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Performance Audit

A Financial Management Framework to Support Managers in the Department of Health and Ageing

Australian National Audit Office

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Australian National
Audit Office

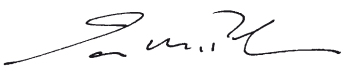
Canberra ACT
11 August 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Health and Ageing in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *A Financial Management Framework to Support Managers in the Department of Health and Ageing.*

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

Yours sincerely



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

ANAO	Australian National Audit Office
AUS	Australian Auditing Standard
CEIs	Chief Executive Instructions
CSA	Control Self Assessment
FMA Act	*Financial Management and Accountability Act 1997*
FMRG	Financial Management Review Group
Health	Department of Health and Ageing
HIC	Health Insurance Commission
IT	Information Technology
NHMRC	National Health and Medical Research Council
TGA	Therapeutic Goods Administration

Glossary

Accountability	The process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities, and roles are clearly defined through a robust organisational structure.
Data Warehouse	A collection of data from various sources gathered and organised so that it can easily be analysed, extracted, combined and otherwise used to further understand the data. Health's project aims to organise its separate information systems and databases to allow its data to be analysed and viewed more effectively. In SAP terminology, a data warehouse is also known as a 'business' warehouse.
Financial Management Information System	In this audit the term 'Financial Management Information System' (FMIS) is used to refer to Health's core accounting and financial management information system.
SAP	A proprietary IT package used by Health as its Financial Management Information System.
Stewardship	Managing efficiently and effectively the resources of others.

Summary and Recommendations

Summary

1. Over the last 20 years, the Australian Government has reformed financial management in the Commonwealth public sector in order to improve performance, stewardship and accountability. Legislation places responsibility for the efficient, effective and ethical use of resources with the Chief Executive Officers (CEOs) of departments and agencies. In order to discharge their responsibilities, they need to ensure that their organisations have a level of financial management that assists their managers to use resources efficiently and effectively. This audit examines the Department of Health and Ageing's (Health's) response to these requirements.

2. Health is the lead agency in the Health and Ageing Portfolio. The 2005–06 Commonwealth Budget provided $39.5 billion[1] for the Portfolio, making it the second largest. The budget for the department was $38.7 billion of administered funds and $457 million of departmental funds.[2]

3. The audit objective was to examine whether Health's financial management framework and processes adequately support Health's Secretary, Executive and managers to make informed decisions on the use of Commonwealth resources. To form the opinion, the ANAO examined whether Health's:

- financial management framework, systems and reports are adequate to assist managers to efficiently and effectively manage the resources for which they are responsible;
- internal control adequately contributes to the assurance provided to the Secretary that the resources allocated to Health are managed efficiently and effectively; and
- approach to strategic financial management provides adequate assurance to Health's Secretary and Executive that Health will have the resources and capabilities required to meet future challenges.

4. The audit considers the measures used by Health to ensure that its managers have appropriate financial management skills and knowledge to inform their judgements on the efficient and effective allocation of resources.

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1 Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio,* CanPrint Communications Pty Ltd, p.7.

2 Departmental items are those 'assets, liabilities, revenues and expenses controlled by agencies in providing their outputs'. Administered items are those 'assets, liabilities, revenues and expenses managed by agencies on behalf of the Commonwealth. Agencies do not control administered items.' Department of Finance and Administration web site, viewed 13 January 2005 <www.finance.gov.au>, *Portfolio Budget Statements 2003–2004*, Glossary and Acronyms.

5. The audit does not comment on Health's finances and is not designed to provide an opinion on Health's financial performance or position. The latter is done through Health's annual financial statements. The audit takes into account and builds on the ANAO's work and opinion on the department's financial statements.

Key findings

Financial Management Framework (Chapter 2)

Health's financial management framework provides a sound structure for the attainment of its objectives.

6. Health has established a financial management framework that covers governance, financial processes, procedures and controls. Health has identified its financial management responsibilities, which are communicated to staff through Chief Executive's Instructions (CEIs), procedural rules and financial delegations. Both the CEIs and financial delegations have recently been reviewed, while procedural rules were, at the time of audit fieldwork, being revised.

At the time of audit fieldwork, Health's risk management framework needed further development before it could be assessed as providing sound support for financial management in the department.

7. ANAO fieldwork found that Health had introduced consistent business planning processes, including risk assessment and risk responses, in all business units. However, these activities were not complemented by a department-wide risk management assessment and plan. Without a department-wide risk assessment Health's Secretary, Executive and Audit Committee will have had difficulty in obtaining assurance that strategies and activities (including internal control) adequately address the risks Health faces. Similarly, there will only be limited assurance that Health's strategic financial plans are sound.

Health is working to introduce, from June 2005, an integrated department-wide approach to risk management.

8. ANAO examination of Health's planned approach has led to the conclusion that it will provide adequate support for financial management, if operated effectively.

Relevant, Reliable and Timely Financial Data (Chapter 3)

The financial data provided to senior managers is relevant. However, programme managers who are not division heads are not provided with information at programme level on the departmental funds for which they are responsible.

9. Health's chart of accounts for departmental funds is not aligned with programme budgets. As a result, at the time of audit fieldwork, Health could not provide many programme managers with reports showing both administered and departmental expenditure for programmes they administered. Health has advised that, in July 2005, it will introduce a chart of accounts for departmental funds that is aligned with programmes. This follows the introduction on 1 July 2004 of a chart of accounts for administered funds aligned with programmes.

10. Health has established performance indicators against all programme activities. However, non-financial data is generally not recorded in Health's Financial Management Information System (FMIS)[3] or in information systems that are integrated with it.

Health's FMIS generally provides information that managers can rely on to meet their financial management responsibilities. However, some information on commitments and liabilities for administered funds can only be obtained from programme administration systems.

11. The ANAO audit of Health's financial statements for 2003–04 found that, for the purpose of preparing the financial statements:

- expenditure and revenue records are reliable;
- assets records are reliable; and
- records of commitments and liabilities for administered appropriations are incomplete but are improving as Health improves its programme administration systems and integrates them more closely with its FMIS.

12. Discussions with managers and staff indicated that Divisions, Branches, Sections and State Offices typically believe they can rely on the transactions recorded in the FMIS. A common theme amongst managers was that, while in the past they had maintained shadow systems,[4] they now used data from the FMIS.

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[3] In this audit the term 'Financial Management Information System (FMIS)' is used to refer to Health's core accounting and financial management information system.

[4] Managers keep shadow systems when they cannot rely on data from a core system or when the data is not available from the core system. These auxiliary systems 'shadow' the core system. Better practice organisations do not have shadow systems.

The timeliness of Health's internal financial reports, while capable of improvement, is acceptable.

13. A standard financial report is delivered to all Senior Executive Service (SES) officers in the department within six days of the end of the month. This compares with a suggested benchmark of two to three working days after the end of the month. The ANAO considers that the timeliness of Health's financial reports is such that improving the relevance and presentation of reports is a higher priority.

Health's reporting to managers has improved significantly over the last two years.

14. Health has consulted widely amongst its managers on the content and format of reports from its FMIS. It has used this information to develop a range of standard financial reports. It has also initiated a major project to review procedures and guidelines and introduced a common business model across the department. Another initiative is a project to develop a Data Warehouse.[5]

Financial Management Skills, Training and Support (Chapter 4)

Health's senior managers and central finance staff have the knowledge and experience to use financial data.

15. Senior managers interviewed, including the Executive, and State Managers, were found to have appropriate financial management knowledge and experience.

16. The ANAO has assessed Health as having a Finance Branch with qualified and experienced financial staff.

The financial management knowledge and experience of less senior divisional staff interviewed were also appropriate. However, there was evidence that the knowledge of some staff required further improvement.

17. Observations from several sources paint a consistent picture of an organisation with an uneven spread of financial knowledge and experience. There are staff who are fully aware of their financial management responsibilities and who have appropriate knowledge and experience. On the other hand, there are some staff who need further training to improve awareness of their financial management responsibilities and to improve their knowledge.

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[5] A Data Warehouse is a collection of data from various sources gathered and organised so that it can easily be analysed, extracted, combined and otherwise used to further understand the data. Health's project aims to organise its separate information systems and databases to allow its data to be analysed and viewed more effectively: known in the terminology used by Health's FMIS as a 'business warehouse'.

Health provides a range of financial training to staff at all levels.

18. In the last 12 months, topics covered by financial training have included delegations, contract management and procurement, accrual accounting, the use of spreadsheets, and the FMIS. Health has developed two financial management and accountability courses, the Diploma of Government (Financial Management) and 'Discovering Clerkliness', to improve the financial management skills of its staff.

Health managers and staff are provided with comprehensive financial support services.

19. The department's managers and staff have access to, and use, a range of financial support services, including the Finance Branch Help Desk, the FinNet intranet site,[6] the procedural rules, the Finance Staff User Group and officers designated as experts for queries on specific issues.

Internal Control (Chapter 5)

Overall, Health's internal control provides an adequate contribution to the assurance provided to Health's Secretary and Executive on the effective and efficient use of resources. However, as mentioned earlier, Health's risk assessment processes did not provide adequate support for internal control at the time of audit fieldwork.

20. Lines of accountability are well established and there are continuing measures to ensure the competency of staff. Processes that provide assurance to Health's Secretary, Executive and Audit Committee are being strengthened. Examples are the introduction of Control Self Assessment (CSA) during 2003–04 and the planned introduction of a revised risk assessment process in June 2005.

There is clear and unambiguous support from Health's Secretary and Executive for strong internal control.

21. Consistent information from managers interviewed led the ANAO to conclude that Health's Secretary and Executive are playing a leading role in improving financial management in the department and in promoting a robust culture of stewardship and accountability.

Health has made good progress in developing an organisational culture of stewardship and accountability.

22. The ANAO concluded from the evidence examined that Health:

- is working to communicate and enforce integrity and ethical values;
- has a demonstrated commitment to financial management competence;

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[6] FinNet is a centralised site on Health's intranet for all financial management related information.

- has strong participation by those charged with governance; and
- is developing a management philosophy and operating style that values stewardship and accountability.

Health has made progress in rationalising its programme administration systems and in moving the processing of payments from these systems to its core FMIS.

23. This has lessened the effort required by Health to maintain the quality of its information systems, simplified its control procedures and increased their robustness.

Health's control activities are, on the whole, reliable for the production of financial statements.

24. The ANAO's interim audit of Health's financial statements for 2004–05 found only one issue (business continuity planning not yet completed) posing a moderate business or financial risk and no issues posing a significant risk.

Health has effective processes in place to monitor its controls.

25. The ANAO has assessed Health as having an effective Audit Committee and internal audit function. Health uses management representation letters to obtain assurance from business unit managers that the information they provide on their transactions during the year has been recorded in accordance with required standards and procedures and is materially correct.

26. Health has strengthened its ability to monitor its controls by introducing a CSA programme during 2003–04.

Internal control in Health would be strengthened by a clear link between Control Self Assessment and Health's risk assessment processes.

27. Without a link between CSA and Health's risk assessment process, Health's Audit Committee, Executive and Secretary will have difficulty in obtaining adequate assurance that Health's control activities are addressing all significant risks satisfactorily. This report includes a recommendation to address this finding.

Responsibility for Control Self Assessment should be moved from Internal Audit to Health's Business Group.

28. Health's Audit and Fraud Control Branch has developed and assisted with the implementation of CSA in the department. The ANAO suggests that responsibility for the process be moved to Business Group. This would allow Internal Audit to provide independent assurance to the Audit Committee and the Secretary on the effectiveness of the CSA process.

Strategic Financial Management (Chapter 6)

Health's approach to strategic financial management is, with the exception of the support provided by its risk management processes, adequate.

29. Health's analysis of the key factors affecting its current and future administered expenses assists it to ensure that it has the resources and capabilities to deliver to the community the services and results required by the Government and Parliament.

30. The department has established an improved planning process, begun to invest in the financial management skills of staff, established long-term strategies for its most significant assets (people, IT and property), and implemented a series of reforms that, when viewed collectively, demonstrate a strategic approach to financial management of departmental funds.

31. The introduction in June 2005 of revised risk assessment processes should complete Health's development of the components required for strategic financial management.

Health has produced a number of strategy documents, including the Financial Strategy 2004–05 to 2007–08.

32. Health's financial strategy addresses the factors affecting departmental expenses and builds on the recently implemented financial reforms.

33. Other strategic plans prepared by Health include:

- People Strategy 2004–07;
- Information Technology Strategy and Road Map; and
- Property Master Plan.

Health has medium and long-term financial plans and goals.

34. Health's financial plans and goals are publicly stated in the Portfolio Budget Statement for the Health Portfolio. Lower level plans and goals are set out in Division, State Office and Branch business plans. Health's strategy documents also contain strategic goals.

Health is monitoring progress against its medium and long-term financial strategies and plans.

35. The Secretary and Executive receive financial and performance data that allows them to develop and manage Health's financial plans.

36. Health is developing a Departmental Performance Report to assist senior management monitor progress against medium and long-term financial plans. The introduction, from 1 July 2005, of a chart of accounts for departmental funds aligned with programme budgets will also enhance the ability of senior management to monitor progress.

Overall audit conclusion

37. In the ANAO's opinion, Health's financial management systems and reports, internal control and strategic financial management have improved significantly in recent years, to the stage where, with the exception of two areas, they provide adequate support to Health's Secretary, Executive and managers in making informed decisions on the effective and efficient use of Commonwealth resources. This strengthening of the department's position has been achieved through ongoing executive attention to the fundamentals of governance and financial management.

38. While noting the improvements being made, the ANAO found that the lack of a department level risk assessment meant that Health's risk assessment and response processes did not provide adequate support for financial management. Further, the fact that Health's chart of accounts for departmental funds was not aligned with Health's budget structure meant programme managers were not fully supported in making informed decisions on the efficient and effective use of resources.

39. The ANAO further found that Health had recognised these deficiencies and was well advanced in action to remedy them. These actions are part of a programme of financial reform, in which Health's Secretary and Executive are playing a leading role. As part of the reform process, Health is working to develop a robust culture of stewardship and accountability.

40. In the ANAO's opinion, the introduction of a revised risk assessment and management process in June 2005 and the introduction of a chart of accounts for departmental funds aligned with Health's budget structure from 1 July 2005 should complete the foundations of a robust system to support Health's Secretary, Executive and managers in the efficient and effective use of resources.

41. The support provided to Health's managers by its financial management framework provides a sound basis for good financial management. However, the effective and efficient use of Commonwealth resources requires ongoing consideration of governance arrangements, coupled with managerial analysis of results, variations and other performance information to inform decisions in relation to the very significant programmes administered by the department.

Recommendations

42. The ANAO made one recommendation in this report, aimed at strengthening the department's internal control.

Health's response

43. The department is supportive of this audit report and agrees with the recommendation.

Recommendations

Set out below is an ANAO recommendation to assist Health in meeting its financial management objectives.

Recommendation No.1

Para 5.76

The ANAO recommends that, in order to ensure the effective functioning of control systems, including their ability to reduce risks to an acceptable level, Health establish a clearly expressed link between the department's Control Self Assessment and risk assessment processes.

Health's response: Agreed.

Audit Findings and Conclusions

1. Introduction

This Chapter briefly discusses financial management, the role of the Department of Health and Ageing (Health) and the environment in which it operates. It sets out the audit's objective, approach and methodology.

1.1 Over the last 20 years there have been a number of reforms in the public sector designed to improve agency performance, stewardship[7] and accountability.[8] These include legislative reform and reforms to public sector accounting and budgeting practices.

1.2 The reforms have established clear expectations for more effective public sector governance. The latter requires effective planning, financial management and risk management. Consequently, public sector organisations, particularly the larger ones, require a high level of management skills supported by appropriate management information systems to ensure effective control over business decisions and operations. These latter play a key role in enabling managers to discharge their performance, stewardship and accountability obligations and meet the challenges of an often-complex environment.

1.3 Health is the lead agency in the Health and Ageing Portfolio. The 2005–06 Commonwealth Budget provided $39.4 billion for the Portfolio,[9] comprising $38.7 billion of administered funds[10] and $1.1 billion of departmental funds. The Budget for the department was $38.7 billion of administered funds and $457 million of departmental funds. The Health and Ageing Portfolio has the second largest budget in the Commonwealth.[11]

1.4 Five programmes account for 85 per cent of the administered funds appropriated to Health. They are Medicare ($10.4 billion, 27 per cent), Australian Health Care Agreements ($8.4 billion, 22 per cent), the

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7 *Stewardship* is managing efficiently and effectively the resources of others.

8 *Accountability* is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities, and roles are clearly defined through a robust organisational structure.

9 Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio,* CanPrint Communications Pty Ltd, p.7.

10 Departmental items are those *assets,* 'liabilities, revenues and expenses controlled by agencies in providing their outputs.' Administered items are those 'assets, liabilities, revenues and expenses managed by agencies on behalf of the Commonwealth. Agencies do not control administered items.' Department of Finance and Administration web site, viewed 13 January 2005 <www.finance.gov.au>, *Portfolio Budget Statements 2003–2004*, Glossary and Acronyms.

11 Appendix 1 describes the Department of Health and Ageing's mission, vision, outcome and structure.

Pharmaceutical Benefits Scheme ($6.5 billion, 17 per cent), residential aged care subsidies ($4.6 billion, 12 per cent) and Private Health Insurance Incentives ($2.9 billion, 7 per cent).[12]

Operating environment

1.5 Health's managers operate in a complex environment. Health is not one of the matters referred to in Section 51 of the Constitution of the Commonwealth of Australia.[13] As a result, the States and Territories have important responsibilities in the provision of health services to the Australian people. Examples are public hospital services and the registration of medical practitioners.

1.6 A consequence is that for a number of programmes Health provides funding on behalf of the Commonwealth to State and Territory governments that, in turn, fund service providers.[14] The primary accountability of the service providers is to State Governments, even where most funding is from the Commonwealth.

1.7 There are other programmes where the Commonwealth provides funds directly to the same service providers (through a form of contract). In some programme areas, particularly for care of the frail aged and the disabled, service providers will receive funding from States and Territories, from joint Commonwealth-State programmes and directly from the Commonwealth.

1.8 The administration and payment of medical benefits, such as Medicare and the Pharmaceutical Benefits Scheme, is the responsibility of the HIC, which is a Commonwealth statutory authority. Health, however, is responsible for administrative support for the committees that advise the Minister for Health on the items to be included in these schemes and the benefit to be paid for each item. Health is also responsible for providing general policy advice on the schemes.

1.9 Officers in Health responsible for managing a programme often have to liaise on both budgetary and operational matters with officers in other divisions. For example, if the officer responsible for cervical cancer screening

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[12] Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio*, CanPrint Communications Pty Ltd, Canberra.

[13] Section 51 states 'The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:….' Matters not included in Section 51 are the primary responsibility of the States.

[14] Examples are the provision of public hospital funding through Australian Health Care Agreements and funding to support the frail aged and other people with disabilities through the Home and Community Care program. Health's payments are made under Section 96 of the Constitution and are Specific Purpose Payments.

(located in Population Health division) is working on an initiative aimed at women in remote areas, he or she must liaise with the branch in Health Services Improvement division responsible for rural health and with the Office for Aboriginal and Torres Strait Islander Health. Each of these divisions may contribute funding to the initiative. There may also be a need for liaison with the Medicare Benefits Branch in the Medical and Pharmaceutical Services division. In other words, managers in Health operate in an environment where reporting and accountability follows a divisional structure, but where interdivisional liaison requirements impose a strong cross-division or 'matrix' element on managers.

1.10 Health works in close liaison with and, in some cases, purchases services from other agencies in the portfolio. It also provides services to some of these agencies. For example, it provides legal services support, Parliamentary services and employee assistance programmes to the Australian Radiation Protection and Nuclear Safety Agency (ARPANSA). In a further example, Health, by arrangement, provides staffing, accommodation and other resources to the NHMRC. To enable the NHMRC's CEO to manage these resources, the Secretary has delegated to him certain of her powers (similar to those delegated to division heads) under the FMA Act. However, the CEO is appointed by the Minister rather than by the Secretary, and his performance agreement is with the Chair of the Council.

Audit objective and scope

1.11 The audit objective was to examine whether Health's financial management framework and processes adequately support Health's Secretary, Executive and managers to make informed decisions on the use of Commonwealth resources. To form the opinion, the ANAO examined whether Health's:

- financial management framework, systems and reports are adequate to assist managers to efficiently and effectively manage the resources for which they are responsible;
- internal control adequately contributes to the assurance provided to the Secretary that the resources allocated to Health are managed efficiently and effectively; and
- approach to strategic financial management is adequate to assist Health's Secretary and Executive put in place the resources and capabilities to efficiently and effectively meet future challenges.

1.12 Health is responsible for both the departmental and administered funds appropriated to it. This audit examines Health in respect of both departmental and administered funds.

1.13 The audit comments on the ability of Health's financial systems and processes to support the Secretary, Executive and managers in their work. The audit does not comment on the finances of the department. As well, it is not designed to, nor does it present a view of Health's financial performance or position.

1.14 TGA and CRS Australia[15] have their own accounts, which are audited separately but published as part of Health's annual report. These entities are not included in this audit.

Audit criteria and report structure

1.15 The ANAO used five criteria in this audit. These were:

- whether Health has an appropriate financial management framework in place (Chapter 2);
- whether Health's managers are provided with financial data that is relevant, accurate and timely (Chapter 3);
- whether Health's managers and staff have the required skills, training and support to use financial data (Chapter 4);
- whether Health's internal control adequately contributes to the assurance provided to Health's Secretary, Executive and managers on the effective and efficient use of resources (Chapter 5); and
- whether Health has a strategic approach to financial management (Chapter 6).

Audit methodology

1.16 The ANAO engaged KPMG to use their knowledge of industry better practice to help review and confirm the audit criteria, develop a test programme, conduct fieldwork jointly with the ANAO, and assist with preparation of a draft report.

1.17 Fieldwork was conducted in Health's Central Office in Canberra and in State Offices in Sydney and Melbourne. Fieldwork comprised:

- an interview with Health's Secretary and Deputy Secretaries;
- interviews with Health's officers; and
- examination and analysis of Health's documents and data.

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[15] CRS Australia was part of the Department of Health and Ageing for the 2003–04 financial year.

1.18 The ANAO's audit of Health's financial statements for 2003–04 was conducted from December 2003 to August 2004. Evidence collected as part of that audit was used to assist in reaching an opinion on aspects of Health's financial management.

1.19 Another ANAO performance audit is reviewing Health's compliance with aspects of the appropriation framework, in particular management of net appropriations.[16] The matters covered by that audit will be reported separately.

Financial statement audit opinions

1.20 The ANAO audit opinion on the financial statements of a Commonwealth agency or authority presents the Auditor-General's conclusion on compliance with accounting standards, other mandatory financial reporting requirements and the Finance Minister's Orders. The opinion provides reasonable assurance that the accuracy of the information contained in the entity's financial statements is such that persons using that information to analyse the financial performance or position of the entity will not be misled. Information in the financial statements includes not only numerical data but also information on the accounting policies of the entity and related matters.

1.21 A financial statement audit opinion does not generally comment on the quality of the entity's accounting systems, procedures and practices, except where inadequate systems result in a qualified audit report. While the effectiveness of management's internal controls over financial reporting will be considered when determining the nature and extent of audit procedures, the audit is not designed to provide assurance on internal controls. These can be of poor quality, but an auditor may still be able to conduct sufficient audit tests to reach a conclusion on the fair presentation and compliance of the entity's financial statements.[17] In other words, an unqualified audit opinion can be reached in an organisation with poor quality accounting systems and an organisation with good accounting systems may receive a qualified audit opinion.

Other relevant documents

1.22 ANAO documents used in preparing the criteria and test programme for this audit include the following:

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[16] The audit is titled '*Management of Net Appropriation Agreements*'. The legislative provision for net appropriation agreements is Section 31 of the FMA Act. The audit is expected to be tabled in October 2005.

[17] Readers seeking further information on the meaning of unqualified and qualified audit reports should read pp.42–44 of ANAO Audit Report No.21 2004–2005, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004.*

- Better Practice Guide, November 1999, *Building a Better Financial Management Framework*;
- Better Practice Guide, November 1999, *Building Better Financial Management Support*;
- Audit Report No.61, 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003* (and similar ANAO publications for earlier years); and
- Audit Report No.7, 2003–04, *Supporting Managers—Financial Management in the Health Insurance Commission*.

1.23 The audit complies with ANAO Auditing Standards. It cost $426 000.

2. Health's Financial Management Framework

This Chapter compares Health's financial management framework against sound practice. It also examines the support provided to financial management by Health's risk management framework and practices.

A sound financial management framework

2.1 A sound financial management framework is a necessary support for good financial management. To assess Health's financial management framework the audit team examined whether Health had:

- developed a governance structure which provided sound support for its financial management framework;
- identified and addressed its financial management responsibilities; and
- established risk management strategies and processes which provided adequate support for financial management.

Governance structure

2.2 Table 2.1 shows the components of the governance structure needed to support a sound financial management framework.

Table 2.1

Governance components supporting a sound financial management framework

Major Element	Supporting Components
Governance	• a clear, well document governance framework; • governance committees with clear, consistent and well documented charters; • regular review to confirm the relevance of the governance framework and committee charters; and • a Chief Financial Officer, appropriately senior, with a direct reporting and accountability line to the CEO.

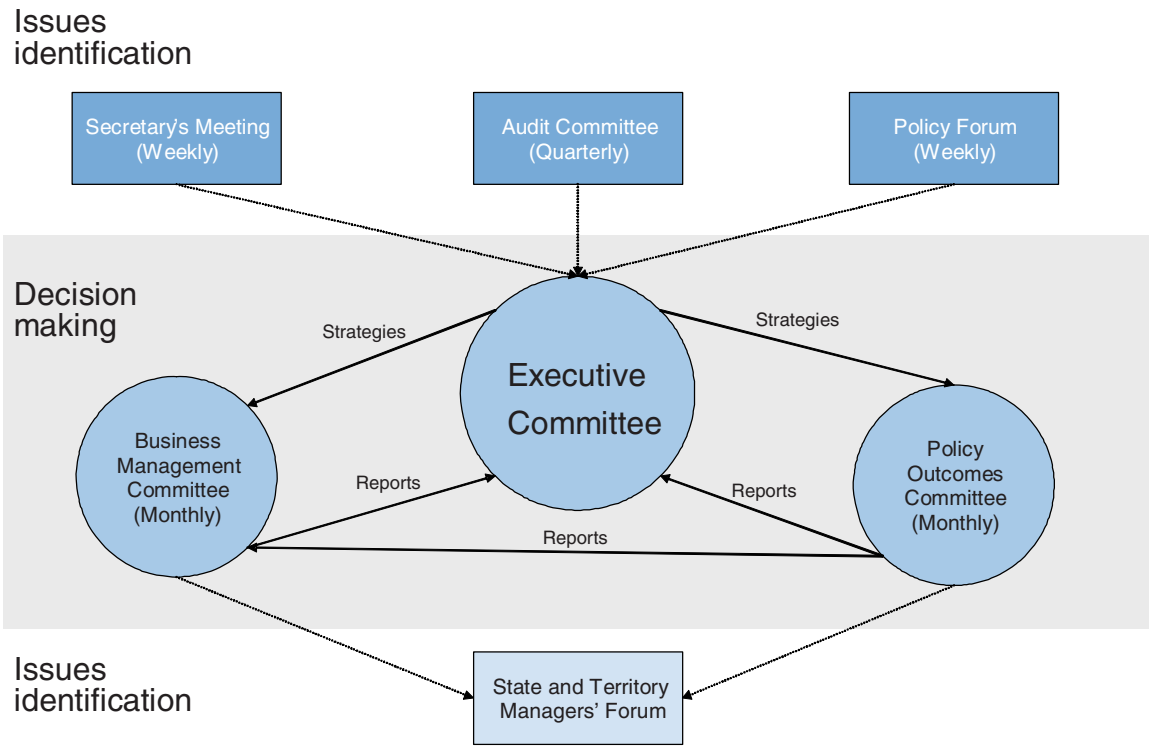
Source: Derived from ANAO Better Practice Guide *Public Sector Governance*.[18]

[18] ANAO July 2003, Better Practice Guide *Public Sector Governance*, Canberra.

2.3 A key component of a sound financial management framework is a clear, well-documented governance framework. The Secretary initiated a review of the department's governance framework in August 2002. This review recommended several changes to Executive Committees. The new structure is illustrated below.

Figure 2.1

Health's Governance Structure (April 2005)



Source: Health's Business Management Committee Charter.

2.4 The Committees shown in Figure 2.1 have well documented charters that describe their roles and responsibilities. These descriptions are clear and consistent.

The Chief Financial Officer's position within the agency structure

2.5 Department of Finance and Administration guidance on the role of the Chief Financial Officer in Commonwealth agencies states:

> The Chief Financial Officer position should be at an appropriately senior level within the agency, ideally with a direct and accountable reporting line to the

Chief Executive, who is ultimately accountable for the financial management of the agency.[19]

2.6 Health's Chief Financial Officer reports to the Secretary through the Chief Operating Officer, rather than to the Secretary directly. In practice there is regular communication between the Secretary and Chief Financial Officer.

Coordinating budget development and monitoring of results

2.7 Experience in the public sector is that preparation of budgets is normally located under the Chief Financial Officer or at least in the same division, to help ensure adequate communication and coordination between the development of budgets and monitoring of results. In Health the preparation of external budgets and the related liaison with the Department of Finance and Administration sits within the Portfolio Strategies division, rather than in the Business Group. The ANAO observed that, despite this separation, the relevant officers worked closely together to ensure a coordinated approach to budgeting and monitoring. With Health's current organisation, the continuing successful coordination of the preparation of budgets and the monitoring of outcomes is dependent on the ability of the relevant officers to work closely together.

Audit finding

2.8 Health's governance structure, as it relates to its financial management responsibilities and practices, is generally sound.

Financial management responsibilities

2.9 Table 2.2 shows the sound practice components supporting managers to meet their financial management responsibilities.

[19] Role of the Chief Financial Officer–Guidance for Commonwealth Agencies, Department of Finance and Administration, April 2003.

Table 2.2

Better practice for financial management responsibilities

Major Element	Supporting Components
Financial management responsibilities	• legislative and policy responsibilities of a financial nature being clearly set out and assigned; • executive instructions, delegations and guidance being in place and accessible; • regular training to ensure managers and staff are aware of their obligations and the activities that need to be performed in order to discharge these obligations; and • regular monitoring and reporting processes to measure compliance with responsibilities.

Source: IBM Business Consulting Services.

Financial management responsibilities identified and addressed

2.10 As indicated earlier, Health is subject to the FMA Act and associated regulations and orders. The FMA Act, regulations and orders provide the general basis for the department's governance, reporting and accountability, and impose a regime for the conduct of its managers and staff.

2.11 Health's responsibilities under the FMA Act are communicated to staff in:

- CEIs and associated Procedural Rules; and
- financial delegations.

2.12 The audit team reviewed Health's CEIs, Procedural Rules, and financial delegations, and concluded that Health has identified and addressed its financial management responsibilities.[20]

2.13 The audit team's review found that Health had recently reviewed its CEIs to ensure their continued compliance with the FMA Act, Regulations and Orders and relevance to Health's actual activities. As part of this review, financial delegations were tightened in order to simplify them and make them easier to understand. For example, within a programme Health changed a delegation to a State Office to approve the expenditure of administered funds

[20] ANAO Audit Report No.15, 2004–05, *Financial Management of Special Appropriations*, found that Health had not disclosed, as notes to its financial statements, use of special appropriations under Section 39 of the FMA Act. The amount involved was $67.8 million over the five years from 1998–99 to 2002–03. Health's financial statements for 2003–04 included full disclosure. Audit Report No.24, 2003–04, *Agency Management of Special Accounts*, found that Health had not reported a number of special accounts. Health's reporting of special accounts has complied fully with Department of Finance and Administration guidelines from 2003–04.

so that the number of officers authorised to exercise the delegation was reduced from three to one. In Central Office, Health reduced the number of delegations from 89 to 75. Health is also reviewing its Procedural Rules[21] to ensure their continuing relevance, completeness and effectiveness.

Processes, procedures and controls

2.14 Table 2.3 describes the department's key processes, procedures and controls to ensure that financial management responsibilities are met. The financial management processes, procedures and controls described in the Table, including regular reviews to ensure that they remain up to date, are typical of a better practice financial management framework.

Table 2.3

Health's processes, procedures and controls

Processes, procedures and controls	Description
Portfolio Budget Statements	Portfolio objectives; Portfolio budget; outcome objectives; outcome budgets; and outcome performance indicators.
Planning and budgeting	business plans are developed based on the Secretary's Key Priority Areas; and development of internal budgets based on approved business plans.
Monthly reporting	variance analysis by divisions, states, branches, sections and programmes of actual expenses against budget; and programme results, Health Operating Statement, Balance Sheet and Cashflow.
Quarterly reporting	Division Heads/ State Managers report to Secretary including financial results; and Control Self Assessment is undertaken by divisions/states and reviewed by Audit and Fraud Control.
Annual Report	financial statements; outcome performance indicators; resources used by outcome; and commentary on results.
Financial delegations	financial delegations are in line with Health's responsibilities under the FMA Act.

[21] Procedural Rules provide Health's staff with guidance on the implementation of CEIs and departmental policy.

Processes, procedures and controls	Description
Financial policies and procedures	Health has financial policies and procedures that address all of its responsibilities under the FMA Act; and Health is currently reviewing procedural rules to ensure they remain up to date.

Source: ANAO.

Audit finding

2.15 Health has identified and addressed its financial management responsibilities through its CEIs, associated procedural rules and financial delegations.

Clearly communicated financial management responsibilities

2.16 Health communicates financial management responsibilities to managers and staff using a combination of methods. The methods used include:

- Finance Services User Group;
- Finance Circulars;
- Budget Branch Circulars;
- Staff notices;
- Finance Help Desk;
- FinNet policies and procedures;
- meetings of Business Unit Managers; and
- financial management training.

2.17 A key initiative designed to strengthen the understanding of staff is the development of the Diploma in Government (Financial Management) and the Discovering Clerkliness courses. Both are discussed further in Chapter 4.

2.18 The ANAO conducted interviews with five Division Heads and two State Managers, along with 37 other staff, to assess, amongst other things, their understanding of their financial management responsibilities. These interviews revealed a good understanding of financial management responsibilities that included budget management, reporting, financial delegations and legislative and governance structures.

2.19 The financial management awareness of managers and staff has been enhanced by the Control Self Assessment[22] initiative that commenced approximately 12 months ago.

2.20 ANAO analysis of interviews found that contact between the Chief Financial Officer and Division Heads and State Managers has increased. This has resulted in increased awareness of financial management within line areas. Furthermore, the Chief Financial Officer advised that he intends to continue to meet regularly with Division Heads and State Managers to further increase their focus on financial management.

2.21 An issue identified by Health and notified to the ANAO during the audit of Health's 2003–04 financial statements was non-compliance with FMA Act Regulations 10 and 13.[23] Of the 1038 instances of non-compliance, 854 occurred in one area of the department. The cause was a lack of understanding by staff that an officer holding an appropriate delegation under Regulation 10 must authorise future spending proposals.[24]

2.22 During interviews managers were asked to comment on the financial management knowledge of their staff. Information from these interviews and the instances of non-compliance noted earlier led the ANAO to conclude that, while many of Health's staff are aware of their financial management responsibilities, there are still areas where awareness needs to increase.

Performance management

2.23 Performance management can be used to ensure that an organisation aligns its performance with its strategy and plans and also with appropriate industry practice and benchmarks.[25] It is another component of a better practice financial management framework.

2.24 Health's managers are held accountable for their financial management through:

- six monthly performance appraisals;
- performance agreements; and
- establishment of goals, including financial management goals.

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[22] Control Self Assessment is a new measure within Health designed to improve awareness of the importance of controls and to provide assurance on the effectiveness of controls. See Chapter 5 for further information.

[23] Regulation 10 requires agencies to seek the written authorisation of the Finance Minister (or delegate) for future spending proposals for which there is no appropriation. Under Regulation 13, a person cannot enter into a contract, agreement or arrangement under which public money is, or may become payable, unless the proposal to spend public money has been approved under Regulation 10.

[24] In response, Health has changed systems, redesigned forms, and conducted awareness and practical training.

[25] ANAO Better Practice Guide 2003, *Public Sector Governance*, p.24.

Training and monitoring

2.25 Financial management training is examined in Chapter 4, while monitoring and reporting processes to measure compliance with responsibilities are examined in Chapter 5.

Audit finding

2.26 Managers and staff interviewed were aware of their financial management responsibilities. However, managers' assessments of their staff and Health's identification of non-compliance with FMA Act Regulation 10 indicates that some officers in Health did not have a full understanding of their financial management responsibilities.

Managing financial risks

2.27 In assessing an entity's management of financial risks, the ANAO first assesses whether the entity has a risk management framework and processes that provide adequate support for managing financial risk. If the answer is yes, the ANAO then assesses the entity's management of financial risks. Table 2.4 shows the components needed to support better practice management of financial risk.

Table 2.4

Components supporting better practice management of financial risk

Major Element	Supporting Components
Financial risk management	• a whole of organisation risk assessment is undertaken and flows down throughout the organisation to appropriate levels of detail; • strategies for managing risks; • policies and procedures for managing risk; • responsibilities assigned for monitoring and reporting on risk; and • risk management is an integral part of management culture.

Source: derived from ANAO Better Practice Guide *Public Sector Governance*.[26]

2.28 One of the requirements for sound risk management is a complete risk management framework. That is, all of the components required to support sound risk management must be in place. In particular, there must be an agency level risk identification and management process. One reason for this is to ensure that all risk management activities are coordinated and take into

[26] ANAO July 2003, Better Practice Guide *Public Sector Governance*, Canberra.

account agency risk management strategies. Another reason is that risk management activities at branch and business unit level may not identify risks that have the potential to affect the agency as a whole, but which do not affect individual business units.

2.29 ANAO fieldwork found that Health had introduced, in all business units, consistent business planning processes including risk assessment and risk responses. However, these activities were not consolidated into a departmental risk management assessment and plan.

2.30 Two areas of financial management discussed later in this report are internal control and strategic financial planning. Without a department level risk assessment Health's Secretary, Executive and Audit Committee will have had difficulty in obtaining assurance that strategies and activities (including internal control) adequately address the risks that Health faces. Similarly, there will only be limited assurance that Health's strategic financial plans are sound.

2.31 Health is working to introduce a comprehensive approach to risk management in June 2005. ANAO examination of the new approach found that Health has defined the following objectives:

- to implement an effective risk management framework that is tailored to meet the challenges of the department's internal and external environments;
- to effectively and efficiently manage all enterprise and operational risks;
- to promulgate the department's risk management framework to relevant stakeholders and provide the necessary tools; and
- to provide timely risk management assurances to relevant internal and external stakeholders.

2.32 In its approach Health has distinguished between *enterprise risks* (those that affect the department as a whole) and *operational risks* (those that affect the business objectives of specific areas in the department). There will be a department level risk assessment and management process for enterprise risks. The approach introduces a Risk and Security Steering Committee, supported by the Business Assurance Section (Risk Secretariat).

2.33 The approach requires quarterly enterprise risk status reports to Health's Executive, and quarterly operational risk owner status reports to Division Heads and State and Territory Office managers. Reporting on operational risks by divisions and State and Territory Offices is quarterly on an exception basis. Health is introducing, at the same time, a Risk Management Information System to assist the reporting and management of risk.

2.34 The approach will need to be in place for about a year before Health can assess its effectiveness. However, the ANAO's examination of Health's

planned approach has led to a conclusion that it will provide adequate support for financial management, provided it is implemented effectively.

2.35 Another requirement of sound risk management is that it must be an integral part of the entity's culture. That is, risk management must be practised in a disciplined way, not as a once-a-year exercise to meet Central Office requirements.

2.36 This audit did not include fieldwork to collect evidence on the use of risk management techniques in Health. However, a concurrent performance audit of the National Respite for Carers Program has found examples of both use of risk management techniques by Health officers in managing resources and a lack of use.

2.37 One part of that programme provides funds to service providers to allow them to provide respite services to carers. In one state the ANAO found Health officers using risk assessments to identify those service providers for whom monitoring could be minimised, and 'at risk' or key service providers who needed close monitoring. This is a good example of the use of risk management techniques to assist with the efficient and effective use of funds.

2.38 In another State the ANAO found limited use of risk management techniques. A consequence was that when a key service provider (the only provider in that state of an important type of service) got into financial trouble, Health had no established contingency plans to ensure the continuing provision of that type of service. The use of risk management techniques could have alerted Health officers to the importance of the provider and prompted closer monitoring.

2.39 This suggests that while there are officers in Health who are making good use of risk management techniques, risk management is not a core component of managerial practices across the department. The ANAO has evidence from other audit activity that is consistent with this observation.

Audit finding

2.40 At the time of audit fieldwork, risk management in Health did not provide adequate support for financial management. However, Health is working to introduce, in June 2005, an integrated department-wide approach to risk management. The new approach has the potential to provide Health with robust risk assessment and response, which will in turn provide adequate support for financial management.

Conclusion—Chapter 2

2.41 In this Chapter the ANAO examined whether Health has an appropriate financial management framework in place to support good financial management.

Audit finding

2.42 Consistent with sound practice, Health has built a financial management framework that covers governance, financial processes, procedures and controls. In general, Health's financial management framework provides a sound structure for the attainment of its objectives.

2.43 However, risk management needed further development before it could be assessed as providing Health with sound support for financial management in the department. Health plans to introduce a new approach to risk assessment in June 2005, which should, in future, provide sound support.

3. Relevant, Reliable and Timely Financial Data for Managers

This Chapter describes the essential characteristics of better practice financial reports and uses these to assess whether Health's systems provide relevant, reliable and timely financial management information to its managers.

Financial reports better practice

3.1 The ability to produce reports that assist managers with the planning, execution and monitoring of an organisation's performance is critical to the effectiveness of financial management. In considering the delivery and use of financial information to Health's managers, the ANAO reviewed the presentation and delivery of financial management reports as well as their content. This included an examination of reports produced for senior managers by Finance Branch and a selection of reports produced by Division and State Business Units for operational managers. The ANAO gained an understanding of past Health reporting through review of a sample of past reports and from discussions with Health's divisional management and staff about changes to reporting.

3.2 The sound practice used to assess Health's financial reports has been derived from ANAO Better Practice Guide *Building a Better Practice Financial Management Framework*.[27] The essential characteristics of financial reports, as defined in the Better Practice Guide, can be grouped under three major elements:

- presentation;
- delivery; and
- content.

3.3 This Chapter first describes the financial reports produced in Health and then discusses them against the sound practice components from the Better Practice Guide. The Chapter concludes with a discussion of other reporting related issues. The ANAO examined financial reporting against all sound practice components, but, for brevity, has only reported significant findings, either positive or negative.

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[27] ANAO November 1999, *Building a Better Practice Financial Management–Defining, presenting and using financial information*, Canberra.

What financial reports are currently produced?

Reporting to managers

3.4 A monthly financial report, covering both departmental and administered funds, is produced and distributed by email shortly after the end of the month. This report has a standard format and managers are able to obtain more information on particular items using a 'drill-down' capability.[28] This report is only available at division level, so that branches need to develop their own reports.

3.5 At present, reporting at branch and section level is through a capability that allows information to be transferred from Health's Financial Management Information System (FMIS)[29] to a spreadsheet on a personal computer within a branch or section. The data is then manipulated in the spreadsheet to a presentation that meets the needs of the branch or section's managers. At this stage financial data from the FMIS may be supplemented by other performance data to present a more complete picture. This provides for flexibility in reporting, and permits divisional and state office finance officers to reformat reports for local consumption.

3.6 Health's FMIS is being constantly updated. Across the department officers are constantly recording transactions. Once approved, each transaction becomes part of the database and information on the transaction is available to any authorised user. Similarly, summary reports from the FMIS reflect the latest transactions. The use of spreadsheets, while making it easier for users to understand data from the FMIS, limits users to a snapshot of the data at the time it was taken from the FMIS. Further, the downloading and reformatting process introduces a possible source of error. Finally, drill-down capabilities are normally limited to the FMIS.

3.7 ANAO experience of better practice organisations (reflected in Table 3.1) is that they develop the entity's FMIS (and associated reporting facilities) so that managers at all levels can generate reports from it in the required format at the required date. Health expects that the Data Warehouse[30] it is

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[28] In modern computerised accounting systems, a drill-down facility allows a user seeking further information on a particular item to double click on the item and bring up further information. For example, a user examining the general ledger can double click on the item 'debtors' and be taken to the debtors' ledger.

[29] In this audit the term 'Financial Management Information System (FMIS)' is used to refer to Health's core accounting and financial management information system.

[30] A Data Warehouse is a collection of data from various sources gathered and organised so that it can easily be analysed, extracted, combined and otherwise used to further understand the data. Health's project aims to organise its separate information systems and databases to allow its data to be analysed and viewed more effectively.

developing (discussed more fully in para 3.13) will eliminate the need for report manipulation.

Reporting to the Secretary and Executive

3.8 Reporting to the Secretary and Executive comes from a number of sources:

- monthly presentations and reports from the Chief Financial Officer that provide financial data about departmental and administered expenses for the core department, portfolio agencies and by division or state;
- quarterly reports on progress in implementing individual budget measures. This provides performance data on the status of budget measures and does not include financial data about measures; and
- quarterly reporting from Division Heads and State Managers that describe stakeholders, strategic and emerging issues, progress against business plans, comments on financial performance for both departmental and administered funds, including discussion of key variances or issues raised in the Chief Financial Officer report and staffing and resource issues.

3.9 The Secretary and Executive's primary source of financial information about the department is the Chief Financial Officer. Monthly reports from the Chief Financial Officer include:

- the department's statements of financial performance, financial position and cashflow;
- commentary on major financial issues;
- progress on major capital projects;
- more detailed supporting documentation including financial information by division/state, aged debtors, asset movements, cashflow and departmental staff numbers by division/state; and
- graphs of key balances such as cashflow, receivables, payables and employee entitlements.

3.10 The Chief Financial Officer's regular access to the Secretary and Executive allows financial issues to be raised as they occur rather than once a month as part of the formal reporting process.

Presentation

3.11 Table 3.1 shows the better practice characteristics for the presentation of financial reports.

Table 3.1

Reporting better practice characteristics–presentation

Major Element	Supporting Components
Presentation	• the needs of managers are evaluated and taken into account in the design of financial reports; • reports are presented in a style which is easy to understand and use; • reports make sufficient use of graphs and tables to convey key financial results and trends; • reports are appropriately succinct, summarised and exception-based to convey the key messages and areas of concern to management; • reports compare financial data over time (eg. year on year, month on month) and between different areas of the organisation; • a standard, agreed format for monthly financial reporting is in place; and • reports are sufficiently flexible to allow different views and aggregations of data to be easily provided to satisfy managers' individual needs.

Source: Derived from the ANAO Better Practice Guide–*Building a Better Financial Management Framework* (1999) Part 2.

Identification of needs

3.12 Health has consulted widely with its managers and staff on the content and format of reports from the FMIS. It has used this information to develop a range of standard financial reports for managers. It has also initiated a major project to review procedures and guidelines and to introduce a common business model across the department. This project has a wide scope and is considering the broad external reporting requirements of the department—beyond issues of financial management only.

3.13 A further initiative is the Data Warehouse project, which is intended to provide a common reporting view for all financial managers. The reporting view will be drawn from the contents of the general ledger[31] and structured

[31] The general ledger is the ledger that contains the accounts that appear in the financial statements. The accounts of an organisation are recorded in ledgers that are divided into the main *general ledger* and specialised *subsidiary ledgers.* The general ledger is the collection of all the accounts of an organisation, maintained by transferring data from the ledgers of original entry, the subsidiary ledgers. Modern, computerised accounting systems are built around a database. All transactions for a financial year are recorded in this database. The general ledger is a summary view of the contents of the database presenting the items that appear in the financial statements. The subsidiary ledgers supporting the general ledger present views of particular aspects of the contents of the database. For instance, the creditors' ledger presents a view of individual creditors' accounts.

according to the reporting needs of departmental managers. The Data Warehouse is already being used for human resources data, but not data from the FMIS. In the long-term, this project will reduce the need for those requesting reports to fully understand the details of data structure and will simplify the delivery of relevant ad hoc reports.

3.14 A consistent theme from both senior divisional managers and finance staff interviewed was that the current state of reporting in Health is a significant improvement over the previous two years. A comparison by the ANAO of the reports available at the time of audit fieldwork with earlier reports confirmed this assertion. Health's investment in improved systems and processes has been of benefit to the management of the department.

Audit finding

3.15 Health has identified the financial data requirements of its managers and established projects to meet them.

Appropriate presentation

3.16 The monthly financial report emailed to senior managers is limited in its content by the reporting capability of the FMIS. It is highly structured and provides useful information in a consistent format. This report is appropriate to financial managers who have been briefed on how to use it.

3.17 However, as mentioned earlier, the ANAO found that Division and State Office finance units download data from the FMIS, reformatting and combining it with other relevant data, such as commitments or personnel information, to produce the financial reports used by managers. A risk posed by reformatting data and combining it with other relevant data is that decisions by lower or middle level managers are based on data, or a view of data, that is not available to senior managers. It is preferable that managers at all levels have access to the same information.

3.18 Further, the need to reformat the data diverts Division and State Business Unit staff away from supporting managers towards routine processing. Both the ANAO's *Building Better Financial Management Support* and Health's strategic financial plan discuss the need to change from an emphasis on transaction processing to decision support. In other words, reformatting reports is not an efficient and effective use of resources.

3.19 The Chief Financial Officer's report contains analysis to divisional and administered programme level. The report is supplemented by graphical representation, trend analysis, variance analysis and explanations. State Office financial personnel prepare a supplementary State Office report directed at the specific reporting requirements of State Office management.

Audit finding

3.20 The reports that Health produces from its FMIS present information to managers appropriately. However, the need to reformat reports to make them suitable for lower level managers does not represent efficient and effective use of resources.

Delivery

3.21 Table 3.2 shows the better practice characteristics for the delivery of financial reports.

Table 3.2

Reporting better practice characteristics–delivery

Major Element	Supporting Components
Delivery	• reports are available within a reasonable time and with regularity that allows data to be effectively used; • reports are easily obtained from financial systems, without the need for specialist intervention; and • managers have a choice in the way they receive reports: for example, electronically via the intranet or email system, but if more appropriate, on paper.

Source: Derived from the ANAO Better Practice Guide–*Building a Better Financial Management Framework* (1999) Part 2.

3.22 A standard financial report, produced from the FMIS, is delivered via email to all Senior Executive Service (SES) officers in the department within six days of the end of the month. This compares with a suggested benchmark of two to three working days after the end of the month.[32]

3.23 The Chief Financial Officer's report (which builds on the standard report) is not always timely because of delays in programme areas providing explanations for variances between actual outcomes and budgets. Such delays necessarily affect the relevance of the report.

3.24 As noted earlier, the financial reports provided to senior managers below division level are commonly FMIS data, reformatted in a spreadsheet. The need to reformat the data requires specialist intervention and reduces the timeliness of these reports.

3.25 The ANAO considers that the timeliness of Health's financial reports, while capable of improvement, is such that improving the relevance and presentation of reports is a higher priority (see para 3.29 onwards).

[32] Source: IBM Business Consulting Service—Financial Management Benchmarking Program benchmarking data.

3.26 Reports for senior managers are distributed by email and can be accessed and queried electronically or can be printed. Reports for lower level managers are distributed in print.

Audit finding

3.27 The timeliness of Health's financial reports, while capable of improvement, is such that improving the relevance and presentation of reports is a higher priority. Reports for senior managers are easy to obtain and offer a choice of delivery method. However, reports for managers below division level require specialist intervention to produce and are not as readily available.

Content

3.28 Table 3.3 shows the better practice characteristics for the content of financial reports.

Table 3.3

Reporting better practice characteristics–content

Major Element	Supporting Components
Content	• content is relevant to the established needs of managers; • reports provide relevant non-financial information such as commentaries and financial/non-financial ratios; • financial data in the FMIS is consistent and reconciled with data from source systems; • financial data is based on accurate and reliable records from the FMIS; • financial data is based on consistently interpreted and classified financial transactions from a common chart of accounts; • financial data is accrual-based and also cash-based where required; • financial data is forward-looking; and

	• financial data provided in reports is used in decision-making and organisation performance management, including: o Executive meetings o corporate and business planning o budget preparation o project business case and cost-benefit analysis o activity based management and costing o output pricing o process improvement o performance monitoring and review.

Source: Derived from the ANAO Better Practice Guide–*Building a Better Financial Management Framework* (1999) Part 2.

Relevance

3.29 The information in Health's financial reports is relevant to senior management needs. However, current reporting for departmental funds is by business unit (by division and by branch). Unless a programme coincides with a division or branch, programme managers have no information on the departmental funds they are using in managing the programme or programmes for which they are responsible. While this continues, Health's financial management framework and processes cannot be said to fully support Health's managers in making informed decisions on the effective and efficient use of Commonwealth resources.

3.30 On 1 July 2004 Health introduced a chart of accounts for administered funds that is aligned with programmes. Health will introduce a chart of accounts for departmental funds aligned with programmes from 1 July 2005. Once this is introduced the ability of Health's programme managers to efficiently and effectively manage Commonwealth resources should be significantly enhanced.

3.31 The information on administered funds contained in Health's FMIS is incomplete for commitments and liabilities. This occurs because commitments for some administered funds are recorded in programme administration systems and are not transferred to Health's FMIS. Better practice is for managers to be able to obtain information on expenditure and commitments from the same system.[33] Health's efforts to reduce the number of programme

[33] The need for integrated data is discussed in Part 2 of ANAO Better Practice Guide *Building Better Financial Management Support* (ANAO, 1999).

administration systems and integrate the remainder with its FMIS are discussed in Chapter 5 under 'Information Systems' (from para 5.25).

3.32 Health's FMIS has only limited ability to report expenditure by region or on particular demographic groups. Again, the development of such a facility would improve the relevance of financial data.[34] However, this type of reporting is beyond what is normally expected from computerised accounting software and will require significant design and development efforts to achieve. Development of such reporting is part of a longer-term project.

3.33 Another measure to improve the relevance of financial data is the proposed introduction of a single client identifier for recipients of Health grants and other payments.

Audit finding

3.34 The financial data provided to Health's senior managers is relevant. However, programme managers who are not Division Heads are not provided with sufficient information at programme level on the departmental funds for which they are responsible. Health has advised that it will introduce, on 1 July 2005, a revised chart of accounts for departmental funds with information by programme.

Integrated financial information

3.35 Better practice is for programme managers to be presented with both financial and non-financial performance data in the same report. This facilitates both analysis of performance and remedial action when desired results are not being achieved. A prerequisite for such reports is an ability to track both departmental and administered expenditure by programme. As mentioned earlier in this Chapter, Health introduced the capability to report administered expenditure by programme on 1 July 2004, but will not have this capability for departmental funds until 1 July 2005.

3.36 In order to form an opinion on the integration of financial information with non-financial performance information, the ANAO interviewed programme staff and examined a selection of reports. The ANAO found that Health has established non-financial performance indicators against all programmes. Performance measures are defined, collected and reported in a range of documents, such as Health Portfolio Budget Statements, Annual Report, Financial Strategy 2004–05 to 2007–08, People Strategy and Property Strategy, and information systems where programme-specific performance

[34] Health has programs that are administered by region (Home and Community Care) or are focused on a demographic group (Aboriginal and Torres Strait Islander Health).

information is collected and stored. At present, non-financial information is generally not recorded in the FMIS or in information systems that are integrated with the FMIS.

3.37 Health has two projects in progress that will improve its ability to report and analyse performance information. The data warehouse project (discussed at para 3.13) will improve the integration of performance indicators and financial information. Furthermore, once Health is able to report departmental expenditure by programme, it will be able to more easily produce integrated programme level reports containing both financial and non-financial performance data.

3.38 Budget data is loaded into the central FMIS so that monthly reports also contain budget information. The Chief Financial Officer's report provides analyses of variances of actual outcomes against budgeted outcomes.

Audit finding

3.39 The ANAO found that, at the time of audit fieldwork, financial information was only partially integrated with other performance information, including budget targets. Health's FMIS allows comparisons between actual results and budgets for both financial and non-financial performance information at division, branch and State and Territory Office level. However, this will not be possible at programme level until the 2005–06 financial year.

Can managers rely on financial data from Health's FMIS?

3.40 As noted above, the information contained within Health's FMIS is incomplete for commitments and as a result reporting of those items from that system is not reliable.

3.41 The ANAO audit of Health's financial statements[35] for 2003–04 found that, for the purpose of preparing the financial statements:

- expenditure and revenue records are reliable;
- assets records are reliable; and
- records of commitments and liabilities for administered appropriations are incomplete but are improving as Health improves its programme administration systems and integrates them more closely with its FMIS.

3.42 Discussions with managers and staff indicated that Divisions, Branches, Sections and State Offices typically believe they can rely on the transactions recorded in the FMIS. A common theme amongst managers was that, while in

[35] See Appendix 2 for the report on the audit of Health's financial statements for 2003–04.

the past they had maintained shadow systems,[36] they now used data from the FMIS. A consequence they identified was that time in meetings was no longer used in debating which number was correct.

Audit finding

3.43 Health's FMIS generally provides information that managers can rely on to meet their financial management responsibilities. However, some information on commitments and liabilities for administered funds can only be obtained from programme administration systems.

Other reporting related issues

The relationship between the FMIS and the published financial statements

3.44 The ANAO found that Health's financial statements are produced directly from Health's FMIS. As a consequence, the data available to Health's Secretary and managers matches the data that will be provided to external stakeholders. The direct relationship facilitates the production of Health's financial statements and minimises the chances of inadvertent error that arise when data from an organisation's FMIS must be manipulated to produce financial statements.

3.45 Further, the ability to produce the financial statements directly from the FMIS facilitates the timely production of the financial statements. The target for the provision of 'audit cleared material financial statements information' to the Department of Finance and Administration for the 2003–04 financial year was 30 July 2004. Health met this target.

3.46 Health's financial statement audit report was signed on 23 August 2004. A factor in the gap between the provision of data to Finance and the signing of the audit report was the need to wait for information from other entities before the financial statement audit report could be finalised.[37]

3.47 Health has identified the need to improve the standard of financial reporting and has made real progress over the last two years. This report describes a number of initiatives to improve financial reporting in the department. The ANAO considers that these initiatives, when completed, should address the issues identified in this report.

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[36] Managers keep shadow systems when they cannot rely on data from a core system or when the data is not available from the core system. These auxiliary systems 'shadow' the core system. Better practice organisations do not have shadow systems.

[37] For more information on the timeliness of financial reporting by Commonwealth agencies see ANAO, Audit Report No.21 2004–2005, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*, pp.25–29.

Audit finding

3.48 Health's FMIS is the direct basis of external financial reporting. As a consequence, the data available to Health's Secretary and managers matches the data provided to external stakeholders.

Financial Statement audit opinion

3.49 The ANAO has provided an unqualified audit opinion for Health's 2003–04 financial statements. A copy of the financial statement audit report is in Appendix 2.

3.50 The unqualified audit opinion on Health's financial statements indicated that Health's accounts and records were able to produce data to meet both the Government's and the accounting profession's external reporting requirements.[38]

Conclusion—Chapter 3

3.51 This Chapter has assessed Health's ability to produce reports that assist managers with planning, execution and monitoring through the provision of financial management data that is relevant, reliable and timely.

Audit finding

3.52 The ANAO found that, while Health has been able, since 1 July 2004, to provide programme managers with information by programme on the administered funds for which they were responsible, it could not provide information on departmental funds by programme. The introduction of a revised chart of accounts for departmental funds from 1 July 2005 should address this.

3.53 Health's FMIS generally provides information that managers can rely on to meet their financial management responsibilities. However, some information on commitments and liabilities for administered funds can only be obtained from programme administration systems.

3.54 The timeliness of the data provided to managers, while capable of improvement, is such that improving the relevance and presentation of reports is a higher priority.

3.55 The ANAO observed that the current state of reporting in Health is a significant improvement over the previous two years. This improvement is a result of the department's investment in improved systems and processes.

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[38] See paras 1.20 and 1.21 for more information on financial statement audit opinions.

4. Financial Management Skills, Training and Support

This Chapter describes principles for sound financial management skills, training and support and compares Health against these principles.

Financial management skills, training and support principles

4.1 Managers and staff with financial management responsibilities must have the necessary skills, receive appropriate training and be provided with adequate support to enable them to use the available financial information.

Skills

4.2 Principles for sound financial management skills are summarised in Table 4.1.

Table 4.1

Principles for sound financial management skills

Principles	Components
Skills	• all staff with financial management responsibilities have appropriate qualifications and/or experience; • role definition/job descriptions for all finance staff positions developed, documented and communicated; and • competency standards established and implemented for each role.

Source: IBM Business Consulting Services.

Financial staff

4.3 The Department of Finance and Administration encourages each major Australian Government organisation to appoint a Chief Financial Officer who has appropriate skills and experience.[39] Health has met this requirement. Further, while there are no specific guidelines on the qualifications of Chief Operating Officers, the current Health Chief Operating Officer also has appropriate financial management skills and experience.

[39] Role of the CFO—Guidance for Commonwealth Agencies, Department of Finance and Administration, April 2003.

4.4 Table 4.2 shows the number of staff in the Financial Reporting and Management Accounting Sections of Health's Finance Branch with finance, economic or accounting qualifications. It also includes staff in Budget Branch with those qualifications.

Table 4.2

Skills—Health's financial staff

Qualification	APS 1-6[40]	EL 1-2	SES	Total
No qualification	13	7	0	20
Studying	1	0	0	1
Tertiary	2	3	2	7
Professional	0	7	0	7
Total	16	17	2	35

Source: Health

4.5 Table 4.2 shows that 63 per cent of senior staff in the core financial areas of Health are studying for or have finance, economic or accounting qualifications.

4.6 During the course of this audit the ANAO interviewed Finance Branch staff and staff in Division and State Office Business Units. These interviews led the ANAO to conclude that staff interviewed had a good level of professional competence. Similarly, ANAO financial statement auditors need to work closely with Health's financial staff when auditing Health's financial statements. These interactions have led to an assessment that Health's financial staff have the skills and experience to provide financial data of the standard required for materially correct financial statements.

4.7 Information on the qualifications of financial staff, coupled with the assessment from ANAO financial statement auditors, has led to a conclusion that Health's financial staff have the skills and experience needed to provide financial data which meets the requirements of managers.

Audit finding

4.8 The ANAO has assessed Health as having financial staff with the knowledge necessary to provide financial data of the required standard.

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[40] APS 1–6: Officers graded Australian Public Sector levels 1 to 6;
EL 1–2: Officers graded Executive Level 1 or 2; and
SES: Officers who are members of the Senior Executive Service.

Operational managers and staff

4.9 During the audit the ANAO conducted interviews with selected staff designed to assess whether they had the knowledge and experience to make good use of financial data. Interviews with five Division Heads and two State Managers led the ANAO to conclude that officers at this level had a sound understanding of their financial management roles and the knowledge needed to effectively use financial data. The ANAO also interviewed 37 other Health officers[41] during the course of the audit, with similar results. However, the non-compliance with FMA Act Regulations 10 and 13 noted in Chapter 2 is evidence suggesting that the knowledge levels of some staff need to be improved.

4.10 This is reinforced by comments from the Division Heads and State Managers interviewed, who consistently stated that while the increased emphasis on financial management and training has noticeably improved the financial skills of staff, the transformation was not yet complete and has not spread uniformly throughout the department. These opinions were consistent with the views of ANAO auditors working on the 2003–04 audit of Health's financial statements and Department of Finance and Administration staff who communicate with Health.

Audit finding

4.11 Senior operational managers interviewed, including Division Heads and State Managers, had appropriate financial management knowledge and experience. The financial management knowledge and experience of less senior staff interviewed were also appropriate. However, there was also evidence that the knowledge of some staff required further development.

[41] Most of these officers were at SES Band 1 (Branch Head) and EL 1–2 level, although there were some more junior officers included. The ANAO interviewed a total of 47 officers.

Training

4.12 Principles for sound financial management training are summarised in Table 4.3.

Table 4.3

Principles for sound financial management training

Principles	Components
Training	• regular assessment of skills/competencies against standards; • responsibility for training clearly assigned; • adequate training capacity and resources in place; and • structured training programme in place and available to all staff that need access to it.

Source: IBM Business Consulting Services.

4.13 Training needs are identified in several ways within the department. First, staff have a performance appraisal every six months. This provides both staff and their managers with an opportunity to identify skill requirements and discuss the most appropriate way of addressing these needs.

4.14 Additionally, the Finance Help Desk analyses questions asked by staff. Help Desk staff communicate any themes or trends identified by this analysis to divisional Business Unit Managers, and so particular problem areas are quickly identified and training arranged for a specific issue or work unit.

4.15 Divisional Business Unit Managers, who are generally the first point of contact for financial management questions from divisional staff, will also identify areas of training need and these will be communicated to the Finance or People Branch or to staff in performance appraisal sessions.

4.16 A recent initiative by Health has been to introduce competency testing as one part of the recruitment process. Applicants are assessed against six core capabilities, which include one capability that can be tailored to job specific requirements such as policy advice, data analysis or finance and accounting. Each requirement has a relevant competency test, which is marked by Health staff with expertise in the appropriate area.

4.17 Competency testing was introduced initially by a single division within Health. It was supported by the People and Finance Branches of the Business Group and used subsequently across the department.

4.18 Managers and staff have access to classroom-style financial management training, support from the Finance Help Desk, on-line training on FMIS processes and one-on-one support from their Divisional Business Units.

4.19 Responsibility for training rests with the People Branch, but the Finance Branch has responsibility for FMIS system training. During our discussions with the divisions, there appeared to be a clear understanding of the separate responsibilities of the People and Finance Branches. In the last 12 months, topics covered by financial training have included delegations, contract management and procurement, accrual accounting, the use of spreadsheets, and the FMIS.

4.20 The department's emphasis on improving the skills of its managers and staff is further demonstrated by the development of two financial management and accountability courses, the Diploma of Government (Financial Management) and 'Discovering Clerkliness'.[42]

4.21 During 2004, 29 staff successfully completed the Diploma of Government (Financial Management).[43] Health has 27 staff enrolled in the Diploma course in 2005 and a further 19 staff enrolled in a new course, the Certificate IV of Government (Financial Management). In the same period 323 Health staff completed the 'Discovering Clerkliness'[44] or equivalent courses.

4.22 The department also has an arrangement with the Canberra Institute of Technology whereby students in their last year of study for the Advanced Diploma of Accounting and Diploma of Accounting, will have work experience in the Finance Branch. The department anticipates that this will lead to the recruitment of some students once they are qualified.

Audit finding

4.23 Health provides a range of financial training to staff at all levels. Training needs are identified and training options are available to address these needs. A recurring theme of the ANAO's discussions with senior Health staff was the difficulty in recruiting and retaining staff with good financial management capability and experience. The department's response has been to invest in financial management training for existing staff.

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[42] See Appendix 3 for information on the curriculum for each course.

[43] The curriculum for the Diploma of Government (Financial Management) initially cost $25 000 to develop and course fees are approximately $4 500 per person. The cost of leave provided to enrolled staff to attend lectures is in addition to these course fees and so in total, the Diploma and associated Certificate IV course has been and continues to be a significant investment in the financial management skills of Health's staff.

[44] Discovering Clerkliness is designed for staff at APS 1 to APS 6 levels. 'Understanding your Accountabilities' covers similar content at the Executive Level (EL) 1 and above. During 2004 there were 16 Discovering Clerkliness courses with 223 participants and 8 Understanding your Accountabilities courses with 100 participants.

Support

4.24 Principles for sound financial management support are summarised in Table 4.4.

Table 4.4

Principles for sound financial management support

Principles	Components
Support	• policies and procedures readily available to all staff; • all staff having access to Help Desk services; • all staff having access to technical experts when required; and • communication forums held on a regular basis to disseminate and discuss information and issues relating to financial management.

Source: IBM Business Consulting Services.

4.25 The department's managers and staff have access to, and use, a range of financial support services, including the Finance Branch Help Desk, the FinNet intranet site, the procedural rules, the Finance Staff User Group and officers designated as experts for queries on specific financial issues.

4.26 FinNet is a centralised site for all financial management related information including electronic copies of CEIs, procedural rules, accounting policies, internal budget templates, Finance Section contacts, and on-line training. The intranet site is available to all staff.

4.27 The Finance Section Help Desk provides assistance to FMIS users, such as how to enter and manage purchase orders, running reports and enquiries, Employee Self Service[45] travel and workflow. Where the Help Desk cannot resolve queries, it refers them to relevant experts within the Business Group.

4.28 Information sharing forums are also coordinated and run by the Finance Branch. A monthly meeting of Business Unit Managers is held to ensure all divisions are informed about corporate, resource and financial management issues. Additionally, there is a Finance Staff User Group that meets monthly to communicate financial management issues directly to Financial Liaison Officers.

[45] The electronic submission of leave forms, travel allowance applications and other routine payroll information.

4.29 Finance Section staff also provide:

- One-on-one assistance to staff members who require specific help; and
- technical accounting and policy advice to managers and staff as requested.

4.30 Interviews conducted during the performance audit found that the department's managers and staff were positive about access and the quality of the financial expertise and support provided to them by the Finance Branch. In addition, evaluation statistics collected from participants in a range of financial management related courses indicated a large majority believed the courses adequately met their needs.

Audit finding

4.31 Health's managers and staff are provided with comprehensive financial support services.

Conclusion—Chapter 4

4.32 In this Chapter the ANAO reviewed the financial management skills of Health's managers and its central finance staff, as well as the training and support provided to them. The ANAO found that Health's senior managers and its central finance staff have the skills and experience to use financial data, as do many more junior staff. It was noted that the increased emphasis on financial management and training has noticeably improved the financial skills of staff in line areas, but that this has not spread evenly throughout the department. A continued effort is needed for strong financial management skills to be entrenched in all areas.

4.33 The ANAO also found that Health has assessed the financial training needs of its staff and is providing extensive training to meet these needs. It also provides comprehensive financial support services to its staff.

5. Internal Control

This Chapter examines the contribution by internal control to the assurance provided to Health's Secretary and Executive on the efficient and effective use of resources. It examines the elements of internal control and the role they play in an organisation's governance, and presents the ANAO's findings.

Responsibility for internal control

5.1 Responsibility for the internal control of FMA entities rests with the CEO. For Health, responsibility lies with the Secretary. The Secretary is accountable to Parliament, through the relevant Minister, for the manner in which she discharges her responsibilities.

5.2 The ANAO has derived the criteria used to examine internal control in Health from Auditing and Assurance Standard (AUS) 402.[46] Findings are based on fieldwork completed as part of this audit and work completed by the ANAO in forming an opinion on Health's 2003–04 financial statements. The emphasis in this Chapter is on the contribution of Health's internal control to the assurance provided to Health's Secretary, Executive and its managers as to whether the department is making efficient and effective use of Commonwealth resources.

5.3 AUS 402 defines internal control as consisting of the following components:[47]

(a) the control environment;

(b) the entity's risk assessment process;

(c) the information systems, including the related business processes, relevant to financial reporting, and communication;

(d) control activities; and

(e) monitoring of controls.

5.4 ANAO findings on internal control in the Australian Public Service are published in an annual report.[48] Further information is published in another report *Audits of the Financial Statements of Australian Government Entities for the*

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[46] Further information on AUS 402 can be found in Appendix 4.

[47] AUS 402 *Understanding the Entity and Its Environment and Assessing the Risk of Material Misstatements* (February 2004). AUS 402, para .43 and Appendix 2 thereof.

[48] The relevant reports are ANAO Audit Report No.56, 2004–05, *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2005* and ANAO Audit Report No.58, 2003–04 *Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending June 2004*.

Period Ended June.[49] The ANAO's opinion on the financial statements of each Commonwealth entity is published as part of the annual report of each entity.[50]

5.5 The findings in this Chapter result from fieldwork conducted as part of this audit, findings from the ANAO audit of Health's financial statements for 2003–04 and findings from an ANAO Business Support Process Audit, *Management of Internal Audit in Commonwealth Agencies*,[51] which included Health as one of the agencies audited.

The control environment

5.6 AUS 402 states:[52]

> 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 organisation, influencing the control consciousness of its people. It is the foundation for effective internal control, providing discipline and structure.

5.7 From this it can be deduced that a key component of an effective control environment is a robust culture of stewardship and accountability.[53] AUS 402 describes the control environment as having seven elements.[54] Table 5.1 lists these elements and shows whereabouts in this report those elements are assessed.

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

50 A copy of the audit report on Health's financial statements for 2003–04 can be found at Appendix 2.

51 ANAO Audit Report No.3, 2004–05, *Management of Internal Audit in Commonwealth Organisations*.

52 op. cit., AUS 402, para .67.

53 Defined by the ANAO as: *a set of values, traditions, attitudes, beliefs and behaviours in an organisation that guides its staff on the way they are expected to manage the resources allocated to them.* In particular, for the staff of Australian Government Departments, a culture of stewardship and accountability is defined as: *that they are managing resources on behalf of the Government and people of Australia; that they are required by legislation to manage these resources efficiently, effectively and ethically; and that they are responsible for their decisions and actions and are subject to external scrutiny.*

54 op. cit., AUS 402, para .69 and Appendix 2.

Table 5.1

Control environment elements

Element	Discussed in:
Communication and enforcement of integrity and ethical values	Chapter 5 (stewardship and accountability)
Commitment to competence	Chapter 5 (stewardship and accountability)
Participation by those charged with governance	Chapters 5 (stewardship and accountability) and 6
Management's philosophy and operating style	Chapter 5 (stewardship and accountability)
Organisational structure	Chapter 2
Assignment of authority and responsibility	Chapter 2
Human resources policies and practices	Chapter 4

Source: ANAO.

Health's stewardship and accountability culture

5.8 An assessment of culture always has an element of subjectivity. The ANAO's assessment is based on:

- interviews with Health's officers;
- actions taken by Health to better educate and change the culture of their staff;
- the assessment by ANAO financial statement auditors of Health's culture during their audit of Health's 2003–04 financial statements; and
- assessments and findings from concurrent and recent ANAO performance audits of Health.

5.9 Health's Secretary and Executive are leading the efforts to improve the organisational culture and are playing a leading role in improving financial management. This finding is based on interviews with officers in Health, who consistently described the leadership role being played by the Secretary. It is also consistent with views expressed by Health's Secretary and Executive during the audit.

5.10 As mentioned in Chapter 4, the ANAO interviewed seven division and state office managers during the audit. All division and state office managers interviewed supported the financial reforms underway in Health, and displayed a clear view of their stewardship and accountability role. However, a consistent theme from these managers was that while some of their staff had a good grasp of stewardship and accountability, others did not. That is, further work is required.

5.11 The ANAO also interviewed 37 other Health officers during the course of the audit. The results of these interviews led the ANAO to conclude that Health is working to establish a culture of stewardship and accountability.

5.12 Measures taken by Health to improve accountability and stewardship amongst its staff include (as described in Chapter 4) the introduction of a new orientation program, which is designed to increase awareness of public sector administration, and a diploma in financial management for staff in financial management support positions.

5.13 Control Self Assessment (CSA) is a new measure within Health designed to provide assurance to management on the effectiveness of controls. One of its impacts has been to improve awareness of the importance of controls.[55] At this early stage of implementation it is more fully adopted in some areas of the department than in others. Middle and lower level managers showed strong support for Health's financial reform programme and for CSA. A common comment was 'we should have done this a long time ago'.

5.14 The auditors involved in the audit of Health's 2003–04 financial statements report a substantial improvement in Health's financial administration. These auditors also reported that some areas had made much more progress than others.

5.15 Information from a concurrent performance audit[56] in Health, which included fieldwork in state offices, indicates a noticeable improvement in stewardship and accountability amongst Health's officers in the last year. However, it also indicates that there are clear differences between state offices. Information from another recent performance audit is consistent with a need for further improvement in stewardship and accountability in some areas of Health.

5.16 The factors described above have led the ANAO to conclude that Health:

- is working to communicate and enforce integrity and ethical values;
- has a demonstrated commitment to financial management competence;
- has strong participation by those charged with governance; and
- is developing a management philosophy and operating style that values stewardship and accountability.

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[55] The use of CSA in Health is discussed fully at para 5.70.

[56] ANAO Audit Report No.58 2004–05, *Helping Carers: The National Respite for Carers Program*.

Organisational structure

5.17 In Chapter 2 the ANAO found that Health's financial management framework, as it relates to its financial management responsibilities and practices, is consistent with good practice. A key element examined in reaching this conclusion is Health's management structure, which has recently been revised to improve its effectiveness.

Assignment of authority and responsibility

5.18 The ANAO also found, in Chapter 2, that Health has identified and addressed its financial management responsibilities through its Chief Executive Instructions (CEIs), associated procedural rules and financial delegations. Health has reviewed or is reviewing these to ensure their continuing effectiveness. In discussing whether Health has identified and clearly communicated its financial management responsibilities, the ANAO concluded that, while most managers and staff understand their financial management responsibilities, there are some who do not.

Human resources policies and practices

5.19 In Chapter 4 the ANAO concludes that Health's senior managers and its central finance staff have appropriate skills and experience to use financial data. A further finding is that the increased emphasis on financial training has noticeably improved the financial skills of operational staff. Health also provides its managers with comprehensive support to assist them to use financial data effectively.

Audit finding

5.20 Health has made good progress towards establishing a robust control environment. It has taken successful measures to improve stewardship and accountability amongst its staff. These measures are strongly supported by Health's Secretary and Executive. However, there are still areas that require further attention.

Risk assessment as a component of internal control

5.21 Based on AUS 402,[57] the risk assessment processes relevant to internal control are those that management uses to:

- identify business risks relevant to the efficient and effective use of resources;

[57] op. cit., AUS 402, para .77.

- estimate the significance of the risks;
- assess the likelihood of their occurrence; and
- decide upon actions to manage them.

5.22 In Chapter 2 the ANAO found that Health had yet to introduce a departmental-level risk assessment process. Without such a process, Health's Secretary, Executive and Audit Committee will have difficulty in obtaining assurance that internal control strategies and activities adequately address all the risks, including financial risks, that Health faces. This has led the ANAO to conclude that, at the time of audit fieldwork, Health's risk assessment processes and practices did not provide adequate support for internal control. Health has recognised the need for a departmental-level risk assessment process, which it plans to introduce from June 2005.

Audit finding

5.23 At the time of audit fieldwork Health did not have a departmental-level risk assessment process that provided adequate support for internal control (see Chapter 2). Health has recognised the need for such a process, which it plans to introduce from June 2005.

Information systems

5.24 An information system is defined in AUS 402 as:[58]

> The procedures and records established to initiate, record, process, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities, and equity.

Programme administration systems

5.25 In 2000, Health introduced an integrated system to provide accounting, payroll and financial management information system services. Prior to then, divisions and branches designed and built their own programme administration systems or amended existing systems. These included payment authorisation and recording functions. The financial information captured by these systems was transferred to Health's general ledger. As a consequence, at the beginning of the 2002–03 financial year, most of Health's financial information was contained in systems other than the department's general ledger system. The general ledger was little more than a historical record of payments with the programme administration systems used for most financial management activity.

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[58] op. cit., AUS 402, para .80.

5.26 This resulted in information systems that were complex and whose quality was difficult to maintain. The complexity increased the effort required to provide an assurance on the accuracy and integrity of the data in the general ledger.

5.27 Health has reduced the number of its programme administration systems from eight to five. One of the systems no longer used, GrantPay (used to manage grants payments), had as many as eight sub-systems. In addition, 100 other systems have been archived and a review of a further 300 small systems is being undertaken with the aim to further reduce the number of systems in use. There are also a large number of databases that are to be catalogued and, where possible, retired.

5.28 By June 2004, while payment authorisations might still be made in programme administration systems, all payments were made through the department's general ledger. At the beginning of the 2004–05 financial year a number of payments processing systems were phased out, continuing a process of centralising financial processing and reporting.

5.29 Health has initiated a project to develop a new payments processing system, which it advised will be fully integrated with its core accounting system. The new system will replace most existing payments management systems. This is a project of significant size, which for some systems involves simply redesigning processes to use the core accounting system, but for others involves a major redesign.

5.30 The reduction in the number of programme administration systems has lessened the effort required by Health to maintain the quality of its information systems, simplified its control procedures and increased their robustness.

5.31 In Chapter 3 the ANAO assessed the accuracy of the information in Health's FMIS. We found that, with some limitations, Health's FMIS produces information that managers can rely on to meet their financial management responsibilities.

Audit finding

5.32 Health's information systems provide reliable information on the resources used by Health, with some exceptions. Health's work to reduce the number of programme administration systems will simplify its control procedures and increase their robustness.

Control activities

5.33 A core component of internal control is control activities. These are defined as:[59]

> … the policies and procedures that help ensure that management directives are carried out.

5.34 Examples of specific control activities include:

- authorisation of expenditure;
- performance reviews;
- information processing;
- physical controls over assets; and
- segregation of duties between officers.

ANAO financial statement audit work

5.35 The primary purpose of financial statement audit work on control activities is to form an opinion on the accuracy of the financial statements. However, this information can also be used to form an opinion on the ability of control activities to provide an assurance that management directives are being carried out. For example, if the financial statement auditor finds weaknesses in control activities that pose a significant risk of material misstatement in the financial statements, there is a strong likelihood that these weaknesses will also prevent the control activities from providing adequate assurance on the completion of management directives.

5.36 The ANAO has relied on work conducted as part of the audit of Health's financial statements for 2003–04 to reach an opinion on control activities. This has been supplemented by a review of control activity findings in previous years and a review of Health's own audits of branch administrative compliance.

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[59] op. cit., AUS 402, para .90.

5.37 Table 5.2, drawn from the ANAO's Controls Reports for the last four years, shows the number of 'A' and 'B' issues[60] outstanding in March of recent years. The Table shows the improvements achieved from 2001 to 2004.

Table 5.2

Health Financial Statement audit issues outstanding at March–2001 to 2004

Year	A	B	Total
2001	1	12	13
2002	0	5	5
2003	0	5	5
2004	0	2	2
2005	0	1	1

Source: ANAO, Audit Report No.58, 2003–04, *Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004*, p.182, and earlier reports.

5.38 The 'B' internal control issue reported during the 2004–05 interim audit[61] was that the department had not yet completed business continuity planning.

5.39 Health responded positively to the ANAO's observations and recommendations and was addressing the deficiency. The ANAO will review progress on this issue as part of the 2005–06 financial statement audit.

5.40 A new issue noted during the final audit for 2003–04 was inadequate understanding and awareness within Health of the authorisation process

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[60] Financial statement audit issues reported in management letters are categorised as level A, B or C:

- A–those matters that pose significant business or financial risk to the agency and must be addressed as a matter of urgency. This assessment takes account of both the likelihood and consequences of the risk eventuating;
- B–control weaknesses that pose moderate business or financial risk to the agency or matters referred to management in the past, which have not been addressed satisfactorily. These would include matters where the consequences of the control weakness might be significant, although there is little likelihood of the consequences eventuating; and
- C–matters that are procedural in nature or minor administrative failings. These could include relatively isolated control breakdowns, which need to be brought to the attention of management.

[61] Financial Statement audits are conducted in two phases. In the first phase (interim audit) the emphasis is on the reliance the auditor can place on the entity's internal controls in forming an opinion on the accuracy and completeness of the financial statements. In the second phase (final audit) the auditor completes the testing needed to form an audit opinion.

required under FMA Act regulations 10 and 13.[62] Health's control procedures identified this issue and Health notified it to the ANAO.

5.41 The ANAO's audit of Health's financial statements for 2003–04 was a controls-based audit. That is, the ANAO, in conducting the audit, was able to place reliance on Health's internal control. There was no need to conduct extra testing as a result of being unable to rely on controls.

5.42 Health's Audit and Fraud Control Branch, at the request of the Secretary, has conducted 12 Branch Administrative Compliance Audits during 2002–03 and 2003–04. The results of these audits indicate an increasing degree of compliance with the department's control framework, with the assessment in recent audits being a high degree of compliance.

5.43 In summary, the reduction in the number of issues identified in financial statement audits from 2001 to 2005, the single issue in 2005, the fact that it only poses a moderate business or financial risk, and that in 2003–04 Health's control procedures, not the ANAO, identified the non-compliance with FMA Act Regulations 10 and 13, are indicative of an organisation with sound control activities. The fact that the ANAO was able to conduct a controls-based audit of Health's 2003–04 financial statements and the results of the Branch Administrative Compliance audits conducted in 2002–03 and 2003–04 are also consistent with sound control activities.

Audit finding

5.44 The quality of Health's control activities is sufficient to produce accurate and reliable financial statements. The interim audit of Health's financial statements for 2004–05 found only one issue posing a moderate business or financial risk and no issues posing a significant risk. The type of issue identified, the small number of issues, and the fact that it only poses a moderate risk, are consistent with sound control activities.

Monitoring controls

5.45 Monitoring of controls is defined in AUS 402 as '… a process to assess the effectiveness of internal control performance over time'.[63] The ANAO examined the following control monitoring processes in Health:

- Health's Audit Committee;

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[62] Regulation 10 requires agencies to seek the written authorisation of the Finance Minister (or delegate) for future spending proposals for which there is no appropriation. Under Regulation 13, a person cannot enter into a contract, agreement or arrangement under which public money is, or may become payable, unless the proposal to spend public money has been approved under Regulation 10.

[63] op. cit., AUS 402 para .97.

- internal audit;
- management representation letters; and
- CSA.

5.46 The better practice principles against which Health's Audit Committee and internal audit function have been assessed can be found in the ANAO Better Practice Guide *Public Sector Audit Committees.*[64]

5.47 In July 2004, the ANAO published an audit report *Management of Internal Audit in Commonwealth Organisations* (hereafter referred to as ANAO Audit Report No.3).[65] Fieldwork for that audit was conducted in four agencies, including Health. A product of this audit was the *Management Report on the Management of the Internal Audit Function in the Department of Health and Ageing* (the Management Report).[66]

5.48 ANAO Audit Report No.3 and the Management Report were an important source of information for this audit. Fieldwork for this report was designed to supplement and confirm ANAO Audit Report No.3. It included (but was not limited to) interviews or discussions with the independent member of Health's Audit Committee and an ANAO officer who attends Health Audit Committee meetings as an observer.

5.49 Health agreed to all recommendations in the Management Report. A review of the minutes of recent meetings of Health's Audit Committee indicates that most recommendations were being addressed.

Health's Audit Committee

5.50 Section 46 of the FMA Act states:

> A Chief Executive must establish and maintain an audit committee for the Agency, with the functions and responsibilities required by the Finance Minister's Orders.

5.51 In this audit the ANAO reviewed the charter of Health's Audit Committee, the composition of the Audit Committee and the support provided to members. Before coming to a conclusion, ANAO Audit Report No.3 and the Management Report were reviewed.

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64 ANAO Better Practice Guide, February 2005, *Public Sector Audit Committees–Having the right people is the key.*

65 ANAO Audit Report No.3, 2004–05, *Management of Internal Audit in Commonwealth Organisations.*

66 Management reports to entities involved in cross-agency audits are not published.

5.52 The FMA Orders[67] establish functions and responsibilities of audit committees in FMA Act organisations. These include:

- the approval of internal annual and strategic audit plans;
- the review of all audit reports, both from internal auditors and the Auditor-General, involving matters of concern to senior management of the agency, including the identification and dissemination of good administrative practices;
- advice to the Chief Executive on action to be taken on matters of concern raised in these reports;
- as far as practicable, the coordination of audit programmes conducted by internal auditors with those conducted by the Auditor-General; and
- advice to the Chief Executive on the preparation and review of financial statements.

5.53 The roles and functions of Health's Audit Committee are stated within its charter and are consistent with the FMA Orders.

5.54 Health's Audit Committee Charter was modelled on the ANAO's 1997 *Better Practice Guide for Audit Committees*. In February 2005 the ANAO released a new better practice guide for Audit Committees.[68] Health's Audit Committee has considered a revised Audit Committee Charter, which it will finalise in light of the ANAO's new better practice guide.

5.55 Health's Audit Committee has five members, at least one of who must be external to the department. Appointments are for an initial period not exceeding three years (one year for the Chair). Currently, a Deputy Secretary chairs the committee and there is one external (independent) member.

5.56 Two internal members are selected by the Secretary on their personal qualities,[69] skills and experience from two pools, one comprising State Office managers and the other divisional managers from Central Office. This ensures that the Audit Committee has members with a strong knowledge of both State and Central Office operations. The fifth member is the Chief Operating Officer, who brings governance and business process expertise to the committee.

5.57 The need for support and education of audit committee members is discussed in the ANAO Better Practice Guide.[70] Health has provided support activities such as:

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67 FMA Orders, sections 2.1.1 and 2.1.2.

68 op. cit., ANAO Better Practice Guide.

69 ibid., p.15.

70 ibid., p.18.

- providing the external member with funding to attend the Institute of Internal Auditors' annual conference in 2003;
- providing another member with training in financial literacy;
- verbal briefings to members on current developments in the department by the Assistant Secretary, Audit and Fraud Control Branch; and
- briefings to the Committee by the managers responsible for major initiatives, strategies and processes.

5.58 Other possible ways for an agency to assist independent members of the Audit Committee to acquire and maintain an adequate knowledge of agency operations include:

- inviting independent members to attend the monthly meetings of the Executive Board of Management (or equivalent body) as observers;
- providing the independent members with copies of the minutes of appropriate governance committees; and
- providing independent members with copies of relevant internal reports.

5.59 The Management Report made eight recommendations, two of which concerned Health's Audit Committee. These covered:

- review of the Audit Committee Charter; and
- the development of and reporting against key performance indicators for Health's Audit Committee.

5.60 The evidence from this audit, ANAO Audit Report No.3 and the Management Report has led the ANAO to conclude that Health's Audit Committee is effective.

Internal audit

5.61 In order to reach a conclusion on the effectiveness of Health's internal audit function, the ANAO used the results of ANAO Audit Report No.3 and the associated Management Report. This was supplemented by a review of the processes use to appoint, and the support provided to, Health's Chief Internal Auditor (CIA).[71]

[71] The head of internal audit. Other titles used for this position include Director Internal Audit, Head of Internal Audit, and National Manager Audit.

5.62 The Management Report made six recommendations on Internal Audit. These covered:

- review of the Audit and Fraud Control Branch charter;
- reporting the rationale for the inclusion of audit topics on the shortlist for the proposed (internal audit) work plan;
- better documentation of aspects of the work of Audit and Fraud Control Branch (two recommendations);
- better use of fraud control performance measures; and
- Audit and Fraud Control Branch reporting against key performance indicators.

5.63 Recalling that ANAO Audit Report No.3 was a cross agency audit, the report concluded that:

> each of the audited Commonwealth organisations had established an internal audit group, with responsibilities and accountabilities that were largely consistent with better practice guidance and professional requirements, as well as the legislative requirements of Commonwealth audit committees.

5.64 The introduction of the FMA Act (on 1 January 1998) placed an increased emphasis on the responsibility of Chief Executives for the efficient and effective use of resources.[72] Health's Secretary, as the Chief Executive of an FMA Agency, requires assurance on the use of the Commonwealth resources for which she is responsible. A key position in providing that assurance is that of CIA. Section 44 of the FMA Act has significantly increased the skills and experience that agencies have expected from officers appointed to the position. This has been reinforced by developments in other areas of auditing in response to high profile corporate failures, which have increased the emphasis on robust internal control.

5.65 In recent times Australian Government departments have exercised a number of options for appointing and supporting CIAs.[73] These range from an in-house internal audit group, to outsourcing of the function, including the CIA position. Health has chosen to have an in-house internal audit group, supplemented by contractors to assist with the conduct of audits.

5.66 In Health, appointees to the position of Manager, Audit and Fraud Control Branch, are senior executives from within the department. They are

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[72] Section 44 of the FMA Act reads 'A Chief Executive must manage the affairs of the Agency in a way that promotes proper use of the Commonwealth resources for which the Chief Executive is responsible. In this section **proper use** means **efficient, effective** and **ethical** use.'

[73] op. cit., ANAO Audit Report No.3, 2004–05, pp.64-68, 'Staffing the internal audit group in audited organisations'.

appointed by the Secretary on the basis of their personal qualities, skills and experience. These officers bring a sound understanding of the department's objectives and operations to the position. Health rotates officers through the CIA position every three to four years. The officers supporting Health's CIA have considerable audit experience.

5.67 The evidence from ANAO Audit Report No.3, the Management Report, and from this audit have led the ANAO to conclude that Health's internal audit function provides an effective contribution to internal control.

Management representation letters

5.68 Health uses management representation letters[74] to obtain written assurance that the information provided by business units (divisions and state offices) on their financial transactions during the year has been recorded in accordance with standards and procedures and is materially correct. The managers of business units prepare the letters, which have a fixed format and contain a series of questions on control procedures and matters that may affect the accuracy of the information supplied.

5.69 The introduction of CSA will allow business unit managers to use the results of the CSA process to assist in the preparation of their management representation letters. Once introduced, this would provide the Audit Committee with greater reason to be confident in representations made in the letters.

Control Self Assessment

5.70 Health established a CSA programme during 2003–04. The programme comprises a series of checklists that test compliance with instructions and controls such as finance regulations and CEIs. The checklists are completed quarterly by state office, division, branch and section managers. The checklists were developed within internal audit through a combination of review of legislation and workshops. The CSA programme requires the managers completing it to explain the action proposed for each instance of non-compliance. The introduction of CSA has strengthened Health's ability to monitor its controls.

5.71 A robust CSA programme will have a clear link to the entity's risk assessment function. It is logical that controls implemented to address newly identified business risks should become part of the CSA report, making CSA part of the risk management reporting process. Without this link Health's

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[74] For further information see <www.auasb.gov.au/standards.htm>, AUS 520, (July 2002), *Management Representations*.

Audit Committee, Executive and Secretary will have difficulty in obtaining adequate assurance that Health's control activities are addressing all significant risks satisfactorily.

5.72 Audit and Fraud Control Branch developed the CSA programme. However, the process is a control, not an audit activity, and more properly belongs to line management. Therefore, it should be managed within Health's Business Group with the risk management function and other internal control activities.

5.73 A principle of auditing is that, to avoid conflict of interest, auditors do not audit systems that they have developed. A transfer of responsibility from internal audit would allow CSA to be subject, like other control processes, to routine internal audit review.

5.74 The ANAO suggests that, in order to allow Audit and Fraud Control Branch to provide assurance to the Audit Committee and Secretary on the robustness and effectiveness of the CSA process, Health move responsibility for the process from Audit and Fraud Control Branch to the Business Group.

Audit finding

5.75 Health has effective processes in place to monitor its controls. However, these processes would be strengthened if Control Self Assessment were clearly linked to Health's risk assessment processes.

Recommendation No.1

5.76 The ANAO recommends that, in order to ensure the effective functioning of control systems, including their ability to reduce risks to an acceptable level, Health establish a clearly expressed link between the department's Control Self Assessment and risk assessment processes.

Health's response

5.77 Agreed.

External audit and internal control

5.78 An external auditor who finds non-compliance with legislation or accounting standards, or a deficiency in internal control, will report the finding to the management of the entity, and if the finding poses a significant risk, to the entity's governing body. In cases where the entity finds the non-compliance or deficiency and notifies both management and the auditor, the auditor will examine the action taken by management and note management's diligence. In such a case the auditor's assurance to the entity's governing body on internal control is likely to be positive.

5.79 On the other hand, in situations where the external auditor is often drawing the entity's attention to issues that have not previously been identified by management, the auditor's opinion on internal controls is likely to be negative. Recent ANAO audits of Health's financial statements have identified few additional financial management or internal control issues.

Internal control—overview

5.80 Table 5.3 uses the findings in this Chapter to provide an overview of internal control in Health.

Table 5.3

Internal control in Health–overview

Component	Finding
Control Environment	Good progress towards a robust control environment.
Risk Management	At the time of audit fieldwork—no support for internal control. From June 2005—adequate support.
Information Systems	Provide reliable information on the resources used by Health—with some exceptions.
Control Activities	Consistent with the provision of adequate support for internal control.
Monitoring of Controls	Effective processes in place.

Source: ANAO.

Conclusion—Chapter 5

5.81 In this Chapter the ANAO examined whether internal control provided adequate assurance to Health's Secretary and Executive on the effective and efficient use of resources.

Audit finding

5.82 The ANAO found that, with the exception of the inadequate support for internal control resulting from the lack of a department-level risk assessment, Health's internal control systems and procedures provide an adequate contribution to the assurance provided to Health's Secretary, Executive and managers on the efficient and effective use of Commonwealth resources. The introduction in June 2005 of revised risk assessment processes should address the remaining significant internal control deficiency.

5.83 This Chapter contains suggestions and one recommendation to assist in improving Health's internal control.

6. Health's Approach to Strategic Financial Management

This Chapter examines whether Health's approach to strategic financial management is adequate to assist Health's Secretary and Executive put in place the resources and capabilities to efficiently and effectively meet future challenges.

Strategic financial management

6.1 Health manages the second largest administered budget ($38.7 billion) in the Australian Government and $457 million in departmental funds.[75] This is a significant responsibility. Good stewardship of these funds requires both control over immediate spending and an understanding of the long-term factors that will affect future spending. Consequently, in order to meet its responsibilities, Health must demonstrate a 'strategic approach' to financial management in addition to establishing a sound financial management framework and maintaining strong internal controls.

6.2 The size of these appropriations means that even small changes in population, technology or methods of service delivery can have a significant impact on Health's financial results and those of the whole Australian Government. Consequently, it is important that Health has a strategic approach to financial management in order to anticipate and address the medium to long-term impacts on the moneys for which it is responsible.

Assessing strategic financial management

6.3 To assist readers, the ANAO has first described aspects of strategic financial management in the public sector. Then, in order to assess strategic financial management in Health the ANAO has examined whether Health:

- had analysed its current and expected environments and used this analysis to identify factors affecting its medium and long-term strategies;
- had developed financial strategies, plans and goals to assist it to meeting its medium and long-term operating challenges; and
- was monitoring progress against its medium and long-term financial strategies and plans.

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[75] Commonwealth of Australia 2004, Budget Paper No. 4, *Agency Resourcing 2004–05*, CanPrint Communications Pty Ltd, Canberra, p.321.

Strategic financial management in the public sector environment

6.4 In the public sector, strategic financial management is the process by which an organisation works to have at its disposal the resources and capabilities, now and in the future, to efficiently and effectively deliver to the community the services and results required by the Government and Parliament.

6.5 A strategic approach to financial management will require attention to both administered and departmental expenses. The principles of strategic financial management will be the same for both types of appropriation. However, in practice the laws and rules governing financial management in the Commonwealth will vary the extent to which the two types of appropriations can be managed strategically. These differences are discussed below.

Administered expenses

6.6 While departments of state do not make decisions about the size of their administered budget or allocation of that budget to outcomes, they provide Government with policy and planning advice, and options on use of those funds. Consequently, to advise Government, departments of state and other Government agencies must identify the medium to long-term, internal and external factors affecting administered appropriations.

6.7 A factor affecting the strategic financial management of administered funds is the size of the resources allocated to particular programmes. Where these are large, central departments[76] have a greater role in providing advice to Government on the size and allocation of resources. For example, because the Medicare Benefits Scheme and the Pharmaceutical Benefits Scheme represent a significant proportion of Australian Government spending, Health is not the only party that provides advice to Government. The Department of the Treasury and the Department of Finance and Administration also review and advise on funding.

Departmental expenses

6.8 Departmental appropriations finance the organisational infrastructure or capabilities necessary to deliver to the community the services required by the Government.

6.9 In this context, government agencies require:

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[76] Departments such as Department of the Prime Minister and Cabinet, Department of Finance and Administration, and Department of the Treasury.

- employees with appropriate skills—employee related expenses will be a major component of the budgets of most government agencies, so that consideration of the current and future cost of staff, including wage and training requirements, is a critical component in all long-term planning;
- the physical infrastructure such as buildings, communications and other plant and equipment;
- information systems needed by management to make decisions (for example, information systems that support management decision making, and financial management); and
- business processes to ensure planning and control of the resources for which the organisation is responsible.

6.10 It would be expected that government agencies will develop and implement medium to long-term plans for these resources and capabilities because employees, physical infrastructure and information systems will represent a significant proportion of the budgets of most government agencies. This planning will help ensure that future organisational infrastructure requirements are anticipated and that an agency's scarce resources are allocated in the most effective and efficient manner possible.

Analysing the environment

Identification of strategic risks

6.11 A key tool in developing robust medium and long-term strategies is robust risk assessment and risk response. Without this, assurance that strategic planning addresses the major long-term risks facing the entity is difficult. In Chapter 2 the ANAO found that, at the time of audit fieldwork, Health had not developed a department-level risk assessment and response process. In June 2005, Health intends to introduce a new risk management process, which will include the identification and management of 'enterprise risks'—defined as 'those risks that can impact on the strategic objectives of the department'.

Medium and long-term impacts on administered appropriations

6.12 In order to have a strategic approach to the financial management of its administered appropriations, Health must monitor current and future factors affecting spending in these areas. The ANAO examined the methods used by Health to forecast expenditure for its major programmes. Table 6.1 shows that in 2004–05, administered spending on the Medicare Benefits Scheme (MBS), the Pharmaceutical Benefits Scheme (PBS), Australian Health Care Agreements (AHCAs) and Aged Care represents 78 per cent of the administered appropriations for which Health is responsible.

Table 6.1

Health's largest administered appropriations—2005–06

Appropriation	Outcome	Budget Estimate 2005–06 ($m)	Percentage of total Health administered appropriation
Health Insurance Act 1973—Medical Benefits	2	10 423	27
Health Care (Appropriation) Act 1998—Australian Health Care Agreements—Provision of Designated Health Services	2	8 388	22
National Health Act 1953—Pharmaceutical Benefits	2	6 508	17
Aged Care Act 1997—Residential Care subsidies	3	4 648	12
Total		29 967	78
Total administered appropriations		38 605	100

Source: Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio,* CanPrint Communications Pty Ltd, Canberra.

6.13 The models[77] Health uses to forecast forward estimates for both the MBS and PBS identify trends in historical data and project these trends into future years. Health takes information on the actual usage of medical services and pharmaceutical goods from the HIC's daily transaction records. The models also take into account changes in policies, demographic forecasts and other known changes such as fee increases due to a rise in the average complexity of services or the addition of new drugs to the Pharmaceutical Benefits Schedule.

6.14 Health uses the MBS model to both provide estimates for the Government's budget estimates and also to understand the financial effect of different policies beyond the four-year forward estimates period.

6.15 AHCAs set out the Australian Government's payments to State and Territory Governments for public hospitals. The agreements are established through negotiation between the Australian and State and Territory Governments. The current agreement, which runs from 2003 to 2008, allows for

[77] This audit describes models used by Health to forecast expenditure for major programs, but does not comment on the validity of those models.

payment of $42 billion to States and Territories during the life of the agreement.

6.16 The formula for calculating the payments is defined in each agreement. The formula takes into account changes in population growth and ageing weighted for 2000–01 hospital morbidity data, and variations in wage and non-wage costs with expenditure estimates revised regularly to reflect the parameter changes. A growth factor for demand for in-hospital services outside of the effects of population and ageing is also included in the formula and was negotiated at the time of signing the Agreements. Health has a model for calculating estimates of future payments under the current Agreements. This model may also be used to inform the development of future Agreements.

6.17 Health has developed models to calculate forward estimates and forecast future demand for aged care services. The residential aged care service subsidy model calculates Health's forward estimates by determining trends in actual aged care subsidy payments and projecting these into the future. The trends are based on various parameters including population data and participation rates for residential aged care.

6.18 Health has also developed the 'Aged Care Dynamic Cohort Model', which estimates the private and public cost and revenue impacts of alternative economic and aged care policy assumptions over the next forty years. The model's parameters include both supply and demand factors that influence aged care costs. The model appears to be a comprehensive approach to understanding the impact of external factors that will affect aged care in the long-term.

6.19 In summary, Health identifies and monitors the factors likely to affect future appropriations for the administered funds for which it is responsible. It has developed models to provide forecasts of expenditure, which are the basis of four-year forward estimates for the Portfolio. The models are also used in investigating the financial impact of alternative policies beyond the four-year forecast.

6.20 Health's analysis of environmental factors affecting administered funds is also used to inform the preparation of Division and State Office business plans. Examination of these plans revealed that while their primary emphasis is on the current (or upcoming) financial year, they also include plans for future years. Business plans focus on both the achievement of programme goals and the departmental resources needed to reach them. They are one mechanism whereby the analysis of environmental issues affecting administered funds flows through into planning for departmental funds.

6.21 Another area where planning for the implementation of government policy flows through to departmental funds is new policy proposals. These

must advise Government on both the administered funds required to meet government objectives (or the likely impact from the funding proposed) and the departmental funds needed to support the proposed programme.

6.22 The funding for many government programmes lapses every four years because of the legislation that establishes them. Before funding is continued beyond the four-year period, an examination of the effectiveness and efficiency of the programme is undertaken. If the review makes a recommendation to continue a programme's funding, information on the proposed level of administered and departmental funding is also required. The approval process for continuation of a lapsing programme is the same as for a new policy proposal.

Medium and long-term impacts on departmental appropriations

6.23 Health has identified the following operational and capital funding pressures on departmental appropriations:

- funding the Scarborough House fit-out, redevelopment and associated staff relocation and accommodation consolidation;
- funding for Information Technology, including network infrastructure;
- funding of Certified Agreements;
- ongoing efficiency dividend–1 per cent[78] ongoing reduction in departmental appropriations;
- development of a common grants management system;
- development of a common data-warehouse for Medicare, the Pharmaceutical Benefits Scheme and Casemix;
- costs associated with possible Administrative Orders; and
- output pricing review[79]–$6 million ongoing reduction in departmental expenses.

6.24 In summary, Health uses information from Division and State Office business plans, and from the department level analysis, to identify the factors likely to affect its medium and longer-term costs.

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[78] Increased to 1.25 per cent in the 2005 budget.

[79] Department of Finance and Administration output pricing reviews were used to assess the effectiveness, efficiency and economy with which government agencies deliver their outcomes and outputs. A suite of techniques, including benchmarking comparisons, was used to determine whether the 'price' government paid for a particular outcome or output was reasonable.

Audit finding

6.25 Health has analysed its current and expected environments and used this analysis to identify factors affecting its medium and long-term financial strategies. Its analysis of administered expenses informs the Government's four-year forward budget estimates, and is used to investigate the financial effects of alternative policies during and beyond this four-year forecast.

6.26 Factors affecting administered expenses are, where relevant, also used to inform forward estimates of departmental funds. Health also conducts analysis at whole-of-agency level of non-programme related factors (such as the impact of Certified Agreements) that affect its need for and use of departmental funds.

6.27 The robustness of Health's long-term strategies will be enhanced by planned improvements to long-term risk management.

Developing strategies

Financial reform

6.28 As discussed in Chapter 1, there have been significant changes in the public sector over the last 20 years. The changes include the passing of the *Financial Management and Accountability Act 1997*, *Auditor-General Act 1997*, *Public Service Act 1999* and the move to accrual budgeting from 1 July 1999. These external pressures were an important factor leading to financial reform in Health. The starting point for Health's recent financial management reforms was a report from the Financial Management Review Group[80] presented to the Secretary in April 2002, that examined the:

- existing and future financial pressures facing the department;
- appropriateness of policies and organisational arrangements for improving financial management;
- appropriateness and adequacy of IT, processing and support systems; and
- best use of resources in meeting existing and emerging needs.

6.29 This report built on previous reviews, including Health's review of its corporate services, as part of an exercise to determine the scope for outsourcing some or all of these services. An internal report, *Service Profile–Financial Services* identified a number of areas where service delivery needed improvement.

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[80] The terms of reference for the Financial Management Review Group can be found in Appendix 5.

6.30 The April 2002 report recommended a range of initiatives to improve the department's financial management through streamlining business processes, improving the quality of financial data and identifying cost savings. The Secretary accepted most recommendations and since then the department has implemented a majority of the report's recommendations. The remaining accepted recommendations have progressed but Health requires more time to finalise their implementation.

6.31 Examples of completed initiatives include:

- integration of programme administration systems[81] into the central financial management information system;
- travel administration reforms including electronic movement requisitions, a central accommodation reservation service and changes to staff entitlements;
- introduction of electronic purchase requisitions, purchase orders, vendor requests and approval of human resource forms; and
- an increase in the amount of information transferred electronically including invoices for office services, credit card reconciliations, accommodation, and travel payments.

6.32 A critical factor in the review's success in improving financial management in the department was the Secretary's unambiguous support for its recommendations.

6.33 Other initiatives that demonstrate Health's improving financial management of departmental funds include:

- a budgeting process that was similar to a zero-based budgeting[82] exercise during development of Health's 2003–04 budget. This was to identify and eliminate activities that represented poor value for money. It was the first occasion on which Health used techniques such as zero-based budgeting; and
- one division developed an initiative to improve the financial management capability of staff it recruits by allocating applicants to

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[81] Program administration systems assist departments to manage the programs for which they are responsible by recording relevant information and in some cases calculating the payments due to recipients of government funding. For example, a grant program system would record information about all grant recipients, including payments made or due, contact details, performance requirements and reporting dates.

[82] Zero based budgeting is a method of budgeting which requires each cost element to be specifically justified, as though the activities to which the item relates were being undertaken for the first time. Without approval, the budget allowance is zero.

policy, data management or finance streams. As mentioned earlier, the department's People Branch has now taken up this initiative and applied it more widely.

6.34 Discussions with senior management including the Secretary, Deputy Secretaries, Chief Operating Officer (COO) and Chief Financial Officer (CFO), coupled with the department's ongoing reforms, indicate Health's continuing commitment to improving its financial management.

6.35 Discussions with management revealed that, in the recent past, inaccurate costing of new policy proposals in some new programmes resulted in them being under-resourced. Health has attempted to address this issue by developing a common approach to costing new policy proposals. Health's emphasis on financial management training will also contribute, in the future, to improved costing and greater consistency between policy objectives and forward estimates.

Strategy documents

6.36 Health has recently developed a series of key strategic documents including the Financial Strategy 2004–05 to 2007–08, the People Strategy, an Information Technology Strategy and Road Map and a Property Master Plan. These documents address three of the department's largest expense items, employees (35 per cent of total expenses), information technology (13 per cent of total expenses) and property (7 per cent of total expenses). A description of each document is provided in Table 6.2.

Table 6.2

Strategic planning at Health

Plan level	Description
Financial strategy	Identifies initiatives in four key areas: financial viability; organisational reform; investing in our people; and continuous improvement in business systems and processes.
People strategy	Includes strategies in nine key areas and states key performance indicators for each area including the current performance and a target.
Information technology strategy and road map	Assesses the current IT environment, states Health's IT goals and broadly indicates how they will be achieved.
Property master plan	Identifies the characteristics the department requires of its accommodation, states some goals for its property portfolio and summarises short, medium and long-term strategies to achieve them.

Source: ANAO analysis of information provided by Health.

Financial Strategy 2004–05 to 2007–08

6.37 Issued in November 2004, Health's financial strategy addresses the issues affecting departmental expenses and builds on the recently implemented financial reforms. This document also demonstrates Health's focus on medium and long-term management of departmental funds, including planning for long-term asset replacement.

6.38 The financial strategy 2004–05 to 2007–08 represents a significant achievement because it articulates the department's financial strategy. However, there are a number of areas where further development may be beneficial. A summary of the issues identified in the financial strategy and the ANAO's observations on these issues are shown below.

Pressures—a substantial list of emerging budgetary pressures is identified, but these are only quantified for the 2004–05 financial year. To be fully effective, the strategy should look further ahead, and the pressures should be quantified, for the full period of the strategic plan.

Maintaining financial viability—given the potential size of the emerging pressures (estimated at $16.8 million in pressures on staff, Information Technology and property-related costs in 2004–05), greater detail would be useful in identifying how these pressures will be funded from internal savings or additional appropriations.

Organisational reform—the organisational strategy seeks to improve financial management by automating or simplifying financial processes and procedures. This allows finance staff to focus more on reporting and analysis of financial results than simply data processing. Greater specificity is necessary to clarify how changes to financial processes and procedures are likely to be achieved.

Recruiting and training—the strategy could be improved by identifying targets for qualification levels across the department, as an aid to assessing the increased professionalism of the department's finance-related staff.

Strategic financial analysis—while details of Health's four-year estimates are in the financial strategy, some explanation of the significant trends and strategies to address them would be beneficial. The financial strategy states that budget pressures will only be identified at the time of each annual review process. This limits the ability of the department to develop a comprehensive long-term financial strategy.

6.39 The ANAO recognises that the department is currently developing additional performance measures, which will be included in future financial strategy documents.

People Strategy 2004–07

6.40 Health has identified nine components in its People Strategy 2004–07. They are workforce health, recruitment and selection, learning and development, performance management, workforce planning, workforce diversity, organisational development, rewards and recognition, and employee relations. Each component states Health's targets including key performance indicators to measure the current and expected performance. Broad strategies for achieving these targets are stated.

Information Technology Strategy and Road Map

6.41 Organisations need IT strategies to ensure information systems objectives are consistent with broader entity objectives, investments in systems are ranked by priority, and developments in IT are exploited at the best time.

6.42 The ANAO examined Health's Information Technology Strategy and Road Map and found it adequately investigates the existing condition of Health information systems, states Health IT goals and broadly indicates how they will be achieved.

Property Master Plan

6.43 The ANAO found that Health has a sound property planning structure based on a hierarchy of the property master plan, property business plan and individual property plans. The aim of the property master plan is to identify Health's property strategy over a 10-year period.

6.44 The property master plan identifies the characteristics the department requires of its accommodation, states some goals for its property portfolio and summarises short, medium and long-term strategies to achieve them.

6.45 The property portfolio business plan identifies the initiatives to be implemented in the next year and sets targets. Health has contracted management of its property services to an external party, and so the use of performance targets is particularly important to effective operational and financial management.

Financial plans

6.46 Financial and business planning at Health is described in Table 6.3. It consists of preparation of the department's external planning document (the Portfolio Budget Statement), and Health's internal planning documents, division, state and branch business plans.

Table 6.3

Financial plans at Health

Plan level	Description
Portfolio Budget Statements	Sets out the strategic direction for Health for the next four years as approved by Parliament. Outcomes, programmes, costs and performance measures are stated.
Division, state and branch business plans	The plans require divisions/states/branches to identify how they will contribute to the department's six key priority areas. The plans include activity identification, resource allocation, risk identification and mitigation plans, measures and targets.

Source: ANAO.

6.47 The Budget estimates and forward estimates for Health for the next four years are outlined in the Portfolio Budget Statements for the Health and Ageing Portfolio,[83] and performance against these is monitored through monthly management reports and external reporting to the Department of Finance and Administration. Health reports its performance against key indicators, identified by Health in its Portfolio Budget Statements, and in its Annual Report.

6.48 The division, state and branch business plans state the programmes for which they are responsible and outline how they will be implemented. Business plans have been mandatory for the last two years, with the planning process still evolving. Discussions with staff in divisions and state offices indicated an important initiative for the 2004–05 planning process was the establishment of 'Key Priority Areas' (KPAs). KPAs are the broad goals/objectives that Health has agreed with the Government. All proposed activity must contribute to these KPAs. These steps have given the Secretary and Executive greater control over the department's activities and provided a well-defined strategic direction for divisions and state offices.

Financial goals

6.49 The Portfolio Budget Statements establish Health's intended financial outcomes for the next four financial years.

6.50 As stated earlier, Health's financial strategy for 2004–05 to 2007–08 identifies the financial pressures expected to face the department and outlines

[83] See Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio,* CanPrint Communications Pty Ltd, Canberra, pp.167–183.

initiatives to meet them. The strategy identifies only one financial target: 'maintaining modest operating surpluses (in the order of $2 million to $4 million)'.[84] However, Health is developing other financial targets and performance measures.

6.51 The people strategy and property plans establish a range of key financial and non-financial goals. The people strategy states the current and target performance for each strategic component. A similar approach is adopted in the Property Portfolio Business Plan that identifies as a key goal for 2004–05 reducing the average discretionary annualised cost for property to $40 per square metre.

6.52 While this represents better practice, the medium and long-term targets identified in the people strategy and property strategy documents are not represented in the overall financial strategy or in a Departmental Performance Report. There would be value in monitoring, at a departmental-level, these and other key financial goals, developed by individual branches and sections.

Audit finding

6.53 Health has developed financial strategies, plans and goals to support its medium and long-term operating challenges. It has developed a number of strategy documents, including a *Financial Strategy 2004–05 to 2007–08*. Health's financial plans are set out in the Portfolio Budget Statement for the Health Portfolio and in division, state, and branch business plans.

6.54 However, the ANAO found that while business-planning processes have been established for two years, they are still being refined and that better financial performance measures should be developed and monitored. Health is currently developing further performance measures.

Monitoring progress

6.55 Operational reports (described in Chapter 3) provide Health's Secretary and Executive with much of the data needed to monitor progress against strategic plans: for instance, Health's target of maintaining modest operating surpluses. Progress against that target in the current year is monitored using operational data from operating reports.

6.56 Operational reports also contain information on strategic matters. An example is the component of the quarterly reports from Division Heads and

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[84] In recent years Health's financial statements have shown small surpluses. However the core department (excluding TGA and CRS Australia) has been in deficit. The deficit for 2003–04 was $2.3 million (0.53 per cent of core departmental revenue), with an accumulated core deficit of $17.9 million (15.24 per cent of core assets).

State Managers that describes strategic and emerging issues and progress against business plans, which include medium to long-term business goals. Another operational report, the Chief Financial Officer's monthly report, provides information and commentary on major financial issues and major capital projects.

6.57 Health also produces reports with a primary emphasis on strategic matters. Examples include reports prepared for the Secretary and Executive by senior finance staff on implementation of recommendations from the Financial Management Review Group's report, and on major capital projects, such as the Scarborough House redevelopment.

6.58 A balanced scorecard[85] is a tool often used to monitor progress against long-term targets and to assist with strategic implementation. Health attempted a scorecard approach several years ago, but it did not meet managements' requirements and was discontinued during 2002. Health has commenced the development of a Departmental Performance Report, which will focus initially on internal performance measures including financial goals and targets. The ANAO supports this initiative.

6.59 The introduction of a chart of accounts for administered funds which is aligned with the budget framework (see Chapter 3) from 1 July 2004, and the planned introduction of a similarly aligned chart for departmental funds from 1 July 2005, will significantly improve Health's ability to provide meaningful financial data to senior management for monitoring both strategic and operational goals.

Audit finding

6.60 Health is monitoring progress against its medium and long-term financial strategies and plans. The Secretary and Executive receive financial and performance data that allows them to monitor, develop and manage Health's financial strategies and plans. The planned introduction of a Departmental Performance Report and a chart of accounts for departmental expenses aligned with the budget framework will enhance Health's monitoring ability.

[85] A balanced scorecard is a technique developed by Kaplan and Norton (1992, 1996) for combining financial control measures with non-financial control measures. 'The Balanced Scorecard translates mission and strategy into objectives and measures' (Kaplan and Norton, 1996). It is a tool for implementing the mission and objectives of the business strategy in a way that encourages action toward achieving long-term goals and enables effective monitoring and control.

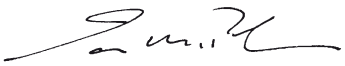
Conclusion—Chapter 6

6.61 In this Chapter the ANAO examined whether Health's approach to strategic financial management was adequate to assist Health's Secretary and Executive put in place the resources and capabilities to efficiently and effectively meet future challenges.

Audit finding

6.62 We concluded that, apart from the inadequate support for strategic financial management resulting from the lack of a department level risk assessment, the answer is yes. The introduction in June 2005 of revised risk assessment processes should address the remaining significant strategic financial management deficiency.

6.63 Health's analysis of the key factors affecting its current and future administered expenses assists it to ensure that it has the resources and capabilities to deliver to the community the services and results required by the Government and Parliament. The department has established an improved planning process, begun to invest in the financial management skills of staff, established long-term strategies for its most significant assets (people, IT and property), and implemented a series of reforms that, when viewed collectively, demonstrate a strategic approach to financial management of departmental funds.



Ian McPhee
Auditor-General

Canberra ACT
11 August 2005

Appendices

Appendix 1: The Department of Health and Ageing

1. Health is the lead agency in the Health and Ageing Portfolio. The 2005–06 Commonwealth Budget provided $39.4 billion for the Portfolio,[86] comprising $38.7 billion of administered funds and $1.1 billion of departmental funds. The Budget for the department was $38.7 billion of administered funds and $457 million of departmental funds. The Health and Ageing Portfolio has the second largest budget in the Commonwealth.

2. The vision, mission and outcomes for the Health and Ageing Portfolio can be found in Health's 2003–2006 Corporate Plan and in the Portfolio Budget Statements for 2004–05. They are:[87]

> The Health and Ageing portfolio's 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.
>
> Our 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 the Department by the Australian people, and the priorities of the Ministerial team and the Government.

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86 Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio*, CanPrint Communications Pty Ltd, p.7.

87 Commonwealth of Australia 2004, Budget Related Paper No.1.11, *Portfolio Budget Statements 2004–05, Health and Ageing Portfolio*, CanPrint Communications Pty Ltd, pp.7–8.

The services provided by the Health and Ageing Portfolio are delivered through nine[88] outcomes set by the Government:

1. Population Health and Safety: To promote and protect the health of all Australians and minimise the incidence of preventable mortality, illness, injury and disability.
2. Access to Medicare: Access through Medicare to cost-effective medical services, medicines and acute health care for all Australians.
3. Enhanced Quality of Life for Older Australians: Support for healthy ageing for older Australians and quality and cost-effective care for frail older people and support for their carers.
4. Quality Health Care: Improved quality, integration and effectiveness of health care.
5. Rural Health: Improved health outcomes for Australians living in regional, rural and remote locations.
6. Hearing Services: To reduce the consequence of hearing loss for eligible clients and the incidence of hearing loss in the broader community.
7. Aboriginal and Torres Strait Islander Health: Improved health status for Aboriginal and Torres Strait Islander peoples.
8. Choice Through Private Health: A viable private health industry to improve the choice of health services for Australians.
9. Health Investment: Knowledge, information and training for developing better strategies to improve the health of Australians.

The first three outcomes reflect the core business of the portfolio. The other six outcomes reflect key priorities for which dedicated resources are provided; most of the six outcomes also draw heavily on resources from the first three outcome areas.

3. The department is organised into five 'Health and Ageing Sector Divisions' and five 'Cross Portfolio Divisions', as shown in Figure A1.1.[89] The department's State and Territory Offices are also key contributors to portfolio outcomes. The Secretary has delegated certain of her financial powers to Division Heads and State and Territory Office managers to allow them to manage the departmental and administered funds for which they are responsible. Each Division or State and Territory Office has a small finance cell to assist its managers.

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[88] The outcome structure for 2005–06 has been increased to 11. See Commonwealth of Australia 2005, Budget Related Paper No.1.11, *Portfolio Budget Statements 2005–06, Health and Ageing Portfolio,* CanPrint Communications Pty Ltd, p.9.

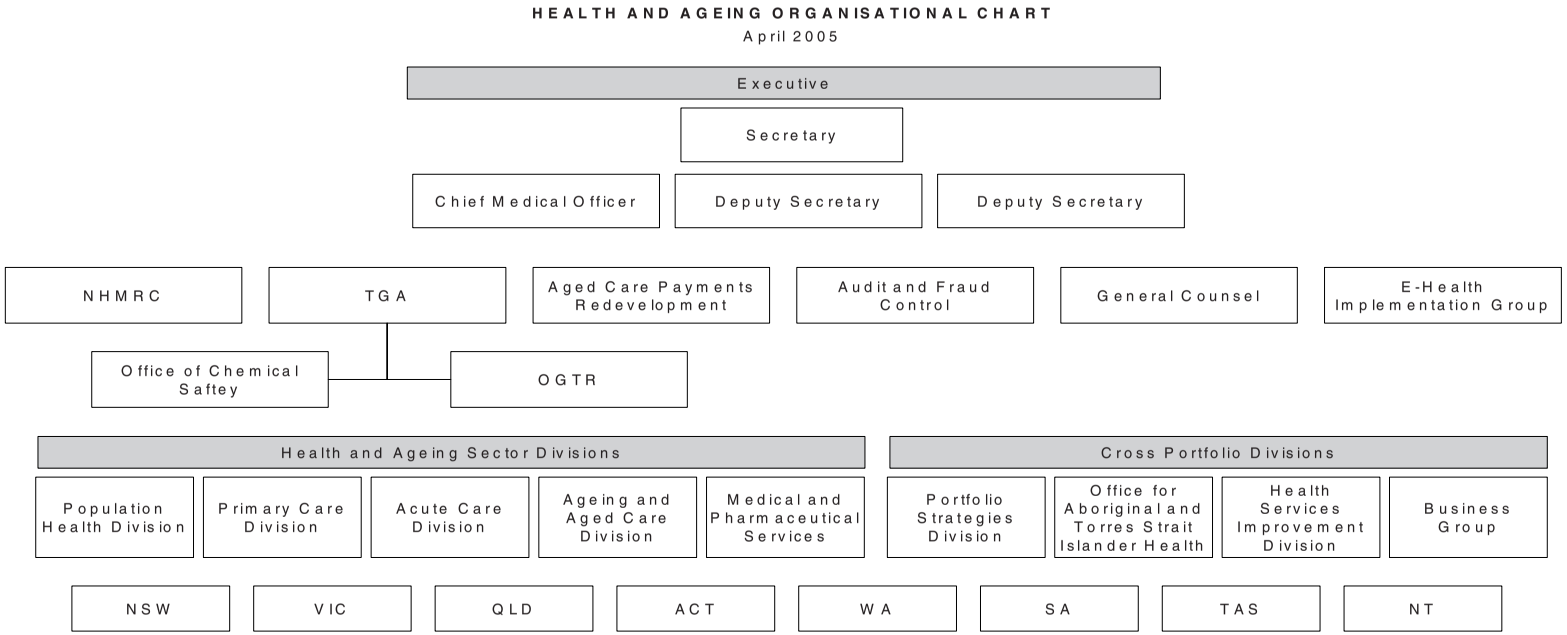
[89] A description of the roles of Health's divisions can be found on its website, <www.health.gov.au>.

4. The Therapeutic Goods Administration (TGA) operates as a division of Health, but with its own audited and published accounts and administrative structure. As shown in Figure A1.1, the Office of Chemical Safety, the National Industrial Chemicals Notification and Assessment Scheme (NICNAS) and the Office of the Gene Technology Regulator (OGTR) operate under TGA's umbrella.

5. The National Health and Medical Research Council (NHMRC) is an independent body established by statute, which, through arrangement, is resourced by Health. Audit and Fraud Control, Aged Care Payments Redevelopment and the General Counsel are branches or officers that report directly to the Secretary and Executive, rather than through the divisional structure.

Figure A1.1

Health's Structure



Source: Department of Health and Ageing.

Note: CRS Australia was a part of Health to 26 October 2004. It moved to the Department of Human Services from that date.

Appendix 2: Independent Audit Report

1. Section 57 of the FMA Act requires the Auditor-General to examine and report on the financial statements of each Agency. Each year the ANAO conducts an audit of Health's financial statements. A copy of the audit report is shown below. The report gave an unqualified audit opinion on Health's 2003–04 financial statements.

2. The audit report includes a 'matter of emphasis' statement. This statement is not part of the audit opinion. Rather, it draws the attention of persons using the information in the financial statement to a matter that the auditor considers is of sufficient attention to warrant emphasis in the audit report. The matter of emphasis concerns inherent uncertainty regarding the liability under the Commonwealth's Medical Indemnity Scheme.

3. The funds involved in the Medical Indemnity Schemes are administered funds. As Health is administering these funds on behalf of the Government, it is required to account to the Government for its stewardship. The nature of the liabilities that the Government accepts through the Medical Indemnity Schemes makes them hard to estimate accurately. As a result there is a significant level of uncertainty inherent in the estimate of Medical Indemnity Scheme liabilities reported by Health in its accounting to Government. The ANAO emphasises that this uncertainty does not affect the accuracy or reliability of Health's financial statements.

Auditor-General for Australia

INDEPENDENT AUDIT REPORT

To the Minister for Health and Ageing

Scope

The financial statements comprise:

- Statement by the Secretary and the Chief Financial Officer;
- Statements of Financial Performance, Financial Position and Cash Flows;
- Schedules of Commitments and Contingencies;
- Schedule of Administered Items; and
- Notes to and forming part of the Financial Statements

of the Department of Health and Ageing for the year ended 30 June 2004.

The Secretary is responsible for the preparation and true and fair presentation of the financial statements in accordance with the Finance Minister's Orders. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial statements.

Audit approach

I have conducted an independent audit of the financial statements in order to express an opinion on them to you. My audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing and Assurance Standards, in order to provide reasonable assurance as to whether the financial statements are free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal control, and the availability of persuasive, rather than conclusive, evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

While the effectiveness of management's internal controls over financial reporting was considered when determining the nature and extent of audit procedures, the audit was not designed to provide assurance on internal controls.

I performed procedures to assess whether, in all material respects, the financial statements present fairly, in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997*, Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with my understanding of the Department's financial position, and of its performance as represented by the statements of financial performance and cash flows.

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The audit opinion is formed on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial statements; and
- assessing the appropriateness of the accounting policies and disclosures used, and the reasonableness of significant accounting estimates made by the Secretary.

Independence

In conducting the audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate Australian professional ethical pronouncements.

Audit Opinion

In my opinion, the financial statements:

(i) have been prepared in accordance with the Finance Minister's Orders made under the *Financial Management and Accountability Act 1997* and applicable Accounting Standards; and

(ii) give a true and fair view, of the matters required by applicable Accounting Standards and other mandatory professional reporting requirements in Australia, and the Finance Minister's Orders, of the financial position of the Department of Health and Ageing as at 30 June 2004, and of its performance and cash flows for the year then ended.

Inherent Uncertainty regarding the liability under the Commonwealth's Medical Indemnity schemes

Without qualification to the opinion expressed above, attention is drawn to the following matter. As indicated in Note 1.26 to the financial statements, the Department of Health and Ageing has recorded an estimate of $442.3 million in relation to the Commonwealth's liability under the Medical Indemnity schemes (i.e., Incurred But Not Received [IBNR] Scheme, High Cost Claim Scheme and Run-off Cover Scheme). The estimate is based upon information available to the Health Insurance Commission from the respective participating Medical Indemnity Insurers and on the advice of the Australian Government Actuary. As explained in the notes, there is inherent uncertainty regarding this estimate of the Commonwealth's liability and the Commonwealth will continue to conduct an assessment of this amount in future years.

P.J. Barrett

Canberra
23 August 2004

Appendix 3: Course or Diploma Outlines

Discovering Clerkliness

1. The course includes:

- the role and responsibilities of a public servant including the Administrative law framework, the Australian Public Sector Act and Australian Public Sector values and ethics;
- financial management;
- the policy/programme cycle;
- Health's planning cycle;
- Control Self Assessment framework; and
- recordkeeping and security.

Diploma of Government (Financial Management)

2. The course curriculum includes study of:

- The *Financial Management and Accountability Act 1997*, *Commonwealth Authorities and Companies Act 1997*, *Auditor-General Act 1997* and Whole of Government reporting;
- risk management;
- accountability in the Public Sector;
- Public Sector financial management and accounting;
- change management;
- implications of Goods and Services Tax and Fringe Benefits Tax;
- accounting standards;
- principles of commercial and contracts law;
- Internal Control Procedures; and
- ethics.

Appendix 4: Australian Auditing and Assurance Standard 402

1. Australian Auditing and Assurance Standards are issued by the Australian Accounting Research Foundation on behalf of CPA Australia and The Institute of Chartered Accountants in Australia. They define the areas an auditor must examine to assess the accuracy of an organisation's financial statements. These standards form the basis of the Auditor-General's auditing standards under Section 24 of the *Auditor-General Act 1997*.

2. Auditing and Assurance Standard (AUS) 402*, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements,*[90] requires auditors to assess internal control as part of the audit of an organisation's financial statements. It defines internal control and provides the auditor with guidance on the procedures to be used in assessing internal control in an entity.

3. The version used as the framework for Chapter 5 applies to audits of financial statements for financial reporting periods commencing on or after 15 December 2004.

[90] AUS 402 *Understanding the Entity and Its Environment and Assessing the Risk of Material Misstatements* (February 2004). Australian Accounting Research Foundation. It replaces AUS 402, *Risk Assessments and Internal Controls* (July 2002).

Appendix 5: Terms of Reference: Financial Management Review Report

4. The work of the Financial Management Review Group and its report were an important influence on financial management reform in Health. The terms of reference for the group are shown below.

Background

Significant improvements in financial management across the Department have been achieved during the last two years. However, the financial position for departmental expenses in 2001-02 and forward years is very tight and a number of unfunded pressures have been identified. Business units continue to express concerns about the accuracy, timeliness and responsiveness of particular aspects of financial management.

In addition, the review of financial management undertaken through the Corporate Activities Review (CAR) process indicates the need for consolidating all corporate financial responsibilities into a single area of the Department.

Proposed approach

It is proposed that the Secretary set up a small group to answer three questions:

- What are the current and future financial challenges facing the Department, and how can we best use our resource base to meet existing and emerging needs?
- Do we have the right policies, approaches and organisational arrangements in place to improve financial management ?
- Do we have the right IT, processing and supporting systems in place in the Department to best support financial management requirements?

Deliverables

Areas for immediate action by February 2002 and medium to longer-term strategies by the end of March.

The review will draw on information arising from existing reform activities (eg CAR, in particular the current FM review, the Department's financial strategy) and such other additional information as necessary.

Membership of group

A State Manager will chair the group. Membership will ensure both a high level strategic perspective and a thorough technical and operational expertise.

The group would report directly to the Secretary and be supported by Corporate Services Division (CSD) and Portfolio Strategies Division (PSD). The two corporate divisions would provide input to the group on the current state of financial management reforms, emerging financial issues, affordability and workability of possible solutions as well as financial data and reports as required.

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