IT controls and the controls underpinning the financial management framework, where performance had been quite variable. In broad statistical terms, the results of the interim phase of the 2004–2005 audit (excluding Defence and DHS) are as follows:

- the number of entities with ‘A’ category audit issues⁴⁰ increased to three in 2004–2005, up from one in 2003–2004;
- the total number of ‘A’ category audit issues increased to nine in 2004–2005 from one in 2003–2004;
- the number of entities with no category ‘A’ or ‘B’ audit issues was six in 2004–2005, up from three in 2003–2004;
- the total number of ‘B’ category audit issues across all entities, decreased from 87 in 2003–2004 to 64 in 2004–2005, due largely to improved performance by HIC; and
- twelve entities reported an improvement in the number of ‘B’ category audit issues; eight entities showed a deterioration in their position, with two entities remaining in the same position.

4.7 A summary of the results of testing for the major entities for the period 1 July 2004 to 31 March 2005, is set out in Chapter 5.

4.8 Commentary on entities’ controls over key financial categories follows. In all cases, the entities concerned have agreed to improve their processes.

Appropriations management

4.9 Appropriations, both departmental and administered, represent the primary source of revenue for most entities.

Audit Issues

4.10 The audit disclosed that controls in entities relating to the management of appropriations were adequate. All of the findings relating to appropriation management are specific to FaCS, and included:

⁴⁰ Audit findings are categorised as significant – ‘A’, moderate – ‘B’ or minor – ‘C’. This is further explained in Chapter 5.

- financial management and reporting of special appropriations and special accounts;
- administered receipts; and
- monitoring of expenditure by outcome.

Receivables, revenue and receipts

4.11 There are entities that collect significant revenues in the form of taxation, excise and administered levies. In the case of the ATO, accounting for these revenues involves the estimation of amounts such as general interest charges, superannuation surcharges and guarantees and the provision for doubtful debts. Lesser amounts of other revenues are also generated from the sale of goods and services and from interest earned from cash funds on deposit.

4.12 In 2003–2004, the Consolidated Financial Statements⁴¹ reported total taxation revenues of \$172.75 billion (exclusive of GST), and non-taxation revenues of \$45.08 billion.

Audit Issues

4.13 All of the findings relating to revenue and receivables are specific to the ATO, and included:

- proper calculation of the provision for doubtful debts and credit amendments;
- estimation of the general interest charge revenue and receivable;
- estimation and confirmation of the superannuation surcharge revenue and receivable; and
- errors in the system to calculate the superannuation guarantee charge.

Cash management

4.14 Departmental appropriations are deposited periodically 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.

⁴¹ A copy of the CFS and associated audit opinion is located at http://www.finance.gov.au/Publications/consolidated_financial_stateme.html.

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

4.16 As at 30 June 2004, the Consolidated Financial Statements reported cash totalling \$3.76 billion.

Audit Issues

4.17 Control weaknesses identified relating to cash management included:

- a lack of timely completion and review of bank and system reconciliations; and
- unauthorised withdrawal of funds.

4.18 Control issues relating to cash management or related issues were noted in the following entities.

- Attorney-General's Department.
- Australian Taxation Office.
- Department of the Environment and Heritage.
- Department of Industry Tourism and Resources.
- Department of Veterans' Affairs.

Purchases, payables and payments

4.19 Departmental appropriations are largely disbursed to meet employment costs and supplier expenses. 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.

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

4.21 In 2003–2004, the Consolidated Financial Statements reported the total cost of goods and services (excluding employee benefits) of \$47.83 billion, and total subsidies, benefits and grants of \$131.02 billion.

Audit Issues

4.22 For most entities, payment processes are routine and well established. The audit disclosed that payment controls were generally effective, with entities sustaining their internal controls over the past year. Individual entities continued to have weaknesses over payment processes, which were specific to their operations, covering issues such as:

- inappropriate delegations;
- inadequate monitoring of controls around the payments under grant programmes and agreements;
- certificate of compliance relating to the payment of public money;
- incorrect classification between administered and departmental expenses; and
- controls to prevent duplicate payments.

4.23 Control issues relating to control over payments or related issues were noted in the following entities.

- Australian Customs Service.
- Australian Taxation Office.
- Centrelink.
- Department of Family and Community Services.

Employment and related entitlements

4.24 Employment and related entitlements normally represent the largest departmental expenditure item. In many instances, employment entitlements also form one of the larger liabilities entities will need to meet, in particular, the annual and long service leave liabilities.

4.25 In 2003–2004, the Consolidated Financial Statements reported \$26.18 billion for employment and related costs, including superannuation contributions by the entities of \$6.38 billion.

4.26 Given the significance of employment expenses, and the fact that by their nature some employee entitlements calculations can be 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 that is designed to ensure fortnightly payroll amounts are accurately recorded. In addition, key controls should include appropriate approval and review processes.

Audit Issues

4.27 FMISs and HRMISs were assessed as generally effective. However, individual entities were found to have issues such as:

- the absence of regular monthly reconciliations of leave balances in the HR system to the general ledger;
- unrecorded prior employment service; and
- deficiencies in the operating controls in relation to the processing of the payroll.

4.28 Control issues relating to employment costs or related issues were noted in the following entities.

- Department of the Environment and Heritage.
- Department of Family and Community Services.
- Department of Immigration and Multicultural and Indigenous Affairs.

Asset management

4.29 As mentioned in last year's report, asset management, particularly in relation to the maintenance of reliable asset registers, has been an issue raised consistently by the ANAO as requiring improvement.

4.30 In 2003–2004, the Consolidated Financial Statements reported total non-financial assets of \$97.39 billion, excluding inventories and 'other' non-financial assets.

Audit Issues

4.31 Control weaknesses identified this year generally related to:

- incorrect costing of internally generated software;
- lack of reviews and timely accounting relating to the capitalisation of assets under construction; and
- unrecorded library collection.

4.32 Control issues relating to asset management or related issues were noted, in the following entities.

- Australian Taxation Office.
- Department of Family and Community Services.

Financial management, accounting and reporting

4.33 The financial management framework within an entity is integral to the structures, processes, controls and behaviours that constitute effective corporate governance. Managerial responsibility and accountability for performance, outputs and outcomes, include financial performance and control. It is therefore important that these imperatives are explicitly recognised and established. This needs to be supported by appropriate reporting policies and procedures directed at, meeting the information needs of users and supporting the reporting requirements of BEFR.

Audit Issues

4.34 A number of entities needed to improve their financial management, accounting and reporting systems and processes. Issues identified by the audit included:

- weaknesses in the financial statement preparation process;
- establishing or updating service level agreements;
- weaknesses in the FMISs;
- outdated financial policies and procedures;
- deficiencies in the financial management of projects; and
- accounting issues relating to provisions.

4.35 Control issues relating to financial management, accounting and reporting or related issues were noted in the following entities.

- Australian Taxation Office.
- Department of the Environment and Heritage.
- Department of Family and Community Services.
- Department of Immigration and Multicultural and Indigenous Affairs.
- Health Insurance Commission.

Information technology systems controls

4.36 All the entities in this report use information technology systems extensively for their financial accounting and reporting processes, as well as human resources processes. Accordingly, the ANAO examination of these IT systems and their related controls is a significant part of our audit examination of internal controls. Information technology systems controls include general controls in relation to IT management and the overall IT environment, as well as specific controls over systems and applications.

Audit Issues

4.37 A significant portion of the control weaknesses observed in interim audits of the entities related to IT systems controls. This is a function of the increasing sophistication and complexity of the IT systems and audit emphasis on the examination of these systems controls. The results of the interim audits indicated that management needs to pay more attention to improving IT management and systems controls.

4.38 IT systems controls issues identified in the audits included the following:

- user and system access management and documentation;
- system administration and management;
- IT strategic planning;
- management of security, including IT security policy and security issues;
- monitoring and review of audit logs;
- change management procedures; and
- duplicate employee records.

4.39 Control issues relating to information technology systems controls or related issues had been noted in the following entities.

- Attorney-General's Department.
- Australian Customs Service.
- Australian Federal Police.
- Australian Taxation Office.
- Centrelink.
- Department of the Environment and Heritage.
- Department of Family and Community Services.
- Department of Immigration and Multicultural and Indigenous Affairs.
- Health Insurance Commission.
- The Treasury.

Accounting estimates

4.40 A significant portion of the Australian Government's financial reports is comprised of items derived through estimation. The balance sheet of the Consolidated Financial Statements includes the consolidated estimates of all Australian Government entities. For the entities included in this report, for amounts greater than \$50 million (and excluding smaller departmental amounts such as employee provisions), at least \$6.24 billion of assets, \$110.83 billion of liabilities, \$38.95 billion of revenue and \$20.37 billion of expenditure were derived from accounting estimates in 2003–2004.

4.41 Australian Auditing Standard 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.

4.42 A number of accounting estimates included in the Consolidated Financial Statements are complex and are also sensitive to changes in underlying assumptions. By their nature, accounting estimates are approximations that may need revision as additional information becomes known⁴². For example, the accounting estimates for the Australian Government's Asbestos-Related Disease Exposure totals \$861.80 million at 30 June 2004. The amount was derived from an actuarial assessment that had to consider such factors as common law claims for compensation for personal injury, government-related claims arising from diseases and a continuation of the current legal, medical and compensation environment with allowance for future cost escalation. The provisions for outstanding medical claims in the Department of Health and Ageing and the Health Insurance Commission are also complex.

4.43 Specialists with the appropriate skills and knowledge are required to produce accounting estimates that are sufficiently reliable for inclusion in entity financial statements. Some entities have specialist areas, which develop models to produce their accounting estimates while other entities produce their own accounting estimates based on models developed by an actuary. However, the majority of entities employ specialist actuaries to produce the estimates required for financial management and reporting.

⁴² Australian Auditing Standard AAS36 Statement of Financial Position, October 1999.

4.44 Even when a specialist is employed to determine an accounting estimate, there can be significant uncertainty about the estimate. In 2003–2004, the ANAO issued audit reports containing an emphasis of matter with regard to the inherent uncertainty attaching to accounting estimates in the following entities.

- Department of Health and Ageing.
- Health Insurance Commission.

4.45 While the preparation and presentation of information in the financial statements is the responsibility of the CE or entity equivalent, where this information is prepared by an actuary the ANAO reviews that work in accordance with Australian Auditing Standard 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*.

4.46 Although entity senior managers may not have the same expertise as an actuary, they are still required to approve the accounting estimates used in the preparation of financial statements. A number of entities compare accounting estimates to actual data at a later date to monitor the accuracy of the estimates.

4.47 Adequate documentation of the basis of the estimates, together with management's review and formal approval, reflects sound practice. This review should include, but not be limited to, endorsement of the appropriateness of the basis used for the estimate, verification of data utilised, and consideration of any subsequent events that may impact on the estimate. The audit identified that entities need to improve the level of documentation and formal review processes with regard to accounting estimates.

Conclusion

4.48 The results of the interim phase in relation to entities covered in this report indicate that the effectiveness of control activities over business and accounting processes have generally been maintained at a reasonable level. Although the total numbers of significant audit findings, excluding Defence, decreased in 2004–2005, the audit findings suggest that entities need to pay attention to the controls underpinning their financial management frameworks, particularly in the areas of IT, FMIS, purchasing and payment of accounts, and policies and procedures. On the other hand, the audit noted fewer control weaknesses in relation to accounting and reporting processes at the operational level.

4.49 The large number of control weaknesses relating to IT systems and controls, such as the management of user and systems access, IT security and change controls, indicates that increased management attention is needed to provide assurance that entities have appropriate IT control structures and systems in place.

4.50 The audit findings in relation to such areas as the financial statement preparation process, purchasing, payment of accounts and financial policies and procedures, further emphasises that entities must continue to give attention to fundamental elements of their internal control.

5. Results of Examination of Control Activities by Portfolio

This chapter discusses the more significant matters identified during the interim phase of the 2004–2005 financial statement audits by Portfolio.

Introduction

5.1 This part of the report summarises the results of examinations of internal control of entities as part of the interim phase of the financial statements for the year ending 30 June 2005. These entities comprise the portfolio departments and other entities that manage the majority of the General Government Sector financial activities and operate the more significant, and complex, financial systems.

5.2 The ANAO's audits of Australian Government entities are performed on a continuous basis. They are structured to meet the Australian Government reporting deadline of 30 July 2005 for material entities. 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 2005.

5.3 The summary of each entity's audit results comprises:

- introductory commentary regarding the entity's business operations;
- identification of the entity's key business and financial statement risks;
- comments on governance arrangements relevant to the entity's financial management responsibilities;
- a summary of the entities financial reporting capability;
- the audit results, including reference to the more significant issues identified covering general audit procedures, IT processes and financial applications, IT security and business continuity management; and
- an overall conclusion.

5.4 In respect to the key audit related 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 interim phase of the audit, focuses on the steps taken by entities to manage those risks that have a potential impact on the financial statements.

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 reporting to entities, indicates the priority the entity needs to give to remedial action. 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 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 The status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO are provided in a summary table for each entity.

5.8 Appendix 7 provides the number of 'A' and 'B' issues included for each entity as at 31 March 2004 and 31 March 2005.

Agriculture, Fisheries and Forestry Portfolio

Department of Agriculture, Fisheries and Forestry

Business operations

5.9 The Department of Agriculture, Fisheries & Forestry (DAFF) is the primary policy formulation and advisory body to the Government on Australian agriculture, fisheries, forestry and food issues.

5.10 DAFF's mission is to increase the profitability, competitiveness and sustainability of Australian agriculture, fisheries, food and forestry industries and enhance the natural resource base to achieve greater national wealth and stronger rural and regional communities. DAFF's responsibilities include sustainable resource management, policies and programmes to promote more profitable, competitive and sustainable industries, quarantine policy and inspection, scientific and economic advice.

5.11 Following the establishment of Biosecurity Australia (BSA) on 1 December 2004 as a prescribed agency under the FMA Act, DAFF made changes to its management structure. Appropriation funding for Biosecurity programmes within DAFF transferred to BSA following a direction under Section 32 of the FMA Act on 11 February 2005.

5.12 There have been no other significant changes to the business and operational environment within DAFF.

5.13 DAFF's funding for the year ending 30 June 2005 includes estimated price of outputs of \$518.32 million and estimated administered expenses of \$1.46 billion. Estimated administered revenue for 2004–2005 is \$577.66 million. DAFF's average estimated staffing level for 2004–2005 is 3 796.

Key business and financial statement risks

5.14 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 programmes;
- 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.

5.15 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- monitoring and reconciliation of funds disbursements with particular regard to personal benefits programmes administered by Centrelink;
- transfer of the Biosecurity Australia programme functions to the new prescribed agency, Biosecurity Australia;
- complex calculation of Commonwealth Contribution payments made by the Levies programme area to research and development organisations;
- calculation of Industry Equalisation Reserves, Revenue Rebates and Industry Initiatives related to Australian Quarantine and Inspection Service fees and charges;
- devolved financial responsibility to DAFF Divisions;
- compliance with all relevant legislation and agreements by DAFF and recipients;
- integrity of information transferred from feeder systems into the FMIS;
- appropriation compliance;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.16 The ANAO's audit approach considers DAFF's goals, priorities, objectives and strategies, along with the critical success factors DAFF considers are necessary to achieve them. In reviewing DAFF's 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 support financial assurance include:

- an Executive Management Team that meets monthly and provides leadership to DAFF Divisions on administrative and operational aspects. It also takes an active role in reviewing and monitoring DAFF's financial performance;
- a corporate committee framework including an Audit Committee. The Audit Committee includes 2 independent members and an observer from the ANAO. 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 of the Audit Committee that meets at least bi-monthly and oversees the production of the financial statements;
- a monthly financial reporting process which provides actual versus budget expenditure and revenue;
- 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.

Financial reporting

5.17 DAFF produces full accrual monthly management financial reports within eight days of the end of each month. DAFF reports comprehensively on its operations, including:

- administered and departmental revenues, expenses, assets, liabilities, cash flows;
- operating surplus/ deficit by division (departmental); and
- outcomes report by programmes (administered).

5.18 These are distributed to the Executive Management Team and Finance Sub-Committee on a monthly basis. Included in these reports is commentary on DAFF's financial position, with detailed variance analysis.

5.19 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

5.20 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New Issues to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0	0
B	3	0	0	3	3	0	0
Total	3	0	0	3	3	0	0

5.21 There are no new significant issues to report as a result of this year's interim audit phase. DAFF has satisfactorily addressed, or has made sufficient progress in addressing the significant issues raised last year in respect of: processing of personal benefits through Centrelink; unrecorded prior employment service; and accounts payable processes.

Conclusion

5.22 DAFF has responded positively to the ANAO's issues and associated recommendations.

Attorney-General's Portfolio

Attorney-General's Department

Business operations

5.23 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 provides legislative policy and advice and other services including administration of legislation, coordination of national security, implementation of Australian Government policy on family law, management of Emergency Management Australia, provision of administrative support to Royal Commissions under the administrative arrangements order and legal aid.

5.24 There were no significant changes to the business and operational environment of the AGD in 2004–2005.

5.25 AGD's funding for the year ending 30 June 2005 includes estimated price of outputs of \$180.89 million, and estimated administered expenses of \$377.84 million. Estimated administered revenue for 2004–2005 is \$9.76 million. AGD's average estimated staffing level for 2004–2005 is 877.

Key business and financial statement risks

5.26 In order to manage its key business risks, AGD addresses issues related to:

- the timely and efficient delivery of advice and other services;
- its reputation and relationship with its business partners;
- ensuring sufficient financial and human resources are available to achieve agreed priorities; and
- data integrity and security due to the diverse number of specific databases and analytical tools.

5.27 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- administration and review of user access to IT systems aimed at reducing the risk of unauthorised or inappropriate access to information assets;
- reconciliation of administered appropriations and special accounts to Australian Government cash and appropriation management system and AGD's FMIS;
- recognition of grant and subsidy expenses;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.28 The ANAO's audit approach considers AGD's goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing 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 support financial assurance include:

- an Executive Board that meets weekly and has a formal bi-annual 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 process;
- an internal assurance branch which has a planned risk based audit coverage of AGD's activities; and
- a fraud control plan, which is regularly monitored and reviewed.

Financial reporting

5.29 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 cash basis. In addition, the CFO's team has a good appreciation of the development of financial budgets, the plans and

modelling associated with AGD's strategic objectives and the production of accrual based financial information and reports.

Audit results

5.30 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	1	1
B	1	1	0	0	3	3
Total	1	1	0	0	4	4

5.31 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Significant Risk Matters - Category A

FMIS Access Management

5.32 The ANAO identified issues related to FMIS access management. Excessive access granted to users created inappropriate authorisation levels and can result in segregation of duties exposures. In addition, there was no review of audit logs that record users' access to the system. In these circumstances there is an increased risk that inappropriate access and unauthorised activity, whether unintentional or malicious, may occur and not be detected by AGD.

5.33 The ANAO also noted that security plans have not been developed for the FMIS. The lack of security plans could result in security controls inadequately or inconsistently addressing the needs of AGD.

Moderate Risk Matters - Category B

HRMIS Access Management

5.34 Access to AGD's HRMIS is based on each user's role. The level of access assigned to each role is stored in the HRMIS. Access to the HRMIS should be granted after a user's supervisor sends either an email or a completed system access request form confirming the user's role. When the ANAO reviewed this process, no emails, or user access request forms could be

located for a majority of users granted new, or modified HRMIS access during the period 1 July 2004 to 30 November 2004. In addition, the access originally established for a number of the roles could not be substantiated. This resulted in an increased risk that users may gain inappropriate access to the HRMIS.

Network Access Removal Procedures

5.35 A review of employees who ceased employment with AGD, identified that network access for a substantial number of employees had not been disabled. This was the result of a breakdown in the cessation process, with no requests having been received by the IT Helpdesk to disable these users from the network. As a result there was an increased risk of data integrity and privacy of information being compromised.

Departmental and Administered Reconciliations

5.36 The audit found that a significant number of reconciliations had not been performed in a timely manner. Any discrepancies were therefore not followed up in a timely manner. This is of particular concern in the context of the above-mentioned system access issues. As a result, there was an increased potential for misstatement or error in AGD's account balances.

Conclusion

5.37 AGD has responded positively to the ANAO's findings and associated recommendations and has indicated that appropriate action will be taken.

Australian Customs Service

Business operations

5.38 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.

5.39 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. To respond to this, Customs has identified the following priorities for 2004–2005:

- counter-terrorism and improved quarantine intervention;
- border protection;
- international cooperation;
- innovation and technology; and
- revenue collection and enhanced organisational performance and capability.

5.40 Customs also 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.

5.41 Customs' major project during the year continued to be the implementation of the Cargo Management Re-engineering (CMR) project, which will replace Customs' existing technology platforms to enable improved processing of goods across Australia's borders. The CMR project is one of the largest and most complex information technology and business re-engineering projects being undertaken in the Australian public sector and has resulted in the allocation of a significant amount of Customs' resources to the project. The communications facility and exports component of the CMR project became operational in September 2004, but the more significant imports component is not due to come online until the second half of 2005.

5.42 The CMR project has been undertaken for the past four years. The original estimated cost for an external provider to deliver the Integrated Cargo System (ICS) component of the project was \$30 - \$35 million. At that time the

decision was made to internally fund the project using depreciation funding and cash reserves. As the scope of the project grew larger and more complex, an additional capital injection of \$43 million was provided in 2003–2004. The estimated cost to complete is now in excess of \$200 million and includes the costs of developing the ICS, construction of a new secure gateway facility, process changes, implementation costs and initial operating costs. The resulting drain on Customs' previous cash and current asset reserves had placed Customs in a negative net current asset position.

5.43 Largely in response to the significant funding impacts that the implementation of the CMR project was having on Customs' resources, a review of the financial health of Customs was performed. This review has been completed and has been considered by Government. The findings of the review, made a number of recommendations, including increasing future capital and operational funding, as well as improving governance and project management practices in relation to such large Commonwealth projects.

5.44 Customs' funding for the year ending 30 June 2005 includes estimated price of outputs of \$950.94 million, and estimated administered expenses of \$0.26 million. Estimated administered revenue for 2004–2005 is \$5.60 billion. Customs' average estimated staffing level for 2004–2005 is 4 630.

Key business and financial statement risks

5.45 In order to manage its key business risks, Customs addresses issues related to:

- 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 quarantine risks; and
- the operation of detection programmes to identify non-compliance with legislative requirements for revenue leakages.

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

5.47 Key business issues for the current year include the:

- phased implementation of the CMR project that will replace a range of existing legacy systems;
- implementation of the Compliance Assurance Strategy;
- implementation of measures for Australia's response to quarantine risks and terrorism;
- collection and reporting of revenue, including issues 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.

5.48 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- implementation and capitalisation of the CMR project;
- Customs' Compliance Assurance Strategy, including revenue compliance audits and leakage estimates;
- asset management, including valuations, stocktakes and reconciliations;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.49 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; and
- a sound monthly financial and operational reporting process to the Executive.

5.50 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

5.51 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 include explanation of variances from budget or expected outcomes and detail any areas that are of special interest to the Executive.

Audit results

5.52 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	1	0	1	1	6	6
Total	1	0	1	1	6	6

5.53 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Fraud Control Plan

5.54 *Commonwealth Fraud Control Guidelines* require fraud control plans to be reviewed and updated every two years based on a comprehensive risk

assessment. Customs' most recently approved plan expired in September 2003. An updated draft fraud control plan was considered at an Audit Committee meeting in March 2005. In order for the Chief Executive to meet his responsibilities for establishing effective fraud control arrangements, Customs' fraud control plan needs to be completed and approved.

IT Disaster Recovery Plan Testing

5.55 Customs has recently developed a Business Continuity Framework (BCF). One important aspect of the BCF is a fully tested Disaster Recovery Plan. However, elements of that IT Disaster Recovery Plan have not been tested. In the absence of a tested IT Disaster Recovery Plan there is an increased risk of not being able to recover effectively and provide essential service within an acceptable time should a disaster occur.

IT Strategic Plan

5.56 An IT Strategic Plan seeks to identify and maintain an optimum balance of IT opportunities and IT business requirements. Customs has been without an IT Strategic Plan since the outsourcing of IT services in 1998. A draft plan covering the period 2005–2010 has been developed, but is yet to be approved and adopted.

IT Security Policy

5.57 In order to implement adequate and appropriate IT security controls, Customs needs to have developed an agreed IT Security Policy based on an examination of potential exposures to its business activity. The 2000 IT Security Policy is out of date, provides insufficient information and does not reflect current ACSI 33⁴³ requirements. In December 2004, Customs commenced negotiations to draft an IT Security Policy on an outsourced basis in consultation with the IT Director. A significant portion of the policy has been updated and released to the Customs Security Committee for consideration prior to being made available to the executive for endorsement.

Management of Security

5.58 A number of weaknesses were identified from a review of access management at the network level. To reduce the risk of unauthorised access to the system, it is important that Customs implement adequate user access management procedures to ensure only valid users be given appropriate access to the systems. Audit logs recording exceptions and other security relevant events should be produced, independently reviewed and archived to assist in the management of access control. The management of these logs is important to ensure that the applications running on the system are secure.

⁴³ Security Guidelines for Australian Government IT Systems (ACSI 33).

Employee delegations set up in FMIS

5.59 A review of all current delegation holders under the Chief Executive Instructions (CEIs) found that in the FMIS certain delegates have the ability to approve expenditure beyond their authorisation, which creates the potential for unauthorised expenditure.

Conclusion

5.60 The interim audit work has indicated weaknesses in internal controls, primarily in relation to information technology management. Customs is working to address these weaknesses.

Australian Federal Police

Business operations

5.61 The Australian Federal Police (AFP) was established to protect Australia's national interests from crime domestically and overseas. 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.

5.62 AFP works 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.

5.63 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 external territories such as Norfolk Island and Christmas Island.

5.64 The former Australian Protective Service (now Protective Services (PS)) was incorporated within AFP from 1 July 2004. PS provides protective services at premises considered by the Australian Government to be at some risk; Counter Terrorism First-Response (CTFR) security arrangements at major airports around Australia; an Air Security Officer (ASO) programme which provides a deterrent to aircraft hijacking; and specialised protective security advisory, monitoring and consultancy services.

5.65 During 2004–2005, AFP finalised the implementation of key changes to functionally align their business structure to a national focus. Key changes of the restructure were:

- new National Manager positions were created for each major crime type and replaced geographically based managers;

- National Manager positions were created for Forensic and Technical Services and Human Resources. A new position of Chief Information Officer was also established;
- the AFP's peak executive decision-making committee, the National Management Team, was replaced by an Executive Management Board supported by a National Managers Group;
- a new position of Chief of Staff was created to oversee corporate performance and planning, policy, media, and to assist in the administration oversight of the Australian High Tech Crime Centre and the Australian Institute of Police Management; and
- the strategic and business planning framework was revised, introducing an overall AFP Strategic Plan and Strategic Plans for each functional stream in addition to the existing annual Business Plans.

5.66 Implementation for the functional structure was supported by a detailed change management strategy. Amendments to internal governance instruments, the realignment of corporate support functions and a training programme for all managers were instituted.

5.67 AFP's funding for the estimated price of outputs in 2004–2005 is \$958.38 million. This includes \$4.92 million appropriated for providing Disaster Victim Identification advice and assistance to the Thai Authorities in response to the December 2004 tsunami. AFP's estimated average staffing level for 2004–2005 is 5 096.

Key business and financial statement risks

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

- countering and otherwise investigating acts of terrorism, illicit drugs trafficking, organised crime, serious fraud against the Commonwealth, money laundering and the interception of assets involved in, or derived from, those activities;
- providing counter-terrorist security capacity, including close personal protection and security intelligence;
- investigating special references and performing special tasking from the Government;
- providing an effective contribution to the implementation of the Government's 'Tough on Drugs' strategy;

- continuing to develop a capacity to deal with new forms of criminal activity requiring special attention to be directed to the investigation of economic crime, in all its forms, transnational crime and crime involving information technology and communications (including e-commerce);
- countering and otherwise investigating organised people smuggling;
- providing an effective contribution to the whole-of-government approach to unauthorised arrivals;
- providing guarding and security services for some diplomatic and consular missions, parliamentary offices, and designated Government establishments;
- CTFR capability in relation to the aviation industry; and
- deterring attempts to disrupt Australia's in-flight passenger safety through the ASO programme.

5.69 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- increased financial expenditure associated with International Operations;
- completeness and accuracy of month end processes;
- revaluation of asset balances;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.70 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:

- 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 Finance Committee which meets regularly to discuss budget and financial matters;
- a committee framework including an Audit Committee. The Audit Committee meets once every three months and focuses attention on internal audit activity, 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; and
- a risk management plan, which identifies the risks at divisional level, to inform divisional managers of the risks they are required to manage.

Financial reporting

5.71 AFP produces monthly financial reports for its Finance Committee. These reports contain commentary on the financial data that facilitates the analysis and monitoring of performance.

Audit results

5.72 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	4	2	2	1	2	3
Total	4	2	2	1	2	3

5.73 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Lack of an Updated Fraud Control Plan

5.74 AFP has not yet replaced its 2001–2004 Fraud Control Plan in accordance with government policy. Notwithstanding that the treatments from the previous plan remain in place, there is a need to update the plan from 30 June 2004 to reflect significant changes in structure and processes. As a consequence, there is an increased risk that fraud will occur and not be detected in a timely manner.

FMIS User Access Management

5.75 AFP has a small number of users with a high level of privileged access to the FMIS. At the time of the audit, there was no specific review of the use of this highly privileged access. As a consequence of this gap in detective controls, there is an increased risk of undetected fraudulent or inappropriate transactions. This, in turn, could adversely impact FMIS data integrity and financial reports.

5.76 In addition, a business area within AFP did not perform regular review of inactive users still on the system to ensure access is removed in a timely manner.

Business Continuity Planning

5.77 AFP has extensive practical experience in dealing with disasters across a varied range of domestic and international situations. AFP has significantly advanced Business Continuity Planning over the last year with important elements of Disaster Recovery Planning (DRP) due to be completed in the short to medium term. These DRP elements include a testing strategy, and additional documented planning for outages and recovery procedures. Whilst the draft DRP remains incomplete, there is an increased risk that in the event of a disaster, AFP may not be able to recover key business processes in a time acceptable to the organisation. AFP is confident that their business experience assists in minimising this risk.

Conclusion

5.78 AFP has accepted the ANAO's recommendations and is in the process of developing an appropriate response.

Communications, Information Technology and the Arts Portfolio

Department of Communications, Information Technology and the Arts

Business operations

5.79 The vision of the Department of Department of Communications, Information Technology and the Arts (DoCITA) is a better future for all Australians by the continued development of world class Australian communications, information technology, cultural, sport and information economy sectors.

5.80 DoCITA's goal is to contribute to the development of Australia's communications, information technology, cultural, sport and information economy sectors so that they are:

- vigorous and sustainable in a global environment;
- innovative, creative and support excellence; and
- increasingly accessible to all Australians.

5.81 The 2004–2005 year has seen one key change to the business and operational environment of DoCITA. This was the announcement by the Government on 15 April 2004 to abolish ATSIC, as from 1 July 2004, which has resulted in a distribution of indigenous programmes to a number of Australian Government departments, including DoCITA, under a 'whole-of-government' approach. DoCITA has gained responsibility for the indigenous functions and programmes relating to culture, sport and broadcasting. DoCITA, in association with other Australian Government entities responsible for indigenous programmes, has developed strategies to address this particular challenge.

5.82 DoCITA's funding for the year ending 30 June 2005 includes estimated price of outputs of \$120.77 million and estimated administered expenses of \$626.20 million. Estimated administered revenue for 2004–2005 is \$272.39 million (excluding dividends from Telstra and Australia Post). DoCITA's average estimated staffing level for 2004–2005 is 770.

Key business and financial statement risks

5.83 In order to manage its key business risks, DoCITA addresses issues relating to:

- policy advice – the ability of DoCITA to deliver the government’s agenda when providing policy advice;
- programme delivery – the delivery of the government’s agenda when delivering programmes;
- corporate governance – the establishment of corporate governance arrangements, including an effective accountability framework, to provide the Minister and Executive 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
- resource management – the ability to deliver agreed outputs and outcomes is dependant on the ability to recruit, maintain and develop an appropriate skill base.

5.84 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as low. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- management and reporting of special accounts;
- data collection for accrual calculations;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.85 The ANAO’s audit approach considers DoCITA’s goals, priorities, objectives and strategies, along with the critical success factors DoCITA 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. Measures which support financial assurance include:

- an Executive Management Group Committee, chaired by the Secretary, which meets weekly to review and assess the overall performance of DoCITA’s operations;
- a corporate committee framework including an Audit Risk and Evaluation Committee, an Information Management Committee, a

Human Resource Management Committee and an Executive Management Group Committee. The Audit, Risk and Evaluation Committee includes an independent member;

- a monthly financial reporting process to the Secretary and Executive Management Group;
- an internal audit strategy and plan which, within available resources, addresses key financial and business risks based on management priorities. The internal audit function is outsourced. The annual internal audit plan is presented to the Audit Risk and Evaluation Committee for approval and performance is monitored quarterly against the approved plan;
- an updated department wide Risk Management Plan will be provided to the DoCITA Executive Management Group for consideration in June 2005, with implementation in the 2005–2006 financial year; and
- in line with the Government's Fraud Control Policy, a periodic fraud risk assessment undertaken by DoCITA with the most recent assessment to be presented at the June 2005 Audit Risk and Evaluation Committee meeting.

Financial reporting

5.86 DoCITA distributes full accrual monthly financial reports within one day of the end of each month to senior managers. Following an analysis of these reports by Divisions, commentary is provided and a full set of financial management reports including commentary is prepared within 13 days of the end of the month.

5.87 During 2004–2005 DoCITA commenced reporting non-financial information on a quarterly basis which includes the non-financial report divided into three areas:

- summary of performance information/achievement of plans by branch which reports on key achievements and areas of concern;
- summary of performance information on timely advice and ministerial services; and
- workforce statistics.

Audit results

5.88 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	2	1	1	1	0	0
Total	2	1	1	1	0	0

Conclusion

5.89 Based on audit work performed to date, internal controls are operating satisfactorily.

Defence Portfolio

Department of Defence

Business operations

5.90 The Department of Defence (Defence) is responsible for the defence of Australia and its national interest. Defence's business is focused on the delivery of the following outputs:

- command of operations;
- air force, army, and navy capability;
- strategic policy;
- intelligence; and
- superannuation and housing support services for current and retired defence personnel.

5.91 Defence's funding for the year ending 30 June 2005 includes estimated price of outputs of \$15.96 billion and estimated administered expenses of \$2.23 billion. Estimated administered revenue for 2004–2005 is \$648 million. Defence's average staffing level for 2004–2005 is estimated at 91 423, comprising permanent forces of 52 872, total reserves of 20 710, and total civilian staff of 17 841.

Key business and financial statement risks

5.92 In order to manage its key business risks, Defence addresses issues relating to:

- maintaining and developing Defence capabilities and operational preparedness;
- the demerger of the Defence Materiel Organisation (DMO) as a prescribed agency from 1 July 2005;
- the adequacy of significant processes and controls to provide assurance over information produced for operational activities, financial reporting and other decision-making purposes;
- organisational systems and the accuracy and integrity of data records in relation to current and future business operations;

- the ability to allocate resources efficiently and effectively, with regard to change management, administrative processes, data ownership and asset procurement and management;
- contract/project management, including the ability to deliver current or enhanced future service levels efficiently and effectively;
- the need to remediate and clear known issues, for which remediation plans have been developed and are discussed later in this chapter;
- the ability to recruit and retain appropriately skilled staff in order to achieve current and future business objectives; and
- the introduction of AEIFRS, which is also discussed later in this chapter.

5.93 The ANAO has assessed the risk of material misstatement in Defence's 2004–2005 financial statements as high. Potential issues include:

- the Department being unable to conclude on the prior year financial statements as to whether they were 'true-and-fair', combined with the extent of audit qualifications in 2003–2004 arising from material internal control breakdowns across a range of significant Defence activities, including assets and military personnel entitlements;
- the adequacy of departmental responses to a number of audit recommendations which have either (i) remained outstanding for a number of years, and/or (ii) been assessed by management as 'closed', whereas subsequent audits (such as internal audit) note otherwise;
- ongoing system and data integrity issues within key operational information systems used to record and manage; (i) inventory and Specialist Military Equipment (SME) balances, (ii) personnel payments and balances, (iii) departmental assets and transactions, and (iv) supplier related transactions; and to ensure the underlying effectiveness of these systems;
- Defence's transition in establishing the DMO as a prescribed agency from 1 July 2005, including the separation of key operational systems with appropriate rigour, and ensuring sufficient time exists to test such separations to ensure (i) related decisions accord with the requirements of the FMA Act, (ii) Defence and the DMO report financial transactions as separate entities under the FMOs, and (iii) the separation results in a secure environment for both entities to transact at arm's length; and
- asset management processes, including asset recognition and valuations of assets under construction, and inventory management practices that accord with Defence's accounting policies.

Corporate governance

5.94 The corporate governance framework is a key component of the control environment within an entity and therefore the assessment of such governance frameworks forms an important element of the audit planning process. Defence has a number of committees responsible for matters relating to the management of finance and strategy (including people, resources, operational delivery and capabilities).

5.95 The Defence Committee (the DC) is the pre-eminent committee in Defence. It is responsible for making decisions that assist the achievement of results specified in the Ministerial Directive to the Secretary and the Chief of the Defence Force including, *inter alia*, the successful joint conduct of military operations and proper stewardship of people and of financial and other resources. The DC meets on a monthly basis and its members include the Secretary as Chair, the Chief of the Defence Force, the CE of DMO, and other senior executives of the Defence leadership group. The members of the DC provide a wide breadth of skills and experience that may be drawn upon for a variety of matters for which the committee is responsible.

5.96 In addition, the following committees are responsible for various Defence strategic matters:

- Chiefs of Service Committee, which provides military advice to the Chief of the Defence Force;
- Defence Capability and Investment Committee, which provides an independent review of major capability and investment issues, ensuring resourcing is consistent with Defence's strategic priorities and resourcing strategy;
- Defence Capability Committee, which, in focusing on individual major capital investment projects, considers and develops options for current and future Defence capability;
- Defence People Committee, which provides strategic advice and recommendations regarding the management of people in supporting Defence capability;
- Defence Information Environment Committee, which provides advice to the Chief Information Officer on the design, development, and sustainment of the Defence information environment; and
- Defence Occupational Health and Safety Committee, which has oversight of the Defence Occupational Health and Safety Strategic Plan.

5.97 A senior Defence board and two senior committees have various oversight responsibilities for Defence financial management matters, namely the:

- Defence Audit Committee (DAC), which reviews the preparation and audit of the Defence financial statements, reviews the internal audit plans and the internal and external audit reports, monitors and provides advice to the Secretary on risk management policies and practices, reviews the Defence fraud control plan and monitors the implementation of this plan, and monitors the conduct of ethics awareness activities within Defence. The DAC meets on a monthly basis and has two independent external members, including the Chair of the committee;
- Materiel Audit Committee (MAC), established in recognition of the DMO becoming a prescribed agency, and therefore, the requirement to prepare its own statutory accounts for audit in accordance with the FMA Act. The MAC is responsible for similar items as the DAC, but reports to the CE of DMO. The demerger and related governance issues are discussed in more detail later in this section; and
- Financial Statements Project Board (FSPB), that reviews all actions and plans to address Defence's financial remediation, which are discussed later in this chapter. The FSPB meets on a regular basis and its members include the Secretary as the Chair, the CFO as the Deputy Chair, two independent members (a representative from the Department of Finance and Administration and an external accounting specialist), the top level of the Defence Executive including the Vice-Chief of the Defence Force and the Chiefs of the three forces.

5.98 In addition to the above committees and board, Defence has a recognised internal audit function, known as the Management Audit Branch (MAB). MAB performs an array of internal audits across Defence and reports its findings, *inter alia*, to the DAC. Furthermore, MAB maintains a register of audit findings, noting their status, including those audit recommendations that are past their due date. MAB performs an effective internal audit function, and where relevant, the ANAO works closely with MAB. However, Defence has a significant management task in addressing; (i) various internal control and information system shortcomings, (ii) the DMO demerger, and (iii) AEIFRS implementation. Consequently, it remains important that the internal audit function continues to be adequately resourced, at a time when there is significant change activity occurring within Defence.

Financial reporting

2003–2004 Audit Report

5.99 In 2003–2004, the audit issues relating to Defence's financial statements, which were expressed as limitations on the scope of the audit⁴⁴, covered significant aspects of Defence assets and military personnel entitlements. These issues resulted in pervasive uncertainties that gave rise to an *inability-to-form-an-opinion*⁴⁵ (disclaimer opinion) being issued by the ANAO. Moreover, the Secretary of Defence in his statement accompanying the 2003–2004 financial statements was unable to conclude that the financial statements were 'true and fair'.

5.100 The audit scope limitations that gave rise to the disclaimer opinion on Defence's 2003–2004 financial statements, have their genesis in an internal control environment that requires significant improvement, and resulted from an inability to validate and conclude on components of the accounts, due primarily to inadequacies in Defence's key systems and processes,⁴⁶ including:

- deficiencies in the stocktaking, recording and reporting of quantities, and inadequate controls to safeguard pricing data, for General Stores Inventory;
- inadequate controls to substantiate pricing data for a portion of Explosive Ordnance Inventory;
- deficiencies in the stocktaking, recording and reporting of quantities of Repairable Items (RIs), a component of SME;
- deficiencies in the revaluation and recording of Land and Buildings and Infrastructure, Plant and Equipment; and
- inadequate processes around the capture and recording of data within personnel systems, including poor maintenance of primary evidentiary documentation relating to the Australian Defence Force employee leave provision⁴⁷.

⁴⁴ Limitations on the scope of an audit arise when sufficient appropriate audit evidence does not exist to support a reported balance.

⁴⁵ An inability-to-form-an-opinion—commonly referred to as a disclaimer, is expressed when a scope limitation exists and sufficient appropriate audit evidence to resolve the uncertainty resulting from the limitation cannot reasonably be obtained; and the possible effects of the adjustments that might have been required, had the uncertainty been resolved, are of such a magnitude, or so pervasive or fundamental, that the auditor is unable to express an opinion on the financial report taken as a whole.

⁴⁶ These matters were previously outlined in the ANAO's Report No.21, 2004–2005, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*.

⁴⁷ In addition, as a result of inadequacies in the Military Leave Provision referred to, it was not possible to validate the amounts reported within the Executive Remuneration note to the financial statements.

2003–2004 Audit Results

5.101 The following table reflects the status of Category A and B issues raised in the 2003–2004 audit.⁴⁸

Ratings	Issues Outstanding at August 2004	Issues Resolved Prior to November 2004	Issue Reclassified or Merged *	New Issues to November 2004	Closing Position at November 2004	New Issues and Issues Resolved at May 2005	Closing Position at May 2005
A	14	0	6	7	27	TBD**	TBD**
B	45	10	2	15	48	TBD**	TBD**
Total	59	10	4	22	75	TBD**	TBD**

* This column represents the net number of issues that have either been reclassified or merged into another issue.

** To be determined – the audit findings arising from the interim phase of the 2004–2005 audit are being finalised.

5.102 Significantly, there was a substantial increase in Category A findings, reflecting the delayed conclusion of the 2003–2004 audit, the recent issuance of the 2003–2004 Closing Report⁴⁹, and the ongoing development of Defence's remediation plans. The 2004–2005 interim audit is in progress. Consequently, the table does not reflect additional findings from the interim audit. However, the qualitative aspects of some of the recent findings, where possible, are discussed below.

5.103 Defence has made progress in resolving a number of the issues outstanding at November 2004 (mainly category C findings), and has provided supporting documentation to the ANAO. This is currently being reviewed as part of the interim audit, to assess whether the issues have been adequately addressed.

5.104 In addition, to provide context to Defence's remediation plans, their relationship to the financial statements, and the ANAO's audit strategy for 2004–2005, the following table summarises the source of the above issues that were reported in the ANAO's 2003–2004 Closing Report, and gave rise to the prior year disclaimer opinion. The issues embodied in the findings from the 2003–2004 audit are illustrated in the table below:

⁴⁸ Due to the delayed conclusion of the Defence financial statements, these were not reported in the ANAO's Report No.21, 2004–2005.

⁴⁹ The 2003–2004 Closing Report to Defence management was finalised in April 2005, after awaiting the incorporation of Defence management comments.

	High Level Summary of the Source of Issues				
	Technical Issues		Control Issues		
Balance Sheet Audit Issues	Differences in Accounting Estimates	Non-compliance with Legislation	Issues in Management Controls and Oversight	Issues Around IT Controls	Issues Relating to Business Process Controls
General Stores Inventory			▣	▣	▣
Explosive Ordnance Inventory			▣		▣
Repairable Items			▣	▣	▣
Military Provisions			▣	▣	▣
Land and Buildings, Infrastructure, Plant and Equipment			▣	▣	▣
Executive Remuneration			▣		▣
Special Accounts		▣	▣		▣

2004–2005 Defence Financial Remediation Plans

5.105 As noted above, the issues raised during the prior year audit are effectively management oversight and internal control matters. Consequently, the issues noted are matters that lend themselves to remediation. As a result, a considerable amount of Defence resources is being applied to the assessment, correction and substantiation of data due to the scale of problems noted in key Defence operational and financial systems and internal controls.

5.106 The remediation activities being undertaken by Defence straddle a number of Defence's core information systems and business processes. Consequently, the remediation plans require significant corporate support and an ongoing assessment of both the timeliness and prioritisation of these remediation activities, *vis-à-vis* the pending DMO demerger, and having regard to Defence's ongoing operational requirements.

5.107 Defence's remediation activities were initially grouped into 12 remediation plans, which the FSPB approved at its February 2005 meeting. These plans have undergone further development since, and their current status is summarised in the table below:

Defence Remediation Plans		Status
G1	Financial Controls Framework	General Plan – Subsequently being rescoped and redrafted
G2	Improving the ANAO Annual Audit Process ⁵⁰	General Plan
G3	Financial Management and Systems Training	General Plan
S1	Stores Record Accuracy	Specific Plan
S2	General Stores Inventory Pricing and Accounting	Specific Plan
S3	Supply Customer Accounts	Specific Plan
S4	Explosive Ordnance	Specific Plan
S5	Military Leave Records	Specific Plan
S6	Civilian Leave Records	Specific Plan
S7	Executive Remuneration	Specific Plan
S8	Property Valuations	Specific Plan
S9	Preventing the Escalation of category A and B Findings	Specific Plan
S10	Stockholding Controls	Specific Plan
S11	Standard Defence Supply System Items (SDSS) 'Not in Catalogue'	Specific Plan
S12	Provision for Contaminated or Potentially Contaminated Land, Buildings and Infrastructure	Plan being Developed
S13	Commitments and Accounting for Leases	Plan being Developed

Source: Department of Defence

5.108 These plans are designed to remediate control and institutional processes over time, as well as quantifying some of the inherent uncertainties in the short term. However, given the; (i) extent of issues that Defence is addressing, (ii) combined management and technical challenges posed by the DMO demerger, along with the introduction of AEIFRS, and (iii) remediation plans are effectively in an early stage of development *vis-à-vis* the 30 June 2005 reporting date, prioritisation of the plans by Defence is critical to ensuring that those remediation processes that can be implemented to support the completion of the 2004–2005 financial statements, are brought forward. The

⁵⁰ Defence's timeliness and utilisation of appropriate methods in dealing with various financial reporting matters is an important factor for Defence management to address. To that end, the external financial reporting standards required under the *FMA Act*, which are well defined and based on generally accepted accounting principles, coupled with the financial management training envisioned under 'G3' in the table above, should provide impetus in this regard.

prioritisation of the remediation activities will also need to include allowance for management assessment and subsequent audit. Such an assessment of the various plans and undertakings at this stage of the financial year may avoid other management issues (e.g. around quality assurance processes) and facilitate the completion of the financial statements, and supporting papers, in a timely manner.

5.109 Importantly though, Defence has proposed a significant evolution to its plan to remediate the framework of financial controls across Defence (G1–Financial Controls Framework). The Secretary’s aim is to have Defence acknowledged by Government as a proficient financial manager within the next five years. The desired outcomes of the plan include:

- providing intranet access to all the policies, processes and procedures required to manage all facets of Defence’s financial business;
- documenting and standardising key financial processes, and standardising internal financial reporting;
- developing a Financial Certification framework and reengineering business skilling requirements;
- implementing a structured QA programme across various functions (to supplement the internal audit programme); and
- communication and change management processes.

5.110 The project plan for the revised G1 remediation strategy is on schedule to be completed by the end of June 2005, followed by stakeholder consultation in July, with a final version then being resubmitted to the FSPB for approval. It is expected to take three years to reach the desired end-state.

5.111 The ANAO supports this initiative, recognising that it will take time and commitment of staff in Defence for the framework to achieve the intended outcomes of enhanced financial management and financial reporting in Defence and DMO.

5.112 The following table summarises the connectivity between the various remediation plans and the audit findings, both in terms of the financial statement line items subject to qualification and the specific category A and B control findings reported to Defence management.

Audit Qualifications on...	Category A findings	Category B findings	Related Remediation Plans
General Stores Inventory – Quantities and Pricing	4	2	S1: Stores Record Accuracy S2: General Stores Inventory Pricing S10: Stockholding Controls S11: Items 'Not In Catalogue'
Repairable Items – Quantities	2	2	S1: Stores Record Accuracy S3: Supply Customer Accounts S10: Stockholding Controls S11: Items 'Not In Catalogue'
Explosive Ordnance – Pricing	1	7	S4: Explosive Ordnance
Military Leave Provisions and Executive Remuneration Note	4 (including Civilian Leave)	5	S5: Military Leave S6: Civilian Leave S7: Executive Remuneration
Land & Buildings, Infrastructure, Plant & Equipment	1	6	S8: Property Valuations S12: Provision for Decontamination
Special Accounts	1	0	S9: Preventing the Escalation of Category A and B Findings
Total	13	22	
Other Audit Findings on...	Category A findings	Category B findings	Related Remediation Plans
Suppliers	2	5	S9: Preventing the Escalation of Category A and B Findings
Personnel	0	4	S9: Preventing the Escalation of Category A and B Findings
Financial Framework and Legislative Compliance	3	4	G1: Financial Reporting Framework S9: Preventing the Escalation of Category A and B Findings
Commitments and Leases	1	0	S13: Commitments and Accounting for Leases
Specialist Military Equipment	3	5	S9: Preventing the Escalation of Category A and B Findings
Defence Computing Bureau	0	4	S9: Preventing the Escalation of Category A and B Findings
SDSS – Defence's inventory and asset logistics management systems	2	1	S1: Stores Record Accuracy S2: General Stores Inventory Pricing S3: Supply Customer Accounts S10: Stockholding Controls S11: Items 'Not In Catalogue'
Asset Management	2	2	S11: Items 'Not In Catalogue'
Revenue	1	1	S9: Preventing the Escalation of Category A and B Findings
Total	14	26	
Total per Closing Report 2003–2004	27	48	

5.113 The effectiveness of the remediation plans will not be known for some time. As noted above, most of the plans were approved in February 2005, although a number have been subsequently revised and additional plans developed. Consequently, the related activities are a work-in-progress, some of which have not yet progressed sufficiently to have a material impact on the 2004–2005 financial statements. Nevertheless, the disciplines embodied in accrual accounting, coupled with Defence’s remediation plans, should see the known issues improve over time. Consequently, the ANAO supports Defence’s remediation programmes and will closely monitor their progress over the next few years.

2004–2005 Financial Reporting Timetable

5.114 Good governance, reliable information systems, and an effective internal control environment are key requirements for the production of reliable financial statements. The production of accurate Defence-wide financial reports supported by robust evidentiary standards has not occurred on a timely basis, which is again likely to contribute to the financial statements being completed after the required 2004–2005 reporting deadline. Defence remains in an on-going cycle of undertaking remediation activities and utilising other processes to fulfill its 30 June 2005 reporting requirements.

5.115 Defence has developed a timetable for the 30 June 2005 financial statements close process (FSCP), comprising major milestones and their suggested completion dates. The ANAO has been involved in this process. The major milestones include:

- the development of pro-forma (template) financial statements, which is currently being reviewed by the ANAO;
- the conduct of a ‘rolling’ hard-close on aspects of the financial statements, recognising that the FSCP, and a number of the remediation activities, are not mature enough to support a traditional hard-close process; and
- a timetable for the submission of a series of draft financial statements through to October 2005.

5.116 Based on the findings of the previous year, the ANAO is consulting with Defence regarding the quality assurance (QA) component of the timetable, in order to ensure timely and appropriate outcomes.

5.117 Nevertheless, refinements have been made to monthly financial reports compiled by the CFO Group, from a variety of sources to service, *inter alia*, the DC and the DAC. However, as many of the financial reporting issues identified in the prior year will, by their very nature, also impact the monthly financial reporting programme, some of these reports remain subject to the

limitations that gave rise to the disclaimer opinion on Defence's 2003–2004 financial statements. Improvements are, however, being evidenced by the introduction of Group monthly balance sheets, which have enabled Defence to identify and resolve some completeness issues.

Summary of Significant Audit Results

Quantities for General Stores Inventory (GSI) and Repairable Items (RI)

5.118 Material weaknesses in the internal controls over stocktaking, the failure to accurately record and report the physical asset quantities, the inability to identify owners of certain Defence assets, and inadequate system controls within Defence's inventory and asset management logistics system⁵¹ to safeguard the accuracy of data, were noted in 2003–2004 and reported in Audit Report No.21 of 2004–2005. In addition, significant asset adjustments continued to be reported and concerns surrounding the completeness of assets were also noted. These weaknesses resulted in significant uncertainty around the General Stores Inventory balance and the Repairable Items balance (which is a component of SME).

5.119 In response to an internal Defence review and issues raised by the ANAO in relation to the overall integrity of the underlying asset and inventory data within SDSS, Defence developed the SDSS Get-Well Program (referred to below), plus four specific remediation plans. The specific remediation plans focus on:

- reducing stocktake error rates below 5% and improving asset management practices, including strengthened governance arrangements for stock record accuracy of the Defence Integrated Distribution System contract;
- allocating accountability for the management of Repairable Items;
- reducing the quantum of asset adjustments processed through the financial statements that are unable to be verified; and
- the completeness of the asset register by identifying assets that may not be recorded on SDSS.

5.120 Overall, the remediation plans are focused on re-baselining both the quantities recorded within SDSS and the modalities around stocktaking and the reporting of such results, including the introduction of improved asset management practices and policies across Defence. In addition, Defence has conducted a series of extensive stocktakes at some of the material Defence

⁵¹ The Standard Defence Supply System (SDSS).

establishments, pre 30 June 2005; for example, a 100 per cent stocktake of DNSDC Moorebank, a significant Defence warehouse facility, was conducted over the period October 2004 to March 2005.

5.121 The ANAO acknowledges the importance of the above remediation plans and the audit programme is focused on assessing the outcomes of these plans. Whilst the above plans address many of the underlying issues, risk factors that are being considered as part of the ANAO's interim audit include:

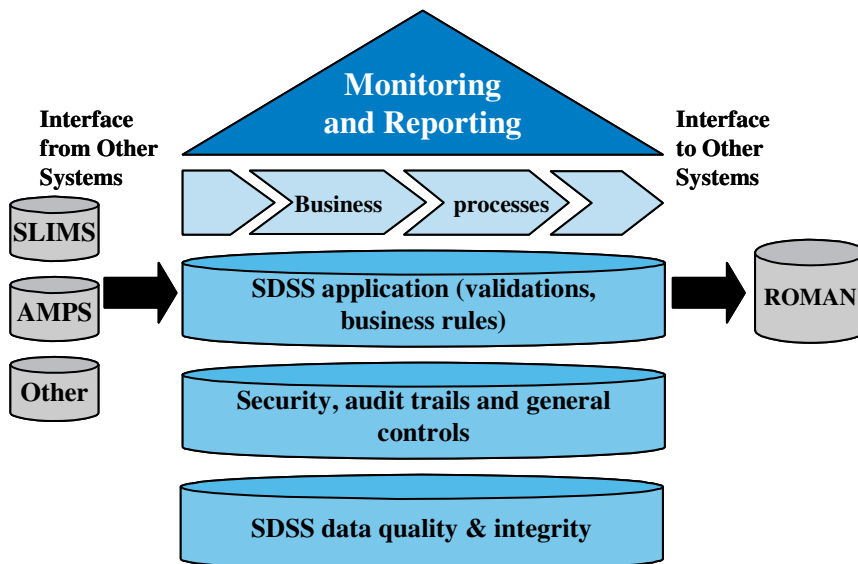
- whether the plans will fully remediate the underlying stock quantity inaccuracies by 30 June 2005;
- whether the SDSS control environment (both IT system and business processes) is sufficiently robust to maintain the accuracy of the stock data, post the 100 per cent stocktakes;
- whether those assets not reported at balance date are able to be quantified; and
- whether ongoing compliance requirements are maintained beyond the remediation plan.

GSI and RI: Defence's inventory and asset management logistics system – SDSS

5.122 As a result of stocktaking pre 30 June, it is critical for both Defence management and the ANAO to be able to place reliance on the controls in, and associated with, Defence's logistics management system, SDSS. This is to ensure that transactions between the time of the stocktake and the balance sheet date are accurate, complete and valid. The assessment of controls and their subsequent impact on these transactions is dependant on the adequacy of key elements of the inventory and asset management assurance framework illustrated in Figure 5.1.

Figure 5.1

Assurance framework for inventory management



Source ANAO

5.123 As stated earlier, Defence established a considerable remediation project in 2004 under the name of ‘SDSS Get-Well Program’ (‘Get Well’). In recognition of Defence’s reported progress under ‘Get-Well’, the ANAO recently conducted a review focusing on each of the key elements of the inventory management assurance framework, with the objective of identifying robust controls on which reliance could be placed. The ANAO’s review, however, has identified significant anomalies exist across key elements of that assurance framework.

5.124 One of the key deliverables of ‘Get Well’ was the identification of controls and/or weaknesses in key business processes used by operations staff, colloquially referred to as Business Process Compliance (BPC). The BPC objective was to assess whether current business processes are capable of supporting the Supply Chain as designed, including a review of whether such processes are being adhered to, and identify issues and recommendations for improvement. The BPC review conducted internally by Defence identified 132 recommendations needed to strengthen the BPC control environment, of which Defence has accepted 118. From the 118 recommendations, Defence has developed management action plans, of which three have been reported as completed, with the remainder being prioritised for implementation, primarily in 2005–2006. The ANAO acknowledges that Defence is aware of the business process issues. However, as significant progress in regards to the implementation of the recommendations has not been made in the current

financial year, those weaknesses still to be addressed will impact upon the reliance that can be placed on SDSS's business process controls for this financial year.

5.125 Furthermore, the ANAO evaluated the BPC results, and as part of our programme of review, validated the controls and weaknesses identified for five key processes. The five processes were selected on the basis that control weaknesses existing in these would result in a cascade effect across the remaining processes in the inventory management assurance framework. The outcome of our review is that the weaknesses for these processes existed throughout the 2004–2005 financial year.

5.126 Moreover, significant weaknesses have also been identified in the application access environment of SDSS, impacting security over the system. The identified issues appear not to have been considered as part of the Get-Well Program. Issues of concern to the ANAO include:

- the use of generic user ID's;
- a high number of users with access to all system functions – that is, full administrative access to the system;
- users being able to perform incompatible activities (that is, the assignment of duties/activities that are incompatible with the principle of segregation of duties), either through a particular profile that grants system access to a series of activities, or, through the assignment of many profiles to the same position;
- weaknesses over the user access management process, in particular the authorisation of user access to the system;
- user access is often not commensurate with the officer's duties;
- no formal review mechanisms to review user access related issues, including general and administrative users; and
- issues around the method by which access is gained to SDSS – that is, whether the graphical user interface is used or not.

5.127 Defence has indicated that for some of the above security concerns identified, there may be an operational requirement. While accepting this may be the case, the ANAO notes that appropriate risk management strategies are not in place to mitigate the risk, nor are the security risk issues being formally evaluated or accepted by management based on a formalised risk assessment. That is, there is no apparent formal assessment to accept those high-risk areas around security and systems access, nor formal, timely and ongoing *ex post* review mechanisms to ensure that inappropriate or unauthorised transactions

have not taken place. The weaknesses identified in the application security environment reduce the reliance that can be placed on many of the controls within the internal control framework. Moreover, the ANAO notes that even in a fluid operational environment, the current management process surrounding the security environment in SDSS, in the ANAO's view, was deficient.

5.128 Accordingly, the effect of the BCP findings combined with a deficient application access environment, is that the ANAO is significantly limited in its ability to rely on SDSS, and the resulting business processes to produce reliable quantity records for General Stores Inventory and Repairable Items for financial reporting purposes. Consequently, the ANAO is unable to confidently perform interim (roll-forward) testing, between the completion date of the 100 per cent stocktakes, and the 30 June balance sheet date. The premise on which such roll-forward testing is performed, is that controls tested and examined continue to operate in a robust manner until the end of the financial period.

5.129 Finally, Defence management has indicated possible concerns regarding the future performance of SDSS in relation to a date boundary issue (stated to be May 2007, and referred to as the 'Julian Date') within the software. Defence is assessing the potential significant risk to the future operation of SDSS arising from the date boundary issue and is formulating strategies to manage the risk, though any IT solution may be compounded by the high level of customisation Defence has applied to the current version of SDSS.

GSI and RI: Stocktakes required to verify inventory / asset quantities at 30 June 2005

5.130 As a result of the SDSS weaknesses, the ANAO will adopt a largely substantive approach to verifying the existence and completeness of the quantities reported for General Stores Inventory and Repairable Items at 30 June 2005. The extensive stocktake programmes undertaken by Defence to date should see an improvement in the overall accuracy of the reported quantities in SDSS. However, there remains a significant risk that an inadequate control environment may not protect the integrity of the data, and by extension, may compromise some of Defence's earlier stocktake activity.

5.131 For example, MAB is conducting a series of stocktakes to assess the accuracy of the stock data, after Defence management stocktakes. Initial error rates from these stocktakes are varied, and in combination with the ANAO stocktakes performed in May 2005, indicate that asset management deficiencies may continue to exist, as previously reported. The ANAO continues to note some quantity anomalies on Explosive Ordnance items (which, while not material for financial reporting purposes, may be a significant business risk), and quantity variances on General Stores Inventory and Repairable Items that may indicate potential issues consistent with the prior year. The results of the

ANAO's end-of-year stocktake activity will be assessed and reported in the year-end report to Parliament.

Pricing for General Stores Inventory and Explosive Ordnance Inventory

5.132 A lack of documentation to support prices used to value General Stores Inventory, and \$845 million of Explosive Ordnance Inventory (recorded on the COMSARM system), were noted in 2003–2004 and reported in Audit Report No.21 of 2004–2005. Furthermore, controls within SDSS were again found to be inadequate to protect the integrity of pricing data for General Stores Inventory. In addition, control breakdowns within Explosive Ordnance Inventory processing were noted. These weaknesses resulted in a range of uncertainty around these Inventory Balances at 30 June 2004.

5.133 In response to the audit issues surrounding the overall integrity of the pricing data within SDSS and COMSARM, Defence has developed specific remediation plans for the pricing of Inventory. These remediation plans focus on:

- establishing a 'line-in-the-sand' position for legacy General Stores Inventory prices, and providing greater confidence in general pricing data quality through improved processes on SDSS; and
- removing the \$845 million qualification for Explosive Ordnance Inventory, ensuring purchases are accurately valued, and generating new business processes to streamline and simplify accounting for asset valuations.

5.134 The current ANAO audit programme is focused on reviewing the outcomes from these remediation plans. Consequently, certain risk factors have been considered as part of the ANAO's interim audit, including whether the:

- plans will fully remediate the underlying valuation uncertainties across legacy records by 30 June 2005;
- SDSS control environment will be robust to safeguard the accuracy of prices to comply with Defence's own accounting policies;
- application of a statistical model will correlate to Defence's experience, where Defence acknowledges that pricing records may not exist; and
- recording and reporting of changes to valuation requirements as a result of AEIFRS will be achieved (that is the comparison of 'cost' and 'replacement cost').

5.135 As noted, the ANAO has assessed that SDSS has inadequate system and business process controls. That is, SDSS has inadequate system controls to assure pricing information is correctly entered into SDSS and subsequently safeguarded. Moreover, the continued existence of inventory recorded at zero and notional prices, including items recorded in this manner in this financial year, highlights the current control weaknesses. Consequently, a substantive approach to verifying the valuation of General Stores Inventory, in accordance with Defence's own accounting policies, will be performed at 30 June 2005.

5.136 Defence is undertaking an extensive review of the prices recorded in SDSS, for legacy items and recent purchases. Defence has acknowledged that appropriate supporting documentation to demonstrate compliance with Defence's own accounting policies on valuation, may be difficult to obtain for some legacy items. Where appropriate supporting evidence cannot be provided, Defence is at a point where some critical decisions will need to be made going forward, particularly in regard to the need to remediate the system issues. To that end, Defence management is considering a statistical model that may address some of the pricing anomalies, notwithstanding the underlying system/process control issues noted. Any model assumptions need to be empirically supported. Moreover, if the outcomes of the process are to be of benefit for the 2004–2005 financial statements, then the critical deliverables will need to be prioritised. The results will be assessed by the ANAO and reported in the year-end report to Parliament.

5.137 Whilst a significant level of work has been completed on the valuation of Explosive Ordnance Inventory, the remediation programme needs to give further consideration to implementing adequate business procedures around key processes, documentation management, and the ongoing monitoring of a critical reliance on an external service provider.

Military and Civilian Leave Processes and Systems

5.138 Inadequate controls and processes within Defence's personnel systems, which were evidenced by insufficient supporting documentation being available, and unacceptable rates of error where documentation did exist, have been noted in the prior two years and reported in Audit Report No.21 of 2004–2005. As a result, there was uncertainty around the entire balance of military leave provisions, and a Category A finding was raised in relation to civilian leave provisions. The effects of the above mentioned control weaknesses on the Executive Remuneration Note were also reported.

5.139 Defence has developed three remediation plans to resolve the internal control issues raised in relation to leave provisions for military and civilian staff, including executives. The aim of the remediation plans is, *inter alia*, to:

- remove the ANAO's qualification over the \$1.23 billion leave provision balance for ADF employees;
- remediate leave processing activities;
- undertake a series of MAB audits to reassess the accuracy of military and civilian leave records, after the remediation of certain leave processing activities; and
- undertake ongoing data integrity checks of leave balances.

5.140 The significance of the above remediation plans is acknowledged by the ANAO, and the assessment of their results is central to the external audit programme. Many of the attendant issues are addressed by the remediation plans. However, risks to their success include:

- the remediation of annual leave records appears likely to extend beyond June 2005;
- whether the Personnel information system control environment is robust enough to preserve the accuracy of leave balances once remediated, until balance date, and in future financial years; and
- the need to articulate an explicit and coordinated approach to dealing with the effect of missing documentation for employees, including an assessment to the ANAO of the impact on certain proposed sampling activities.

5.141 The MAB reviews of some leave balances mentioned in the remediation plan have been subject to consultation with the ANAO. MAB has completed an audit of military long service leave, which is now being subject to ANAO review. However, MAB's review of other leave entitlements is still in progress, and therefore, it is premature for the ANAO to comment upon their outcome.

5.142 In addition to the MAB reviews, Defence is developing a statistical sampling approach that may 'quantify' the error in military leave provisions. The proposed approach is resource-intensive. The approach requires validating employees' leave records to supporting documentation and confirming leave balances directly with employees. Additionally, the required sample size is typically large. Consequently, Defence has redirected the efforts of some personnel from lower priority remediation activities to this task. Until the outcome of the MAB audits are known, some duplication of effort may occur as both processes are assessing the same line item in the financial statements. As well, the planned timetable for the proposed statistical sampling approach is tight; the risk of missing documentation may be significant and the timetable has since been subject to some slippage and

therefore requires considered management if it is to be completed for the 30 June 2005 audit.

5.143 It is important that Defence continues to place emphasis and effort on remediation of the underlying business process issues in 2004–2005, which is critical to the long-term remediation of this issue.

Land and Buildings, Infrastructure, Plant and Equipment

5.144 During the 2003–2004 financial statement audit significant weaknesses were identified within the control environment surrounding the valuation of Land and Buildings and Infrastructure, Plant and Equipment that gave rise to uncertainties in aspects of the reported values. The uncertainties were the consequence of items not being revalued due to the application of predetermined thresholds, certain finance lease assets not being revalued, and other asset valuation matters due to insufficient management oversight, analysis and review. These matters were reported in Audit Report No.21 of 2004–2005.

5.145 In responding to the identified issues, Defence has developed a specific remediation plan to establish an accurate fair value of Land and Buildings and Infrastructure, Plant and Equipment. The remediation plan requires valuations to be performed for all Land and Buildings and Infrastructure, Plant and Equipment assets, after (a) adjusting down the threshold limits, and (b) capturing the known finance lease assets excluded previously.

5.146 The ANAO has been involved throughout the planning phase of this task. Considerable progress has been made in the revaluation programme. Nevertheless, certain risk factors that could impact the finalisation of the 2004–2005 financial statements are being assessed as part of the ANAO's interim audit, such as the:

- completeness of the valuation programme in general, including the valuation of finance lease assets;
- practicability of the valuer completing the heavy task of revaluing the entire Defence estate in less than five months;
- operational risk around the timely, accurate and complete uploading of all the revaluation data into Defence's general ledger; and
- QA procedures over the revaluation upload processes to assure the accuracy of the reported information.

5.147 Further, in response to an issue raised in 2003–2004, Defence is developing a remediation plan to identify and value any liability for decontamination costs. It is not expected that this plan will be implemented before the end of June 2005. Defence has indicated that a considerable period

will be required for the effective remediation of this issue. This may create uncertainty regarding an aspect of the valuation of certain assets reported by Defence.

5.148 In addition, the ANAO is awaiting Defence management analysis in support of other significant audit matters raised in 2003–2004, such as: (i) the selected capitalisation and revaluation thresholds; (ii) valuing assets that have been marked for disposal for a considerable period of time; and (iii) ensuring the completeness of the Heritage and Cultural asset register.

5.149 The ANAO has provided advice to Defence regarding certain valuation principles and has commenced its review of the control environment surrounding fixed asset management at Defence, including reviewing valuations that have been completed. The ANAO will continue to monitor developments regarding the known audit issues and review these as part of the 30 June audit and report the results in our year-end report.

ROMAN (General Ledger)

5.150 The ANAO has undertaken a review of ROMAN system controls that impact on the reliability of the information provided by Defence. The review was performed across key modules used by Defence's financial system. The key issues impacting on ROMAN continue to be the high number of users with access to functions and the number of interfaces.

5.151 The effectiveness of the control environment for the procurement process, from the purchase order through to the payment cycle ('purchase-to-pay'), is heavily dependant on process controls managed by a large number of stakeholders. As a result, there continues to be concerns over the robustness of these process controls, which will require additional audit work prior to the ANAO being able to rely on the validity of data residing within the system.

5.152 The large number of interfaces to ROMAN and the dependence on the external systems' control environments supporting these interfaces continues to be of concern, as these systems are managed and maintained external to the control environment around ROMAN. Work is continuing by both Defence and the ANAO to ensure that all data integrity issues from feeder systems will not impact the information used by management.

5.153 Defence continues to perform activities associated with the restructure of the financial management information system to meet the operational and financial reporting requirements related to the establishment of DMO as a prescribed agency from 1 July 2005. This activity is discussed in more detail later in this chapter.

Commitments

5.154 Commitments are intentions to create liabilities. Issues encountered in 2003–2004 included the incomplete provision of supporting documentation

and misapplication of definitions. Assurance regarding this item was further affected by a failure to implement appropriate processes and procedures to verify the completeness and accuracy of Defence's lease register.

5.155 Defence is developing a remediation plan relating to the management and external reporting of leases, including the compilation of a complete lease register and reconciling lease payments against leases held. Risk factors that may impact the finalisation of the 2004–2005 financial statements and are being considered as part of the ANAO's interim audit, include whether:

- the late completion of the remediation plan may impact the completeness of the register; and
- Defence is able to locate sufficient, appropriate source documentation to support entries on the lease register.

5.156 In the event that Defence is not able to demonstrate a complete lease register, it may affect the level of assurance that can be gained on the reporting of commitments. Once compiled, it would be beneficial to utilise the lease register to enhance the internal control environment by keeping it up to date, so that it may be of maximum benefit for management purposes. Separately, Defence is reassessing the classification of certain leases. The product of this work will be assessed as it is made available, and communicated within the ANAO year-end report.

Escalation of Audit Findings

5.157 An outcome of the 2003–2004 financial statement audit was that sufficient management attention, resources and prioritisation, had arguably not been applied to clearing ANAO and internal audit findings on a timely basis. Notably, the financial report items that were subject to the audit scope limitations, have had audit findings raised against them, to varying degrees, over a number of years.

5.158 Furthermore, Defence analysis highlights that the deadlines to resolve numerous audit findings have been extended several times. Moreover, in excess of half of the active audit recommendations had extended completion dates, with the average extension period being in excess of one year. It was also noted that a number of audit findings have been designated as 'closed' (that is, completed), but on subsequent examination were found to only be partially implemented. The management oversight of audit findings, such as the timeliness of resolution and ensuring that proper QA processes exist before attesting that an audit matter is closed, is critical to ensuring that audit issues do not escalate into future more significant findings.

5.159 That said, Defence has formally recognised that it is crucial to address audit findings in a timelier manner in order to reduce the number of significant audit matters raised. As a result, the DAC has strengthened existing modalities

to ensure relevant Defence personnel are accountable for long standing audit issues. This is also being supported by MAB continuing to monitor and report to the DAC on the status of recommendations in Defence's Audit Recommendation Management System, as well as implementing a strategy to prevent the extension of timelines for resolution. This initiative is supported by the ANAO. In addition, Defence has promulgated a remediation plan to prevent the escalation of category A and B findings. However, its achievement may be at risk until:

- KPI's and other performance measures are clearly articulated within the plan; and
- appropriate QA procedures over all significant findings are firmly embedded, including prioritising resources and setting realistic targets/deadlines.

5.160 The escalation of audit matters is an issue of management's attentiveness to audit findings, not a reflection on the effectiveness of the internal audit function. It is important that Defence is successful in preventing a further degradation of known audit issues, particularly as audit resources (internal and external) are finite, and both the DMO demerger and AEIFRS implementation add additional complexities that need to be carefully managed.

Defence Materiel Organisation (DMO) as a Prescribed Agency

5.161 Effective 1 July 2005, the DMO will become a prescribed agency. Efforts to achieve this objective have been ongoing for over a year.

5.162 Noting the relatively little time remaining to prescription (at the time of preparing this report), it remains important that Defence continues to focus on prioritising and completing the most significant matters relating to the establishment of the DMO as a prescribed agency. The ANAO understands that key decisions around the modalities of the separation and finalisation of the funding arrangements have been largely completed, with the testing of systems concentrated around mid to late June.

5.163 Defence and the DMO will transact at arms-length as though they are distinct entities upon prescription of the DMO. Consequently, service agreements that form the interface between Defence and the DMO need to be formal and explicit. Defence management have prepared a number of such agreements, including the Defence Services Agreements, Materiel Acquisition Agreements (MAA), Materiel Sustainment Agreements (MSA), Free of Charge Agreements, and a Workforce Agreement. To illustrate the extent of the management task in developing and sustaining these agreements, it is noted that there are six MSAs, which have 95 schedules/appendices to cover individual sustainment projects, and approximately 200 MAAs. These

agreements determine the type, timing, location, price and quantity of services and deliverables to be provided, and as such, it is imperative that they include clear accountabilities. The ANAO is currently reviewing these agreements.

5.164 Defence has progressed the allocation of certain Defence assets between Defence and DMO financial statements, with some key policy decisions on the allocation of certain items being finalised. It is important that the accounting for various Defence assets, between Defence and DMO, reflect the actual management and control structures that Defence and DMO will have in place.

Segregation of Access to Defence and DMO Company Codes in ROMAN

5.165 The impending DMO demerger highlights the need for Defence to have sufficient controls to preserve data integrity between, and enable data identification pertaining to, Defence and DMO transactions. In order to facilitate appropriate security administration in an entity, the security structure design should reflect the assignment of data ownership and resources, and also the level within the organisation where ownership resides. With the proposed demerger of the DMO from Defence, the ANAO has reviewed the level of security arrangements that may be in place from 1 July 2005, including a review of the ROMAN security structure, to ascertain whether users may have access to both the Defence and the DMO company codes in the underlying financial reporting systems, both currently and post-demerger.

5.166 The review identified anomalies in the designation of company code privileges afforded to various users. Effectively, 2 885 users had the potential to perform transactions in both the DMO and Defence company codes. Whilst the ANAO acknowledges that this was a planned transition year activity, the extent of the issue was not identified.

5.167 Defence has taken action to identify the number of personnel who require access to both company codes. All Defence Groups have been requested to justify the number of users who require dual access. Defence is confident that sufficient time exists to remove users whose dual access cannot be justified, however, the ANAO is mindful of the impact of any further delays on operational effectiveness.

5.168 The ANAO will again review the outcome of this exercise, and re-examine user profiles in effect after 1 July 2005, including the underlying processes and detective controls to support the correct identification of transactions pertaining to either Defence or the DMO.

Australian Equivalents to International Financial Reporting Standards (AEIFRS)

5.169 There are significant issues facing Defence in relation to implementing AEIFRS. Defence has advised that it will not be able to provide a reliable

AEIFRS opening balance sheet as at 1 July 2004 at this time. Specific issues include SME, inventory, and make-good costs.

5.170 A consequence of Defence's financial statements being qualified in the prior year is that Defence may be unable to make an unreserved statement of compliance on adoption of AEIFRS, which provides access to certain, critical, exemptions on first-time adoption. The implications are likely to impose significant challenges and costs on Defence. The ANAO is liaising with Defence on various options that may exist in transitioning to AEIFRS.

Conclusion

5.171 Due to the lack of robust detective and preventative controls surrounding core systems and processes in Defence, the ANAO continues to place limited reliance on aspects of Defence's internal control environment for financial reporting purposes. Consequently, a predominantly substantive audit approach to obtain assurance over the reported balances for 2004–2005 is required. This will involve a significant increase in audit resources applied to the audit.

5.172 There has been limited completed remediation or agreement, at this stage of the financial year, on the resolution of key audit issues noted in 2003–2004. However, considerable work by Defence is progressing and is being examined and evaluated by the ANAO. Both Defence and the ANAO have noted further issues, which are being analysed and will necessitate action to be taken by management prior to the year-end. The current momentum, which has been supported by the Secretary and the CFO, individually and via the FSPB, is essential in progressing and realising the remediation, cultural and structural changes necessary to sustain the required Defence outputs in the current financial reporting environment.

5.173 The system and process concerns being noted during the financial statements audit have been pervasive in their breadth and depth, and span a broad cross-section of the financial statements. Many of the issues arise from both legacy systems and process issues, and the effectiveness of current systems and processes to react to the current and future reporting environments. Nevertheless, considerable resources are being applied by Defence to remediate processes to deal with known inadequacies. The ANAO will maintain its support of Defence's commitment to enhance assurance related to its financial statements and the ongoing role of the FSPB and the audit committees.

Department of Veterans' Affairs

Business operations

5.174 The Repatriation Commission is responsible, under the *Veterans' Entitlements Act 1986*, for granting pensions, allowances and other benefits; and providing health care to veterans. The Department of Veterans' Affairs (DVA), in its role of providing administrative support to the Repatriation Commission, delivers its responsibilities by making pensions, allowances, other benefit payments and health care to veterans and other entitled persons. DVA also administers programmes of commemoration and remembrance and the *Defence Service Homes Act 1918*.

5.175 The Military Rehabilitation and Compensation Commission is responsible for the administration of benefits and arrangements under the *Military Rehabilitation and Compensation Act 2004*. DVA also administers the Military Rehabilitation and Compensation Scheme under the *Safety Rehabilitation and Compensation Act 1988* on behalf of the Department of Defence for ex-defence personnel injured in the course of their duties.

5.176 DVA's funding for the year ending 30 June 2005 includes estimated price of outputs of \$304.77 million and estimated administered expenses of \$10.24 billion. Estimated administered revenue for 2004–2005 is \$2.40 million. DVA's average estimated staffing level for 2004–2005 is 2 489.

Key business risks

5.177 In order to manage its key business risks, DVA addresses issues relating to:

- the effective management of service level arrangements 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;
- 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;
- maintenance of a good public profile;
- increased financial management responsibilities and accountability; and

- business risks concerned with the Defence Service Homes Insurance Scheme.

5.178 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- risks and impact on the financial statement by the *Military Rehabilitation and Compensation Act 2004*;
- payments to veterans together with a verification of year-end accrual calculations;
- management of contracts and service level agreements;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.179 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 support 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 programmes 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

and implementation of a significant portion of the recommendations suggested by the internal audit; and

- a risk management policy supported by risk management strategies which is refreshed annually. The development of a fraud risk profile is undertaken every two years and is directly linked to DVA's fraud control activities.

Financial reporting

5.180 Reporting processes implemented by DVA are comprehensive and include financial and non-financial information. The Balanced Scorecard reports performance measures against cost, quantity, timeliness, quality and outcome. In addition, monthly reports comparing actual and 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

5.181 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	5	0	5	4	1	2
Total	5	0	5	4	1	2

5.182 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters – Category B

Disaster recovery plan

5.183 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. The ANAO noted that the Business Continuity Plan (BCP) was updated and released in August 2004. In reviewing DVA's business continuity planning processes, the ANAO noted that the BCP has defined the maximum

acceptable outage for key systems of no more than 7 days. Under current arrangements, DVA's key systems may require much longer to effect proper recovery in the event of a major disaster.

Payroll Clearing Account Reconciliation

5.184 Payroll clearing account reconciliations had not been performed on a monthly basis from July 2004 to March 2005. Reconciliations are a fundamental control providing assurance as to the completeness and integrity of data within the FMIS from which financial reporting information is sourced. The lack of regular reconciliations of clearing accounts increases the risk of fraud and inaccuracies in the reporting of departmental expenses.

Conclusion

5.185 DVA has responded positively to the ANAO's issues and recommendations. The implementation of recommendations has commenced and DVA has advised it is actively resolving issues.

Education, Science and Training Portfolio

Department of Education, Science and Training

Business operations

5.186 The Department of Education, Science and Training (DEST) provides advice to the Government and administers programmes to achieve the Australian Government's objectives for education, science and training. DEST works in partnership with the States and Territories, non-government authorities, education and training providers and industry towards achieving three long-term outcomes.

5.187 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 for work and life; 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.

5.188 DEST's funding for the year ending 30 June 2005 includes estimated price of outputs of \$367.45 million and estimated administered expenses of \$16.93 billion. Estimated administered revenue for 2004–2005 is \$373.50 million. DEST's average estimated staffing level for 2004–2005 is 1 835.

Key business and financial statement risks

5.189 In order to manage its key business risks, DEST addresses issues relating to:

- political sensitivity;
- on-line service delivery;
- legislative changes;
- human resource management, including work force planning;
- provision of timely and effective policy advice and implementation;
- ensuring an adequate framework for the management of service providers; and

- service delivery – the ability to provide new and/or existing services that are timely and of a high standard.

5.190 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- reliance on external parties for the provision of data;
- complex administered balances reliant on actuarial assessments for valuation;
- addition of Youth Allowance to DEST's administered functions;
- inappropriate recognition of liabilities and commitments for grants;
- consolidation of Questacon;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.191 The ANAO's audit approach considers DEST's goals, priorities, objectives and strategies, along with the critical success factors DEST 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 support financial assurance include:

- a Corporate Leadership Group (CLG) that measures and monitors DEST's progress in meeting its goals and objectives. The CLG monitor financial and non-financial performance and review monthly financial management reports;
- 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 Parliamentary, Assurance and Legal Group. The plan takes into account the high priority risks and risk minimisation strategies identified by all divisions and links the critical success factors set down in the corporate plan;

- an Audit and Business Assurance Committee (ABAC) meets five times per year and actively focus on the internal and external audit. All audit reports and audit plans are approved by the ABAC based on their assessment of risk and coverage required;
- a monthly financial reporting process, which provides actuals versus budget expenditure and revenue;
- an internal audit plan that addresses key business risks and covers over time all programmes administered by DEST; and
- a fraud control plan.

Financial reporting

5.192 DEST has in place a financial reporting process that includes comparison to budget, variance analysis and commentary. The monthly financial reports are distributed to members of the CLG, for utilisation when making decisions, on a monthly basis with a brief commentary on key variances.

Audit results

5.193 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	2	2	0	0	0	0
Total	2	2	0	0	0	0

Conclusion

5.194 Based on audit work performed to date, internal controls are operating satisfactorily.

Commonwealth Scientific and Industrial Research Organisation

Business operations

5.195 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.

5.196 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. CSIRO's vision and mission are to be delivered through outcomes including research, policy development, programme management and partnerships with consumers and stakeholders.

5.197 From 1 July 2004 the National Measurement Laboratory became a part of the Department of Industry, Tourism and Resource (DITR). Accordingly departmental appropriation of \$11.9 million was transferred to DITR.

5.198 CSIRO received government funding for the year ending 30 June 2005 of \$577.14 million and revenue of \$332.20 million from other sources. CSIRO's average estimated staffing level for 2004–2005 is 5 898.

Key business and financial statement risks

5.199 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;
- the governance of associated entities – the risk that governance controls over associated entities established to transfer technology to the market are not effective; and

- the impact of current and future regulation – the risk that existing or future regulation impacts adversely upon the research undertaken by CSIRO.

5.200 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as low. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- recognition and measurement of work in progress and deferred revenue;
- completeness of contingent liabilities and assets;
- financial and legal requirements relating to CSIRO's controlled companies;
- valuation of investments and equity accounting;
- integrity of project management processes;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.201 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 to address the risks identified. To support these plans, CSIRO has:

- a Board made up of external members plus the Chief Executive, which meets on a regular basis to review the operation of CSIRO;
- the Executive Team, Executive Management Council and Group Chairs all meet regularly to monitor operational issues as well as the financial performance of its activities at varying organisational levels;
- 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

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 Audit Committee approves the annual plan; and performance is reviewed quarterly against the approved plan.

Financial reporting

5.202 CSIRO has an extensive monthly reporting process, which incorporates both financial and non-financial indicators for reporting through to the Board, Group Chairs and the Executive Committee. A monthly close process that ensures a complete understanding of CSIRO's financial position underpins this reporting regime.

5.203 CSIRO is involved in a broad range of activities and, as a result, there is an ongoing 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 effective in meeting these needs.

Audit results

5.204 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	3	3	0	0	0	0
Total	3	3	0	0	0	0

Conclusion

5.205 The ANAO review confirmed that CSIRO has a generally effective financial control framework to support its financial management responsibilities. Strong cost centre management at the Divisional and Corporate levels supports this control framework. CSIRO has made progress in strengthening its control environment. At this time and there are no issues to report arising from the interim phase of the 2004–2005 financial statement audit.

Employment and Workplace Relations Portfolio

Department of Employment and Workplace Relations

Business operations

5.206 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.

5.207 There have been changes to the structure of DEWR's portfolio as a result of the Administrative Arrangement Orders (AAO) of 24 June 2004, 26 October 2004 and 16 December 2004, and other administrative changes within the portfolio. These changes include:

- the AAO of 24 June 2004 transferred the Community Development Employment Projects (CDEP) and the Business Development and Assistance Program (BDAP) from Aboriginal and Torres Strait Islander Services (ATSIS) to DEWR, with functional responsibility effective 1 July 2004. On 24 March 2005, the BDAP was transferred to Indigenous Business Australia – part of the Employment and Workplace Relations Portfolio.
- the AAO of 26 October 2004 transferred nine special appropriations administered under the *Social Security (Administration) Act 1999* and six administered annual appropriations from Department of Family and Community Services (FaCS) to DEWR, with functional responsibility effective from 26 October 2004;
- the AAO on 16 December 2004 transferred a further three special appropriations administered under the *Social Security (Administration) Act 1999*, with functional responsibility effective 16 December 2004; and
- on 7 February 2005, the National Occupational Health and Safety Commission (NOHSC) Office was transferred to DEWR. The Office provides occupational health and safety services. DEWR will receive section 31 revenue from NOHSC for the services delivered until June 2005. From 2005–2006, DEWR will be directly appropriated to deliver these services.

Outcome changes for DEWR include:

- An increase in outcomes from two to three and retitling of Outcome 1 as follows.
 - Outcome 1 has changed from 'An effectively functioning labour market' to 'Efficient and effective labour market assistance'.
 - There are no changes to Outcome 2 'Higher productivity, higher pay workplaces'.
 - Outcome 3 'Increased workforce participation' has been created, effective from January 2005.

5.208 DEWR's funding for the year ending 30 June 2005 includes estimated price of outputs of \$1.06 billion and estimated administered appropriations of \$16.49 billion. DEWR's average estimated staffing level for 2004–2005 is 2 735.

Key business and financial statement risks

5.209 In order to manage its key business risks, DEWR addresses issues relating to:

- contract management - in delivering employment programmes, 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;
- policy advice and analysis – policy advice given by DEWR to its ministers and other stakeholders must be accurate, timely and relevant;
- programme administration and output delivery – DEWR's ongoing relationships with its varied stakeholders is extremely important. These 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 programme delivery. DEWR must manage its critical IT systems to ensure they meet the

changing needs of DEWR and provide accurate and timely information; and

- increased financial management responsibilities and accountability requirements.

5.210 The ANAO's assessment of the risk of material misstatement in the 2004–2005 financial statements is moderate to high. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- controls over personal benefit expenditure;
- grants administration including timely acquittals;
- AAO changes;
- reliance on the timeliness and accuracy of third party information;
- contract management arrangements including consistency of monitoring and review;
- complex general IT environment and IT applications;
- completeness of year-end accruals;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.211 DEWR continues to have in place elements which contribute to sound corporate governance and, in particular, to financial statement assurance. Measures which support financial statement assurance include:

- 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 Sub-committee 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

5.212 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, that reports against a range of financial and non-financial indicators, including client, business and people management needs and goals.

Audit results

5.213 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	2	2	0	0	1	1
Total	2	2	0	0	1	1

5.214 The 2004–2005 audit highlighted the following issue that should be addressed to support the adequacy of the control environment.

Moderate Risk Matters - Category B

Business Continuity Planning

5.215 Key elements of DEWR's Business Continuity Management Plans are yet to be completed including some criticality assessments, business continuity and disaster recovery plans. Notwithstanding this finding, significant progress has been made in relation to the staffing, oversight, prioritisation of key business processes and strategy development. Dual processing sites are already in place.

Conclusion

5.216 DEWR has responded positively to the ANAO's finding and is well placed to meet the 2005 reporting timetable.

Environment and Heritage Portfolio

Department of the Environment and Heritage

Business operations

5.217 The Department of the Environment and Heritage's (DoEH) role is to work towards achieving the following outcomes:

- Environment - the provision of advice on and implementation of policies and programmes 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.
- Antarctic - 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 Australian Antarctic Division (AAD) also promotes Australia's interests within the Antarctic Treaty System and administers the Australian Antarctic Territory, Heard Island and McDonald Islands.

5.218 DoEH administers a range of acts to protect and conserve the environment, a significant one being the *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act). The EPBC Act provides a national framework for environment and heritage protection through a focus on protecting matters of national environmental and heritage significance and on the conservation of Australia's biodiversity.

5.219 Since 1 July 2004, there have been two significant changes to the role and structure of DoEH:

- the Indigenous programme functions were transferred to DoEH from Department of Immigration and Multicultural and Indigenous Affairs (DIMIA), following the decision in June 2004 to abolish the Aboriginal and Torres Strait Islander Commission; and
- the abolition of the Australian Greenhouse Office (AGO) and the National Oceans Office (NOO) as executive agencies under the *Public Service Act 1999* on 26 October 2004, and as prescribed agencies under the FMA Act on 3 November 2004. Both these agencies were incorporated into DoEH following the Administrative Arrangements Order changes.

5.220 DoEH's funding for the year ending 30 June 2005 includes estimated price of outputs of \$327.95 million, and estimated administered expenses of

\$443.80 million. Estimated administered revenue for 2004–2005 is \$12.26 million. DoEH's average estimated staffing level for 2004–2005 is 1 451.

Key business and financial statement risks

5.221 In order to manage its key business risks, DoEH addresses issues relating to:

- implementation and administration of Environment legislation;
- policy advice and analysis;
- public interest in activities, including programme delivery and provision of grants;
- increased and changing financial management responsibilities and accountability; and
- major restructure of DoEH.

5.222 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- restructuring of DoEH with the integration of the indigenous programmes from DIMIA, the AGO and the NOO;
- revaluation of assets at fair value;
- changes to DoEH's key financial and human resource management systems;
- prior year control weaknesses including those relating to the financial statement preparation process;
- significant grants administration;
- the absence of a system capable of providing full accrual based accounting and reporting for the AAD;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.223 The ANAO's audit approach considers DoEH's goals, priorities, objectives and strategies along with the critical success factors management

considerations are necessary to achieve them. In reviewing DoEH's strategies, the ANAO focused on the key initiatives in place to meet DoEH's objectives and management of the business risk associated with those initiatives. Measures which support financial assurance include:

- a senior executive committee which meets weekly to evaluate and determine DoEH'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 Audit Committee includes two independent members and an observer from the ANAO;
- the executive and operational areas are provided with financial information on a monthly basis in relation to DoEH's financial position and operating performance. The reports provide results by outcome on actuals versus budgeted expenditure and revenue;
- a monthly reporting process;
- a documented risk management strategy which identifies and treats medium and high rated exposures; and
- a fraud control plan and publication of fraud control arrangements and guidelines on DoEH's intranet.

5.224 As a result of the restructure, which occurred in November 2004, a number of the above components of corporate governance require management to re-assess and implement changes to incorporate the new functions. DoEH is in the process of assessing the impact on the risk management strategy, fraud risk assessment and fraud control plan.

Financial reporting

5.225 DoEH provides accrual monthly management financial reports to the executive. DoEH reports comprehensively on its operations, including:

- an overall summary level report as well as more detailed individual reports for each division;
- actual revenues and expenses;
- budgeted revenues and expenses; and
- projected variance analysis based on year to date figures.

5.226 These reports include commentary on DoEH's financial position, including detailed variance analysis.

Audit results

5.227 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New issues reported in August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0	0
B	4	4	5	5	2	5	8
Total	4	4	5	5	2	5	8

5.228 The 2004–2005 highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Financial Statements Preparation process

5.229 DoEH did not achieve a number of milestones in its 2003–2004 financial statement preparation timetable, including an appropriate quality assurance review of drafts prior to provision to the ANAO leading to inefficient use of departmental and ANAO resources. A number of recommendations were made to assist DoEH in meeting future deadlines. These recommendations are being implemented for the 2004–2005 financial statement preparation process.

Reconciliation of Leave balances

5.230 In 2003–2004, the ANAO noted the absence of regular monthly reconciliations of leave balances in the HRMIS and the FMIS. At the time of the audit, DoEH has not completed a reconciliation of the HRMIS to the FMIS. Where reconciliations between systems are not undertaken, the risk increases that discrepancies may not be detected and resolved. Enhancements to the systems to facilitate the reconciliation process were being developed.

Reconciliation of Special Accounts

5.231 DoEH has not been reconciling special account ledgers to the bank account. The absence of a reconciliation between a number of special accounts and the bank account for these special accounts could result in the

non-detection of error and/or mismanagement of special account funds. DoEH is currently in the progress of implementing this recommendation that arose from the 2003–2004 audit.

Fraud Control Planning

5.232 DoEH does not have a current and endorsed fraud control plan in place (last endorsed June 2003). On 26 October 2004, the Administrative Arrangement Orders merged the AGO and the NOO back into DoEH's structure effective from 4 November 2004. The updated draft fraud control plan submitted for approval has not been amended to include these new functions. Where fraud control plans are not updated in a timely manner the risk is increased that fraud risk may not be identified and effectively managed.

Business Continuity Management

5.233 DoEH does not have a formally established, department-wide business continuity management framework and continuity plan. Work has commenced to complete the initial requirements for business continuity, that being a Business Impact Analysis for each of the relevant Divisions. The lack of a business continuity management framework and continuity plan exposes DoEH to the potential risk that in a disaster situation critical business processes may be significantly interrupted.

HRMIS and FMIS Access Management

5.234 The ANAO's review of DoEH's HRMIS and FMIS identified weaknesses in key configurable⁵² and security controls. Concerns exist over user access and security administration for these systems. It was found that there were a significant number of users with unrestricted and wide-ranging access whose activities were not subject to regular review. In addition, a large number of users have access to financially sensitive transactions and have been granted access to transactions with incompatible functions. This contravenes the principles of segregation of duties and was found to be inconsistent with DoEH's business processes. As a result, there is an increased risk that inaccurate, unauthorised and/or fraudulent transactions may be processed.

Reconciliation Procedures

5.235 Control exposures were noted with the reconciliation of DoEH's financial records to associated bank accounts, as well as the reconciliation of DoEH records to those held by the Department of Finance and Administration. Reconciliations are a fundamental control providing assurance as to the completeness and integrity of data within the FMIS from which financial

⁵² Configurable controls are system based 'switches' that can be set by turning them on or off to secure the application against inappropriate processing, based on the organisation's business rules.

reporting information is sourced. The non-performance of any reconciliation may delay the identification and resolution of potential discrepancies and can result in delays in the preparation of the year-end financial report.

Antarctic Provision Review

5.236 The Antarctic Treaty requires the Australian Government, to restore the Antarctic environment to the condition existing prior to commencement of operations in the Antarctic region. A provision for Antarctic Base Restitution was recognised in the financial statements of the DoEH in prior years. As the project clean up process enters its fourth year, actual performance will inevitably vary from the estimates made at the commencement of the process. With increased variability to the original estimates, this reduces the appropriateness of the carrying amount of the provision. The ANAO has recommended that DoEH perform a detailed review of the provision to ensure the original assumptions used in the calculation of the provision remain appropriate, in light of the activities undertaken to date and the change in the expected timeline.

Conclusion

5.237 DoEH has responded positively to the ANAO's findings and associated recommendations and has indicated that appropriate action will be taken.

Family and Community Services Portfolio

Department of Family and Community Services

Business operations

5.238 FaCS aims to create a fair and cohesive Australian society by focusing on policies that strengthen the capacity of individuals, families and communities to participate in social and economic life.

5.239 FaCS achieves its vision by:

- working in partnership with other governments, agencies, communities and citizens;
- providing advice to government on social policy issues; and
- managing the delivery of service through a wide range of external service providers, including Centrelink, other Australian Government entities, non-government organisations, private providers and state and territory governments.

5.240 In 2004–2005 FaCS has three outcomes Families are Strong, Communities are Strong and Individuals Reach their Potential.

5.241 There has been a significant change to the role of FaCS as a result of the Administrative Arrangements Orders (AAO) issued on 1 July 2004, 26 October 2004 and 16 December 2004 respectively, as follows:

- FaCS assumed responsibility for gender issues through the Office for Women, which moved from the Department of the Prime Minister and Cabinet;
- Aboriginal Hostels Limited now also comes under the Family and Community Services portfolio having moved from the Immigration and Multicultural and Indigenous Affairs portfolio;
- in July 2004, FaCS assumed responsibility for some functions previously undertaken by Aboriginal and Torres Strait Islander Commission (ATSIC) and Aboriginal and Torres Strait Islander Services (ATSIS);
- the creation of a new agency, the Department of Human Services as part of the Finance portfolio which has brought together six entities including Centrelink and Child Support Agency previously part of the FACS portfolio; and

- responsibility for a number of working age income support payments and open employment services for people with a disability moved to the Employment and Workplace Relations portfolio whilst responsibility for income support for students now lies with the Education, Science and Training portfolio.

5.242 FaCS' funding for the year ending 30 June 2005 includes estimated price of outputs of \$2.62 billion and estimated administered expenses of \$48.34 billion. FaCS' average estimated staffing level for 2004–2005 is 1 763.

Key business and financial statement risks

5.243 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.

5.244 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as high. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- integrity of personal benefit expenditure;
- measurement of Pension Bonus Scheme liability;
- measurement of receivable from, or payable to, Centrelink under the Centrelink Funding Model;
- complexity of personal benefit debt and provision for doubtful debts;
- validity of grant payments;
- AAO changes;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.245 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 support financial assurance include:

- an Executive Management Group that meets weekly and has a formal bi-annual corporate governance process. The Executive Management Group takes an active interest in the financial operations of FaCS and receives monthly detailed reports from the Chief Financial Officer, who is a member;
- a 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 process which provides actuals versus budget expenditure and revenue; and
- an internal audit branch that has a planned risk based coverage of FaCS' activities.

Financial reporting

5.246 The current approach includes monthly reporting to the Board on actual results against budget and a performance scorecard in relation to departmental financials. The information provided to management includes high-level explanation of variances from budget on a monthly basis.

Audit results

5.247 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New issues to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0	0
B	8	2	2	8	4	8	12
Total	8	2	2	8	4	8	12

5.248 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Review of Logs and Privileged Accounts

5.249 Standard industry practice for controlling access to IT systems indicates that audit logs recording exceptions and other security relevant events should be produced, independently reviewed and archived to assist in the management of risks associated with privileged access. While the audit logs are maintained within FaCS' Windows NT environment, there is presently no formal process to review and monitor these logs, particularly for users with privileged system accounts. Not reviewing the audit logs increases the risk that inappropriate activity by users of IT systems is not detected. This issue has been outstanding for the last two years. FaCS agreed that a process is to be fully implemented by 30 June 2005.

Pension Bonus Scheme

5.250 The Pension Bonus Scheme (PBS) was introduced in 1998–1999 with the aim of providing an incentive for older Australians to defer claiming the Age Pension and instead remain in the workforce. In 2003–2004, FaCS and the ANAO agreed that FaCS should recognise a provision in the financial statements for the PBS. In last year's ANAO report to the Parliament⁵³ the ANAO recommended that FaCS review the methodology used to estimate the liability. At the time of the audit FaCS has not completed this review but had engaged an actuary to assist in a more rigorous estimate of the liability for 2004–2005.

⁵³ *Audit of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*, Audit Report No.21 2004–2005.

Commonwealth State Housing Agreement

5.251 FaCS needs to strengthen its monitoring controls around payments under the Commonwealth State Housing Agreement, including implementation of a formalised reconciliation process between a spreadsheet used to monitor grant payments and the financial management information systems. This issue is still outstanding from the previous year. In addition, a grant overpayment to the Aboriginal Rental Housing Program was identified, resulting in a breach of the agreement.

Indigenous Community Housing Infrastructure Grants

5.252 Internal grant processes have resulted in programme and regional managers transferring monies to third parties to facilitate the delivery of funds to grantee organisations. Grant projects were identified by the ANAO where either funds were released in advance of need and/or projects were finalised in which surplus funds had been identified. Towards the end of the 2003–2004 year, substantial balances of grant monies remained in the bank accounts with very little activity, resulting in an inefficient use of Commonwealth funding. The administration of the Community Housing Infrastructure Program was transferred from ATSIC to FaCS as a result of the AAOs. FaCS advised that the balance held in third party arrangements under the Indigenous Housing Program has reduced considerably and that a process to monitor balances of grant monies is being implemented.

Accounts Payable Process

5.253 A number of duplicated vendors have been created in FaCS' financial management system. In addition, the process of raising purchase orders was not always in accordance with FaCS' 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 fraudulent payments. FaCS advised a review of duplicate vendors has commenced.

Monitoring of Expenditure per Outcome

5.254 Each agency is responsible for ensuring its administered expenditure against each Outcome does not exceed the amount appropriated. Expenditure in excess of an appropriation is a breach of section 83 of the Constitution. FaCS has not introduced monitoring controls to ensure that there are sufficient amounts remaining in an appropriation to cover each payment they make against an appropriation item. Drawdowns were being made without an assurance that sufficient funds/appropriation existed prior to payments being made, exposing FaCS to a risk of exceeding the appropriation limit. FaCS advised that the drawdown schedule now reports on appropriation drawdown and the available funds against each Appropriation Act and Outcome.

Classification of Departmental/Administered Payments

5.255 The Australian Accounting Standard *AAS 29 Financial Reporting by Government Departments* and the FMOs state that the direct and indirect costs of administering or managing government programmes are departmental costs. FaCS has made payments, which have been classified as administered but appeared to be departmental in nature. Departmental costs need to be captured accurately and fully, to ensure FaCS' price of outputs and other key attributes such as quantity and quality, are adequately considered. This information is essential for FaCS to effectively manage purchasing services and managing contracts from a range of providers. FaCS is undertaking a review of its administered expenditure to ensure that the classification between administered and departmental expenses is correct.

Unrecorded Library Collection

5.256 FaCS' Library has a large number of items (in excess of 30 000) including monographs, reference material, journals, regulatory archive and items in historical collection. The number of these items has been steadily increasing over the last several years. With the changes imposed by the AAO, FaCS also received a large number of library items from other entities. FaCS has not performed any recent review/assessment as to whether the amount of the unrecorded Library Collection could have a material impact on the financial statements. FaCS has engaged an independent valuer with the valuation expected to be completed prior to year-end.

Financial Policies and Procedures

5.257 Chief Executive Instructions together with associated policies and procedures provide a structure by which a consistent approach to financial management can be implemented. FaCS' policies and procedures have not been updated since November 2001. When policies and procedures are not updated there is a potential risk that incorrect procedures could occur, as officers may not be aware of their responsibilities. FaCS advised a project was underway to update procedures and manuals that will also ensure reviews are undertaken more frequently.

Unrecorded Prior Employment Service

5.258 The ANAO highlighted instances where employees had potential prior service with eligible Australian, State and Local government entities that was unrecorded in FaCS' HRMIS. It is important that prior service is systematically assessed and accurately recorded to ensure that there is not a significant understatement of employee provisions in the financial statements. FaCS' Internal Audit has commenced a review of the unrecorded prior employment service in order to determine the significance of this issue and the action required.

Management of Assets Under Development

5.259 FaCS needs to review the procedures for the management of, and accounting for, software assets under development. A number of issues were highlighted during the audit, including a lack of reviews and accounting for completed projects. This impacts on the integrity of reported asset balances in FaCS' financial statements. FaCS has advised it is strengthening its reviews of assets under construction.

Administered Receipts

5.260 The ANAO identified that for the period prior to 1 October 2004, FaCS had incorrectly retained administered receipts from other agencies and applied them to reduce its administered expenses. FaCS has commenced a thorough review of administered receipts to detect and take corrective action where receipts have been incorrectly recorded against expenses.

Conclusion

5.261 Improvements are required in relation to a number of FaCS' financial and accounting processes together with maintaining the systems of control. FaCS also needs to ensure that it has adequate systems and procedures to produce accurate and complete information for financial reporting purposes. FaCS has responded positively to the ANAO recommendations and has advised of remedial action.

Finance Portfolio

Department of Finance and Administration

Business operations

5.262 The Department of Finance and Administration (Finance) plays an important role in assisting the Government to achieve its policy objectives by helping shape and deliver its fiscal and economic agendas and providing high quality advice and services. Finance accomplishes this by contributing to four key outcomes:

- sustainable government finances;
- improved and more efficient government operations;
- an efficiently functioning parliament; and
- effective and efficient use of information and communication technologies by the Australian Government.

5.263 Finance's operations are diverse, ranging from budget preparation and managing the Australian Government's non-Defence, domestic property portfolio, to providing infrastructure and a range of professional support services to Parliamentarians and their staff, and former Senators and Members.

5.264 Finance has continuing outsourced arrangements in place for the provision of services for human resource management, Australian Government financial reporting, internal audit, office services, IT, property portfolio management, and Comcover's client services.

5.265 The 2004–2005 year has seen the following key changes to the business and operational environment of Finance;

- the functions of the Australian Government Information Management Office (AGIMO) were transferred to Finance as a result of the Administrative Arrangement Order of 27 October 2004. This resulted in the creation of Outcome 4 'Effective and efficient use of information and communication technologies by the Australian Government'; and
- the Office of Evaluation and Audit (OEA), formerly a function of the Aboriginal and Torres Strait Islander Commission (ATSIC), was transferred into the Financial Management Group within Finance on 1 July 2004. The function of the OEA is to undertake the evaluation and audit of the expenditure of money on indigenous affairs.

5.266 Finance's funding for the year ending 30 June 2005 includes estimated price of outputs of \$412.74 million, and estimated administered expenses of \$5.95 billion. Estimated administered revenue for 2004–2005 is \$1.41 billion. Finance's average estimated staffing level for 2004–2005 is 1 057.

Key business and financial statement risks

5.267 In order to manage its key business risks, Finance addresses issues relating to the:

- appropriateness and accuracy of advice provided to Ministers, Members of Parliament and departments;
- appropriateness and rigidity of the Australian Government's financial management framework;
- appropriateness of control 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;
- valuation of superannuation liabilities administered on behalf of the Australian Government;
- valuation of insurance liabilities administered on behalf of the Australian Government and the appropriateness of asset cover and reinsurance policies;
- validity and accuracy of entitlements paid to Parliamentarians and their staff;
- management of staff turn-over and associated loss of corporate knowledge and skills; and
- valuation of the Australian Government's domestic property portfolio and adequacy of asset management procedures.

5.268 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- accounting for the actuarial assessment of the public sector unfunded superannuation liability;
- accounting for asset management;

- reliability of valuations provided from third parties for assets and liabilities
- changes to financial and regulatory requirements;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.269 Finance has structures and processes in place that contribute to effective corporate governance and, in particular, to gain assurance over the financial statement process. Specific processes assisting Finance in achieving this assurance include:

- a comprehensive risk management process;
- annual internal audit work programme approved by the Audit Committee;
- business planning and budget process;
- defined policies and procedures intended to ensure operations are within legal and social requirements;
- established control and accountability systems;
- regular updating of the audit committee charter;
- 'Finance Managers' committee and fortnightly meetings with Finance's Chief Financial Officer; and
- established performance review, monitoring and evaluating framework.

Financial reporting

5.270 Finance has developed strong financial reporting processes that provide monthly reports on administered and departmental revenues, expenses, assets, liabilities and cash flows. The reports provide actual versus budget information on an accruals basis, allowing Finance to reliably assess its financial position and operating performance.

5.271 During 2003–2004 Finance managed the 'close the books' process successfully. Finance has distributed internally comprehensive financial statement instructions detailing procedures and a timetable aimed at achieving the 30 July 2005 deadline.

Audit results

5.272 The following table provides a summary of the status of prior year issues as well as a 2004–2005 audit issue raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	0	0	0	0	1	1
Total	0	0	0	0	1	1

5.273 The 2004–2005 audit highlighted the following issue that should be addressed to support the adequacy of the control environment.

Moderate Risk Matters - Category B

Business Continuity Planning

5.274 Finance has a sound Business Continuity Management (BCM) framework in place. Executive endorsement of the framework and organisational wide Business Continuity Plan (BCP) has been given. However, as at March 2005, detailed testing of the departmental BCP and individual BCPs, and completion of IT Disaster Recovery Planning documentation had not been undertaken. Whilst these key elements remain incomplete, there is an increased risk that Finance may not be adequately prepared in the event of a major disruption to critical business processes.

Conclusion

5.275 Finance has responded positively to the ANAO recommendation regarding business continuity planning. Finance has advised that both group plans and the Disaster Recovery Plan will be significantly advanced, including testing, over the next six months. The ANAO noted continued refinement of corporate governance and control structures in place. Based on the work performed to date, the ANAO considers the control framework and the internal controls are generally operating satisfactorily.

Department of Human Services

Business operations

5.276 The Department of Human Services (DHS) – part of the Finance and Administration Portfolio - was established on 26 October 2004 to improve the development, delivery and coordination of Government services. DHS is responsible for ensuring the Government is able to get best value for money in service delivery while emphasising continuous service improvement and a whole-of-government approach.

5.277 DHS consists of the core department, the Child Support Agency (CSA) and CRS Australia (CRS). The core department is small and strategic. The role of the core department is to direct, coordinate and broker improvements to service delivery. CRS assists people with an injury or a disability to obtain employment or return to work by providing individualised vocational rehabilitation, and helping employers to keep their workplaces safe. CSA ensures that children of separated parents receive financial support from both parents.

5.278 The following entities report through the Secretary of DHS to the Minister:

- Centrelink – delivers a range of government payments and services for retirees, families, carers, parents, people with disabilities, Indigenous people, and people from diverse cultural and linguistic backgrounds and provides services at times of major change.
- The Health Insurance Commission – looks after the health of Australians through efficient services and payments, such as Medicare, the Pharmaceutical Benefits Scheme, the Australian Childhood Immunisation Register and the Australian Organ Donor Register.

5.279 Under section 32 of the FMA Act appropriations totalling \$157.80 million have been transferred to DHS for departmental outputs and \$5.81 million for administered items. For the departmental appropriations, \$150.22 million was transferred from FaCS for the departmental expenses of CSA and the remaining \$7.58 million was transferred from contributing departments for the establishment of the core DHS department. The \$5.81 million administered transfer was specific to child support payments in CSA.

5.280 In addition to the above appropriations transferred, under the AAOs the net assets of CRS Australia were transferred from the Department of Health and Ageing to DHS effective 27 October 2004 and the net assets of CSA were transferred from FaCS to DHS effective 17 December 2004. The total

contributed equity to DHS resulting from these transfers is estimated at \$44.01 million.

5.281 It is estimated that for the period to 30 June 2005, DHS will also report departmental revenue from other sources of \$113.11 million from CRS operations and consolidated expenses for the department of \$251.97 million. Administered revenue and expenses for the operations of CSA for the period to 30 June 2005 are estimated to be \$461.31 million and \$505.72 million respectively. DHS' estimated average staffing level for 2004–2005 is 4 508.

Key business and financial statement risks

5.282 DHS has designed and is in the process of putting into place a governance framework. As part of this framework, the Audit Committee has endorsed a risk assessment and management discussion paper and has recommended that a comprehensive assessment of DHS' business risks be carried out in the near future.

5.283 With the exception of the key business risks that will be identified for the core department, DHS' key business risks relate to those of the operations of CSA and CRS, which include:

- CRS – the key business risks relate to non-compliance with legislation/regulations; incorrect pricing of services; failure to maintain the client service network; and inappropriate decisions made based on analysis of incorrect data; and
- CSA – the key business risks relate to voluntary disclosure; welfare and child support reforms; managing key stakeholder relationships; and the complexity and dynamics of the IT environment.

5.284 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. In this first year of operation, the financial statement audit focused on the material financial reporting risks flowing from the following key issues.

- The proper and accurate transfer of net assets from CSA and CRS in accordance with the Administrative Arrangement Orders.
- Completion and approval of proper Section 32 FMA Act documentation for the transfer of appropriations from contributing departments.
- Effective completion of the audits of the financial statements of CSA and CRS that considered the business and financial risks of these operations.

- Proper consolidation of CSA and CRS statements with the statements of the core department.
- Harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005.
- The financial statement close process in light of the tighter reporting deadlines for completion of the financial statements.

Conclusion

5.285 The ANAO is working with DHS for the audit of the transition of CRS and CSA to the new department and to establish the audit arrangements for the new department. The interim phase of the 2004–2005 audit has commenced.

Centrelink

Business operations

5.286 Centrelink is an authority, established under the *Commonwealth Services Delivery Agency Act 1997*, and is part of the Human Services portfolio. It is the principal service delivery organisation within the portfolio and is also responsible for linking 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 a purchaser/provider framework 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.

5.287 Centrelink is in the process of implementing a structural change across the organisation with focus on stakeholder relationships and service delivery. Further, the Minister for Human Services has announced the intention to dissolve the existing board of Centrelink and create a statutory agency which will report through the Secretary of the Department of Human Services to the Minister.

5.288 Centrelink's estimated price of outputs for the year ending 30 June 2005 is \$2.29 billion. Centrelink's average estimated staffing level for 2004–2005 is 23 423 across an extensive Australia-wide customer service centre network.

Key business and financial statement risks

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

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

5.290 The framework requiring voluntary disclosure by customers heightens the risks associated with ensuring accurate payment and assessment of personal benefits. Centrelink has controls and strategies in place to mitigate this risk to the extent possible and encourage timely disclosure by customers.

5.291 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. Potential issues include:

- integrity of benefit payments;
- costing of internally developed software;
- measurement of unearned revenue;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate Governance

5.292 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.

5.293 Although the Minister for Human Services has announced the intention to establish Centrelink as a statutory agency, the following governance and accountability structure currently in existence at Centrelink includes:

- 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 agencies 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 five times annually 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 detailing how the strategies outlined will be achieved. This strategy provides the basis for a range of other plans within the organisation;
- a comprehensive monthly accrual based financial reporting process, which includes statements of financial performance and position, cash

flow, analysis of actuals to budget, key statistics and the integration of non-financial performance information;

- an internal audit function undertakes a programme 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); and
- up-to-date Chief Executive Instructions (CEIs) that provide the framework for Centrelink's financial operations. CEIs are currently under redevelopment following the major review conducted, and changes in senior management in December 2004.

Financial reporting

5.294 Centrelink has a monthly financial reporting process, which includes comparison to budget, variance analysis and commentary. All reports are prepared on a full accrual basis. The Resource Management Team prepares financial analysis and commentary on a monthly basis to National Managers and Team Leaders. In addition, Centrelink uses a balanced scorecard to report on progress against key performance indicators.

Audit results

5.295 The following table provides a summary of the status of prior year issues as well as 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	5	0	5	4	3	4
Total	5	0	5	4	3	4

5.296 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Mainframe 'Superuser' Privilege Access

5.297 The mainframe 'Superuser' account provides a user with powerful privileges that allows unlimited access to the mainframe operations including system configuration changes. An excessive number of users were identified as having these 'Superuser' privileges. In addition, the process for granting and revoking 'Superuser' access needed to be incorporated into the standard user account management procedures. This increased the risk of erroneous changes being made to the mainframe environment if not adequately controlled.

Access Privilege

5.298 Centrelink have an excessive number of users who could access a database related to a major personal benefit payment system. Further, a formal monitoring and review process was not implemented over users' access to the database. This increases the risk of users making unauthorised and/or erroneous changes to data stored.

Direct Access to Personal Benefit Payment File

5.299 Centrelink needs to review systems-based resource rules that permit inappropriate 'write access' to a personal benefit payment file. This file is the source file for the generation of payment allocations and payment delivery processes for personal benefits. This is a critical file that requires a high level of security protection. Inadequate access controls increase the risk of data integrity issues and fraud through unauthorised changes to personal benefit payment data.

Inappropriate use of Manual Request to Pay Forms

5.300 Centrelink is in the process of tightening controls over the use of Manual Request to Pay (RTP) forms. The use of these RTP forms by-passes the automated FMIS purchasing controls and makes it difficult for Centrelink to ensure appropriate delegates approve all purchases, increasing the risk that unapproved purchases may be processed. This is a 2003–2004 finding that remains unresolved. Centrelink is in the process of resolving this issue through the implementation in July 2005 of alternative options.

Conclusion

5.301 Centrelink has agreed to focus on the timely resolution of the outstanding issues to further strengthen its control environment.

Health Insurance Commission

Business operations

5.302 The Health Insurance Commission (HIC) is the Australian Government statutory authority responsible for delivering national health programmes such as Medicare; the Pharmaceutical Benefits Scheme (PBS); the Private Health Insurance Rebate Scheme; 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.

5.303 HIC also administers a number of health incentive programmes 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.

5.304 HIC processes more than 400 million transactions each year and pays benefits in excess of \$18 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.

5.305 The 2004–2005 year has seen a number of key changes to the business and operational environment of HIC including:

- formation of the Department of Human Services following the AAO of 26 October 2004 and making HIC part of the portfolio;
- the announcement of the impending change of HIC to become an FMA Act agency, Medicare Australia;
- the move to a direct appropriation funding model for its operating requirements;
- responsibility for the administration of key elements of the Government's Medicare initiatives;
- responsibility for administering all aspects of the Medical Indemnity package; and
- continued implementation of the e-Business and technology improvement programme, including the movement to online claim lodgement for PBS and Medicare.

5.306 HIC received operational funding of \$527.60 million from Government, and revenue of \$66.61 million from other sources. HIC's average estimated staffing level for 2004–2005 is 4 676.

Key business and financial statement risks

5.307 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 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.

5.308 The ANAO has assessed the risk of material misstatement in HIC's 2004–2005 financial statements as high. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- adequacy of internal control over critical information systems;
- implementation of Medicare initiatives;
- valuation and impairment of internally developed software;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.309 The ANAO's audit approach considers HIC's goals, priorities, objectives and strategies, along with the critical success factors management

considerations 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 support financial assurance include:

- a Board of Commissioners with predominantly non-executive members;
- monthly meetings of the Board of Commissioners;
- a governance committee framework consisting of sub-committees of the Board including an Audit Committee, Fraud and Service Audit 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 process;
- 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 programmes administered by HIC through the prevention, detection and investigation of fraud and abuse; and
- a fraud control policy and plan.

5.310 These activities contributing to corporate governance have been reviewed and assessed as operating satisfactorily to assist HIC meet its 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

5.311 The HIC monthly financial reporting process is primarily focused on reporting actual results against budget/plan. As HIC continues with its measures to enhance the quality of monthly financial reporting, further improvement can be expected to HIC's financial management reporting framework. The improvements will embed greater preventative controls within the reporting framework and enhance the quality of financial reporting.

Audit results

5.312 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New Issues to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0	0
B	21	7	3	17	15	0	2
Total	21	7	3	17	15	0	2

5.313 HIC has appropriately addressed the moderate risk findings from 2003–2004 which resulted in the clearance of 15 of those findings. The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Change management

5.314 A number of deficiencies were identified in the controls over change management. It is recognised that that processes are in place to implement an enhanced tool for controlling changes in the mainframe environment, to investigate tools for tracking change requests and associated information and formalising procedures for managing change documentation.

Project financial management framework

5.315 The project financial management framework is not sufficiently developed to ensure the financial outcomes associated with projects are aligned with corporate objectives and the activities of project management

consistently contribute to these objectives. It has been confirmed that significant work is progressing to establish a robust and effective project financial management framework. However, until this work has been completed project financial management will continue to be a risk to HIC.

Conclusion

5.316 HIC has responded positively to the ANAO's findings and the associated recommendations. The ANAO acknowledges that HIC has undertaken significant work to address the findings from the 2003–2004 financial statements audit. The ANAO will undertake further reviews on relevant areas to ensure that the actions taken by HIC continue to address the previously reported issues.

Foreign Affairs and Trade Portfolio

Department of Foreign Affairs and Trade

Business operations

5.317 The Department of Foreign Affairs and Trade (DFAT) is responsible for: the protection and advancement of Australia's national interests through contributions to international security, national economic and trade performance and global cooperation; providing consular and passport services to Australian citizens; promoting public understanding of Australia's foreign and trade policy; projecting a positive image of Australia internationally; and managing overseas property owned by the Commonwealth Government. DFAT's work towards its four outcomes is 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.

5.318 During the 2004–2005 financial year, there has been a further deterioration in the security environment in which DFAT's overseas missions operate. In response to heightened risks, DFAT is implementing a range of new security measures.

5.319 DFAT's funding for the year ending 30 June 2005 includes estimated price of outputs of \$826.58 million, and estimated administered expenses of \$283.50 million. Estimated administered revenue for 2004–2005 is \$205.87 million. DFAT's average estimated staffing level for 2004–2005 is 3 138.

Key business and financial statement risks

5.320 In order to manage its key business risks, DFAT addresses issues relating to:

- maintaining a secure and effective overseas network;
- the delivery and implementation of timely and effective policy advice in line with the Government's and Ministers' priorities;
- meeting client expectations and demands for consular and passport services, including the requirement to have continued security over passport operations;
- efficient management of the Commonwealth Overseas Owned Estate;
- maintaining effective relations with other countries and the ability to influence global and regional developments to protect Australia's interests;

- effective promotion of trade and investment through bilateral and multilateral activities, including the provision of assistance to businesses and the removal of barriers to trade; and
- managing workforce and budget planning challenges to ensure the ongoing delivery of services.

5.321 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.

5.322 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. Key issues for the current year include the:

- sensitivity and complexity of the National Interest Account;
- management of specific reporting requirements for appropriations;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.323 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 support financial assurance include:

- an Executive Committee which oversees the operational performance of divisions, reviews departmental wide issues and monitors financial performance;
- a 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 process which provides actual versus budgeted expenses and revenues;

- an internal assurance section (the section is currently reviewing its audit approach and coverage);
- a fraud control plan; and
- a risk management register.

Financial reporting

5.324 DFAT has a sound financial reporting framework in place that incorporates key financial and non-financial measures to monitor performance and financial management. Monthly reports are produced to identify and explain variances between budgeted and actual performance.

Audit results

5.325 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	0	0	0	0	0	0
Total	0	0	0	0	0	0

Conclusion

5.326 Based on audit work performed to date, internal controls are operating satisfactorily.

Health and Ageing Portfolio

Department of Health and Ageing

Business operations

5.327 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.

5.328 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.

5.329 DoHA's vision and mission are to be delivered through outcomes including research, regulation, policy development, programme management and partnerships with consumers and stakeholders.

5.330 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 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.

5.331 The 2004–2005 year has seen a number of key changes to the business and operational environment of DoHA including;

- the transfer of CRS Australia from DoHA to the Department of Human Services, as announced in the AAO of 26 October 2004;
- the impact of the significant changes to Medicare during 2003–2004; and
- the impact of the Government’s response to the Hogan review of pricing arrangements in residential aged care.

5.332 The Therapeutic Goods Administration group of regulators comprising Therapeutic Goods Administration, National Industrial Chemicals Notification and Assessment Scheme, and the Office of the Gene Technology Regulator form key parts of DoHA and its consolidated financial statements.

5.333 DoHA’s funding for the year ending 30 June 2005 includes estimated price of outputs of \$516.65 million and estimated administered expenses of \$36.21 billion. Estimated administered revenue for 2004–2005 is \$277.84 million. DoHA’s average estimated staffing level for 2004–2005 is 3 877.

Key business and financial statement risks

5.334 In order to manage its key business risks, DoHA addresses 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 programmes relating to delivery of a wide range of services; and
- public perception of DoHA.

5.335 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate to high. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- reporting the Government's liabilities under the medical indemnity initiative;
- complex calculations of payments made to State and Territory Governments, service providers and programme recipients;
- resolution and timeliness of year end accruals emanating from HIC;
- compliance with all relevant legislation and agreements by DoHA and recipients;
- integrity of information transferred from feeder systems into the FMIS.
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.336 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 support 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 process;
- 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;
- an entity wide Risk Management Plan was presented to the Risk and Security Steering Committee in April 2005. Further work will be required before being presented to the Executive for consideration. Implementation of the Risk Management Plan is expected early in 2005–2006; and
- in line with the Government's Fraud Control Policy, a rolling programme of fraud risk assessments is undertaken across DoHA.

Financial reporting

5.337 DoHA produces full accrual monthly management financial reports within six working days of the end of each month. DoHA reports comprehensively on its operations, including:

- administered and departmental revenues, expenses, assets, liabilities, cash flows;
- net cost of outputs by Divisions and State & Territory Offices (departmental); and
- outcomes report by programmes (administered).

5.338 These are distributed to the Executive, Division Heads and State and Territory Managers on a monthly basis. Included with these reports is commentary on DoHA's financial position with detailed variance analysis.

5.339 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

5.340 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New issues to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0	0
B	2	0	1	3	2	0	1
Total	2	0	1	3	2	0	1

5.341 The 2004–2005 audit highlighted the following issue that should be addressed to support the adequacy of the control environment.

Moderate Risk Matters - Category B

Business Continuity Planning

5.342 As was noted by the ANAO in the prior years, DoHA does not have a formally established department-wide business continuity plan. However, considerable work has been undertaken to address the issue. Whilst there is a Disaster Recovery Plan (DRP) for the mainframe, except for the file and print servers, 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 for the handling of disaster situations following the finalisation of the business continuity plan.

Conclusion

5.343 DoHA has responded positively to the ANAO's finding and the associated recommendation. The ANAO also acknowledges the actions that DoHA has undertaken on business continuity planning across the department.

Immigration and Multicultural and Indigenous Affairs Portfolio

Department of Immigration and Multicultural and Indigenous Affairs

Business operations

5.344 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, settling migrants and refugees, promoting the benefits of citizenship and cultural diversity, and working with other portfolio agencies and government departments to advance the social, economic and cultural interests and status of Indigenous people.

5.345 DIMIA's funding for the year ending 30 June 2005 includes estimated price of outputs of \$1.02 billion and estimated administered expenses of \$1.16 billion. Estimated administered revenue for 2004–2005 is \$1 billion. DIMIA's average estimated staffing level is 5 692.

Key business and financial statement risks

5.346 In order to manage its key business risks, DIMIA addresses issues relating to:

- sufficient 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;
- 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
- the management of Indigenous service delivery functions.

5.347 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as high. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- significant issues identified in the internal controls of the FMIS;
- integration of functions transferred from ATSIC and ATSIIS;
- management of specific reporting requirements imposed on the funding of appropriations;
- continued implementation of the Global Workings Initiative;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.348 Generally, corporate governance 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 relating to financial systems, accounting processes, audit planning and reporting. The committee regularly reviews performance and monitors achievements against internal audit plans;
- preparation of monthly financial reports for review and analysis by branches and the Executive;
- a fraud control plan;
- 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.

Audit results

5.349 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	1	1
B	12	0	12	11	3	4
Total	12	0	12	11	4	5

5.350 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Significant Risk Matters - Category A

Management of the Financial Management Information System

5.351 A review of the robustness of the controls within DIMIA's FMIS, highlighted significant weaknesses in the management of the FMIS and associated key accounting processes. A divergence occurred between DIMIA's business practice requirements and how the FMIS was configured.⁵⁴ In part this divergence was due to a lack of clear internal protocols giving the Chief Financial Officer visibility and control over the FMIS's configuration. The major weaknesses identified in the preventative controls within the FMIS have been compounded by significant issues relating to access management, specifically segregation of duties and the high number of users with access to sensitive transactions.

5.352 Strong convergence between DIMIA's business practices and the internal controls configured in the FMIS is essential to mitigate financial risks. The number and significance of the issues related to controls in the FMIS and

⁵⁴ Configurable controls are system based 'switches' that can be set by turning them on or off to secure the application against inappropriate processing, based on the organisation's business rules.

access management poses a considerable increase in the risk to the integrity of financial information. Lack of appropriate segregation of duties and high levels of access to sensitive transactions increases the risk that unauthorised, inaccurate and/or fraudulent transactions may be entered, approved and processed by the same user. In the absence of regular reviews these transactions may be going undetected.

Moderate Risk Matters - Category B

User Access

5.353 As was noted by the ANAO in the prior year, delays were observed in the removal of local area network access for employees who have left DIMIA. This year the ANAO has made a similar observation regarding the management of access to DIMIA's onshore visa processing application. In addition, the ANAO noted a lack of documentary evidence that processes to ensure access to this application was appropriately granted had been followed. Inadequate access management increases the risk of unauthorised access, fraud, data manipulation and data integrity issues.

Change Management

5.354 The ANAO noted that, during 2004–2005, the IT change management and documentation process, related to the onshore visa processing application, had not been undertaken in accordance with established processes. Failure to approve and appropriately document changes to this application increases the risk that unapproved and untested changes are being implemented into the production environment.

Payroll Processes

5.355 The review of payroll processing within the Office of Indigenous Co-Ordination identified deficiencies in the operating controls in relation to the processing of the payroll, maintenance of adequate documentation and review of the cost allocations. This increases the risk of errors and fraud in employee expenses.

Conclusion

5.356 DIMIA has responded positively to the ANAO's issues and associated recommendations. DIMIA is placing an appropriate level of priority on addressing the issues identified by the ANAO.

Industry, Tourism and Resources Portfolio

Department of Industry, Tourism and Resources

Business operations

5.357 The Department of Industry, Tourism and Resources (DITR) develops and implements a range of industry policies and business assistance programmes that build on the Australian Government's three key drivers of economic growth - innovation, investment and international competitiveness.

5.358 These policies and programmes are designed to increase the international competitiveness of Australian manufacturing, resources and service industries, develop Australia's innovation and technology capabilities and infrastructure, and facilitate an increased level of foreign investment in Australia.

5.359 DITR works in close partnership with industry, and with a range of other stakeholders, to achieve these goals. Most of DITR's business and assistance programmes are delivered through AusIndustry, the programme delivery arm of DITR.

5.360 DITR pursues the vision of prosperity for all Australians through internationally competitive and sustainable business. In addition, to provide and implement quality industry policies and effective programme assistance and business services.

5.361 DITR's mission is:

- to enhance the development of internationally competitive and sustainable business through excellence in policy formulation and implementation;
- to excel in business programme and service delivery; and
- to be a respectful source of knowledge through our understanding of the business environment and business networks.

5.362 The 2004–2005 year has seen a number of key changes to the business and operational environment of DITR including;

- The establishment of Tourism Australia (TA) subsuming the functions of the Australia Tourist Commission, the Bureau of Tourism Research, the Tourism Forecasting Council and See Australia. TA is to be established as a statutory authority under the CAC Act;

- the formation of the National Measurement Institute (NMI) by amalgamating the National Measurement Laboratory, the National Standards Commission and the Australian Government Analytical Laboratories (AGAL); the three government agencies that provide measurement services for government and industry; and
- the commencement of the National Offshore Petroleum Safety Authority (NOPSA) operations from Perth, Western Australia. NOPSA is a statutory body and will operate pursuant to the *Petroleum (Submerged Lands) Act 1967*.

5.363 DITR's appropriation funding for the year ending 30 June 2005 includes estimated price of outputs of \$310.32 million and estimated administered expenses of \$1.79 billion. Estimated administered revenue for 2004–2005 is \$1.49 billion. DITR's average estimated staffing level for 2004–2005 is 1 750.

Key business and financial statement risks

5.364 In order to manage its key business risks, DITR addresses issues relating to:

- the complexity of operations with the delivery of programmes;
- the timely implementation of system changes required to cater for policy/legislative changes;
- the retention and attraction of staff; and
- the increased level of financial management responsibilities and accountability.

5.365 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- administration of grants programmes;
- appropriation funding;
- completeness of information provided by the divisions;
- financial statement preparation process including appropriate recognition and reporting of accounts;
- closure of the AGAL special account and the creation of NMI as a division;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and

- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.366 The ANAO's audit approach considers DITR's goals, priorities, objectives and strategies, along with the critical success factors DITR 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 support financial assurance include:

- an Executive Board that meets weekly to consider strategic organisational issues, and to review quarterly performance reports and 'traffic light' reports. Traffic light reports graphically show key risks and priorities;
- monthly monitoring by portfolio managers of both financial and non-financial measures of performance down to divisional level. The monthly financial reporting process provides actuals versus budget expenditure and revenue;
- an Audit Committee comprising senior executives, and independent advisors, which meets quarterly and oversees a comprehensive programme of internal audit, and fraud control plans and policies;
- a financial statement sub-committee that meets at least monthly during the period of the preparation of the financial statements and focuses on monitoring the financial statement process and DITR's interaction with the ANAO;
- a comprehensive business risk assessment framework as part of the Corporate Plan 2003–2005, including risk management plans for each Division which are reviewed and updated regularly;
- a fraud control plan and a self-assessment of fraud risk, which are undertaken every two years. The latest fraud risk self-assessment was conducted in September 2004; and
- a legislative compliance review was conducted in late 2004.

Financial reporting

5.367 DITR prepares full accrual monthly financial management reports for the Portfolio Managers' Meetings (PMM) within 6–10 days of the month end. The PMM is comprised of the Executive and Division Heads.

5.368 The reports provide information at the divisional and output levels about financial performance. The reports are also designed to monitor actual spending against budgeted spending. The following reports are presented at the PMM:

- administered and departmental revenues, expenses, assets, liabilities, cash flows;
- cash at bank report (reconciled to general ledger);
- special accounts and special appropriations;
- net cost of services by divisions (including full year budget figures, forecasted figures and commitments);
- summary of capital project progress (greater than \$100 000); and
- contingent liabilities report.

5.369 Continuous improvement initiatives implemented by DITR have resulted in a comprehensive monthly reporting process. Improved data collection practices coupled with improvements stemming 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

5.370 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	0	0	0	0	2	2
Total	0	0	0	0	2	2

5.371 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Bank Reconciliations

5.372 Bank reconciliations had not been performed during the period of audit examination, for a bank account used solely for receipts. The absence of bank reconciliations may result in errors in financial reporting, inaccurate financial information being utilised for management decisions and delays in finalising year end financial reports.

Goods and Services Tax (GST) Administration

5.373 The monthly Business Activity Statement (BAS) was not evidenced as approved by the delegate, prior to lodgement, in accordance with DITR's procedural rules, for the period July to December 2004. In addition, the reconciliation of the BAS to the general ledger for August to December 2004 included an unresolved variance of \$219 000. These issues need to be resolved for accurate financial reporting.

Conclusion

5.374 DITR has responded positively to the ANAO's findings and associated recommendations and has indicated that appropriate corrective action will be taken.

Prime Minister and Cabinet Portfolio

Department of the Prime Minister and Cabinet

Business operations

5.375 The Department of the Prime Minister and Cabinet (PM&C) is responsible for providing:

- policy advice on economic, industry, infrastructure and environment issues; and effective servicing of the Council of Australian Governments (COAG);
- policy advice on social issues;
- policy advice on international, defence, intelligence and security issues; and
- provision of a range of support services for government operations including; coordination of Cabinet and Executive Council business; policy advice on parliamentary, machinery of government and legal and cultural issues; policy advice on coordination and promotion of national awards and symbols; coordination of government communications and advertising; administration of the Prime Minister's official residences; support services to ministerial offices within the portfolio; and administration of the visits and hospitality programme.

5.376 PM&C's business activities and operational environment are predominately consistent with prior years. The only significant changes are:

- the Office of the Status of Women (OSW), except for a unit that is responsible for women's policy, transferring to the Department of Family and Community Services (FaCS) from 26 October 2004; and
- the creation of a new division to manage the hosting of Asia Pacific Economic Cooperation (APEC) in 2007.

5.377 PM&C's appropriation funding for the year ending 30 June 2005 includes estimated price of outputs of \$61.77 million and estimated administered expense of \$25.24 million. PM&C's average estimated staffing level is 375.

Key business and financial statement risks

5.378 In order to manage its key business risks, PM&C addresses issues relating to:

- the delivery of timely and effective policy advice and services in line with the Government's and the Prime Minister's priorities;
- 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.

5.379 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. Key issues for the current year include:

- restructuring – transfer of OSW to FaCS;
- administration and management of appropriations and special accounts;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.380 PM&C has an extensive corporate governance framework in place. Measures which support financial statement assurance include:

- an Executive Committee which oversees the operational performance of the various divisions, reviews department-wide issues and monitors financial performance;
- an 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;
- an 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 process against budget, providing analysis of variations; and
- a fraud control plan.

Financial reporting

5.381 PM&C has a stable and efficient transactional financial reporting system. PM&C reports against budget for the various programmes and activities, in both summary and detail form, and provides variance analysis.

Audit results

5.382 The following table provides a summary of the status of prior year issues as well as 2004–2005 audit issues raised to date by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	1	0	1	1	0	0
Total	1	0	1	1	0	0

Conclusion

5.383 Based on audit work performed to date, internal controls are operating satisfactorily.

Transport and Regional Services Portfolio

Department of Transport and Regional Services

Business operations

5.384 The Department of Transport and Regional Services (DoTARS) is responsible for supporting the Government in achieving a better transport system for Australia and the greater recognition and opportunities for local, regional and territory communities. DoTARS provides a range of transport and regional services to achieve this. DoTARS conducts research, analysis and safety investigations, provides safety information and advice based on those investigations and performs a range of regulatory functions. DoTARS is also responsible for the provision of services to Australia's external territories.

5.385 DoTARS's funding for 2004–2005 includes estimated price of outputs of \$202.13 million, and estimated administered expenses of \$3.93 billion. Estimated administered revenue for 2004–2005 is \$250.33 million. The DoTARS average estimated staffing level for 2004–2005 is 1 164.

Key business and financial statement risks

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

5.387 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. The financial statement audit is focused on the material financial reporting risks flowing from the following potential issues:

- reclassification of Indian Ocean Territories assets from Departmental to Administered;
- recognition and valuation of the Asbestos Claims Liability;
- recognition and valuation of land at airports;
- classification of the new IT Service Agreement as either an operating or finance lease;
- grant processing and management;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and

- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.388 The ANAO's audit approach considers the DoTARS goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the DoTARS 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 support financial assurance include:

- an Executive Board that meets weekly and has a formal bi-annual 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 process;
- an internal audit function which has a planned risk based audit coverage of DoTARS' activities; and
- a fraud control plan that is regularly monitored/reviewed.

Financial reporting

5.389 DoTARS has developed financial reporting processes that include monthly reports on administered and departmental revenues, expenses, assets, 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 DoTARS' strategic objectives, and the production of accrual based financial information and reports.

Audit results

5.390 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	1	0	1	0	0	1
Total	1	0	1	0	0	1

5.391 The 2004–2005 audit highlighted the following issue that should be addressed to support the adequacy of the control environment.

Moderate Risk Matters - Category B

Business continuity and disaster recovery planning

5.392 Business Continuity Planning (BCP) was raised in 2002–2003 and 2003–2004 as an audit issue. The ANAO noted that DoTARS has applied considerable effort in developing its business continuity plan over the last year. However, a review of the current BCP identified a number of deficiencies in the proposed plan. An appropriate timetable should be developed for the finalisation of the BCP and testing of the plan, particularly in relation to the FMIS and HRMIS.

Conclusion

5.393 DoTARS has responded positively to the ANAO's finding and the associated recommendation.

Treasury Portfolio

The Treasury

Business operations

5.394 The 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 the implementation of government decisions.

5.395 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.

5.396 The Royal Australian Mint (RAM) and the Australian Government Actuary form parts of the Treasury and its consolidated financial statements.

5.397 There has been one change to the business operations of the Treasury as a result of Administrative Arrangement Orders in 2004–2005. Responsibility for the administration of product safety and related consumer information functions was transferred to the Australian Competition and Consumer Commission.

5.398 The Treasury's funding for the year ending 30 June 2005 includes estimated price of outputs of \$176.0 million and estimated administered expenses of \$984.49 million. Estimated administered revenue for 2004–2005 is \$1.72 billion. The Treasury's average estimated staffing level for 2004–2005 is 878.

Key business and financial statement risks

5.399 In order to manage its key business risks, Treasury addresses issues relating to:

- HIH Insurance Claims Support Program;
- Reserve Bank of Australia (RBA) contingent liability, RAM guarantee and other guarantees;
- grant payments to States and Territories–GST;

- IMF and other international financial investments; and
- loss of corporate knowledge and skills.

5.400 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as moderate. Potential issues consist of:

- internal controls and processes;
- impact of fluctuations in foreign exchange rates on the value of assets and liabilities.
- timing of information from consolidated entities and complexity of the consolidation process;
- integrity of data preparation;
- compliance with financial and other regulatory requirements;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.401 The ANAO's audit approach considers Treasury's goals, priorities, objectives and strategies, along with the critical success factors management 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 support financial assurance include:

- an Executive Board that meets twice a month and is responsible for high level policy issues relating to Treasury's strategic leadership and management;
- a 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 Treasury;
- a monthly financial reporting process which provides actuals versus budget expenditure and revenue;
- an internal assurance function that has a planned risk based coverage of the Treasury's activities; and

- in line with the Government's Fraud Control Policy, a periodic fraud risk assessment undertaken by the Treasury with the most recent assessment presented at the December 2004 Audit Committee meeting.

Financial reporting

5.402 The Treasury has comprehensive and detailed monthly reporting processes. These processes include a preliminary report being produced and distributed by the fifth day after month end. The preliminary report includes a high level comparison of actual to budget for revenues and expenses. 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's departmental results against the year to date budget, and a quality assurance report.

Audit results

5.403 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding March 2004	Issues resolved prior to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	0	0	0	0	0	0
B	1	1	0	0	2	2
Total	1	1	0	0	2	2

5.404 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Moderate Risk Matters - Category B

Change Management Procedures for Updating Standing Data

5.405 Within the HRMIS, users with System Administrator access can modify standing data on the system, for example pay rates. It was noted by the ANAO that, when a request has been given to make changes to the standing data, no documentation is kept regarding who authorised the change and what has been changed. The changes to standing data are recorded on an audit log. However, these logs are not reviewed regularly. The System Administrator can

potentially make erroneous changes to the standing data within the HRMIS system and there are inadequate processes to detect these errors.

Duplicate employee records within the HRMIS

5.406 A number of duplicate employees were recorded on the HRMIS system. There is the potential that these employees could be incorrectly paid twice for a given pay period.

Conclusion

5.407 The Treasury has responded positively to the ANAO's issues and associated recommendations. The Treasury has advised the ANAO that it has already taken action to address the issues identified.

Australian Taxation Office

Business operations

5.408 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.

5.409 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. A new group of activities and a corporate change programme have been introduced to address the initiative to improve client interaction with the tax system.

5.410 The ATO's funding for the year ending 30 June 2005 includes estimated price of outputs of \$2.43 billion, and estimated administered expenses of \$12.29 billion. The estimated administered revenue for 2004–2005 is \$229.31 billion. The ATO's average estimated staffing level for 2004–2005 is 20 682.

Key business and financial statement risks

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

- tax administration covering tax reform and corresponding legislative changes, for an 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
- maintaining community confidence.

5.412 The ANAO has assessed the risk of material misstatement in the 2004–2005 financial statements as high. Potential issues include:

- the resolution of a number of major issues that gave rise to a number of qualifications on the 2003–2004 financial statements;
- ATO administered financial statement preparation process which is complex, uses data from a number of business systems and requires significant estimation to be made for a number of items;
- the requirement to have fully supported reconciliations associated with the ATO business systems and financial management information system;
- compliance with legislative requirements, both in tax administration and financial statements preparation and presentation;
- harmonisation with International Financial Reporting Standards and the associated additional disclosures required for 2004–2005; and
- the financial statement close process in light of the tight reporting deadlines for completion of the financial statements.

Corporate governance

5.413 The ANAO's audit approach considers the ATO's goals, priorities, objectives and strategies, along with the critical success factors ATO 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 implements strategies through a comprehensive planning process based on the ATO's corporate priorities;
- an Executive Board that meets at least monthly and has a formal bi-annual 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 process;
- an internal assurance branch that has a planned risk based coverage of the ATO's activities; and
- fraud control plans and risk assessment plans.

Financial reporting

5.414 The ATO management reporting process includes internal financial reports prepared for distribution and discussion at monthly executive meetings. These reports include an overall analysis of expenditure, operating performance of business lines, cash and capital positions, budget changes, and workforce information.

5.415 For the administered items, 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

5.416 The following table provides a summary of the status of prior year issues as well as the 2004–2005 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Issues outstanding 31 March 2004	Issues resolved prior to August 2004	New issues to August 2004	Issues outstanding as at August 2004	Issues resolved prior to March 2005	New issues to March 2005	Closing position as at March 2005
A	1	0	9	10	3	0	7
B	9	5	3	7	0	5	12
Total	10	5	12	17	3	5	19

5.417 The 2003–2004 ANAO audit found significant deficiencies in the financial statements close process. The Audit Report was qualified on uncertainties relating to amounts disclosed as superannuation surcharge, superannuation guarantee charge and components of general interest charge.

5.418 The 2004–2005 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reflected in the financial statements.

Significant Risk Matters - Category A

Administered Financial Statement Preparation

5.419 An effective process for the preparation of the financial statements is critical to the ability of the ATO to meet its accountability obligations, as well as to meet reporting deadlines set by the Department of Finance and Administration. The level of adjustments made in prior years to the draft administered financial statements highlighted the need for an improved understanding by the preparers of the financial statements of the ATO business, its systems, reports, transactions and allocation methods used to prepare the financial statements.

5.420 The ATO has now recruited additional qualified and experienced staff in the Administered Accounting Team for the preparation of the financial statements. Significant progress has been made in the process for derivation of the financial statements using the ATO's FMIS and business system reports. The financial statement procedure and corresponding quality assurance process were being drafted at the time of the audit.

5.421 The ATO has advised that there continues to be a variance between the reported cash FMIS balance and business systems which impacts on the financial statements. This variance is being analysed. Timely resolution of these issues, and the provision of adequate supporting evidence, including quality assurance of the balances are essential for the effective completion of the 2004–2005 financial statements.

Provision for Doubtful Debt and Credit Amendments

5.422 In prior years, ANAO has reported that the calculation of the provision for doubtful debts and credit amendments under \$1 million required more rigour including improved supporting evidence and documentation. The estimation process initiated in 2003–2004 has now progressed, with the Australian Government Actuary approving the sampling and scorecard methodology for non-scheme debts. The sampling results and the extrapolation of those results over the debt population had not been assessed by the ATO at the time of the audit.

5.423 With regard to debts over \$1 million, a complete reconciliation of debts included in the provision calculation with debts in the business systems is yet to be performed in order to ensure the provision is calculated for the total debt population.

General Interest Charge

5.424 General Interest Charge (GIC) provides a common single rate of interest for all tax types where a correct payment is not received by the due date. One of the income tax business systems was unable to calculate the

general interest charge relating to the annual income tax payments from companies and superannuation funds. The GIC was not calculated unless manual intervention was made by the ATO on these accounts. As a result, the ATO had to estimate the balance of this debt as at 30 June 2004 and the revenue foregone commencing from the date of the introduction of this charge in 1999–2000.

5.425 The ATO's financial statement was qualified in 2003–2004 as the GIC estimate was not supported by appropriate documentation and the ANAO was unable to form an opinion on the reasonableness of the GIC balance. At the time of the audit, the ATO was in the process of establishing a methodology to calculate accrued but un-posted GIC at 30 June 2005 and to correct issues within the business systems that prevent the posting of accrued GIC to taxpayer's accounts.

Superannuation Surcharge Exceptions

5.426 The audit opinion on the ATO financial statements was qualified in 2003–2004 due to uncertainties over the estimated balance for superannuation surcharge exceptions. The ATO had a significant backlog of exceptions that required action through manual or electronic intervention. This backlog of exceptions was built up over the last 8 years with the total number of exceptions reaching 10.4 million as at 30 June 2004. A significant amount of surcharge revenue will not be collected until the exceptions are cleared through the surcharge assessment process. It is acknowledged that action is in progress to clear the backlogs. The ATO has sought and received legal advice on whether it can in certain circumstances decide not to issue superannuation surcharge assessments. The correct application of this advice is being reviewed by the ANAO, as this impacts on the amount of revenue to be collected. In addition, adequate evidence supporting the estimation process for deriving the value of exceptions not cleared at 30 June 2005 had not been provided to the ANAO for review, at the time of the audit.

Monitoring of Unfunded Defined Benefit Superannuation Funds

5.427 The ATO issues superannuation surcharge assessments to all members of Unfunded Defined Benefit (UDB) superannuation funds. For those assessments that are deferred, the superannuation funds are required to maintain a surcharge debt account for each member, collect the surcharge, and remit collections to the ATO. One of the reasons for qualification of the 2003–2004 ATO financial statements was due to the fact that the portion of the receivables balance relating to the superannuation surcharge - UDB could not be confirmed. As was the case in 2002–2003, a comparison of the UDB receivable as per the ATO records with the information received from the UDB superannuation funds identified a number of variances. The ATO advised the ANAO that the UDB superannuation funds' compliance with legislation had

been noted as a concern and action would be taken to establish processes to ensure that these debts were managed appropriately. The integrity of the ATO records of the UDB receivable balance is dependant upon the result of the compliance review process initiated by the ATO. A number of compliance reviews have been completed or are underway and are due for completion by 30 June 2005. These reviews should provide assurance over this receivable balance in the financial statements.

Superannuation Guarantee Charge

5.428 As a result of major errors in the new superannuation guarantee system introduced in November 2003, the ATO was unable to issue superannuation guarantee assessments since February 2004 or make superannuation guarantee payments to employees' superannuation funds since November 2003. The ATO developed a methodology to estimate the revenue and payments for 2003–2004 financial statements that would have been raised if there had not been any system problems. Uncertainty relating to the completeness and accuracy of data used in calculating the revenue and payment estimates, resulted in the qualification of the audit opinion on the 2003–2004 financial statements.

5.429 The ATO has advised that the superannuation guarantee system is now appropriately processing current transactions. The ANAO is in the process of reviewing this system and related controls. The ATO acknowledges that there may still be some backlogs in processing superannuation guarantee assessments. The ATO is in the process of developing methodologies for quantification of the residual backlog and determination of compensation.

Financial Management and Reporting of Special Appropriations

5.430 The FMOs require disclosure of cash payments made against each individual special appropriation. In 2003–2004, the ANAO identified that there was a need for improvement in the financial management and reporting of special appropriations. The ATO is required to maintain accounting records to monitor and report throughout the year the level of expenditure made against each special appropriation for which it has administrative responsibility. The ATO agreed to establish appropriations ledgers during the 2004–2005 financial year, appropriate to the operation of the tax system. The ATO is in the process of providing evidence of progress on this issue.

Moderate Risk Matters - Category B

5.431 In addition to the above issues, five Category B findings were identified during the 2004–2005 interim audit phase and seven matters were carried over from 2003–2004. These matters and related corrective actions are as follows.

- Administered Cash Reconciliation—In previous years the ANAO raised major audit findings in relation to the reconciliations of the administered cash in SAP and the business systems. Significant improvements have been noted in the reconciliation process. Further improvements are still required in relation to superannuation and Fringe Benefit Tax consolidated reconciliations.
- Unauthorised Withdrawal of Funds—Unauthorised withdrawal of funds from the ATO's Administered Cash Overseas Receipting Account by the Department of Foreign Affairs and Trade over a period of several months indicates that controls and procedures need to be strengthened over third party access to all ATO's bank accounts.
- Management of Special Accounts—The ATO is continuing to clear significant balances carried forward from prior years and reconcile subsidiary records.
- Certificate of Compliance for Payment of Public Money—The ATO is implementing a 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 certificate of compliance process is being reassessed as part of the management review of the corporate governance and assurance framework. The risks and controls associated with activities involving Excise, Superannuation business systems, HECS, Legacy systems and third party refunds are yet to be documented by the ATO.
- Service Level Agreements—Establishing or updating agreements for the provision and receipt of services between the ATO and other Australian Government entities is in progress. In the absence of current agreements there is an increased risk that service levels may be compromised.
- Costing of Internally Developed Software—The ATO does not have a formalised mandatory process for time recording and approval of timesheets for all ATO staff deployed on developing IT projects. This creates the potential for incorrect values for internally developed software assets.
- Access to HRMIS—The ATO has not reviewed user access to payroll and recruitment functions to ensure segregation of duties is appropriately implemented.
- Firecall security—The Firecall facility is a powerful software tool designed to make changes to production data when emergency fixes are needed during processing of transactions. The ATO is using the

Firecall facility to rectify issues that are recurring in nature. The use of the Firecall facility in this manner is not in accordance with generally accepted practice or with the ATO's policies and increases the risk of inappropriate changes being made to data that may not be detected.


- **Business Continuity Plan**—It is acknowledged that the ATO has prepared business continuity plans (BCP) for many areas, however the ATO needs to prepare and finalise BCPs for all critical business processes, information technology systems and sites. In the absence of finalised plans there is an increased risk that the ATO does not have appropriate strategies to manage risks associated with events leading to an interruption in the ATO's business.
- **Findings to be Reviewed**—Issues associated with IT change management and documentation processes will be reviewed in June 2005. In addition, there are also two Category B findings from the audit of the 2003–2004 financial statements relating to GST revenue and FBT that will be reviewed as part of validating the ATO's processes for compiling the 2004–2005 financial statements.

Conclusion

5.432 The ATO has committed a significant amount of resources to rectify the matters identified. In order to address related system deficiencies, backlogs and the audit findings, the ATO has designed a programme of work and set timetables with key deliverables and milestones. A committee, comprising members of the Senior Executive has been established to oversight corrective action.

5.433 The ATO will need to ensure the successful outcome of this programme of work as it directly impacts on the ATO's ability to produce reliable financial information and to clear the issues giving rise to the ANAO's qualification of the 2003–2004 financial statements.

Canberra ACT
24 June 2005



Ian McPhee
Auditor-General

Appendices

Appendix 1: Information Technology Systems Control Ratings

Level	Rating	Detailed Description
0	<i>Non-existent</i>	There is a complete lack of any recognisable process.
1	<i>Ad-hoc</i>	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.
2	<i>Marginal</i>	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.
3	<i>Established</i>	Systems and procedures have been standardised, documented, endorsed, 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.
4	<i>Mature</i>	There is full understanding of issues at all levels. Responsibilities are clear and process ownership is established. A complete set of policies, procedures and standards has been developed, endorsed, maintained and communicated and is a composite of internal best practices.
5	<i>Best Practice</i>	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 improvement and maturity modelling with other organisations.

Appendix 2: Information Security Management Indicators

3 - Established	<p>Entity has developed a security statement that is supported by a security policy.</p> <p>Responsibilities for IT security are assigned.</p> <p>An IT security plan exists, driving risk analysis and security solutions.</p> <p>Security awareness exists and is promoted by management.</p> <p>Security awareness briefings have been standardised and formalised.</p> <p>IT security reporting is internal to IT section.</p> <p>Logical access restrictions are applied, with only approved personnel granted access.</p> <p>Physical access restrictions are applied, with only approved personnel being allowed access to the computing facilities.</p> <p>Physical profile is appropriate for computer centres.</p> <p>Visitors are logged and sometimes escorted, depending upon the responsible individual.</p>
4 - Mature	<p>IT security processes are co-ordinated with the organisation's overall security function.</p> <p>Security policies and practices are completed with specific security baselines.</p> <p>Responsibilities for IT security are clearly assigned, managed and enforced.</p> <p>IT security risk and impact analysis is consistently performed.</p> <p>Security awareness briefings have become mandatory.</p> <p>All employees receive the appropriate level of system security practices training in protecting against harm from failures affecting availability, confidentiality and integrity.</p> <p>IT security reporting supports business objectives and is distributed to key business owners.</p> <p>Intrusion testing is a standard and formalised process leading to improvements.</p> <p>User identification, authentication and authorisation are standardised.</p> <p>Security certification of staff is established.</p> <p>Access is strictly controlled with environmental and physical security requirements being monitored.</p> <p>Standardised control mechanisms are in place and documented for restricting physical access to facilities.</p>

5 - Best Practice	<p>IT security is a joint responsibility of business and IT management and is integrated with corporate security business objectives.</p> <p>Security functions are integrated with applications at the design stage and end-users are increasingly accountable for managing security.</p> <p>IT security requirements are clearly defined, optimised and included in a verified security plan.</p> <p>Information on new threats and vulnerabilities is systematically collected and analysed, and adequate mitigating controls are promptly communicated and implemented.</p> <p>Periodic security assessments evaluate the effectiveness of implementation of the security plan.</p> <p>There is a positive attitude with respect to system security principles evidenced by entity culture.</p> <p>IT security reporting provides early warning of changing and emerging risk, using automated active monitoring approaches for critical systems.</p> <p>Incidents are promptly addressed with formalised incident response procedures supported by automated tools.</p> <p>Intrusion testing, root cause analysis of security incidents and pro-active identification of risk is the basis for continuous improvements.</p> <p>The environment is monitored and controlled through specialised equipment and equipment rooms become 'unmanned'.</p> <p>Access is strictly controlled on a job-need basis and monitored continuously, and visitors are escorted at all times.</p>
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Appendix 3: Extended Reporting Group—Information Security Management

The ANAO undertook more in-depth reporting of information security management for five larger entities (the extended reporting group), namely, the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and the Health Insurance Commission. Individual summary assessments of information security management practices for this group are provided below.

Australian Taxation Office

The ATO is striving to provide easier more personalised services to the Australian people. This requires the ATO IT environment to evolve and adapt to these changing business needs, which is constantly adding to the complexity and diversity of IT solutions and hence the IT environment. This continually changing IT environment results in constantly changing IT security threats, and hence risks. It is clear that the ATO recognise that effective IT security risk management is a continuous process, which requires awareness and proactive action from all of the ATO's employees and out-sourced service providers.

To manage IT security related risks the ATO has a well-developed security management framework, which clearly identifies key governance roles and responsibilities. The ATO directs its staff that security is an essential part of management and that responsibility cannot be delegated. The responsibility for security flows from the executive through line management such that every manager, employee and contractor has direct security responsibilities.

The ATO executive provides clear support to achieving these IT security objectives and plans, through the funding of dedicated sections that are responsible for specific IT security functions. These sections provide coverage across a range of IT security related activities, which include: development of policy, awareness and training, access control management and monitoring, and assurance and reporting. Supporting these IT sections are formal policies, standards, procedures and guidelines.

Over recent years the ATO has consistently been assessed at an *Established* control rating for its information technology security practices. This reflects the ATO executive's recognition of IT security risks and its acceptance of the need to support measures to reduce such risks to acceptable levels. However, the ever-changing and evolving ATO IT environment results in the ongoing creation of new IT security threats and changes to current IT security risks. The ATO must reassess the IT security risks across its whole IT environment, whether it is managed directly or via a third party, if it is to ensure adequate protection in the future.

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 for security is developed centrally. All security policies detailed within the IT Security Policy have been endorsed by the CE and reflect management commitment to that policy. A Security and Privacy Committee has been established to advise the CE 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 throughout various IT teams.

Line managers and product 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 programme 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 system, network, database and applications. Monitoring procedures over mainframe security and special access privileges (e.g. super user access) require improvement to ensure access to sensitive transactions and 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.

Remote dial-up access is available and restricts access to authorised users through certified hardware and dial-up software. There are dedicated communication links between Centrelink and other external entities. These communication links use encryption technology. Centrelink's network is protected from intruders through various perimeter controls (e.g. firewalls) that are Defence Signals Directorate (DSD) certified.

Overall, Centrelink has attained an *Established* control rating for its information security practices. Due to the ANAO requirement to meet all indicators for a level, Centrelink has not achieved a rating of *Mature* as in 2004 because there is no formal process for intrusion detection. The ANAO understands that Centrelink is in the process of undertaking a risk assessment of mainframe

security and the financial management information application to identify critical risk areas that require formal monitoring to ensure user access is appropriate.

Department of Health and Ageing

DoHA has an Information Technology and Telecommunications (IT&T) Security Policy that sets the framework for the establishment of security controls. This policy is currently under review, with a revised IT security policy being developed to reflect improved compliance with government security requirements. When completed, it is expected the Executive will approve the revised policy.

The development of the revised IT security policy is underpinned by a Security Risk Assessment completed in 2004, and an overarching Security Policy endorsed by the Business Management Committee in March 2004.

DoHA's IT security framework consists of a collection of policies and procedures which address the safeguards against unauthorised use, disclosure, modification, damage or loss of data and/or information. These policies and procedures are supported with a set of DoHA and IBM Global Services procedures that are designed to protect DoHA data at the operational level, which has been outsourced to IBM Global Services.

These policies and procedures cover areas such as the unique identification of users, the restriction of functions on a 'needs to know basis', the monitoring of user activity and restricting access to information in accordance with its importance. DoHA has identified that a significant number of these policies and procedures are to be reviewed and a project is currently underway to update and revise them. As part of this process DoHA is defining and negotiating security related reporting requirements and service levels.

A security awareness strategy has been developed and is in place. State visits have been undertaken to increase security awareness throughout the Department as each state runs its own awareness programmes. Training is provided through induction courses and the security area has developed other security training courses that are provided on an 'as required' basis.

To obtain access to DoHA's mainframe, midrange or network 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 the business applications which have their own system access and approval processes and are monitored by the respective application System Managers/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.

Overall, DoHA has attained an *Established* control rating for its information security management practices. Further improvements in IT security can be made with the finalisation of the revised IT security policy, updating of various security policies and procedures, and completion of security related reporting requirements and service levels.

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 currently with DVA's Information Management Unit—Security and Mainframe Support Section.

The policy articulates DVA's 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 the implementation of appropriate mitigation strategies.

DVA's support of ICT infrastructure services is outsourced. However, DVA retains responsibility for security management. This role is managed by the Security and Mainframe Support Section, which administers access to DVA's ICT resources, including access by staff of the service providers. DVA has controls that enable it to detect and analyse security events, so that direct and appropriate action can be taken.

User access to DVA's systems is established and maintained by the IT security administrators on receipt of an approved request from the business and system owners. Users are provided only with the appropriate privileges to perform their job and any request for access is to be authorised by the user's supervisor or manager. Any amendments to user access privileges are logged and reviewed by the administrators and business or system owner. Remote access to DVA's ICT systems is through a Virtual Private Network that is monitored by the IT Security unit.

DVA has achieved a control rating of *Established* for its information security practices. Areas for improvement include standardising and documenting the processes for the creation and administration of user accounts for the network, automatic password reset and inclusion of the IT Security unit in DVA's employee/contractor termination process to ensure access to corporate systems is removed in a timely manner.

Health Insurance Commission

HIC is in the process of completing the implementation of its IT Security Policy framework. HIC's Security Steering Committee endorsed the HIC IT Security Policy in December 2004. The framework considers HIC's risk profile, Managing Director's Instructions and PSM requirements and encompasses all hardware, software, environmental and personnel components of the HIC systems. HIC completed IT security plans, procedures and standards and these documents were endorsed by the HIC executive in April 2005.

Since the previous report (2003–2004), HIC has improved mainframe administration practices, completed the first round of reviews of RACF⁵⁵ controls and significantly reduced the number of mainframe user access classifications. HIC also improved mainframe audit logging requirements and introduced new security reports to improve monitoring of user access. HIC has made good progress towards enhancing its IT Security Event Handling processes and procedures in accordance with the IT Security Policy and the HIC Business Continuity Plans and Procedures.

Overall, HIC has attained a high *Marginal* control rating for its information security management practices. Management endorsement and implementation of the draft Security Plans, Procedures and Standards, and completion of the IT Security Event Handling process will assist HIC in moving towards an *Established* control rating.

⁵⁵ Resource Access Control Facility—a software application to manage access to mainframe computer resources.

Appendix 4: Business Continuity Management Indicators

3 - Established	<p>Management responsibility for business continuity planning and disaster recovery is clearly identified within the entity.</p> <p>Accountability is unambiguous and responsibilities for business continuity and disaster recovery planning and testing are clearly defined and assigned.</p> <p>A business continuity plan (BCP) including a disaster recovery plan (DRP) has been documented for the entire organisation.</p> <p>The BCP/DRP is based on system criticality and business impact assessment.</p> <p>High-availability components and system redundancy are considered in the formulation of the business continuity plan.</p> <p>An inventory of critical systems and components is rigorously maintained.</p> <p>Business continuity incidents are recorded and reported.</p> <p>There is periodic reporting of BCP/DRP testing.</p> <p>Individuals take the initiative for following standards and receiving training.</p>
4 - Mature	<p>Responsibilities and standards for business continuity are enforced.</p> <p>Responsibility for maintaining the business continuity plan including DRP is assigned.</p> <p>The recoverability of computing resources is incorporated into an organisational risk management process.</p> <p>System redundancy practices, including use of high-availability components, are being consistently deployed.</p> <p>Business continuity incidents are classified and the increasing escalation path for each is well known to all involved.</p> <p>Regular and integrated testing occurs and lessons learned are incorporated into plan revisions.</p> <p>Service availability targets are regularly monitored, analysed, reported and acted upon.</p> <p>Staff identified with responsibilities under the BCP/DRP have been fully trained in continuity/disaster situations.</p>
5 - Best Practice	<p>Business continuity plans are integrated, aligned and routinely maintained.</p> <p>Integrated BCP/DRP takes into account benchmarking and best external practices.</p> <p>Management does not allow single points of failure and provides support for their remedy.</p> <p>Buy-in for continuous service needs is secured from vendors and major suppliers.</p> <p>Standards are defined for all facilities, covering site selection, construction, guarding, personnel safety, mechanical and electrical systems, fire, lighting and flooding protection.</p> <p>Escalation practices are understood and thoroughly enforced.</p> <p>Gathering and analysis of data is used to identify opportunities for improvement.</p>

Appendix 5: Extended Reporting Group—Business Continuity Management

The ANAO undertook more in-depth reporting of business continuity management for five larger entities (the extended reporting group), namely, the Australian Taxation Office; Centrelink; Department of Health and Ageing; Department of Veterans' Affairs; and the Health Insurance Commission. Individual summary assessments of business continuity management practices for this group are provided below.

Australian Taxation Office

The ATO has defined a framework for business continuity that is strongly based on the ANAO Better Practice Guide. The framework gives consideration to the size, complexity, devolved nature and nation-wide presence of the organisation. It is endorsed by the ATO Executive and supported by ATO Corporate Management Practice Statements on Business Continuity and Emergency Control. Responsibility for business continuity has been assigned within the ATO Executive and at operational levels.

The ATO has made considerable in terms of raising awareness of business continuity planning, improving co-ordination and escalation procedures, and enhancing centralised business continuity information systems. This centralised business continuity planning system is readily available to all key staff with a business continuity role. Information maintained by the system includes regional and site data, key contacts, escalation chains and procedures, sensitivity assessments, and strategies to be adopted in the event of emergency.

The ATO has developed business continuity plans for many of its key business processes and recognises the importance of testing and reviewing the adequacy of these plans and strategies. Consideration is given to risk management principles in the testing of business continuity plans and strategies, which is undertaken on a rolling basis.

It remains for the ATO to formalise business continuity plans for all of its key business processes and the services that support these processes. The completion of criticality assessments and business continuity plans and strategies for all key business processes, sites and functional areas would contribute to the ATO moving from a *Marginal* to an *Established* control rating for its business continuity practices.

Centrelink

A formal Business Continuity (BC) & Emergency Management (EM) framework has been developed which encompasses business continuity, emergency management, disaster recovery, and crisis management. This framework has been progressively updated in the past year and is anticipated to be fully implemented in April 2005.

The Centrelink BC & EM governance structure consists of three levels, with the Deputy CE having overall responsibility for the sponsorship of the BC & EM process. The National Manager of Service Delivery and Support is responsible for managing and monitoring Centrelink's BC & EM processes. Operational managers (e.g. Area Managers and Customer Service Centre (CSC) managers) are required to determine the need for, and subsequently develop BC & EM plans to support their critical business processes in preparation for a disaster.

The use of a BC & EM template has enabled the development of standardised plans across Centrelink. Business continuity policies and procedures are communicated throughout the organisation via the BC and EM home page on the Centrelink intranet.

The Centrelink BC & EM framework requires plans to be developed for the following functional areas - Customer Service Centres (CSC), National Support Offices (NSOs) and Centrelink Call Centres. The BC & EM team monitor the existence of plans developed by the CSCs and operational testing is performed over these plans. However, it was noted that there are no formal requirements for Centrelink non-client facing functional areas to validate and test BC & EM Plans subsequent to their development.

Disaster Recovery Plans (DRPs) have been developed for the mainframe applications and SAP 'Infolink' system. A disaster recovery testing schedule has been developed to facilitate the periodic testing of DRPs.

The Mainframe Disaster Recovery Plan was updated in the past year by Centrelink in conjunction with IBM and was last tested on 10-11 April 2004. The DRP was updated with lessons learned from the testing performed.

The DRP 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 event has been identified. This plan was last tested in February 2004 and the results of the test are documented. Lessons learned from the test are reflected through the DRP.

Overall, Centrelink has achieved a *Mature* control rating for its business continuity and disaster recovery plans. Improvements could be made by implementing a centralised monitoring process to ensure that all BC & EM plans are tested, reviewed and updated on a periodic basis.

Department of Health and Ageing

DoHA does not have a formally established department-wide business continuity plan. However, significant progress has been made since last year in the development of a BCM framework. This framework consists of a BCM policy, a BCM awareness strategy, Business Continuity Guidelines and a BCP template. The Department is in the process of using the template to assist in the development of BCPs for Central and State Offices. The NSW State Office has, in conjunction with the Technology Group, started to develop the NSW State Office BCP and Central Office has commenced work with a BCP scenario workshop held in March 2005. This will be used as a pilot for other Offices.

DoHA has a formal DRP for the mainframe environment. However, formal DRP have not been developed for critical systems, such as various payment systems and SAP, or for the midrange and network environments. It is understood that this is being addressed with a proposal being forwarded to the Risk and Security Committee for consideration.

Overall, DoHA has attained a relatively low *Marginal* control rating for the business continuity management practices. However, it is expected that this rating will be improved significantly once the BCPs being developed have been finalised and tested.

Department of Veterans' Affairs

DVA's business continuity arrangements consist of a Business Continuity Plan (BCP), regional contingency plans, escalation, and recovery procedures. The National BCP incorporates core requirements including essential services and associated maximum outage periods, underpinning IT systems and infrastructure. The essential services have been identified through a business impact analysis.

Responsibility for the maintenance of the BCP and contingency plans is assigned to the Division Head, Corporate Division. The National BCP Co-ordinator updates the BCP on a regular basis. The BCP is required to be updated annually and was last updated in August 2004.

DVA's BCP incorporates key elements of the ANAO Better Practice Guide to Business Continuity Management and DVA participates in ComCover's Risk Management Benchmarking programme, for which it received the maximum rating in 2004.

Maximum acceptable outages were identified through the business impact analysis (BIA). However, examination of the BCP indicates that under current arrangements, recovery within the maximum acceptable outages may not be achievable for all key systems. The last major BIA process was completed in

August 2003. A number of new processes, confirmed by this BIA were incorporated into the BCP.

The process to inform key staff of their roles and responsibilities includes awareness sessions and provision of business continuity kits to the Business Continuity Team members and their deputies. A testing strategy is in place for the BCP and detailed test plans have been developed. Results of testing are formally recorded, documented and reported back to individual state office and business areas for incorporation into the National and State BCPs.

Manual verification testing, which required key business areas to respond in writing to a disaster scenario was carried out nationally in August 2004. Walk-through testing of the National BCP, also scenario based, was completed on 15 April 2005. Similar testing will be undertaken in the State Offices in May 2005.

DVA is continuing to improve its ICT disaster recovery plan (DRP). However, there is potential, in the event of a major disaster, that infrastructure replacement and recovery may not be achieved in a timely manner to meet the requirements specified in the BCP.

DVA has achieved a control rating of *Established* for business continuity planning and *Marginal* for the disaster recovery process. Improvement opportunities identified within these processes include the completion of the ICT DRP.

Health Insurance Commission

HIC has continued to develop and implement a business continuity management framework in accordance with the ANAO's better practice guide for business continuity.

HIC has made significant progress in the testing and development of State and Divisional business continuity plans in the period since the previous audit. HIC experienced an internal restructure in late 2004. This resulted in the need for several of the existing plans to be revisited. As at 31 March 2005, nine of the 13 State and Divisional business continuity plans were compliant with HIC's defined business continuity framework. In addition, HIC had completed continuity exercises (testing) of six of these plans. HIC expect to endorse the current business continuity management framework and associated documentation prior to July 2005 following the completion of the remaining continuity exercises.

At the time of the audit HIC was completing integrated disaster recovery testing of the HIC network in conjunction with IBM Global Services. This testing included the mainframe, midrange and e-business environment. HIC indicated that such testing was scheduled to be completed in mid-May 2005.

Overall, the HIC attained a high *Marginal* control rating for business continuity management, improving appreciably on the rating from the previous year. With completion of the continuity exercises, updating of the four non-compliant business continuity plans, and completion of disaster recovery testing, HIC will be better positioned to attain an *Established* control rating. HIC should also ensure that the continuity management framework includes a suitable process for the monitoring and recording of all continuity incidents.

HIC has since advised that, subsequent to controls testing, the updates to the BCPs and successful testing of all plans including the DRP have been completed. The ANAO will review this progress during the final phase of the audit.

Appendix 6: SAP Application Controls

1. Access for terminated users is removed upon separation.
2. Authorisation procedures are in place for adding and changing user access.
3. Segregation of duties exists when allocating user access for new users.
4. A review is conducted over any transactions initiated by SAP security administrators.
5. User access is changed when employees change positions.
6. SAP audit trails are reviewed on a regular basis.
7. Responsibility for administration of SAP database is suitably allocated.
8. Changes to SAP security structure are approved and subsequently reviewed.
9. User security violations are reviewed regularly.
10. Passwords for SAP supplied users have been changed (that is Early Watch, SAP* and DDIC)
11. Unused or inactive user access is reviewed.
12. Operation of authorisation objects has not been turned off.
13. No users are allocated to the SAP_NEW profile in the production environment.
14. System parameters have been set up adequately (RSPARAM).
15. Access to SAP security functions is adequately restricted.
16. SAP* access has been restricted.
17. Access to SAP_All has been adequately restricted.
18. Access to incompatible transactions has been restricted.
19. Access to SAP Administration functions has been adequately restricted.
20. Restrict access to development programmes and capabilities.
21. The ability to change configuration items in the production environment is restricted.
22. Access to operating system commands through SAP is restricted.
23. Access to authorisation object S_BTCH_ADM (background jobs) is restricted.
24. Access to database management transactions has been adequately restricted.
25. Standard SAP profiles are not used and ideally removed.

Appendix 7: Significant Findings by Major Entity

‘A’ and ‘B’ ratings by entity at 31 March

Entity	2005 Rating		2004 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry	0	0	0	3
Attorney-General's Department	1	3	0	1
Australian Customs Service	0	6	0	1
Australian Federal Police	0	3	0	4
Department of Communications, Information Technology and the Arts	0	0	0	2
Department of Defence	TBA*	TBA*	27	48
Department of Veterans' Affairs	0	2	0	5
Department of Education, Science and Training	0	0	0	2
Commonwealth Scientific and Industrial Research Organisation	0	0	0	3
Department of Employment and Workplace Relations	0	1	0	2
Department of the Environment and Heritage	0	8	0	4
Department of Family and Community Services	0	12	0	8
Department of Finance and Administration	0	1	0	0
Department of Human Services	TBA*	TBA*	N/A	N/A
Centrelink	0	4	0	5
Health Insurance Commission	0	2	0	21
Department of Foreign Affairs and Trade	0	0	0	0
Department of Health and Ageing	0	1	0	2
Department of Immigration and Multicultural and Indigenous Affairs	1	4	0	12
Department of Industry, Tourism and Resources	0	2	0	0
Department of the Prime Minister and Cabinet	0	0	0	1
Department of Transport and Regional Services	0	1	0	1
The Treasury	0	2	0	1
Australian Taxation Office	7	12	1	9
Total*	9	64	1**	87**

Note: * TBA means to be advised as the audit is still in progress.

** The totals for 2003–2004 excluded Defence as there are no comparative 2004–2005 figures available.

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Health Insurance Commission
Department of Health and Ageing
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