The Auditor-General
Audit Report No.44 2007–08
Financial Statement Audit

Interim Phase of the Audit of Financial Statements of General Government Sector Agencies for the Year ending 30 June 2008

Australian National Audit Office

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Australian National
Audit Office

Canberra ACT
25 June 2008

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major General Government Sector agencies as part of the audits of their 2007–08 financial statements 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 Interim Phase of the Audit of Financial Statements of General Government Sector Agencies for the Year Ending 30 June 2008.

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

Yours sincerely

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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ANAO audit reports and information about the ANAO are available at our internet address:

http://www.anao.gov.au

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Abbreviations

AAO	Administrative Arrangements Order
AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
AEIFRS	Australian Equivalents to International Financial Reporting Standards
AGD	Attorney–General's Department
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
ASA	Australian Auditing Standard
ATO	Australian Taxation Office
AUASB	Auditing and Assurance Standards Board
BCM	Business Continuity Management
BCP	Business Continuity Plan
BPG	Better Practice Guide
CAC Act	Commonwealth Authorities and Companies Act 1997
CEIs	Chief Executive's Instructions
CE	Chief Executive
CFO	Chief Finance Officer
CIO	Chief Information Officer
CSA	Child Support Agency

Customs	Australian Customs Service
DMO	Defence Materiel Organisation
DAFF	Department of Agriculture, Fisheries and Forestry
DBCDE	Department of Broadband, Communications and the Digital Economy
DCC	Department of Climate Change
DCITA	Department of Communications, Information Technology and the Arts
Defence	Department of Defence
DEST	Department of Education, Science and Training
DEEWR	Department of Education, Employment and Workplace Relations
DEWR	Department of Employment and Workplace Relations
DEWHA	Department of Environment, Water, Heritage and the Arts
DEW	Department of Environment and Water Resources
DFAT	Department of Foreign Affairs and Trade
DIAC	Department of Immigration and Citizenship
DITR	Department of Industry, Tourism and Resources
Infrastructure	Department of Infrastructure, Transport, Regional Development and Local Government
DIISR	Department of Innovation, Industry, Science and Research
DoHA	Department of Health and Ageing
DOTARS	Department of Transport and Regional Services
DRP	Disaster Recovery Plan
DVA	Department of Veterans' Affairs

FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FBO	Final Budget Outcome
Finance	Department of Finance and Deregulation
FMA Act	Financial Management and Accountability Act 1997
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
GGS	General Government Sector
HRMIS	Human Resources Management Information System
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IT	Information Technology
JCPAA	Joint Committee of Public Accounts and Audit
PM&C	Department of the Prime Minister and Cabinet
RET	Department of Resources, Energy and Tourism
Treasury	The Department of Treasury

Glossary

System availability	Information systems are available and usable when required, and can appropriately resist attacks and recover from failures.
Confidentiality	Information is observed by, or disclosed to, only those who have a right to know.
Control activities	Control activities are the policies and procedures that ensure management directives are carried out and the necessary actions are taken to address risks to achieving these objectives.
Control environment	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.
Governance	A set of responsibilities and practices exercised by executive management with the goal of proving strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that an entity's resources are used responsibly.
Information security	Information security is the protection of information and information systems and encompasses all infrastructure that facilitate its use—processes, systems, services and technology. It relates to the security of any information that is stored, processed or transmitted in electronic or similar form, and is also defined as the preservation of confidentiality, integrity and availability of information.

Integrity	Information is protected against unauthorised modification or error so accuracy, completeness and validity are maintained.
Purchase to Pay	This accounting cycle includes a number of processes associated with the ordering, receipt, payment of invoices and management of vendors.
Stakeholder	A person or a party who has either a responsibility for, a legitimate interest in, or an expectation from the agency.

Foreword

This report is designed to provide assurance to the Parliament that the systems, controls and processes that are in place in Australian Government agencies[1] are operating in a way that allows agencies to prepare financial statements that fairly report their financial performance and position at year end.

The report outlines the results of the audit coverage of key financial systems and controls in 26 agencies that represent some 95 per cent of total General Government Sector[2] (GGS) revenues and expenses. The audit coverage undertaken forms an integral part of our audit of the 2007–08 financial statements of these agencies. The report includes reference to issues that have the potential to have a material impact on agencies' financial statements and to other control related matters requiring attention by agency management. The report also discusses contemporary issues and developments that impact on public sector accounting and auditing.

At the individual agency level, a report on the results of our audits is provided to each agency Chief Executive and Audit Committee. Our reporting arrangements act as a catalyst for improvement and provide a stimulus to agency management for the resolution of issues, where this is warranted.

It is good to note that the results of the interim phase of our 2007–08 financial statement audits represent a continuation of the downward trend over recent years in the number of significant and moderate risk audit findings. It is also a reflection of the maturity of the control regimes in the majority of agencies. Nevertheless, our audits continue to identify control weaknesses in a number of areas including the management of Information Technology (IT) systems access and IT change processes, the conduct of reconciliations of key financial accounts and between business systems and agency Financial Management Information Systems, the segregation of duties and the management of assets.

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1 The term 'agencies' refers to all organisations subject to the *Financial Management and Accountability Act 1997* (FMA Act). As the organisations covered by this report are 'agencies', this term is used predominantly in the report.

2 The General Government Sector (GGS) comprises all government agencies and other entities that provide largely non-market public services and are funded primarily through taxes and other compulsory levies. This report covers the portfolio departments and other major GGS entities that comprise approximately 95 per cent of total GGS revenues and expenses.

A significant impact on a number of agencies' governance frameworks has been the Machinery of Government (MOG) changes that took effect on 3 December 2007 and 25 January 2008. In all, these changes involved the abolition of three agencies, the creation of five new agencies, and the transfer between agencies of a number of programs and functions. Affected agencies were required to establish, or review and revise, their governance arrangements to take account of the MOG changes. In some cases, particularly where new agencies were created, revised governance arrangements have taken some time to finalise. For some agencies this has included negotiating interim arrangements involving agencies continuing to provide various levels of support for functions and programs transferred to other agencies. Some agencies' 2007–08 financial statements will require additional disclosures of financial information in respect of abolished departments and the inclusion of information relating to programs and functions transferred during the year. In light of these changes, the timely preparation of the financial statements will require a focused effort from both the affected agencies and the ANAO.

The impact of the MOG changes has required the ANAO to review, for the agencies affected, its audit approach to take into account the revised arrangements. In some cases, this has involved an increase in interim audit coverage and will require additional audit coverage to finalise the audit of the 2007–08 financial statements.

Following a period of significant change in financial reporting requirements, 2007–08 has been a year of consolidation with the only significant new requirement being the implementation of the new accounting standard AASB 7 *Financial Instruments: Disclosures* that is applicable for reporting periods on or after 1 January 2007. This period of stability is expected to extend until at least 2008–09 in the light of the International Accounting Standards Board's decision that it would not require the application of new international financial reporting standards before 1 January 2009. As a result, the Australian Accounting Standards Board (AASB) is giving greater priority to a range of public sector specific issues.

A significant development that has occurred in respect of public sector reporting has been in the area of harmonising the two accounting frameworks under which Australian Governments report at the aggregate level – Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP).

The new accounting standard to implement this change, AASB 1049 *Whole of Government General Government Sector Financial Reporting*, applies from 2008–09. As a consequence the ANAO has recently devoted resources to prepare for the impact of this change.

The ANAO's focus on key aspects of legislative compliance as an integral part of the audit of agencies' financial statements is continuing. The ANAO's assessment to date of agencies' compliance with legislative requirements in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public moneys has indicated that agencies are continuing to give appropriate attention to meeting their financial legislative compliance responsibilities.

There is a substantial work effort involved in our interim audit coverage so that we are well placed to complete the audits following the preparation by agencies of their financial statements after the close of the 2007–08 financial year. I would like to acknowledge the professionalism and commitment of my staff in undertaking the interim audit work that is reflected in this report. Their efforts have again ensured that the audit work program is on track, and enabled the tabling of this report in a timely manner for the information of the Parliament. I would also like to record our appreciation for the cooperation of Chief Financial Officers and other relevant agency staff in the production of this report.

Ian McPhee

Auditor-General

Summary

Summary

Introduction

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

2. Our interim audits of agencies encompass a review of governance arrangements related to agencies' financial reporting responsibilities, and an examination of relevant internal controls, including information technology system controls. An examination of such issues is designed to assess the reliance that can be placed on internal controls to produce complete and accurate information for financial reporting purposes.

3. This report presents the results of the interim phase of the 2007–08 financial statement audits of all portfolio departments and other major General Government Sector (GGS) agencies that collectively represent some 95 per cent of total GGS revenues and expenses. The agencies covered by this report are listed at Appendix 1.

4. All ANAO findings have been reported to agency management and summary reports provided to the relevant Minister(s). In addition, our audit processes provide for audit issues identified to be formally reported to agency Chief Executives and their respective Audit Committees.

5. Chapter 1 of this report discusses a number of recent developments in the accounting and auditing frameworks designed to improve the overall quality and comparability of entity financial reports for 2007–08 and subsequent years.

6. Observations relating to various elements of agencies' internal controls (including the control environment, the risk assessment process, control activities and monitoring of controls) are discussed in summary form in Chapter 2.

7. Chapter 3 discusses the Machinery of Government (MOG) changes resulting from the Administrative Arrangements Orders (AAOs) of 3 December 2007 and 25 January 2008 that have had a significant effect on a number of agencies during 2007–08.

8. Findings relating to the audit of Information Technology (IT) systems focusing on the IT control environment, IT security, systems delivery and application controls in financial management information systems and human resource management information systems are discussed in summary form in Chapter 4.

9. Chapter 5 outlines, for each agency, details of business operations; governance arrangements relevant to an agency's financial statements; factors impacting on an agency's financial reporting risks; estimated key financial figures and average staffing levels for 2007–08, and significant and moderate risk issues identified from our audit coverage.

Financial statement audit coverage

10. A central element of the ANAO's financial statement audit methodology, and the focus of the interim phase of our audits, is a sound understanding of an agency's internal controls. To do this, the ANAO uses the framework contained in the Australian Auditing Standards ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. The key elements of internal control, as discussed in ASA 315, are the control environment; the risk assessment process; information systems, including the related business processes, relevant to financial reporting, and communication; control activities and monitoring of controls.

11. The final phase of most audits will be completed in the period July to September 2008. Consistent with past practice, a second report will be tabled in the Parliament in December 2008 following completion of the financial statement audits of all entities for 2007–08. The ANAO will also report, at that time, on any additional control issues arising from the final audits.

Control environment

12. The ANAO assesses whether an agency's control environment comprises measures that contribute positively to sound corporate governance in the context of the preparation of an agency's financial statements. These measures should be designed to mitigate identified risks of material misstatement in the financial statements, and reflect the specific governance requirements of each agency.

13. Consistent with past findings, the ANAO observed that agencies have established key elements of a financial control environment designed to provide a sound basis for the effective preparation of the agency's financial statements. Audit Committees, in particular, continue to have a positive influence on the effectiveness of agencies' control environment particularly in the areas of risk assessment, legislative compliance and financial system controls. Consistent with the results of our 2006–07 audits, no instances of non-compliance with key elements of the financial framework have been identified in our interim audits. The Certificate of Compliance process, introduced in 2006–07, has resulted in an ongoing focus on wider compliance issues.

14. A review of accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008 will be finalised during the 2007–08 final audits of affected agencies.

Risk assessment process

15. An understanding of an agency's risk assessment framework is an essential element of the ANAO's financial statement audits. Agencies are expected to manage the key risks specific to their environment and our interim audits include a review of controls relating to risks that may have a material impact on agencies' financial statements. The ANAO found that the majority of agencies have a risk assessment process and the results are generally reviewed by audit committees.

16. Important elements of the risk assessment process common to all agencies are business continuity and fraud control management. Our audits noted that most agencies now have Business Continuity and Disaster Recovery Plans in place. However, a number of agencies needed to give further attention to periodically testing these plans, and updating them as necessary. All agencies have in place fraud control plans prepared in accordance with the Commonwealth Fraud Control Guidelines, or were in the process of developing them as part of implementing the MOG changes. A small number of agencies needed to improve aspects of their fraud control arrangements.

Information systems

17. The very substantial ongoing investment in information technology (IT) by Australian Government agencies continues to impact on the nature of public sector administration and service delivery. By continuing to adopt and make use of emerging technologies, this investment is contributing to the ongoing transformation of business processes, wider access to government services and improved client service. The financial statement reporting process within agencies is also facilitated by IT. While technology and related improvements continue to represent agencies with major business opportunities, they also involve new or enhanced risks that need to be effectively managed.

18. During the interim phase of the 2007–08 financial statement audits, the ANAO again assessed the effectiveness of controls that affect the availability and integrity of information and information systems supporting the financial statement reporting process.

19. The ANAO found that all agencies had governance arrangements in place that encompassed the oversight and management of their information systems and IT change processes. However, our audits continue to identify a range of IT control weaknesses in some agencies relating to security and management controls in both FMIS and HRMIS systems, the management of release management processes, and the updating and testing of Business Continuity and Disaster Recovery Plans.

Control activities

20. The results of the 2007–08 interim audit phase indicated that, overall, control activities relating to financial and accounting processes have been maintained at an effective level. The total number of significant audit findings has decreased, continuing the trend over recent years. However, our interim audits identified control issues relating to areas such as the conduct of key reconciliations and the timely follow up of any discrepancies, controls over the processing of transactions in agencies' FMIS and HMRIS, and the management and exercise of delegations in a number of agencies.

Monitoring of controls

21. Many activities undertaken by an agency contribute to their regime of monitoring controls. These include quality assurance arrangements, internal and external reviews, control self-assessment processes, and internal audit. The ANAO noted that control self-assessment arrangements, first introduced to assist agencies meet their responsibilities to provide a Certificate of Compliance in respect of 2006–07, has become an integral part of agencies' control regimes. Internal audit was also continuing to have a key role in some agencies in assisting in the Certificate of Compliance process.

Summary of audit results

22. The ANAO rates its findings according to a risk scale. Audit findings that pose a significant risk to the entity and that should be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate risk are rated as 'B'; these should be addressed by entities within the next 12 months. Findings that are procedural in nature, or reflect relatively minor administrative shortcomings, are rated as 'C'.

23. Most agencies had areas of their financial control environment that required attention although our interim audits found there had been an overall improvement in agencies' financial and related controls. This is reflected in a reduction in the number of significant (Category A) and moderate risk (Category B) findings.

24. A summary of the trend in Category A and B audit findings between 2006–07 and 2007–08 is outlined below:

- there were four agencies with Category A audit findings in 2007–08 and three agencies in 2006–07;
- the total number of Category A audit findings in 2007–08 is ten compared with 24 in 2006–07;
- the total number of Category B audit findings across all agencies decreased from 97 in 2006–07 to 84 in 2007–08; and
- there was a decrease in the number of Category B audit findings in eight agencies; five showed an increase and the number of Category B audit findings in three agencies remained the same as in 2006–07.

A summary of Category A and B audit findings by agency is provided in Chapter 5.

Audit Findings and Conclusions

1. Financial Reporting and Auditing Frameworks

This Chapter provides commentary on recent developments in the financial reporting and auditing frameworks under which the Australian Government and its reporting entities operate. The frameworks are illustrated at Appendix 2 and 3 of this Report.

Introduction

1.1 Australia continues to be a leader in advancing public sector accounting developments. The Australian Accounting Standards Board (AASB) performs a major role in this advancement by improving Australian Accounting Standards. The ANAO, for its part, contributes to the development of accounting standards through commenting on exposure drafts and directly engaging the AASB where appropriate.

1.2 The Australian Accounting Standards Board has recently reviewed the accounting standards that apply specifically to governments and government departments. Outdated standards have been removed and requirements that continue to be relevant have been transferred to other existing standards or to new standards dealing with specific topics.

1.3 One of the AASB's priorities is the modification of Australian Accounting Standards to better reflect the nature of public sector operations. This AASB project aims to address a number of key issues during 2008. Of particular importance are taxation revenues, grants, welfare payments and the definition of not-for-profit entities.

1.4 Perhaps the most significant recent change to public sector reporting is harmonising the two accounting frameworks under which Australian governments report at the aggregate level — Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP). The new accounting standard to implement this change, AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, provides for budgetary information and key fiscal measures used in the Budget to be included in audited financial statements of Australian and State and Territory governments. AASB 1049 applies from 2008–09.

1.5 The other major change to public sector reporting is the introduction of AASB 7 *Financial Instruments:Disclosures* in the 2007–08 financial year. This standard requires enhanced disclosures about financial instruments held by entities and the risks arising from those instruments.

1.6 In the longer term, we look forward to the development of a conceptual framework for the public sector by the International Public Sector Accounting Standards Board (IPSASB). The final framework document is expected to be issued in 2012.

1.7 Auditing standards are also changing. The International Auditing and Assurance Standards Board (IAASB) is revising its standards to improve their clarity and aid consistency of application. This is a significant revision of these auditing standards, adding to the requirements that must be met by auditors in undertaking audits of financial statements. The revised standards are expected to be issued internationally by the end of 2008 for application from 15 December 2009. The Australian Auditing and Assurance Standards Board (AUASB) plans to review these IAASB standards for adoption in Australian with effect from reporting periods beginning on or after 1 January 2010.

1.8 The AUASB has also been giving priority to projects of relevance to the public sector, including proposed standards on performance engagements and compliance engagements. In addition, the AUASB has commenced a project on the audit implications of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

1.9 The ANAO is continuing its focus on legislative compliance in its financial statements audits. The ANAO is also planning a number of potential performance audits on compliance, mentioned later in this Chapter, which may be undertaken in 2008–09.

Public sector accounting standards

Sector-neutral accounting standards

1.10 As mentioned in Audit Report No. 18 2006–07 *Audit of the Report of the Financial Statements of Australian Government Entities for the period ended 30 June 2007*, the Financial Reporting Council (FRC) completed a review of the AASB's policy of sector-neutrality in accounting standard setting in Australia in early 2006. The FRC concluded that the needs of users for a single conceptual framework covering the requirements in respect of for-profit, not-for-profit and public sector entities were not being met.

1.11 In recent times we have been encouraged by the progress made in developing sector-neutral standards with due consideration to public sector differences. This has most recently culminated in the re-release of AASB 1049 to incorporate whole of government reporting; the progressive review and subsequent replacement of several public sector standards by existing and new topic-based standards; and the ongoing IPSASB conceptual framework project.

1.12 In 2008 the AASB plans to continue its focus on issues of relevance to the public sector. The FRC is set to review the progress of the AASB in this regard in mid 2008.

1.13 Currently, an entity's financial reporting requirements depend in part on whether it meets the definition of a not-for-profit entity. The absence of established AASB guidance to accompany this definition increases the risk that entities with similar characteristics might apply different reporting requirements. This risk is less for Australian Government entities, given the issue of guidance in 2005–06 by the then Department of Finance and Administration that listed for-profit entities.

1.14 The AASB released ITC 14 *Proposed Definition and Guidance for Not-for-Profit Entities* in response to these concerns. The ITC proposed adoption of the definition and guidance for 'public benefit entities' from the New Zealand Financial Reporting Standards Board's NZ IAS 1 *Presentation of Financial Statements.* The proposed definition of a public benefit entity focused on the primary objective of the entity, not purely on whether there is an intention to make a profit.[3] The guidance that accompanied the definition set out five equally weighted criteria to assist in applying the definition. [4]

1.15 At its May 2008 meeting the AASB decided to retain the existing definition and the term 'not-for-profit entity'. Guidance will now be developed from a range of sources. The AASB also proposed that not-for-profit entities disclose their status in certain circumstances.

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[3] 'Public benefits' entities are defined in the New Zealand Standard NZ IAS 1 *Presentation of Financial Statement*s as 'reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders'.

[4] The guidance provides the following five criteria; founding documents; nature of the benefits; quantum of expected financial surplus; nature of equity interest; and nature of funding.

Conceptual Frameworks for accounting standards

1.16 AASB standards mainly comprise Australian equivalents to the International Financial Reporting Standards (IFRS) developed by the IASB. The AASB conceptual framework, which underpins AASB standards, is also largely based on the IASB's conceptual framework.

1.17 The IASB, in partnership with the United States Financial Accounting Standards Board (FASB), is undertaking a major review of its conceptual framework. The objective of this joint review is to develop a common framework that provides a sound foundation for developing future standards that are principles-based, internally consistent, and internationally converged. This is intended to lead to more useful financial reports to present and potential investors and creditors and others making resource allocation decisions. The framework will build on the existing IASB and FASB conceptual frameworks.

1.18 The project consists of eight phases, of which at June 2008 four had commenced.[5] Discussion papers and exposure drafts are planned to be issued progressively.

1.19 As the IASB has a focus on for-profit entities, the IPSASB along with a number of national accounting boards, including the AASB, considered it timely to develop its own framework for general purpose financial reporting by public sector entities other than government business entities. The final framework document is planned to be published in 2012.

AASB review of its public sector-specific standards

1.20 Previous ANAO reports[6] have referred to the AASB's approach to dealing with public sector issues.

1.21 In keeping with its policy of issuing sector-neutral standards, in late December 2007 the AASB released revised and newly developed topic-based standards resulting from the exposure draft ED 156 *Proposals Arising from the*

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5 Of the eight phases, the following four phases have commenced: objectives and qualitative characteristics; elements and recognition; measurement; and reporting entity. The phases yet to be commenced are: presentation and disclosure, including financial reporting boundaries; framework purpose and status in GAAP; applicability to the not-for-profit sector; and remaining issues.

6 ANAO Audit Reports No.51 2006–07, op.cit., No.15 2006–07, op. cit., No.21 2005–06 *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2006* and No.48 2005–06 *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ended 30 June 2006* have referred to the AASB's approach to public sector accounting standards.

Short-term Review of the Requirements of AAS 27, AAS 29 and AAS 31. The contents of AAS 27, 29 and 31, which prescribed financial reporting requirements for governments, government departments and local governments, have been moved to new topic-based standards or incorporated into existing standards. At this stage the contents of the superseded standards have been moved largely unamended.

1.22 The new and revised standards will be applicable from reporting periods commencing 1 July 2008.[7] The requirements that have been moved to stand-alone standards include administered items, land under roads, and disaggregated disclosures. The remaining content has been relocated to existing accounting standards.

1.23 The next step in the review is to examine the contents in greater detail. For example, the AASB considers that accounting for administered items by government agencies raises some fundamental conceptual issues relating to users' needs, the concept of control in the public sector and the reporting entity concept.

1.24 The AASB has also updated its Public Sector Policy Paper for 2008.[8] The paper identifies a number of public sector issues that the Board intends to address during 2008. Apart from the issues discussed elsewhere in this chapter, the following are of particular significance to the public sector:

- income from non-exchange transactions, including tax revenue and grants. In a September 2007 submission to the AASB, the Australasian Council of Auditors-General (ACAG) identified accounting for grants, including accounting by grantors, as a high priority issue; and
- social benefit obligations, particularly whether governments should recognise welfare payments in future years as a liability.

1.25 The Paper also identifies other issues such as consolidation of for-profit entities into a not-for-profit group, measurement of contributions by owners and accounting for service concessions.

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[7] The review of AAS 27, AAS 29, and AAS 31 and the new and revised standards can be found on the AASB website <www.aasb.com.au>.

[8] The AASB Public Sector Policy Paper (as at February 2008) can be found on the AASB website <www.aasb.com.au>.

Accounting Standards for Small and Medium-sized Entities

1.26 During 2007 the IASB released an exposure draft for a proposed standard titled *International Financial Reporting Standard for Small and Medium-sized Entities* (IFRS for SMEs). The release of this exposure draft represents a positive step towards reducing the reporting burden for small and medium-sized entities. The exposure draft proposed a single standard that would provide simplified financial reporting requirements for entities that are defined as not being 'publicly accountable'.[9]

1.27 In May 2007 the AASB issued an Invitation to Comment (ITC 12), *Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities* (IFRS for SMEs).[10] ITC 12 proposed replacement of the 'publicly accountable' criterion with a threshold based on the revenue and assets of the entity because the former was not seen as a useful criterion for sector-neutral Australian standards.

1.28 While there has been general consensus that there is scope for reducing the reporting burden for SMEs in Australia, there is not yet a common view on the criteria that should be equally applied to for-profit, not-for-profit, and public sector entities.

1.29 The AASB tentatively decided in May 2008 that financial reporting at the Federal, State and Territory levels would apply the full Australian Equivalents to IFRS (AEIFRS) and that all other not-for-profit public sector entities could apply either full AEIFRS, AEIFRS for SMEs, or full AEIFRS recognition and measurement requirements with limited specific disclosures to be determined by the AASB[11]. The choice between these three options would rest with the relevant Government. For example, the Australian Government would choose which options would apply to its controlled not-for-profit entities.

1.30 Australian Government agencies and authorities report under the Finance Minister's Orders, which invoke Australian Accounting Standards. If the AASB decision is confirmed, the Finance Minister would be expected to

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9 'Publicly accountable' is defined as an entity that is required to make its financial reports available on a public register, or otherwise makes it available to the public at large.

10 ITC 12 can be found on the AASB website <www.aasb.com.au>.

11 AASB Action Alert 114 (23 May 2008) at <www.aasb.com.au>.

decide which of the available options should apply to Australian Government not-for-profit entities.

1.31 Given the continuing expansion in financial reporting requirements over recent years, the opportunity to explore a reduction in the reporting burden on smaller public sector entities is worthwhile. While there is considerable scope to improve the cost-effectiveness and focus of reporting requirements for these entities, this needs to be done in a way that continues to provide sufficient information in financial reports to meet the needs of users, particularly the Parliament.

GAAP/GFS harmonisation

1.32 The AASB, at the direction of the FRC, has given priority to the completion of the GAAP/GFS harmonisation project for whole-of-government reporting by the Australian and State and Territory Governments.

1.33 For the Australian Government, this project offers the potential to harmonise the requirements for the Final Budget Outcome (FBO) and the Consolidated Financial Statements (CFS). Currently, both these year-end financial reports are generated using, in the main, the same underlying data. However, they are prepared under different frameworks which leads to differing content. The FBO report is primarily presented in accordance with the Government Finance Statistics (GFS) and the CFS report is prepared in accordance with Generally Accepted Accounting Principles (GAAP). The CFS is audited annually by the ANAO, while the FBO is not currently audited.

1.34 Potential confusion arises due to the different requirements of each framework. The pursuit of harmonisation is intended to achieve a single set of government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

1.35 Phase 1 of the harmonisation project was completed with the release in November 2007 of a revised AASB 1049, re-titled *Whole of Government and General Government Sector Financial Reporting*. In terms of its whole-of-government requirements, it will replace AAS 31 *Financial Reporting by Governments* from the 2008–09 financial year.

1.36 Key requirements of the new Standard for whole-of-government reporting include:

- application of other Australian Accounting Standards, except as specifically varied;
- application of the principles and rules in the ABS GFS manual[12] where they do not conflict with GAAP;
- reporting, on the face of the primary statements, of specified key fiscal aggregates used in GFS,[13] measured in accordance with GAAP;
- where the measurement of a key fiscal aggregate differs between GFS and GAAP, a reconciliation of the two amounts, presented in a note;
- presentation of the original budgeted financial statements and explanations of major variances between budget and actuals, but only where the budgeted financial statements are tabled in Parliament; and
- presentation of financial statements and key fiscal aggregates for each sector.

1.37 The new AASB 1049 incorporating GGS and whole-of-government financial reporting requirements represents a good opportunity to facilitate economic and financial analysis and allow the GGS and whole-of-government statements to be prepared on a consistent basis for the first time. The Australian Government, in its 2008–09 Budget Papers, has adopted a single presentation that is based on AASB 1049. This replaces the multiple reporting frameworks under which budgets have been reported in past years.

1.38 The AASB decided in May 2008 that the broad principles of harmonisation should be extended to not-for-profit entities within the GGS. The AASB will not be proceeding with GAAP/GFS harmonisation for public sector entities within the other two sectors (Public Non-Financial Corporations, such as Australia Post, and Public Financial Corporations, such as the Reserve Bank).[14]

1.39 AASB 1049 raises a number of issues for audit offices relating to the auditing of GFS measurements and explanations for variances between budget and actual figures. In this regard, the Australian Auditing and Assurance Standards Board (AUASB) has commenced a project addressing the audit

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[12] *Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2005*, (latest issue released 31 July 2006), available on the ABS website www.abs.gov.au.

[13] The key fiscal indicators required by AASB 1049 are: net worth; net operating balance; total change in net worth (before transactions with owners); net lending/borrowing; and cash surplus/deficit.

[14] AASB Media Release 10 October 2007 available on AASB website www.aasb.com.au.

implications of AASB 1049. Adoption of the new standard by the Australian Government will have some resource consequences for the ANAO as we need to build expertise in the application of the GFS framework.

Changes to Australian equivalents to International Financial Reporting Standards (AEIFRS) affecting Australian Government entities

1.40 In mid–2006 the IASB announced that it would not require new or amended International Financial Reporting Standards (IFRSs) to be applied before 1 January 2009. In this way, the IASB is providing four years of stability in the IFRS platform of standards.

1.41 One exception is the implementation of AASB 7 *Financial Instruments: Disclosures*. This standard was approved in August 2005, but only applies from reporting periods commencing on or after 1 January 2007.

1.42 AASB 7 supersedes AASB 130 *Disclosures in the Financial Statements of Banks and Similar Institutions* and the disclosure requirements in AASB 132 *Financial Instruments: Disclosure and Presentation*. The application of this standard will have implications for all Australian Government entities, with a particular impact on those with significant holdings of financial instruments.

1.43 The standard enhances balance sheet and income statement disclosures in relation to financial instruments. It prescribes quantitative and qualitative disclosures about entities' exposure to risks arising from financial instruments, and minimum disclosures of credit risks, liquidity risks and market risks. Examples of typical disclosures are:

- the carrying amounts and fair value of financial instruments, by category;
- net gains and losses on financial assets;
- the time periods in which financial liabilities are due for payment; and
- reasonably possible changes in value due to market movements, such as in foreign exchange or interest rates.

1.44 In March 2008 the IASB released a discussion paper *Reducing Complexity in Reporting Financial Instruments*, which investigates ways of achieving less complex and more principle-based reporting requirements for financial instruments.

Reporting compliance with the Financial Management Framework

ANAO auditing of compliance

1.45 An important element of the ANAO's financial statement audit continues to be a focus on legislative compliance. The coverage involves addressing key aspects of legislative compliance in relation to annual and special appropriations, annotated appropriations, special accounts and the investment of public monies.

1.46 In the context of its compliance focus, the ANAO's annual work programme includes performance audits that continue the ANAO's examination of aspects of the Australian Public Sector financial framework. Potential audits for the 2008–09 program include:

- Implementation of the Certificate of Compliance;
- Management of the Receipt or Custody of Public Money by Outsiders;
- Advance to the Finance Minister; and
- Financial Management of Administered Annual Appropriations.

Changes to Financial Management Legislation

1.47 Audit Report No.18 of 2007–08 noted that the *Financial Framework Legislation Amendment Act (No. 1) 2007*, which received royal assent on 25 September 2007, made amendments to the FMA Act, the *Auditor-General Act 1997* and the *Legislative Instruments Act 2003*. The changes are intended to simplify the financial framework and address issues relating to the management of appropriations, in order to improve government operations. Primary amendments relate to the FMA Act, with consequential amendments made to the other Acts.

1.48 The *Commonwealth Authorities and Companies Amendment Bill 2008* passed the Senate on 15 May 2008. This Bill updates provisions of the *Commonwealth Authorities and Companies Act 1997* (the CAC Act) to take account of amendments to the *Corporations Act 2001*; enhance the accountability of Commonwealth companies; harmonise specific penalty provisions in the CAC Act with the Corporations Act and clarify various provisions of the CAC Act.

1.49 The *Financial Framework Legislation Amendment Bill 2008* is proposed for introduction in the 2008 winter sittings of the Parliament.[15] This Bill is intended to further simplify the financial management framework and reduce red tape in internal Australian Government administration, repeal unused special appropriations and update, clarify and align other financial management, governance and reporting provisions.

Developments in Australian Auditing Standards

1.50 The ANAO Auditing Standards incorporate, by reference, the current versions of the standards set by the AUASB for the auditing of financial statements ('Australian Auditing Standards' or 'ASA's).[16] Audits conducted by the ANAO are thus bound by the same standards as apply to the broader auditing profession in Australia.

1.51 ASAs were issued initially with effect from 1 July 2006. The issue of these standards was, in part, due to concerns about the quality of financial reporting, following high-profile corporate collapses both in Australia and overseas. As a result, these standards imposed more stringent requirements on auditors, including the ANAO.

1.52 The AUASB uses International Standards on Auditing (ISAs)[17] as the basis for making Australian Auditing and Assurance Standards. ISAs are made by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants.

1.53 The IAASB recognises that standards need to be understandable, clear and capable of consistent application. In 2003 the IAASB reviewed the drafting

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[15] *Legislation Proposed for Introduction in the 2008 Winter Sittings*. Department of the Prime Minister and Cabinet. <http://www.pmc.gov.au/parliamentary/index.cfm>.

[16] The AUASB Standards made for the purposes of section 336 of the *Corporations Act 2001* are published on Federal Register of Legislative Instruments.

[17] International Standards on Auditing (ISAs) are made by the International Auditing and Assurance Standards Board (IAASB) of IFAC, of which the Auditor-General is a member. The strategic direction of the AUASB includes the development of Australian Auditing Standards that:
- have a clear public interest focus and are of the highest quality;
- use as a base, as appropriate, the ISAs;
- make such amendments to ISAs as are necessary to conform with the Australian regulatory environment and statutory requirements; and
- incorporate additional requirements based on standards in other national jurisdictions, where appropriate and considered to be in the public interest.

conventions used in its standards in order to improve their clarity and hence the consistency of their application.[18]

1.54 The IAASB plans to complete its 'clarity' project by the end of 2008. The clarified ISAs are all to be effective for audits of financial statements for periods beginning on or after 15 December 2009. In settling on this implementation date, the IAASB recognised that a significant number of the ISAs, including some that have been substantively revised, will be finalised in clarified form in the latter half of 2008 and will be effective at the same time. The implementation date is intended to allow time for jurisdictions to adopt the ISAs and for audit practitioners to organise training and implementation activities.

1.55 In late October 2007, the AUASB announced that Australian Auditing Standards will be further revised and reissued based on the new clarified versions of the ISAs. The revised Australian standards will be operative for reporting periods beginning on or after 1 January 2010. The AUASB will undertake a comprehensive project to ensure that the revised Australian standards in the new format will continue to conform to ISAs and the enforceability required under Australian regulatory arrangements. Exposure drafts for the revised standards will be issued during the course of 2008 and early 2009.[19] The AUASB approved an overall project plan at its February 2008 meeting.

1.56 The AUASB has also been giving priority to projects of importance to the public sector. An exposure draft of a proposed Standard on Assurance Engagements, ASAE 3500 *Performance Engagements*, was released on 29 February 2008 for comment by 15 April 2008. ASAE 3100 *Compliance Engagements* is expected to be released in June 2008. ASAE 3500 will replace the two existing performance audit standards, AUS 806 and AUS 808, and has been developed as an adjunct standard to ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

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[18] The IAASB's document *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, which was revised in December 2006, establishes the conventions to be used by the IAASB in drafting future ISAs and the obligations of auditors who follow those standards. It is available at <http://www.ifac.org/Members/DownLoads/IAASB-AP-AmendedPreface.pdf>.

[19] As noted in AUASB Media Release 26 October 2007 available on the AUASB website <www.auasb.gov.au>.

1.57 ACAG has responded to the AUASB indicating its support in principle with the proposed standards but raising a number of matters that are considered to warrant further consideration in finalising the standard, primarily relating to how the issue of compliance is addressed. ACAG has also suggested deferral of the date of application of the standard until 1 January 2009. From the ANAO's perspective, the new standard will assist in framing our performance audit reports in accordance with the assurance framework.

1.58 In addition, as mentioned earlier in this Chapter, the AUASB has commenced a project to address the audit implications of AASB 1049.

1.59 ANAO Report No.18 of 2007–08 noted the AUASB's intention to monitor developments internationally on auditing Small and Medium-Sized Entities.[20] The IAASB released in December 2007 a *Guide to Using International Standards on Auditing in the Audits of Small and Medium-sized Entities*.[21] The AUASB has welcomed an initiative by the Institute of Chartered Accountants in Australia to adapt the guide for use in Australia.

Conclusion

1.60 Harmonisation of the two government accounting frameworks, GFS and GAAP, has the potential to align government budgets and outcome reports, providing the Parliament and the Australian public with audited information on the achievement of budget targets. Two important steps in this process during 2007–08 were the partial adoption of AASB 1049 in the Australian Government's 2008–09 Budget Papers and the AASB's decision to extend the principles of AASB 1049 to all not-for-profit entities in the General Government Sector. These changes will have an impact on Australian Government reporting entities and the work of the ANAO. Work being done by the AUASB to address the audit implications of AASB 1049 will need to be addressed and incorporated into ANAO practices over the next 12 months, and will affect the resources required to audit the Australian Government's financial statements.

1.61 An important enhancement of the auditing framework is the development of new standards on performance audits and compliance engagements. These standards will continue to develop the AUASB's

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[20] Bulletin: Auditing Small and Medium Sized Entities (SMEs), AUASB September 2007.

[21] Small and Medium Practices Committee, International Federation of Accountants, December 2007.

Framework for Assurance Engagements in ways that are directly relevant to the public sector.

1.62 More broadly, the AASB review of public sector accounting standards and the development of a conceptual framework by the IPSASB provide opportunities to fully address issues of importance to the public sector. The ANAO supports this work and continues to contribute to debate around the development of public sector accounting standards including by providing comments to the AASB.

2. Summary of Audit Findings and Related Issues

This Chapter provides a summary of the ANAO's review of internal controls as part of the audit of the financial statements of material agencies and discusses a number of issues relevant to the 2007–08 financial statement audits.

Introduction

2.1 The Chief Executives of General Government Sector (GGS) entities subject to the FMA Act and the CAC Act are required to prepare annual financial statements and present them to the Auditor-General for audit.[22] For large entities, the audit is conducted in two main phases—interim and final. This report focuses on the results of the interim audit phase of the 2007–08 financial statement audits of all portfolio departments and other major General Government Sector agencies that collectively represent some 95 per cent of total GGS revenues and expenses.

2.2 Chief Executives of FMA agencies are required to manage their affairs in a manner that promotes effective, efficient and ethical use of resources.[23] While there is no equivalent legislative provision applying to CAC Act entities, the same general standard could reasonably be expected to apply. This requires the development and implementation of effective corporate governance arrangements and internal controls designed to meet the individual circumstances of each entity and to assist in the orderly and efficient conduct of its business and compliance with applicable legislative requirements, including the preparation of annual financial statements that give a true and fair view.[24]

2.3 The objective of an audit of an agency's financial statements, as identified in the Australian Auditing Standards, is to form an opinion on whether the financial statements, in all material[25] respects, are in accordance

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22 *Financial Management and Accountability Act 1997*, section 49 and *Commonwealth Authorities and Companies Act 1997*, sections 9, 12, 36 and 37.

23 *Financial Management and Accountability Act 1997*, section 44.

24 *Financial Management and Accountability Act 1997*, section 49.

25 Australian Accounting Standard *AASB 1031 Materiality* states that information is material if its omission, misstatement or non-disclosure has the potential, individually or collectively, to influence the economic decisions of users taken on the basis of the financial report or affect the discharge of accountability by the management or governing body of the entity.

with the Australian Government financial reporting framework.[26] In planning the audit so as to achieve this objective, audit procedures are designed to achieve reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. In accordance with generally accepted audit practice, the ANAO accepts a low level of risk that the audit procedures will fail to detect whether the financial statements are materially misstated. This low level of risk is accepted because it is too costly to perform an audit that is predicated on no level of risk. Specific audit procedures can be performed to ensure that the risk accepted is low. These procedures include, for example, obtaining knowledge of the entity and its environment, reviewing the operation of internal controls, undertaking analytical reviews, testing a sample of transactions and account balances, and confirming year-end balances with third parties.

2.4 A central component of the ANAO's audit methodology, and the focus of the interim phase of our financial statement audits, is a sound understanding of the agency and its environment, including its internal controls, as they relate to the preparation of the financial statements. This enables the ANAO to make a preliminary assessment of the risk of material error in an entity's financial statements and to plan an audit approach to reduce audit risk to an acceptable level. The ANAO reviews and evaluates an entity's internal controls to assess its capacity to prevent and detect errors in business processes, accounting records and financial reporting systems. In doing so, the ANAO recognises that the reliability of business processes, accounting records and financial systems can be enhanced through effective internal controls, and this influences the timing and extent of audit work required.

Internal control

2.5 The ANAO uses the framework in Auditing Standard ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements* to consider how the different elements of an entity's internal controls impact on the conduct of an audit. These elements, as detailed in ASA 315, are:

- control environment;
- risk assessment process;

[26] The key elements of this framework are set out in Appendix 2.

- information systems, including the related business processes, relevant to financial reporting, and communication;
- control activities; and
- monitoring of controls.

2.6 The following discussion of these elements reflects observations arising from our review of relevant aspects of each agency's control environment and the results of our interim audits that have been formally communicated to agency management. As such it includes, where relevant, summary comments on 'A', 'B' and 'C' category audit findings.

Control environment

2.7 The control environment directly influences the way business and operations are undertaken in every entity. For this reason, the control environment needs to be carefully reviewed as part of the audit process when assessing the risk of material error in financial systems and reports. ASA 315 at paragraph 80 states:

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

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

- **senior management arrangements**—including the framework within which an agency's activities for achieving its objectives are planned, executed, controlled and reviewed;
- **audit committee arrangements**—including the assurance and performance role of the audit committee, its use as a forum for communication between management and internal and external

auditors, and the degree of independence and expertise of the committee;

- **systems of authorisation, recording and procedures**—designed to ensure that transactions are processed, recorded and accounted for correctly, including the assignment of appropriate authority and that responsibilities and compliance arrangements accord with applicable legislative requirements; and
- **a financial performance management regime**—that prepares budget reports, including comparison of actual results to budgets, variance analysis and relevant commentary to provide assurance about the financial performance of the agency.

2.9 The ongoing performance and effectiveness of these measures can make a significant contribution to the level of assurance that agency management and, in turn, the ANAO requires for financial statement purposes.

2.10 A matter that has had a significant affect on a number of agencies during 2007–08 was the Machinery of Government (MOG) changes resulting from the Administrative Arrangements Orders (AAOs) of 3 December 2007 and 25 January 2008. A discussion of these MOG changes is included at Chapter 3 Machinery of Government Changes.

Observations[27]

2.11 Consistent with our findings in prior years, agencies have senior management arrangements in place to provide direction, guidance and control over their organisations. Executive management committees met regularly to plan and monitor strategic direction and performance. The majority of agencies had produced a corporate plan or similar statement that articulates the agency's goals and objectives, and assists in measuring agencies' progress in meeting them. Chief Executives and their senior management group continued to focus attention on financial, accounting and audit matters, risk management and performance outcomes.

2.12 The ANAO noted that most agencies have mature audit committee arrangements. These include a formal charter that articulates each committee's composition, roles, responsibilities and reporting lines, regular reporting to the

[27] At the time of audit a small number of agencies affected by the MOG changes were in the process of establishing some or all of the above mentioned elements of their control environments.

Chief Executive and a periodic self-assessment of performance. There has also been an increase in the number of independent committee members, including as Chair.

2.13 Audit committees have an important role to play in reviewing and advising on important components of corporate governance. The ANAO found that generally all audit committees have a role in:

- assessing whether management has in place a current and comprehensive risk management framework;
- reviewing the entity's financial statements and recommending their signature by the CE;
- approving the internal audit program and regularly evaluating the performance of internal audit;
- reviewing the effectiveness of legislative compliance arrangements, including the preparation of an annual Certificate of Compliance;
- reviewing fraud control plans; and
- regularly providing assurance to the Chief Executive or raising matters of concern.

2.14 The ANAO observed that the majority of agencies periodically reviewed their Chief Executive's Instructions (CEIs) with the objective of ensuring that they remain relevant. In addition, delegations and authorisations were regularly reviewed and updated.

2.15 Agencies impacted by the MOG changes of 3 December 2007 and 25 January 2008 had generally taken action in a timely manner to create or amend, as appropriate, CEIs and delegations and authorisations.

2.16 As also reported in recent years consideration of the financial results regarding current and future operations is included on the agenda of agencies' executive management meetings. These meetings are usually held monthly, but some agencies have weekly and fortnightly meetings. Financial performance reports to agencies' executives included budget forecasts and commentary on performance, based on information supplied by line managers. The financial information provided to the agencies' executives was generally supplemented by non-financial operational information so that a balanced view of performance was considered.

Compliance with financial legislation

2.17 The financial framework for Australian Government entities is established by the FMA Act, the CAC Act and their respective subsidiary legislation. The key feature of the framework is that the Chief Executive of each entity is responsible for the financial management of their entity, including compliance with applicable laws and associated policies. A number of the requirements of this financial framework result in financial transactions that are reported in entities' financial statements.

2.18 In reviewing an agency's control environment, the ANAO assesses whether management has established adequate controls to enable the agency to comply with key aspects of the FMA Act.

2.19 In recognition of the increasing importance that the JCPAA and other Parliamentary Committees have placed on compliance with the financial framework, and in the light of a series of past performance audits which disclosed significant contraventions, the ANAO has increased its focus on legislative compliance as part of its financial statement audit coverage. The increased coverage involves the ANAO assessing key aspects of legislative compliance in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public monies. Audit testing includes confirming the presence of key documents or authorities, and sample testing of relevant transactions directed at obtaining reasonable assurance about agencies' compliance with targeted legislative aspects of the financial management framework. Our audits also review the results of compliance self-assessment and processes and other reviews undertaken in the context of the agencies' Certificate of Compliance.

Observations

2.20 The 2007–08 interim audits identified that most agencies maintain a listing of the laws, regulations and associated government policies that are relevant to their responsibilities. Most agencies also assign responsibility to a work area or individual to ensure that the listing is reviewed and updated regularly, while other agencies rely on individual business areas to maintain and update lists relevant to their respective work areas. Agencies also have processes in place to obtain assurance from line managers regarding compliance with relevant legislative requirements to enable Chief Executives to provide an annual Certificate of Compliance.

2.21 Systems or processes for monitoring legislative compliance have also been established or are being established by most agencies. The majority of audit committees are responsible for oversighting the effectiveness of legislative compliance arrangements particularly in relation to financial management requirements with the internal audit function often assisting with monitoring.

2.22 Based on our sample testing, no instances were identified of legislative non-compliance during our interim audits in the relevant key areas referred to above. A review of the accounting for appropriations in the period following the MOG changes of 3 December 2007 and 25 January 2008 will be finalised during our final audits. This matter is further discussed in Chapter 3.

2.23 The results of the audit also indicated that the majority of agencies had identified financial management and reporting risks as an integral part of their overall risk management systems. Agencies have a variety of mechanisms to communicate the importance of compliance with legislation through documents such as their Corporate Plan, Chief Executive's Instructions, Fraud Control Plan and delegations, as well as conducting targeted training or induction courses.

Risk assessment process

2.24 An understanding of an agency's risk assessment process is essential to an effective and efficient audit. The ANAO reviews how agencies identify risks relevant to financial reporting objectives, how these risks are managed and considers the residual risk of material misstatement of an agency's financial statements.

2.25 The ANAO found that the majority of agencies have some form of risk assessment process in place that involves developing and updating risk management plans at the organisational and work area levels. Oversight of the process is usually provided by the agency's audit committee. However, the level of integration of risk management, corporate planning and budgeting processes is an area requiring management attention in a small number of agencies.

2.26 Two common elements of agencies' risk management frameworks that the ANAO reviews as part of its interim audits are business continuity management and fraud control management.

Business continuity management

2.27 An agency's business strategies and decisions are based on the assumption of the business continuing in the face of adverse circumstances. Business continuity management (BCM) is an overarching and structured approach developed by agencies to consider the risk to the continued availability of key resources that sustain and support essential business processes.

2.28 The range of risks that threaten the continuity of agencies' business processes is considerable. Continuity risks extend from traditional emergencies, such as natural disasters or fires, to both physical and cyber terrorism, through to utility, technology and communications failures, to theft and sabotage. Any one of these events can be disruptive and hence can affect, often to a significant degree, an agency's ability to meet its policy and/or service delivery responsibilities in a timely manner.

2.29 Without effective BCM, there is an increased risk of agencies' business processes and IT systems functioning incorrectly or stopping altogether in the event of a disaster. BCM comprises two key elements supported by a number of activities that interrelate to identify, analyse and treat continuity risks and deal with the consequences should preventative treatments fail. These two elements are a:

- Business Continuity Plan (BCP) that defines the continuity risks and the approach an agency intends taking to deal with and recover from disruptions to service; and
- Disaster Recovery Plan (DRP) that describes how an agency will recover from an actual disruption event.

2.30 Regular testing of business continuity and disaster recovery plans enables an agency to observe the overall performance and suitability of those plans and to develop, if necessary, a set of objectives to improve future performance. Testing generally includes a review of business process recovery timeframes and processes, as well as the currency and validity of the plans themselves.

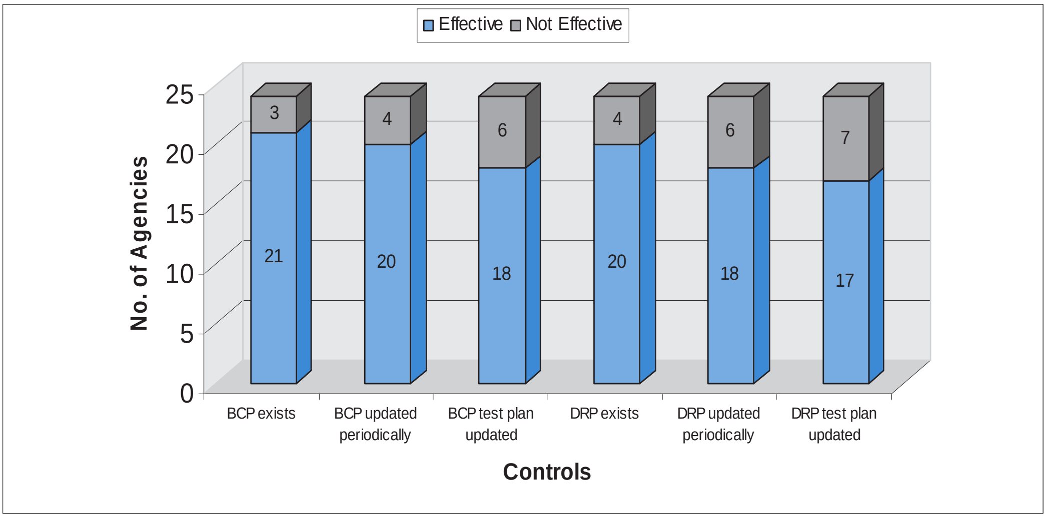
Observations

2.31 Audit Report No.51 2006–07, that reported the results of the interim phase of our 2006–07 financial statement audits, mentioned that most agencies had improved their management of business and technology risks by taking action to establish, document and communicate policies and procedures concerning business continuity management. Those same agencies had also assigned executive accountability for continuity management and had allocated responsibility for developing and maintaining continuity-related plans.

2.32 Business continuity management continues to be an essential part of an agency's ability to restore key business functions and hence the ability to report on its outputs, outcomes and financial information. As part of our 2007–08 interim audits, the ANAO again assessed key BCM controls. The summarised results of our review are illustrated in Figure 2.1 below.

Figure 2.1

Assessments of Business Continuity and Disaster Recovery Arrangements



Source: ANAO

2.33 The ANAO found that most agencies now have Business Continuity and Disaster Recovery Plans. Such plans assist in managing the risk of disruptions to agency operations in the event of a disaster or incident.

2.34 However, our audits identified that a number of agencies do not have established arrangements for reviewing and updating these plans. As the nature of risks to business and the demands on IT systems are not static, these plans should remain current. Regular reviews and updates increase the confidence that an agency is able to address a disruption to its business operations.

2.35 Our audits also found that a number of agencies had not updated their plans for testing their BCPs and DRPs. A test plan should be periodically reviewed and updated as required particularly following the testing of the plans. This assists in ensuring that an agency is well prepared in the event of a disaster or accident. In addition, a number of agencies had not documented business continuity requirements for all their key business processes or activities.

2.36 Continuity-related plans cannot be considered reliable until they have been fully tested. Testing provides management with the required assurance that the plans will be both effective and workable. Testing also provides an important aid to training staff. The ANAO noted that more than a third of agencies had not performed regular testing of either their BCPs or DRPs. These agencies were therefore not well placed to identify aspects of their plans that required attention, nor were they able to integrate lessons learnt into revised plans.

2.37 Overall, the results of our 2006–07 audits in this area reflect an improvement compared to previous year's findings, although in a number of agencies higher priority needs to be given to developing a comprehensive business continuity framework including the periodic testing of BCPs.

Fraud control management

2.38 *The Commonwealth Fraud Control Guidelines* (the Guidelines) outline the principles for fraud control within the Australian Government and set national minimum standards to assist agencies in carrying out their responsibilities to combat fraud[28] against their programs.

2.39 The importance of agencies establishing effective fraud control arrangements is recognised in section 45 of the FMA Act which specifies that Chief Executives must implement a fraud control plan for their agency. The Guidelines require agencies to conduct fraud risk assessments at least every two years. Order 2.2 of the FMA Orders requires Chief Executives to prepare a report on fraud control for their agency at least every two years, in accordance

[28] The Commonwealth Fraud Control Guidelines define fraud against the Commonwealth as 'dishonestly obtaining a benefit by deception or other means'. This definition includes theft; obtaining property, a financial advantage or any other benefit by deception; causing a loss, or avoiding or creating a liability by deception; providing false or misleading information to the Commonwealth, or failing to provide information where there is an obligation to do so; making, using or possessing forged or falsified documents; bribery, corruption or abuse of office; unlawful use of Commonwealth computers, vehicles, telephones and other property or services; relevant bankruptcy offences; and any offences of a like nature to those listed previously.

with the Guidelines, and to provide the report to the agency's responsible Minister. All agencies are required to provide the Australian Institute of Criminology (AIC) with fraud control information for its annual report on fraud against the Commonwealth to the Minister for Home Affairs in line with the Guidelines.

2.40 The information provided by agencies is collated and a fraud annual report is provided to Government to facilitate analysis of fraud and future policy development. Unaudited data provided to the AIC for the year ended 30 June 2007 showed that:

- a total of 124 908 allegations of fraud were reported by 158 agencies;
- an estimated total cost of fraud managed and reported by agencies during 2006–07 was $34.3 million;
- the Australian Federal Police investigated 367 complex cases in 2006–07 and estimated the cost of fraud for these cases to be $508.6 million;
- 5490 defendants were referred to the Commonwealth Director of Public Prosecutions for prosecution;
- 3301 convictions for fraud were achieved during 2006–07; and
- there were 51 acquittals for fraud during 2006–07.

These data continue to highlight the importance of agencies effectively managing their fraud control responsibilities.

2.41 An explanation of an auditor's responsibility for preventing and detecting fraud is provided in Australian Auditing Standard ASA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report*, which states in paragraph 16:

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

2.42 In considering the risks of material misstatement in the financial statements due to fraud, ASA 240 requires that a number of audit procedures be undertaken, including making enquiries of agencies regarding their risk assessment processes for identifying and responding to the risks of fraud and the internal controls that management has established to mitigate those risks.

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

2.44 As with risk management plans, fraud control plans need to be reviewed regularly and updated when significant changes to roles or functions occur, so that they reflect an agency's current fraud risk and control environment. There are benefits in agencies assessing their fraud risks as part of their risk management process.

Observations

2.45 Consistent with observations in Audit Report No.51 2006–07, our 2007–2008 audits found that, although fraud control planning was well established, a number of agencies were still not complying with all aspects of the Guidelines.

2.46 Areas identified as requiring further attention in some agencies included the processes for reviewing and updating fraud control plans, developing timetables in respect of strategies identified and establishing performance indicators and related targets or other mechanisms to monitor the effectiveness of these plans.

2.47 Our 2007–08 interim audits also identified an overall improvement in agencies' compliance with the guidelines, although the effectiveness of fraud controls plans was not being monitored by a number of agencies.

Information systems

2.48 In all agencies information systems are used extensively for financial management and reporting, as well as for human resource management processes. As a consequence, the review of these information systems and their related controls forms a significant part of the ANAO audit examination of internal controls. Information system controls include agency-wide general controls that establish an agency's IT infrastructures, policies and procedures, together with specific application controls that validate, authorise, monitor and report financial and human resource transactions.

Observations

2.49 The ANAO observed that all agencies had governance arrangements in place that encompassed the oversight and management of their information systems and IT change processes. Nevertheless our audits continued to identify a range of control-related issues.

2.50 Given the significance of information systems and the ongoing issues in this area, a detailed commentary is provided in Chapter 4. In summary, the main information system control issues identified in our audits related to the following matters:

- security and management controls in both FMIS and HRMIS systems including the management of special and privileged users;
- the management of release management processes and;
- the updating and testing of business continuity and disaster recovery plans, particularly for HRMIS systems.

Control activities

2.51 Australian Auditing Standard ASA 315 at paragraph 106 states:

> Control activities are the policies and procedures that help ensure that management directives are carried out; for example, that necessary actions are taken to address risks that threaten the achievement of the entity's objectives.

2.52 ASA 315, paragraph 107, requires the auditor to consider whether, and how, a specific control activity, individually or in combination with others, prevents, or detects and corrects, material misstatements in classes of transactions, account balances, or financial statement disclosures. Examples of control activities include reconciliations, authorisation, segregation of duties and information processing.

2.53 As part of the interim audit, the ANAO reviewed accounting processes and their related control activities, including in the following areas:

- appropriations management;
- revenue and receivables;
- purchases and payables;
- human resource management processes;
- cash management; and
- asset management.

Appropriations management

2.54 Appropriations, both departmental and administered, represent the primary source of revenue for most agencies. One of the key controls is reconciliation between the Australian Government's central budget management system administered by Finance and agency financial management information systems. This is designed to ensure that departmental expenditure does not exceed the total departmental appropriation available and that administered expenditure for each portfolio outcome accurately reflects anticipated final budget outcomes in the central budget system.

2.55 Our audits disclosed that controls in agencies relating to the accounting for appropriations were generally adequate. Weaknesses noted related to controls over the timely completion and review of reconciliations between the Finance budget management system and agencies' financial management information systems.

2.56 As mentioned earlier, the accounting for appropriations following the MOG changes is an issue that is still subject to review and will be finalised during the 2007–08 final audits.

Revenue and receivables

2.57 A number of agencies collect significant revenues in the form of taxation, excise duties and administered levies. Lesser amounts are generated by agencies from the sale of goods and services and from interest earned from cash funds on deposit. In some agencies, such as the ATO, accounting for these revenues involves the estimation of amounts such as fringe benefits tax, petroleum resource rent tax, goods and services tax, luxury car and wine equalisation taxes.

2.58 In 2006–07, the Consolidated Financial Statements reported total taxation revenues of $260.74 billion, and non-taxation revenues of $25.95 billion.

2.59 The ANAO's testing disclosed weaknesses in some agencies relating to controls over their revenue systems. Weaknesses related to controls over the documentation and timely completion of reconciliations, together with the investigation of variances between relevant revenue systems and the agencies' financial management systems.

Purchases and payables

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

2.61 In 2006–07, the Consolidated Financial Statements reported the total cost of goods and services (excluding employee benefits) of $45.39 billion, total subsidies, benefits and grants of $193.49 billion, and borrowing cost expenses of $6.72 billion.

2.62 Controls including reconciliation processes, segregation of duties, appropriate delegations and access controls provide an effective means of ensuring that payments are valid and accurately recorded, and that funds are not mismanaged or subject to material fraud.

2.63 Our 2007–08 interim audits identified a range of procedural weaknesses in some agencies, in such areas as: the lack of segregation of duties relating to the purchasing and authorisation for payment of goods and services, a lack of controls designed to prevent duplicate payments, the failure to acquit grants and the failure to undertake credit card reconciliations.

Human resource management processes

2.64 Human resource management processes encompass the day-to-day management and administration of employee entitlements and payroll functions. Employee entitlements and payroll normally represent an agency's largest departmental expenditure item. In many instances, employee entitlements, particularly annual and long service leave liabilities, typically form one of the larger liabilities on an agency's balance sheet.

2.65 In 2006–07, the Consolidated Financial Statements reported $28.77 billion in employee benefits, including employee superannuation contributions of $8.66 billion.

2.66 Given the significance of employee expenses, and the fact that by their nature some employee entitlement calculations can be quite complex, agencies need to have adequate control mechanisms in place to capture and process employee data and related payments. Those agencies that do not have an integrated FMIS and HRMIS require a reconciliation process that is designed to ensure that fortnightly payroll amounts are accurately recorded in their FMIS. In addition, key controls should include appropriate approval and review processes.

2.67 The ANAO observed a number of control weaknesses in some agencies in payroll processing, unapproved leave requests and a lack of documentation supporting reconciliations between the agencies' HRMIS and FMIS. Consistent with our findings in prior years, our audits also found that in some instances documentation for both commencements and terminations was not being maintained. In addition, there was a lack of independent review of separation payments in some agencies.

Cash management

2.68 The cash management accounting process covers the collection and receipting of public monies, processing of payments and the management of official bank accounts. Cash management processes are linked to the accounting for appropriations and receipts and also to the payment of employment and suppliers' costs. In 2006–07, the Consolidated Financial Statements reported cash totalling $3.44 billion.

2.69 Each agency is required to ensure it has the necessary liquidity to meet its commitments as they fall due and to maintain proper controls over its official bank accounts. In this environment, it is essential that adequate management processes are in place to track fund transfers and to safeguard assets.

2.70 Weaknesses identified in this year's interim audits related to the completion of bank and petty cash reconciliations in a timely manner and instances where official bank accounts were overdrawn and overdraft arrangements were not in place.

Asset management

2.71 The ANAO's review of asset management covered acquisition, disposals and recording of non-financial assets. The maintenance of a reliable asset register that includes adequate information about assets acquired and disposed of, depreciation and asset reconciliations with periodical stocktakes is a prerequisite to effective asset management. Regular reconciliations of the asset register with agency's financial systems will help to ensure the timely and accurate recognition of asset items and facilitate their physical control.

2.72 In 2006–07, the Consolidated Financial Statements reported total non-financial assets of $80.42 billion, excluding inventories and 'other' non-financial assets.

2.73 Consistent with previous years' findings, the control weaknesses identified in some agencies in our 2007–08 audits included reconciliations between the asset registers and the agencies financial systems not being completed in a timely manner, delays in the capitalisation and disposals of assets, the misclassification of assets between asset classes, the inconsistent application and a lack of clarity in policies and procedures relating to stocktakes, and the absence of a consistent policy on the useful life of assets. Weaknesses in the accounting for assets continue to be noted in the Department of Defence. Details of the particular issues are outlined in Chapter 5.

Monitoring of controls

2.74 Australian Auditing Standard ASA 315 at paragraph 114 states:

> Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Those charged with governance and management accomplish monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

2.75 Agencies undertake many types of activities as part of their monitoring of control processes, including external evaluation reviews, control self assessment processes, post-implementation reviews and internal audits. The level of review of different types of activities by the ANAO is dependent on the nature of each entity. However, given the significance of the investment by Australian Government agencies in the internal audit function and the requirements of Australian Auditing Standards, this function is reviewed by the ANAO each year to gain an understanding of how it contributes to the overall monitoring of controls.

Internal audit function

2.76 Internal audit is a key source of independent and objective assurance advice on an agency's internal control and risk framework. Depending on the role and mandate of an agency's internal audit function, it can play an important role in assessing the adequacy of financial systems that underpin an agency's financial statements and in the preparation of the statements themselves.

2.77 As part of its financial statement coverage, the ANAO reviews the activities of internal audit in accordance with Auditing Standard ASA 610 *Considering the Work of Internal Audit*. The ANAO approach takes into account the work completed by internal audit, and, where appropriate, reliance is placed on it to ensure an effective audit approach. Before reliance is placed on specific internal audit work, ASA 610 requires a number of audit procedures to be undertaken, including a review of relevant internal audit working papers, examination of a sample of items already examined by internal audit and observation of internal audit procedures.

2.78 To assist agencies in the management of their internal audit functions the ANAO issued a Better Practice Guide *Public Sector Internal Audit* in September 2007. The Better Practice Guide outlines the key characteristics for an Internal Audit function that will provide confidence and assurance to Chief Executives and or Boards that those financial and operational controls, which manage the organisations risks, are operating in an efficient and effective manner. It also assists management in approving the agencies performance.

Observations

2.79 The ANAO found that internal audit coverage is generally based on a work plan that is aligned with agencies' risk management plans and includes a combination of audits that address assurance, compliance, performance improvements and IT systems reviews. In addition recommendations from management, audit committees and external influences such as the ANAO work program are factors considered in the development of internal audit work plans. We also observed that the composition of internal audit work plans were weighted more towards assurance and compliance activities than performance activities.

2.80 Where appropriate, the ANAO places reliance on internal audit work with aspects of the work being used to determine the nature, timing and extent of the ANAO audit procedures. The extent of reliance varies between agencies.

Greater reliance is placed on internal audit work where the work is focused on financial controls and legislative compliance, including coverage that is used to underpin the Certificate of Compliance process. The ANAO continues to encourage agencies to identify opportunities for internal audit coverage of key financial systems and controls as a means of providing increased assurance to Chief Executives to support their expressing an opinion on the agency's financial statements.

2.81 The ANAO also found that the internal audit functions of most agencies are generally subject to annual review by their respective audit committee or by external reviewers. At the time of the interim audit, those internal audit functions that had been reviewed had been assessed as providing a satisfactory service.

2.82 The ANAO observed that some agencies needed to improve the timeliness of reports and the achievement of the audit work plan.

Financial statement preparation

2.83 For 2007–08, agencies are required to submit audit cleared financial statement information including narrative note information to Finance by 15 August 2008. This is consistent with the 2006–07 financial statements deadline.

2.84 To assist agencies in achieving efficiencies in the preparation of their financial statements, the ANAO released a Better Practice Guide titled *Preparation of Financial Statements by Public Sector Entities* in April 2006 to provide advice to entities on approaches which can be taken to produce materially correct financial statements in a timely manner.

2.85 Agencies' financial statement preparation processes will be reviewed as part of our 2007–08 financial statement audits.

Conclusion

2.86 The results of our 2007–08 interim audits reflect, in general, the maturity of agencies' control environments and the effectiveness of controls over finance and accounting processes in the majority of agencies.

2.87 Control weaknesses that continue to be identified in a number of agencies predominately relate to agencies' information systems particularly in relation to the management of systems and user access, IT change management and the testing and updating of business continuity and disaster recovery plans. Other issues identified in a number of agencies related to the reconciliation of key financial accounts and reconciliations between business systems and agencies' FMIS, the segregation of duties and the management of assets.

2.88 While control weaknesses in these areas are unlikely to have a material impact on agencies' financial statements, they reinforce the importance of agencies maintaining a focus on establishing and maintaining the control regimes in their financial, human resource and business systems.

3. Machinery of Government Changes

Introduction

3.1 The implementation of Machinery of Government (MOG) changes that took place following the change of government in December 2007 required a significant change management process on the part of agencies and has had a consequential impact on the ANAO's 2007–08 financial statement audit arrangements for the affected agencies. Successful implementation of MOG changes requires effective communication between all the parties impacted by the changes, the full cooperation and commitment of both central and line agencies and sound project management arrangements to be developed and implemented. Changes made in a number of areas, particularly those that have a significant impact on governance, appropriation arrangements, IT systems, internal controls and financial reporting also require ANAO examination as part our financial statement audits.

3.2 The impact of the MOG changes resulting from the 3 December 2007 and 25 January 2008 Administrative Arrangements Orders (AAOs) was significant for the portfolios and agencies affected. In all, four agencies were abolished, five new agencies were created, and a number of functions and programs were transferred between agencies.

3.3 By their very nature, agencies affected by such changes will often have little or no notice of the specific changes that are determined by government. This is particularly the case in circumstances where there is a change of government, as occurred on 3 December 2007. Agencies are expected to implement the MOG changes in a way that does not impact on the government's policy and service delivery responsibilities. The Good Practice Guide, (the Guide) *Implementing Machinery of Government Changes*, emphasises that:

> A key to achieving good results in implementing MOG changes is for agencies to take a whole-of-government approach. The need to take a cooperative and collegiate approach underpins the whole-of-government process whereby agencies are encouraged to work across organisational barriers to achieve Government objectives. It is expected that agencies will communicate openly with one another, and with central agencies, to achieve the best outcome for the APS.

3.4 While there is no overall timeframe within which agencies are expected to implement the MOG changes, the Guide also states that:

> While the transfer of staff under section 72 of the PS Act are unlikely to be completed by the time the new AAO is made, the Prime Minister expects agency heads to implement AAO changes cooperatively and as soon as possible, if necessary by administrative means such as issuing new delegations. However, if as a result of a post-election MOG change, a department is abolished, transfers of staff and appropriations must take effect on the day the AAO is made.

3.5 The need for MOG changes to be implemented quickly is reinforced by Estimates Memorandum 2007/43 that set a deadline of 16 January 2008 for details of final appropriation transfers to be submitted to Finance.

3.6 Agencies are affected by MOG changes in six main areas:

- governance arrangements;
- Parliamentary appropriations and related matters;
- staffing;
- systems, particularly IT systems;
- accommodation; and
- financial reporting.

Governance arrangements

3.7 In some cases, potential MOG changes can be foreshadowed by policy announcements or through consultations with central agencies. In these circumstances, there is an opportunity for agencies to take some action to plan for the possible changes as a way of mitigating, to the extent possible, the risks involved. The timing of the MOG changes may, however, limit the extent of consultation that can take place, as was the case following the change of Government in November 2007. In any event, MOG changes require agencies to establish new or revised internal governance arrangements within short timeframes. This requires agency chief executives and senior managers giving priority to the implementation of changes in a way that has minimal impact on agencies' policy and service delivery responsibilities while ensuring that relevant legislative and policy requirements are met.

3.8 Agencies also needed to establish arrangements to effectively manage the implementation of the MOG changes, including communicating to those staff directly impacted as well as other staff in each agency. Generally, agencies established a steering or implementation committee or identified senior staff members who were assigned responsibility for settling implementation issues. In most cases these committees included representatives of both gaining and losing agencies. In some agencies senior staff were taken off line and dedicated to the implementation of the MOG changes.

3.9 All impacted agencies recognised the importance of regular communication with staff and adopted a variety of means to achieve this including: establishing a register of issues that all staff were encouraged to contribute to, establishing an intranet site dedicated to the MOG changes, and regular email and other communications from the Chief Executive and other senior executives. At least one agency also put in place an internal appeals process that provided staff with an opportunity to appeal against transfer decisions.

3.10 Generally, agencies had put in place, or initiated action to address, governance issues in a timely manner, although the task was clearly more difficult in the case of the five newly created agencies. In this regard, some agencies indicated that the limited availability of assistance, including detailed guidance, on the many issues that needed to be addressed in establishing a new agency, inhibited the efficiency of the implementation of the new arrangements.

Parliamentary appropriations and related matters

3.11 A central tenet of financial management for public sector agencies is the requirement that money can only be expended in accordance with a valid Parliamentary Appropriation. In circumstances where agencies were abolished and created, or functions were transferred between agencies, appropriate amendments need to be made to the schedules to the Appropriation Acts to ensure that agencies have sufficient appropriation cover for all expenditure. Amendment of the Appropriation Acts to provide for the transfer of appropriations among agencies is effected by executing a determination under Section 32 of the FMA Act (s32 determination). These determinations are typically made by a Delegate of the Minister for Finance and Deregulation following agreement between the relevant agencies about the appropriation amounts to be transferred. In addition to Estimates Memorandum 2007/43, Finance issued Finance Circular No. 2007/03 dealing with the transfers of appropriations.

3.12 Finance advised that as at the end of May 2008, 36 s32 determinations relating to the MOG changes have been issued involving the transfer of some $4.6 billion between 21 agencies. A number of the determinations made were interim in nature as in some circumstances it understandably took some time for losing and gaining agencies to agree on the exact amount of appropriation that should be transferred.

3.13 To enable the business of government to continue while still meeting the legislative requirements relating to appropriations and expenditure, agencies put in place a number of different arrangements in the period between the date of effect of MOG changes and amendment of the Appropriation Acts. These included interim s32 determinations and losing agencies continuing to make program and other payments on behalf of the gaining agency.

3.14 While a number of s32 determinations transferring administered and departmental expenses were issued within a few weeks of the MOG changes, delays occurred in settling final s32 determinations in relation to both administered and departmental expenses. In particular, agencies advised the ANAO the main issues encountered related to: settling the details of programs and functions to be transferred, determining an agreed proportion of corporate overheads and settling details of relevant assets, cash reserves (sourced from depreciation funding) and employee provisions to be transferred. On occasions, detailed and protracted negotiations took place over an extended period (up to five months in some cases) before agreement was reached between agencies.

3.15 In settling final s32 determinations for departmental expenses, agencies needed to determine the overall staffing implications of the MOG changes and then agree on the number and level of staff, including corporate support staff, impacted. While all agencies worked on the general principle 'that staff follow function', in many cases, particularly in State or Regional Offices, staff are involved in the administration of more than one program. In such cases, it was only after a detailed assessment of likely staff impact of the MOG changes did agencies consider they were in a position to settle appropriation transfers. Not all agencies adopted a similar approach or outlook in relation to these matters. Some agencies took more of a global perspective that enabled staffing and appropriation details to be settled relatively quickly. Other agencies considered it was important to assess the impact of the changes on both staff and budgets at a more detailed level. This inevitably led to some delays in finalising s32 determinations.

3.16 In some cases, it also took some time for agencies to settle the more difficult details of assets and cash reserves relating to prior year depreciation funding that needed to be transferred.

3.17 A particular operational issue identified by some agencies was the difficulties involved in incorporating the effect of MOG changes into the Central Budget Management System, a system used to manage budgets, appropriations, revenues, expenditure and cash at the whole-of-government and individual agency levels.

3.18 At the time of this report, the ANAO was reviewing in a number of the affected agencies the accounting for appropriations in the period immediately following the AAOs of 3 December 2007 and 25 January 2008. The outcome of this review will be finalised as part of the final audits of agencies' 2007–08 financial statements.

Staffing

3.19 Section 72 of the Public Service Act provides a mechanism for the Public Service Commissioner to give effect to MOG changes by making determinations relating to the transfer or cessation of employment of APS and non-APS employees impacted by the changes. The APSC advised that as at the end of May 2008, 46 determinations had been issued by the Commissioner or her delegate. These involve the transfer between agencies of in excess 11 500 APS employees. Other key processes to give effect to MOG changes can involve the determination of remuneration and other terms and conditions and the duties of employees transferred between agencies.

3.20 In relation to remuneration and other terms and conditions, determinations were made by the Special Minister of State pursuant to sub-section 24(3) of the Public Service Act that broadly had the effect of determining the terms and conditions of employees of the five newly created agencies to be equivalent to those that would have applied had the MOG changes not occurred. The current determination applies to each of the new agencies until such time as each agency makes a new collective agreement. Individual agencies also made determinations under sub-section 24(1) of the Public Service Act relating to the remuneration and terms and conditions of employees transferred between agencies as a result of the transfer of functions.

3.21 Agencies also advised the ANAO that determinations under section 25 of the Public Service Act relating to the assignment of duties were generally not required as the duties of staff transferred between agencies remained substantially the same.

Systems, particularly IT systems

3.22 The abolition and creation of agencies and the transfer of functions and programs between agencies often has significant implications for agencies' IT infrastructure, systems and related processes and procedures. Historically, all agencies have been responsible for establishing and maintaining their IT infrastructure and corporate and business systems to meet their specific business requirements. This has meant that agencies have in place a variety of IT hardware platforms and applications[29].

3.23 Agencies gaining programs and functions, or new agencies assuming functions or programs from abolished agencies, were faced with managing disparate IT environments that were supported by different IT service arrangements, including from external parties. In some cases as an interim measure, agencies are continuing to manage programs and make program payments from systems operated by the agency that had previous responsibility for a program. Such arrangements are generally underpinned by Memoranda of Understanding (MOU) or similar agreements.

3.24 Gaining agencies have also been faced with the task of migrating data relating to both staff and programs into their systems. At times this has required system reconfiguration to accommodate new data and the conduct of a validation exercise to confirm the accuracy and completeness of the data being migrated.

3.25 Implementing solutions to such situations to enable the delivery of Government programs and functions in an integrated and cost effective manner will take some time and potentially involve considerable expenditure.

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[29] In April 2008, the Minister for Finance and Deregulation announced an independent review of the Australian Government's management of information and communication technology. The aim of the review is to identify ways in which the Australian Government can strengthen the whole-of-government management of ICT and maximise the benefits from ICT to drive greater efficiency and better services. The review will also examine the way in which agencies manage ICT investments, including maintenance, intra-agency links, development and staffing

3.26 The impact on agencies' IT infrastructure and systems will require additional IT audit coverage in some of the affected agencies over the next two years.

Accommodation

3.27 The magnitude of the MOG changes has also inevitably impacted agencies' accommodation requirements in view of the fact that, as noted above, a substantial number of staff have been transferred between agencies. Affected agencies have needed to reassess their short and longer term accommodation requirements having regard to their operational needs, the views of staff, and existing contractual lease arrangements.

3.28 Agencies advised the ANAO that various arrangements had been made to meet their new accommodation requirements in the short and medium term. These included: reaching agreement with losing agencies for staff to remain in existing accommodation, the relocation of other portfolio agencies to free up accommodation for transferring staff and the leasing of additional accommodation.

Financial reporting

3.29 An important consideration in the implementation of the MOG changes is the way in which the financial transactions and asset and liability balances of both abolished and newly created agencies will be reported. In a Financial Management and Accountability Order (FMO) dated 6 April 2008, the Minister for Finance and Deregulation specified the reporting arrangements for abolished and new departments.

3.30 The central requirement is that the financial statements of each abolished department are to be incorporated into the financial statements of the corresponding new department as though they were the one entity. This is a departure from previous practice that involved the preparation and audit of separate financial statements for each abolished department. The ANAO was advised by Finance that this approach was adopted so that the full year financial performance of relevant programs would be available from a single source, rather than requiring two sets of financial statements to be added together to obtain financial performance for the full year for programs that effectively continued in the same agency. Finance also advised that this approach is similar to the reporting arrangements for restructures that apply when agencies are not abolished.

3.31 For the 2007–08 financial statements, the FMO requires additional disclosures by new agencies including:

- a description of the objective, outcomes and outputs of the corresponding abolished department(s);
- separate disclosure in the notes for the period 1 July 2007 to 2 December 2007 for each abolished department and 3 December 2007 to 30 June 2008 for each new department of revenue from government, grant expenditure, total income, total expenditure and the operating result;
- separate disclosure for special accounts, appropriations and outcomes for the periods 1 July 2007 to 2 December 2007 and 3 December 2007 to 30 June 2008; and
- disclosure in the notes of comparative information for 2006–07 for the corresponding department(s).

3.32 To meet these reporting requirements agencies will be required to maintain the capacity to access financial and related information that relates to abolished departments. The ANAO has modified its audit approach for the new agencies to reflect the need to audit the additional FMO disclosures.

Summary

3.33 From observations and enquiries made by the ANAO, it was evident that implementation of the MOG changes that took effect on 3 December 2007 and 25 January 2008 have involved a significant and sustained effort on the part of the impacted agencies, as well as the central agencies PM&C, Finance, the Department of Education, Employment and Workplace Relations (DEEWR) and the APSC[30]. Determining the program and operational implications of the AAOs, and then settling the revised staffing and appropriation arrangements, has taken some time. Many decisions on a range of governance and operational matters have, by necessity, needed to be made within short timeframes and without the benefit of a considered examination of all the available options. Agencies also advised the ANAO that, at least in some cases, agency negotiations were predicated on the basis of achieving the best outcome for the agency, rather than always considering the best outcome from a whole-of-government perspective, which at the time still needed to be

[30] These four agencies are 'central agencies' in the context of MOG changes.

fully developed and understood. This involved both losing and gaining agencies seeking to ensure they were well placed in the future to meet their new or revised program or service delivery responsibilities. Not surprisingly, reaching agreement in these circumstances at times involved considerable time and effort.

3.34 While noting the usefulness of the Good Practice Guide, and recognising that the Guide relates primarily to moves between agencies, some agencies observed that the guidance material did not address many of the practical issues faced by agencies, particularly newly created agencies. As a result, the Guide in itself did not provide sufficient guidance to assist agencies to implement the MOG changes in a timely and cooperative manner.

3.35 More broadly, MOG changes often create an environment of initial uncertainty for staff (generally a consequence of any change) and invariably lead to increased workloads for those staff responsible for their implementation. While difficult to quantify, discussions with a number of agencies also highlighted that the implementation of the MOG changes, together with the need at the same time to meet important Budget and other operational deadlines had an impact on the operational efficiency of ongoing service delivery, particularly in the finance and human resource areas of agencies.

3.36 Against this background, the ANAO's enquiries and discussions with relevant agencies suggest there is an opportunity to learn from agencies' individual and collective experiences in implementing MOG changes. In this regard, and recognising that MOG changes occur periodically, the ANAO suggests there would be benefit in PM&C, Finance, DEEWR and the APSC in consultation with other agencies, supplementing existing guidance with a set of protocols that guide agencies responses on the outcome of the administrative changes required. These protocols would give a stronger focus to a number of the matters included in the existing Guide such as the need to adopt a whole-of-government approach, adopting the 'staff follow function' principle and ensuring the open and honest identification of resource implications.

3.37 A key aspect that could usefully be addressed, once the extent of MOG changes is known, is the timeframes in which it would be expected that key milestones would be settled. For example, target timeframes could be set for the exchange of relevant information, the transfer of staff and settling the quantum of necessary appropriation transfers. Other matters that could be addressed include the level of support that could be expected to be provided by losing agencies, the business rules to be applied in determining the level of corporate overhead and staff to be transferred, and arrangements for the progressive transfer of functions, staff and appropriations. Further guidance on the many issues faced by newly created agencies would also be beneficial.

3.38 In circumstances where policy announcements or consultations with central agencies suggest the potential for revised administrative arrangements, there is benefit in agencies undertaking early planning in the event that such changes are made. This could include: determining appropriate governance arrangements and responsibilities for implementing changes, discussing potential scenarios with central agencies and ensuring, to the extent possible, that agency records of staffing profiles, expenditure, assets, liabilities and commitment are accurate and up to date.

3.39 The ANAO also considers that central agencies should consider, in consultation with line agencies, the benefits of committing to the establishment of a dedicated, multi-disciplinary capability tasked with assisting agencies in implementing future significant MOG changes.

4. Information Technology Controls

This Chapter presents the audit results of the ANAO's review of key elements of the information technology (IT) control environments that underpin financial transaction processing within major Australian Government agencies.

Introduction

4.1 Information Technology (IT) continues to assist agencies to transform the way Government agencies operate and support business process improvement. Ongoing advances in technology are contributing to expanded or enhanced service delivery and improved efficiency, functionality and/or automation. While technology and related improvements present agencies with major business opportunities, they also involve new or enhanced risks that need to be effectively managed.

4.2 Within the Australian Government, a number of major IT change projects are in progress, including within the Australian Taxation Office, the Department of Defence, and the Department of Immigration and Citizenship. There are also smaller change programs underway in other agencies, including those affected by the MOG changes resulting from the AAOs of 3 December 2007 and 25 January 2008. The ANAO reviews the governance arrangements of these programs in the context of an agency's financial statement responsibilities. IT governance arrangements contribute to the implementation of effective controls that reduce or mitigate risks that influence the achievement of agency objectives, including sound financial management and the preparation of timely and accurate financial statements.

4.3 The evaluation of the IT control environment is an important component of the overall financial statement audit process. In this year's report we have included an across agency assessment of key IT control areas.

4.4 Details of significant and moderate risk audit findings in relation to IT system controls are included for individual agencies in Chapter 5.

IT control environment

4.5 Agencies' financial statement preparation and reporting processes are supported by IT systems and related business processes. IT systems therefore form a key component of agencies' control environments and a key focus of our audit approach. The ANAO reviews both IT general and application controls within these environments as part of its annual interim financial statement audit.

4.6 IT general controls are agency-wide structures, policies, procedures and standards applied to information systems that support accounting and business processes. Effective operation of these controls helps ensure IT application controls were working as intended throughout the financial year.

4.7 IT application controls operate at the accounting and business process level, consisting of access, configuration, and reporting controls. Reliance on the effective operation of these controls assists agencies to gain assurance about the systems that underpin their financial statements.

4.8 As part of the annual financial statement audit, the ANAO assesses the design and operation of key IT controls to determine the effectiveness of these controls and their impact on reducing the overall risk of material misstatement in agencies financial statements. This assessment is undertaken in accordance with the Australian Auditing Standards[31].

4.9 Table 4.1 below outlines the IT general and application control areas reviewed by the ANAO as part of the 2007–08 financial statement audits of 23 agencies. At the time of the preparation of this report, the interim audit in three agencies was in progress.

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[31] Australian Auditing Standards, *ASA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*, AUSAB April 2006, <www.auasb.gov.au>

Table 4.1

Elements of the IT control environment

Control Category	Control Area	Description
IT general controls	IT Security	The policies, plans, and access management practices that provide for the protection of, and authorised access to, information.
	Incident and Problem Management	The procedures used to ensure resolution of issues and that IT systems remain operational and meet agencies' business needs.
	IT Change Management	The procedures used to develop, deliver, and maintain IT systems that meet the business needs of agencies.
IT application controls	Financial Management Information System	Integrated processes used to capture, process, report and monitor financial business transactions and support financial management processes.
	Human Resource Management Information System	Integrated processes used to capture, process, report and monitor human resource business transactions and support human resource management processes.

IT general controls

4.10 General controls are the foundation of agencies' IT control structures. They act to ensure the reliability of the information and outputs generated by that system. With the increasing complexity of IT enabled business processes, coupled with significant and ongoing change to IT in many agencies, there is a need to ensure adequate resources are applied to the maintenance of effective IT controls.

4.11 The ANAO's review of general controls focused on the controls present in the IT environment surrounding those information systems that process financial transactions, including controls over:

- IT security (including security policies and plans, access management, security monitoring, intrusion detection and security awareness training activities);

- incident and problem management (including incident recording, prioritising, resolution and closure); and
- IT change management (including requirement definitions, specifications, development, testing, and release).

IT security

4.12 IT security is used to protect information and information systems from unauthorised access, use, disclosure, disruption, modification, or destruction. The minimum requirements for the protection of Australian Government information resources that agencies must meet in their operations are detailed in the *Australian Government Protective Security Manual* (PSM)[32] and the *Australian Government Information and Communications Technology Security Manual (*ACSI 33*)*[33].

4.13 The administration of government programs often involves agencies managing large amounts of financial and personal information that they must protect. The integrity of such data can be threatened by an IT security incident, and impact the accuracy and completeness of an agency's financial statements. Any incident can also pose a direct threat to the privacy, legal and operational responsibilities of an agency.

4.14 Awareness of IT security is critical to successful design and implementation of any system change. Addressing IT security as part of design and testing will generally be more effective than after implementation. The nature of risks to IT security is constantly changing as new technologies create security threats and vulnerabilities that did not previously exist. The identification and management of these risks requires a flexible and proactive risk management approach to maintain a high quality of service delivery.

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32 The *Australian Government Protective Security Manual* (PSM) sets out the policies, practices, and procedures that provide for an appropriate protective security environment.

33 The *Australian Government Information and Communications Technology Security Manual* compliments the PSM by providing policies and guidance to assist Government agencies to achieve an assured IT security environment.

4.15 The ANAO reviewed the following components of IT security that are significant for providing assurance over financial information:

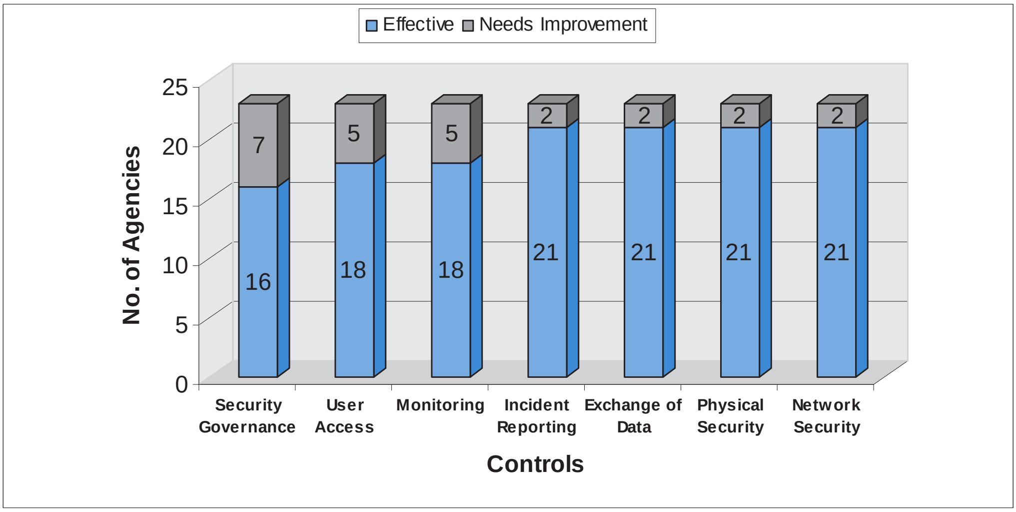
- security policies;
- user access;
- security awareness;
- segregation of duties; and
- security monitoring and review.

Observations

4.16 A summary of the ANAO's assessment of the effectiveness of security controls within agencies is provided in Figure 4.1 below.

Figure 4.1

Assessment of IT security controls



Source: ANAO

4.17 While the ANAO found that, generally, agencies had in place sound security arrangements, security governance and user access related issues continue to be identified in a number of agencies. The audit also identified there is a need for a number of agencies to implement security practices that are consistent with defined security requirements. These should be consistent and aligned with each agency's culture and its approach to security. Several agencies had yet to complete the development and/or update and implementation of detailed security practices. Maintaining security arrangements and practices can be resource intensive, but is a necessary activity for all agencies.

4.18 The majority of agencies had effectively implemented key controls in the areas of security management. Operation of these controls provides assurance that systems are protected from unauthorised use that could affect the integrity of financial information. For example, the ANAO observed that Incident Response Plans were generally well-structured and assisted agencies to provide rapid and effective responses to security events. This minimises the chance of a security incident damaging the integrity of financial information, or hindering the service delivery of the agency.

4.19 ANAO testing indicated almost a quarter of agencies did not have a complete or current System Security Plan for all IT systems. As these plans form the basis for all security processes and procedures within an agency, this situation creates a risk that security policy is not implemented in accordance with expectations. This could result in data integrity threats not being appropriately identified and mitigated.

4.20 The ANAO also observed that a small number of agencies were not correctly issuing waivers in instances where they were not fully compliant with the security requirements prescribed by the PSM or ACSI 33. Although a waiver is not a risk mitigation method in itself, the issuing of waivers demonstrates an awareness and acceptance of a particular risk. Failure to issue a wavier when security requirements are not met is contrary to government expectations and potentially could expose another agency to an increased level of risk.

Incident and problem management

4.21 Agencies commonly use a service desk[34] approach to establish a centralised and structured process for collecting, managing, and responding to incidents and problems.[35] Effective implementation of a service desk assists agencies to minimise adverse impacts to service delivery from IT incidents and problems.

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[34] Also commonly referred to as an IT Helpdesk.

[35] IT incidents and problems are generally daily events and are 'business-as-usual' or routine matters that every agency encounters and must manage.

4.22 IT incidents are events that may interrupt or diminish the quality, accuracy, availability, or timeliness of an IT system and incident management refers to the methods and procedures used to resume normal service as soon as possible.

4.23 IT problems are multiple incidents that have a common source and problem management is the process of finding and resolving the underlying causes of related incidents.

4.24 The following were the key control areas for incident and problem management examined by the ANAO:

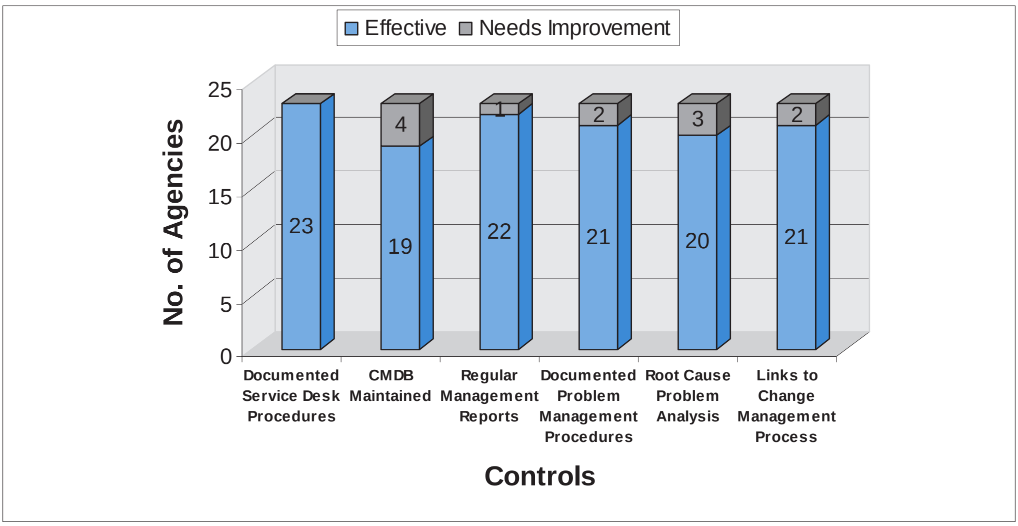
- detection of issues;
- recording of incidents and problems;
- investigating cause and effects;
- resolution; and
- closure.

Observations

4.25 The aggregated results of ANAO's assessment of the controls for incident and problem management are provided in Figure 4.2 below:

Figure 4.2

Assessment of IT incident and problem management controls



Source: ANAO

4.26 ANAO testing indicated all reporting agencies have a Service Desk in operation with established procedures to operate in an organised and structured manner. In addition, our testing found that personnel followed these procedures to create a logical workflow, ensuring incidents and problems were managed in a repeatable and consistent manner. This assisted agencies to deliver and maintain a consistently high quality of service.

4.27 A Configuration Management Database (CMDB) is a tool used by an agency for maintaining the integrity of application systems, and generally stores information on system attributes a central location using a common format. ANAO testing suggested almost 20% of agencies did not utilise such a tool, or had not implemented procedures for updating it regularly. Although we did observe that some agencies had initiated projects to create and populate a CMDB, until established and regularly updated, procedures for incident and problem management may be less efficient and effective.

Change management

4.28 Changes in IT systems and applications create new functionality for agencies, but can have a negative impact on the reliability of agencies' financial statements if not effectively managed.

4.29 An IT change management process prescribes a standardised method for making changes to an IT environment, including changes to communications networks, hardware platforms, application software, or the process and procedure documentation explaining and supporting systems. The overall aim of process standardisation is to allow changes to occur quickly and effectively in a controlled and timely manner, with a minimal number of incidents occurring on change release.

4.30 Change management processes help ensure that changes are correctly planned, implemented, and evaluated and assist in implementing system changes that will enhance agency service delivery in the manner intended.

4.31 The ANAO tested controls supporting the change process, with key areas being:

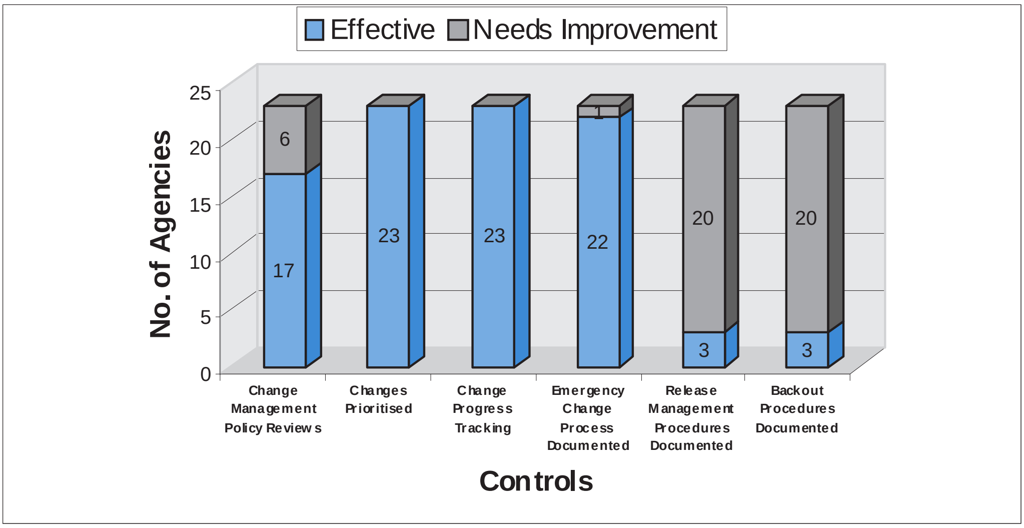
- management of the change process;
- change governance arrangements;
- reviewing and endorsing change requests; and
- management reporting of the change process.

Observations

4.32 The aggregated results from ANAO's testing of change management controls are provided in Figure 4.3 below.

Figure 4.3

Assessment of IT change management controls



Source: ANAO

4.33 Most agencies had established effective IT change management procedures and practices. Generally, the roles and responsibilities for enacting change were well defined. Stakeholders were involved throughout the process, and management reviewed and approved changes made. These factors contributed significantly to the integrity and reliability of systems undergoing change.

4.34 However, our testing identified that almost all agencies had control weaknesses in the area of release management. The primary objective of a release management process is to protect the integrity of the production environment, and releasing only the correct elements to that environment.

4.35 Release management procedures describe how to promote software into production[36], and how to record change details. Release management also includes the procedures for backing out (or reversing) a release that is having a negative impact on the production environment. Strong controls over all areas of release management help ensure that actual changes made not only maintain the integrity of the system, but also are appropriately designed and tested.

4.36 Several agencies did not fully document or follow their release management processes. Additionally, most agencies had not established consistent back-out procedures for the release of changes into the production environment, presenting additional risks to system availability or integrity.

4.37 A key control for mitigating this risk is to have back-out procedures in place for returning the system and its financial information to its previous state, if required. The absence of this procedure creates a risk every time there is a change to the production environment.

IT application controls

4.38 There are two key systems used across Australian Government agencies that directly affect the use and preparation of their financial information. The first of these is the Financial Management Information System (FMIS) and the second is the Human Resource Management Information System (HRMIS).

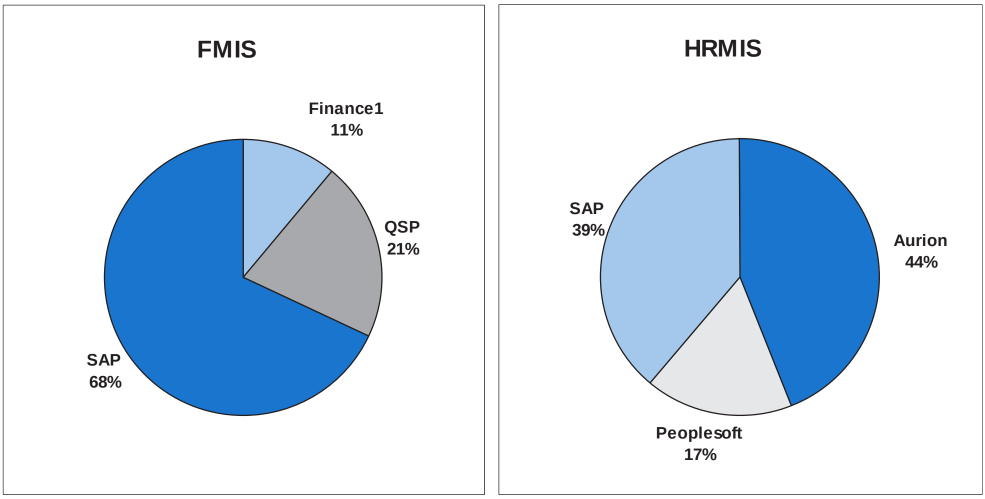
4.39 In view of their consistent use and the financial materiality of the outcomes, the ANAO reviews, tests and reports on key controls for both FMIS and HRMIS systems. While there is a range of application systems used, they require a similar set of controls to help ensure the accuracy, completeness, and reliability of the information.

[36] Also called the 'live' environment.

4.40 Figure 4.4 below details the relevant systems used by the agencies covered by this report.

Figure 4.4

Summary of financial reporting systems



Source: ANAO

Financial management information systems

4.41 The objective of an FMIS is to support and automate financial management processes. They are used to capture, process and record agencies' financial transactions and, therefore, are integral components of the overall financial statements generation and reporting processes.

4.42 FMIS controls reviewed as part of the 2007–08 interim audits were:

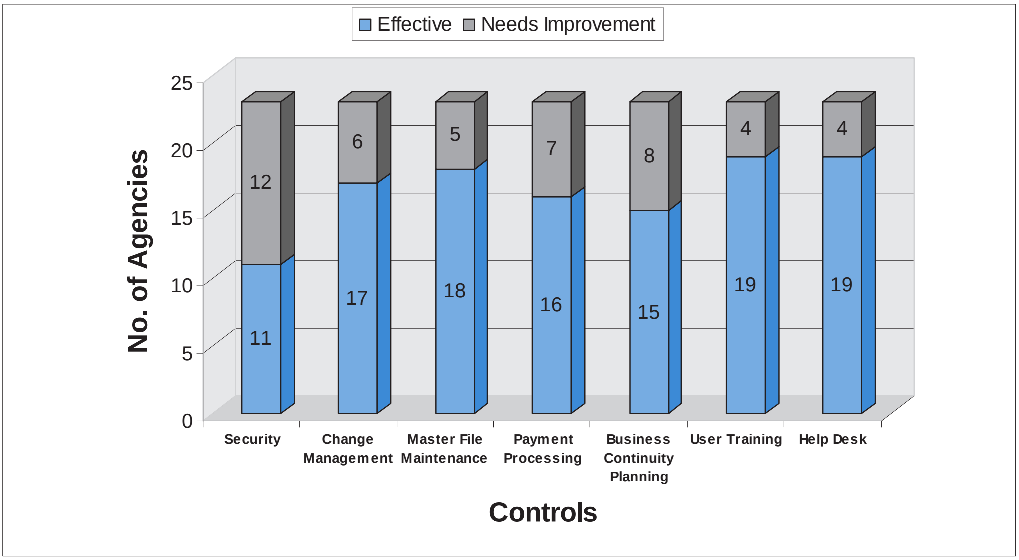
- maintenance of reference information;
- system administration;
- segregation of duties;
- user support;
- management of application access; and
- business continuity.

Observations

4.43 The ANAO's assessment of key FMIS controls is provided in Figure 4.5 below.

Figure 4.5

Assessment of FMIS controls



Source: ANAO

4.44 The ANAO's interim audit identified that in over one third of agencies, logging and monitoring of activities undertaken by system administrators and other special users was inadequate. Such users have greater access to the FMIS than other staff, and hence have privileged access that, if used inappropriately, can affect the integrity of financial information. The logging and monitoring of administrator access is a key control to verify that the use of this access is restricted to those that were authorised to have such access.

4.45 A second major risk area, present in almost a quarter of all agencies reviewed, related to inadequate segregation of duties. It is accepted practice that an individual should not perform conflicting functions that could compromise the effectiveness of controls. Not adhering to this practice exposes an agency to the possibility of financial misstatement, either inadvertently or through fraud.

4.46 There were several weaknesses in the management of FMIS systems across agencies. As these systems play a core role in the management of agencies financial statements, review of these systems is a key and on-going area of focus for the ANAO.

Human resource management information systems

4.47 The objective of a HRMIS is to support and automate personnel management processes. HRMIS are used to capture, process and record agencies' human resource transactions and, as such, represent significant components of the overall financial statements generation and reporting processes.

4.48 Key elements of agencies' HRMIS controls reviewed as part of our audit coverage were:

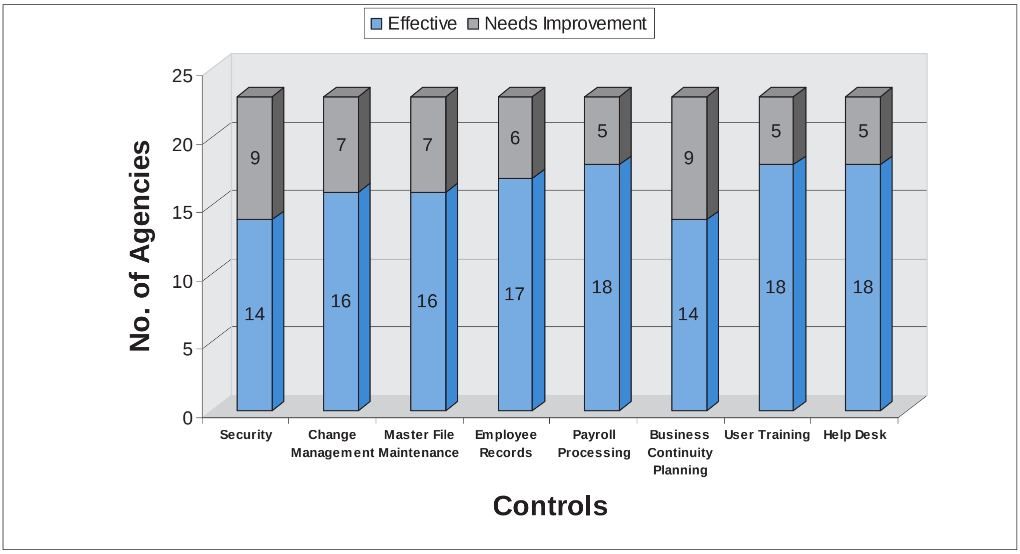
- employee masterfile maintenance;
- payroll processing;
- segregation of duties;
- security plans;
- user support;
- application access; and
- business continuity.

Observations

4.49 The ANAO's assessment of key HRMIS controls is provided in Figure 4.6 below.

Figure 4.6

Assessment of HRMIS controls



Source: ANAO

4.50 Similar to the management of FMIS, some agencies were not appropriately recording and monitoring the actions of system administrators and other users who have special privileges, with approximately a quarter of agencies failing to implement adequate monitoring procedures.

4.51 Our audit also found there had not been sufficient business continuity planning for HRMIS systems. In particular, there was a lack of Business Continuity Plan testing. This increases the risk that, in the event of a continuity or disaster event, the HRMIS Business Continuity plan will fail and result in a loss of services and/or information.

Conclusion

4.52 The range of IT controls discussed in this Chapter underpin the secure, reliable and cost-effective provision of Australian Government services. The failure to effectively manage IT controls, both individually and collectively, in an agency can lead to an increased risk that financial information is inaccurate or incomplete.

4.53 An effective service desk a key mechanism to manage IT incidents and problems. Our audits found that agencies had demonstrated an improved understanding of the role a service desk plays in collecting, managing and responding to incidents and problems. The widespread use of service desks demonstrated the awareness that agencies have of the importance of maintaining service levels. This focus improves an agency's level of service delivery, as it reduces the amount and impact of service interruptions and recurring errors and becomes a driver for changes and improvements to IT systems.

4.54 Most agencies also recognised that IT changes are an integral part of their operational environment and had implemented governance structures to manage change processes, assisted by whole-of-government policies and guidance, such as the Gateway review process. Our audits found that, in the majority of agencies, change management arrangements incorporated effective internal controls. However, consistent with our findings in previous years, our audits identified that in some agencies security and management controls in both FMIS and HRMIS systems, and the management of releases to the production environment were issues requiring further management attention.

4.55 A common weakness identified across a number of agencies was the management of special or privileged users in FMIS and HRMIS systems. While these systems generally have strong security and configuration controls, the failure to manage special or privileged users can undermine the integrity of these systems.

4.56 We also found many agencies had not implemented fully effective release management processes. The lack of such processes affect the integrity of planning, design, control and scheduling for software releases, and can also impact an agency's reputational risk, particularly if a poorly managed release interrupts service delivery.

4.57 In future audits the ANAO will continue to monitor the status of FMIS and HRMIS security and release management. In addition, with the expectation that many large IT projects will be coming on line over the next two years, the ANAO will assess IT governance and change and release management arrangements, as part of providing assurance about the reliability of key financial systems and related business processes.

5. Interim Audit Results by Agency

This Chapter discusses the more significant matters identified during the interim phase of the 2007–08 financial statement audits by agency.

Introduction

5.1 This part of the report summarises the results of the ANAO examination of the internal control of agencies as part of the interim phase of the audits of financial statements for the year ending 30 June 2008. These agencies comprise the portfolio departments and other entities that manage the majority of the GGS financial activities.

5.2 The ANAO's audits of Australian Government agencies are designed to be performed on an ongoing basis to allow material agencies to submit audit cleared financial information to Finance by 15 August 2008 for the purposes of informing government of the financial outcome for the 2007–08 financial year. The audit reports on agencies' financial statements are issued following the receipt of signed financial statements and the completion of all audit procedures.

5.3 The final results of the audits of the agencies covered by this report will be included in the Auditor-General's report on the audits of financial statements of Australian Government agencies, expected to be tabled in December 2008.

5.4 The summary of each agency's audit results comprises:

- introductory commentary regarding the agency's business operations;
- estimated actual key financial figures and the estimated staffing level for the year ended 30 June 2008; [37]
- an overview of the environment including comments on governance arrangements relevant to the agency's financial management responsibilities and a summary of the agencies financial reporting capability;
- identification of the agency's key financial reporting risks;
- the audit findings relating to Category A and B issues identified; and
- an overall conclusion.

[37] These figures are sourced from each agency's 2008–09 Portfolio Budget Statements or as advised by agencies.

5.5 Category C audit findings reported to management are minor matters and are not included in this report's summary of audit results for each agency.

5.6 Key audit related business and financial statement risks were identified and communicated to each agency as part of the planning phase of each audit. These risks represent the ANAO's assessment of the key factors that give rise to the potential for material misstatement in an agency's financial statements. The ANAO's interim phase of the audit focuses on the steps taken by agencies to manage risks that have a potential impact on the financial statements, including their systems of internal control.

5.7 Issues arising from audit activity are rated in accordance with the seriousness of the particular matter. The rating that is included in ANAO reporting to agencies indicates the priority the agency needs to give to remedial action. The ratings are defined as follows:

- Category A: those matters which pose significant business or financial risk, including financial reporting risk, to the client and should be addressed as a matter of urgency. This assessment has taken account of both the likelihood and consequences of the risk eventuating;
- Category B: those matters which pose moderate business or financial risk, including financial reporting risk, to the client 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, however there is little likelihood of the consequences eventuating; and
- Category C: those matters which are procedural in nature or minor administrative failings. These could include minor accounting issues or relatively isolated control breakdowns which need to be brought to the attention of management.

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

5.9 The status of prior year Category A and B issues as well as the 2007–08 A and B findings raised by the ANAO are provided in a summary table for each agency.

5.10 The following table provides an overview of the Category A and B issues relating to each agency resulting from the 2006–07 and 2007–08 interim audits. As a result of the MOG changes the ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008 for those affected agencies. This issue will be finalised during the 2007–08 final audit of these agencies.

Significant findings of agencies grouped by portfolio covered by this report

Entity	2007–08 Rating		2006–07 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry	0	0	0	0
Attorney–General's Department	0	1	0	3
Australian Customs Service	0	2	0	8
Department of Broadband, Communications and the Digital Economy^	0	1	0	0
Department of Defence*	7	40	16	39
Defence Materiel Organisation*	1	12	6	16
Department of Veterans' Affairs	0	1	0	2
Department of Education, Employment and Workplace Relations^	0	0	0	0
Department of the Environment, Water, Heritage and the Arts^	0	0	0	1
Department of Families, Housing, Community Services and Indigenous Affairs	0	1	0	5
Department of Finance and Deregulation	0	0	0	0
The Board of Guardians and the Future Fund Management Agency*	0	0	0	0
Department of Foreign Affairs and Trade	0	0	0	0
Department of Health and Ageing	0	4	0	2
Department of Human Services	0	0	0	3
Centrelink	0	3	0	3
Medicare	0	2	0	0
Department of Immigration and Citizenship	1	11	0	6
Department of Infrastructure, Transport, Regional Development and Local Government ^	0	1	0	1
Department of Innovation, Industry, Science and Research^	0	0	0	0
Department of the Prime Minister and Cabinet	0	1	0	1
Department of Climate Change*	0	0	0	0
Department of Resources, Energy and Tourism *^	0	0	0	0
Department of the Treasury	0	0	0	0
Australian Office of Financial Management	0	0	0	0
Australian Taxation Office	1	4	2	7
Total	**10**	**84**	**24**	**97**

Source: ANAO

Note: *At the time of this report the interim audit was still in progress.

^ The number of audit findings includes those relating to agencies that existed in 2006–07.

Agriculture, Fisheries and Forestry Portfolio

Department of Agriculture, Fisheries and Forestry

Business operations

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

5.12 DAFF's role is to contribute to more sustainable, competitive and profitable Australian agricultural, fisheries, forestry and food industries.

5.13 A key aspect of DAFF's responsibility is working with rural and regional communities, industries and state and territory governments.

5.14 DAFF is responsible for enhancing the natural resource base on which portfolio industries rely and for delivering scientific advice and economic research, policy advice, programs, quarantine and export services to help industries deal with the challenges they face. DAFF's responsibilities span Australia's entire food chain, from producer to processor to the consumer.

5.15 To help the government achieve its policy objectives in these areas, DAFF contributes to the following outcome:

> Australian agricultural, fisheries, food and forestry industries that are based on sustainable management of and access to natural resources, are more competitive self-reliant and innovative, have increased access to markets, are protected from diseases and are underpinned by scientific advice and economic research.

5.16 DAFF's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	640	578
Total expenses	656	3 014
Total assets	214	227
Total liabilities	198	83

DAFF's estimated average staffing level for 2007–08 is 4345.

Understanding the environment

5.17 As part of DAFF's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DAFF's corporate governance arrangements and financial reporting framework.

Corporate governance

5.18 The key elements of DAFF's corporate governance that contribute to good financial management by DAFF include:

- an executive management team that meets monthly and provides leadership to DAFF divisions on administrative and operational aspects;
- a corporate committee framework including an audit committee. The audit committee meets at least bi-monthly and focuses attention on risk management, effectiveness of the control environment and improving reliability of internal and external reporting;
- a finance sub-committee of the audit committee that meets at least bi-monthly and oversees the preparation of the financial statements;
- a corporate governance and policy division that is responsible for the monitoring and management of risks; and
- an up-to-date fraud control plan. The fraud control plan provides a high level overview of systems to prevent, control and monitor fraud.

Financial reporting framework

5.19 DAFF reports comprehensively on its operations through full accrual monthly management financial reports to the executive management team and to the Department of Finance and Deregulation within ten days of the end of each month. Included in these reports is commentary on DAFF's financial position, including detailed variance analysis.

5.20 The financial reports are supplemented with non-financial information and are produced at monthly intervals. More substantial reports are prepared at quarterly intervals. The non-financial information is primarily focused on programs and budgeted outcomes. Key Performance Indicators (KPIs) are monitored throughout the year at a divisional level and are reported bi-annually at a corporate level. The KPIs are reviewed when each division prepares its annual business plan.

Identifying financial reporting risks

5.21 The ANAO's understanding of DAFF and its environment enables the risks of material misstatement of the financial statement to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.22 The ANAO has assessed the risk of material misstatement in the 2007–08 DAFF financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the large number of grant programs which increases the risk and the value of inappropriate payments being made, and the potential for misstatement of liabilities and commitments for grants and industry rebates;
- risks to the accuracy and completeness of information transferred from subsidiary business systems into the FMIS and the performance and adequacy of reconciliations between business systems and the FMIS;
- the reliance on Centrelink's systems and processes to deliver personal benefits payments, totalling some $530 million, made on behalf of DAFF; and
- financial compliance risks arising from DAFF's decentralised divisions and responsibilities.

Audit results

5.23 There were no audit issues of a significant or moderate rating raised by the ANAO in 2007–08, or in 2006–07.

Conclusion

5.24 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DAFF can produce financial statements free of material misstatement.

Attorney–General's Portfolio

Attorney–General's Department

Business operations

5.25 The Attorney–General's Department (AGD) is the central policy and coordinating element of the Attorney–General's Portfolio. AGD provides essential support to the Government in the maintenance and improvement of Australia's system of law and justice and its national security and emergency management systems. AGD provides legislative policy and advice and other services in relation to constitutional policy, legislative drafting, international law, indigenous law and justice, coordination of national security, and management of Emergency Management Australia.

5.26 The MOG changes of 3 December 2007 have resulted in a number of added responsibilities for AGD. These changes include AGD assuming responsibility for:

- the administration of Territories – the Jervis Bay Territory, the Territory of Cocos (Keeling) Island, the Territory of Christmas Island, the Coral Sea Territory, the Territory of Ashmore and Cartier Island and Commonwealth responsibilities on Norfolk Island, and Constitutional development of the Northern Territory and the Australian Capital Territory; and
- natural disaster relief and mitigation in the form of financial assistance to the States and Territories; and

5.27 In addition, since the end of 2006–07, AGD has gained the functions and resources of the former Office of Film and Literature Classification and has relinquished resources relating to the Australian Commission for Law Enforcement Integrity.

5.28 The MOG changes have added a considerable workload during the year, particularly on the central administrative functions of the department. While a number of governance and systems issues needed to be overcome in order to align administrative and governance systems in the areas of finance, human resources and supporting IT systems, these were mitigated to some extent by the new functions and programs being relatively mature.

5.29 AGD's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	242	32
Total expenses	256	903
Total assets	213	810
Total liabilities	59	599

AGD's estimated average staffing level for 2007–08 is 1414.

Understanding the environment

5.30 As part of AGD's financial statement audit, the ANAO gained an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are AGD's corporate governance arrangements and financial reporting framework.

Corporate governance

5.31 The key elements of AGD's corporate governance that contribute to good financial management by AGD include:

- an executive management group that meets weekly and addresses strategic issues, monitors AGD's financial performance, and oversees the operational performance of divisions that includes formal bi-annual performance reviews;
- an audit committee that meets at least quarterly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of AGD's activities; and
- a fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines.

Financial reporting framework

5.32 AGD has developed a financial reporting framework that includes monthly reports on departmental revenue and expenses and administered expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

Identifying financial reporting risks

5.33 The ANAO's understanding of AGD and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.34 The ANAO has assessed the risk of material misstatement in the 2007–08 AGD financial statements as moderate. The major factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- risks to the accuracy and completeness of grants that are subject to a decentralised approval and review processes;
- the estimation, through an actuarial process, of judges' pension liabilities given the materiality of the amount (approximately $550m at 30 June 2007);
- the need to put in place appropriate business and accounting processes to comply with the transferred legislative and policy changes resulting from the MOG changes that occurred on 3 December 2007;
- difficulties associated with the implementation of internal controls and the accurate reporting of payments relating to the new AusCheck program;
- complexities associated with accounting for the wind up of the APEC project, particularly relating to the disposal of assets; and
- risks to the accuracy of the administered investment in Law Courts Ltd which is undertaking an extensive capital investment program.

Audit results

5.35 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	3	(3)	0	0	0	1	1
Total	**3**	**(3)**	**0**	**0**	**0**	**1**	**1**

5.36 The 2007–08 audit highlighted the following issue that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matter—Category B

Disaster Recovery Plan

5.37 AGD has in place Business Continuity Plans (BCP) and associated Disaster Recovery Plans (DRP). However, the currency of AGD's DRP arrangements and the existence of gaps in the testing program are areas where improvement is needed. The lack of an up to date, fully tested DRP may prevent AGD from restoring critical business systems within acceptable timeframes in the event there is an interruption to operations.

Conclusion

5.38 The ANAO found that the majority of AGD's key internal controls were operating satisfactorily. AGD has responded positively to the ANAO's finding and associated recommendation.

Australian Customs Service

Business operations

5.39 The Australian Customs Service (Customs) is responsible for providing effective border management with minimal disruption to legitimate trade and travel, and the prevention of illegal movement across the Australian border. Customs also has some responsibility for maritime security which is jointly co-ordinated with the Department of Defence.

5.40 Customs collects revenue, provides trade statistics, and administers trade measures and certain Government industry schemes. Customs also assesses and collects, where appropriate, Goods and Services Tax on imported goods, Wine Equalisation Tax and Luxury Car Tax. The Tourist Refund Scheme is also managed by Customs on behalf of the Australian Taxation Office.

5.41 In 2007–08 Customs received additional funding in areas of fisheries and maritime security, air cargo security and monitoring equipment.

5.42 Customs' estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	1 296	6 558
Total expenses	1 296	3
Total assets	603	120
Total liabilities	219	13

Customs' estimated average staffing level for 2007–08 is 5864.

Understanding the environment

5.43 As part of Customs' financial statement audit, the ANAO gains an understanding of the agency and its environment, including internal controls. Two important factors considered are Customs' corporate governance arrangements and its financial reporting framework.

Corporate governance

5.44 The ANAO's audit approach considers Customs' corporate governance structure. The key elements of this structure that contribute to good financial management by Customs include:

- an audit committee, including two newly appointed independent members, that meets at least quarterly and focuses on internal and risk management issues;
- an internal audit function that has a planned risk based audit coverage of Customs' activities, including IT system management and development;
- a monthly Executive meeting to evaluate performance, in addition to a bi-annual meeting of senior executives from central and regional offices to discuss strategic management issues and future directions; and
- the development of a risk-based compliance framework designed to enable Customs' Chief Executive to prepare a Certificate of Compliance for 2007–08.

5.45 Customs continues to develop its risk management framework including fraud policies and plans, to assist in monitoring external client compliance with regulations and to detect fraud in relation to revenue collection.

Financial reporting framework

5.46 Customs prepares a monthly management report for the Executive that compares year-to-date actuals to budgets, identifies and analyses variances, and provides details of the year's full budget. Reporting of trends and future implications is done through narrative variance analysis. Financial reports, based on the monthly management reports, are also provided to the audit committee.

Identifying financial reporting risks

5.47 The ANAO's understanding of Customs and its environment enables the risks of material misstatement of the financial statement to be identified and assessed, and for appropriate audit procedures to be designed and performed to form an opinion on the financial statements.

5.48 The ANAO has assessed the risk of material misstatement in the 2007–08 Customs' financial statements as high. The key risks identified and assessed on which the financial statement audit is particularly focused include:

- risks associated with significant revenue collection in a self assessment environment;
- the potential impact on the internal control framework of the IT transition to an IT multiple provider model; and
- risks associated with the use of large and complex IT systems.

Audit results

5.49 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	8	(5)	0	3	(3)	2	2
Total	**8**	**(5)**	**0**	**3**	**(3)**	**2**	**2**

5.50 The 2007–08 audit identified the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

IT User Security Controls

5.51 The ANAO conducted user security reviews of information systems identified as significant to Customs' financial statements. These reviews identified inconsistencies between the Customs' ICT Security Policy and the procedures being applied in a number of the information systems. Weaknesses in these areas expose Customs to an increased risk of unauthorised and inappropriate access or changes to information systems. Customs has agreed address this issue through a review of these inconsistencies.

Asset Management

5.52 Customs manages physical assets, including infrastructure, plant and equipment valued at over $170 million. The location of these assets should be recorded in the assets register as a control to assist in ensuring that the assets exist and to assist in their management. ANAO audit testing found that for a number of assets the location recorded in the asset register was not correct. Customs has agreed to improve its asset recording and stocktaking procedures to rectify this matter.

Conclusion

5.53 The ANAO found that, with the exception of the abovementioned audit findings, Customs' key controls relevant to the financial statements were operating as designed. Customs has responded positively to the ANAO's findings and the associated recommendations. Customs is working to address the issues identified by the ANAO.

Broadband, Communications, and the Digital Economy Portfolio

Department of Broadband, Communications and the Digital Economy

Business operations

5.54 The Department of Communications, Information, Technology and the Arts (DCITA) was abolished as a result of the Administrative Arrangement Order of 3 December 2007 and was replaced by the newly established Department of Broadband, Communications and the Digital Economy (DBCDE). As a consequence of these changes, the following functions were transferred to other departments:

- indigenous, cultural and arts responsibilities were transferred to the Department of the Environment, Water, Heritage and the Arts (DEWHA);
- sports responsibilities were transferred to the Department of Health and Ageing (DHA); and
- information and communication technology industry development responsibilities were transferred to the Department of Innovation, Industry, Science and Research (DIISR).

5.55 DBCDE assumed responsibility for the following functions from the former DCITA:

- broadband policy and programs;
- postal and telecommunications policies and programs;
- spectrum policy management;
- broadcasting national policy issues relating to the digital economy; and
- content policy relating to the information economy.

5.56 DBCDE has adopted the following outcome:

Development of vibrant, sustainable and internationally competitive broadband and communications sector which promotes the digital economy for the benefit of all Australians.

5.57 DBCDE's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	95	470
Total expenses	110	241
Total assets	89	5 709
Total liabilities	23	18

DBCDE's average staffing level is 563. This is a significant reduction from DCITA's 882 staff at 3 December 2007 when the MOG changes came into effect.

Understanding the environment

5.58 As part of DBCDE's financial statement audit, the ANAO gains an understanding of the agency and its environment and internal controls, including the impact of the MOG changes outlined above.

5.59 DBCDE management worked quickly to implement the new governance, HR, financial management and banking frameworks required of a new agency and to manage the transfer of functions. The abolition of the former department and the creation of DBCDE presented unique and considerable challenges. DBCDE considered that the effectiveness of its efforts would have been improved with increased practical support and guidance on the processes that had to be followed to ensure compliance with the Australian Government legislative framework. The ANAO's review of the implementation of the MOG changes, including compliance with this framework, was in progress at the date of this report.

5.60 Interim arrangements with gaining agencies, supported by memoranda of understanding, involved DBCDE continuing to manage a number of functions on behalf of the gaining agencies. Under these arrangements, DBCDE continued paying administered expenses, departmental operating expenses, salaries and also accommodating transferred staff. At the time of our audit, the majority of gaining agencies had assumed responsibility for these functions.

Corporate governance

5.61 DBCDE has maintained the key elements of the former DCITA's corporate governance arrangements that contribute to good financial management, including:

- an executive management group that meets fortnightly and addresses strategic issues, monitors DBCDE's financial and non-financial performance, oversees the operational performance of divisions, and contributes to the development of departmental policies and procedures;
- an audit committee that meets at least quarterly and focuses attention on internal controls, internal audit activity, management of risks, review of financial reports, control of public monies, fraud control, and regulatory compliance;
- an internal audit function that has a planned risk-based audit coverage of DBCDE's activities; and
- fraud control and risk management plans that are regularly monitored and reviewed.

Financial reporting framework

5.62 DBCDE has also adopted DCITA's financial reporting framework that involves key financial and non-financial performance indicators being tracked and measured at the divisional level and reported to senior management for decision making. This includes the monthly preparation and distribution of divisional financial management reports which include administered and departmental revenues, expenses, assets, and liabilities. They incorporate explanations for variances between actual, budgeted and expected outcomes on both an accrual and cash basis. They also include additional details on specific areas of interest to the executive.

Identifying financial reporting risks

5.63 The ANAO's understanding of DBCDE, its environment and the issues it has been facing since the MOG changes of 3 December 2007 have been considered when determining the risk of material misstatement in the financial statements and in the design of appropriate audit procedures.

5.64 The risk of material misstatement in DBCDE's 2007–08 financial statements has been assessed as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the impact of the MOG changes on business operations, additional financial reporting disclosures, meeting the legislative requirements of the Commonwealth Financial Framework, and funding transfers between agencies;
- grant and subsidies processing and management, given the complexity of related grant eligibility criteria, legislation and review processes; and
- appropriation management, given the complexity of DBCDE's appropriations and disclosures.

Audit results

5.65 The following table provides a summary of the status of prior year issues as well as audit issues raised as a result of the 2007–08 interim audit.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
Total	**0**	**0**	**0**	**0**	**0**	**1**	**1**

5.66 The 2007–08 audit of DBCDE identified the following moderate risk issue that required management attention.

Banking Arrangements and Cash Management

5.67 DBCDE was unable to provide the ANAO with evidence that it has an agency banking agreement with its transactional banker that fulfilled the requirements of the FMA Act and the Agency Banking Framework. The ANAO found that DBCDE overdrew its bank accounts on 17 different occasions, including one instance where the combined bank balance was overdrawn by $529 448. This potentially represents a breach of sub-section s8(3) of the FMA Act that states that agencies are not able to overdraw bank accounts unless their agency banking agreement specifies that overdrafts must be repaid within 30 days.

5.68 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.69 The ANAO found that with the exception of its banking arrangements, DBCDE's key internal controls were operating satisfactorily to provide reasonable assurance that the department will be able to produce financial statements free of material misstatement.

Defence Portfolio

Department of Defence

Business operations

5.70 For 2007–08, the Department of Defence (Defence) responsibilities were described as delivering seven outcomes, as follows:

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

5.71 To better reflect the Government's Defence policy objectives and the services Defence delivers to the Government and the community, revisions to the outcome and output structure within Defence were approved with effect from 2008–09. The revised structure comprises the following three outcomes:

- Australia's national interests are protected and advanced through the provision of military capabilities and the promotion of security and stability;
- Military operations and other tasks directed by Government to achieve the desired results; and
- Defence's support to the Australian community and civilian authorities achieves the desired results.

5.72 Defence's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	20 974	783
Total expenses	21 183	2 834
Total assets	57 820	1 168
Total liabilities	3 510	35 704

Defence's estimated average staffing level for 2007–08 is 89 078, comprising permanent forces of 53 156, total reserves of 19 530, total civilian staff of 15 228 and professional service providers of 1164.

Understanding the environment

5.73 As part of Defence's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two important factors considered are Defence's corporate governance arrangements and financial reporting framework.

Corporate governance

5.74 Defence has a number of committees responsible for matters relating to corporate governance including, finance, people, strategy, resources, operational delivery and capabilities, however only those considered most relevant to the assessment for the financial statement audit are detailed below:

- The Defence Committee (DC), chaired by the Secretary, is the pre-eminent committee within Defence supporting the Secretary and CDF in meeting their joint obligations under the Ministerial Directive. The Defence Committee provides holistic senior management advice to the Secretary and Chief of the Defence Force (CDF) on strategic management and governance issues, and monitors the overall performance of the Defence Organisation.
- The Chiefs of Service Committee (COSC), chaired by the CDF, provides military advice to assist CDF to discharge his responsibilities in command of the Defence Force and as principal military adviser to the Government.

- The Defence Audit Committee (DAC) is a sub-committee of the Defence Committee. The Chair of the DAC is responsible and accountable to the Secretary (as Chief Executive) for the functions of the DAC. The DAC is responsible for reviewing the preparation and audit of the Defence financial statements and providing advice to the Secretary on: the adequacy of these statements; and the adequacy of accounting policies, procedures and systems. The DAC is also responsible for approving Defence's annual internal audit plans and monitoring Defence's enterprise risk management.
- The Financial Management and Controls Committee (FMCC) (formerly the Financial Statements Project Board) is responsible for overseeing and monitoring the inventory remediation project and the financial controls environment, the remediation of audit findings; and the risks to financial statements. The FMCC includes the Chief Finance Officer as Chair, the Chief Finance Officer of DMO, and representatives from the three Services and key Defence groups.

5.75 Another key element of Defence's corporate governance arrangements is its established internal audit function, known as the Management Audit Branch (MAB). MAB performs a range of internal audits across Defence and the DMO (a major provider of goods and services to Defence) and reports its findings to the DAC and Defence Executive.

5.76 Responsibility for risk management has recently been transferred to the newly created Strategy, Coordination and Governance (SCG) Executive. The SCG Executive was established under the Office of the Secretary and the Chief of the Defence Force, and is aimed at ensuring that closer links are developed and nurtured between broader strategic guidance, business planning, performance management, and the Defence reform program. As part of this process, Defence is currently developing a Defence-wide risk profile and tolerance statement. This statement will complement the Defence enterprise risk management plan which is being finalised and once approved, implementation of the plan will complement and strengthen Defence's overall internal control environment.

5.77 Critical to the success of these corporate governance initiatives is the need for Defence to identify, document, and critically assess the levels of compliance activity planned, to ensure adequate funding and resources are available to complete required compliance activities. This will assist in ensuring that compliance activities appropriately address and mitigate key enterprise risks.

The financial management framework

5.78 Defence identified the need to establish an overarching Financial Management Framework to align the management of Defence's finances to industry best practice. Defence's Financial Management Framework (excluding IT controls assessment) has now been established and provides a formalised structure to manage Defence's financial risks by:

- documenting key financial management processes, financial management risks and the controls to mitigate these risks within Defence;
- assigning accountability for the effective operation of controls;
- implementing a comprehensive training regime to support financial management; and
- establishing a single system of monitoring, designed to ensure that the controls framework retains its relevance and integrity.

5.79 As part of this process, identification and prioritisation of key risks and controls, based on general ledger accounts, was undertaken. Defence has advised that this resulted in the identification and documentation of over 583 key financial process controls designed to mitigate 499 financial risks (including 137 controls and 66 risks relating to General Stores Inventory (GSI) and Repairable Items (RIs) which are separately managed by the DMO). There are currently three mechanisms by which Defence manages and monitors the operation of these controls, namely:

- the performance of monthly self assessments tests (SATs) by designated control owners to confirm the status of the operation of a sample of controls;
- the monitoring of the performance of SATs by Defence's CFO Group on a monthly basis; and
- independent testing of the operation of controls by Defence's CFO Group in order to independently validate and assess the overall design and operating effectiveness of controls.

5.80 The 2006–07 financial year was the first year that independent testing and control-self assessment over the majority of identified controls was completed. Over 750 control tests were performed with 89 per cent identified as being fully effective across significant balance sheet accounts. Subsequently a control effectiveness statement was issued to assist the Secretary and the CFO of Defence in their signing of Defence's 2006–07 financial statements.

5.81 Defence's financial management framework includes the provision of monthly reports to the DC on administered and departmental revenues, expenses, assets, liabilities, and cash flows. The reports include explanations for variances from budgeted or expected outcomes on both an accrual and cash basis and provide additional details on specific areas of interest to the Executive.

Defence reforms

5.82 Defence is managing its comprehensive reform program under four themes: Accountability and Governance; Supporting our Minister and the Government; People Management; and Business Reform.

5.83 Defence has advised that the reform program complements the work on the White Paper and associated Companion Reviews (referred to below), the Government's commitment to audit the Defence budget and a savings and efficiency program. In addition, Defence is progressively implementing the agreed recommendations of the Government response to the Defence Management Review (Proust Review).

5.84 An enhanced governance framework is being implemented together with a new Defence Business Model. The new Business Model is expected by Defence to 'enhance accountability and governance through the clear identification of roles and responsibilities, improved information management to support decision making, a strengthened internal service delivery model with clear cross-group performance agreements, strengthened cost visibility to build a better picture of long-term costs, and enhanced performance management.[38]

Internal and External Reviews of Internal Audit – Management Audit Branch

5.85 MAB was subject to an external review in 2006–07 that examined MAB's role, objectives, internal structure, outputs, and staffing. One of the

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[38] Defence Portfolio, Portfolio Additional Estimates Statements 2007-08

major recommendations of this review was for Defence to consider co-sourcing their internal audit resources from both MAB and within the private sector, to enhance the skill sets available to the internal audit program.

5.86 An internal review of the location and reporting responsibility of MAB is currently considering the relocation of the function from its current position within the Inspector-General's Division to the newly established Governance Division, within the SCG Executive, with the Chief Audit Executive reporting directly to the Secretary on audit matters. This review is considering the relocation as a means of promoting a strategic, proactive, forward-looking and integrated governance and assurance function.

5.87 From the ANAO's perspective, the success of the proposed restructure will be dependent on the implementation and management of functions to minimise the potential increase in the risks to MAB's independence, coupled with the provision of adequately trained resources within the Branch. The 2006–07 external review did not consider the quantum of resources necessary to fulfil Defence's internal audit requirements, however once the internal review is complete the required level of resources for the ongoing internal audit function would benefit from consideration by Defence.

Defence White Paper

5.88 In February 2008, the Minister for Defence announced a new Defence White Paper and Companion Reviews that will form the foundation for future Defence capabilities, business and budget priorities to 2030.

5.89 Further impacts relating to current Ministerial reviews, are referred to in the DMO section later in this chapter.

Identifying financial reporting risks

5.90 The ANAO's understanding of Defence and its environment enabled the risks of material misstatement to the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.91 The ANAO has assessed the risk of material misstatement in the 2007–08 Defence financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the extent of qualifications of previous years' financial statements, primarily those resulting from ongoing system and data integrity issues within the key operational information system of Defence, the Standard Defence Supply System (SDSS), and the underlying deficiencies in the maintenance of appropriate accounts and records as evidentiary support for significant transactions and balances in the financial statements, relating to GSI; and
- complexities surrounding the arrangements between DMO and Defence, including the provision of bureau services to each other.

5.92 Defence's financial reporting objectives for 2007–08 include the remediation of remaining qualification issues relating to GSI and ensuring that the issues that were remediated during the previous two years continue to be well managed and do not resurface.

5.93 Defence acknowledge that the achievement of these objectives requires:

- addressing audit findings as part of Defence's ongoing commitment to improving financial management;
- improving the timeliness of the preparation of Defence's 2007–08 financial statements;
- performance of a greater proportion of financial adjustments and reconciliations by Defence and DMO throughout the 2007–08 financial year, culminating in a formal hard-close at 31 May 2008. This will minimise post 30 June activity;
- resolution of the legacy pricing issues relating to GSI (further detail is provided below);
- more comprehensive planning; and
- embedding processes designed to ensure continued compliance with Australian Equivalents to the International Financial Reporting Standards requirements such as embedded derivatives, stepped leases, and discounting of non-current receivables and payables.

Audit results

5.94 The following table provides a summary of the status of prior year issues as well as 2007–08 audit issues raised by the ANAO.

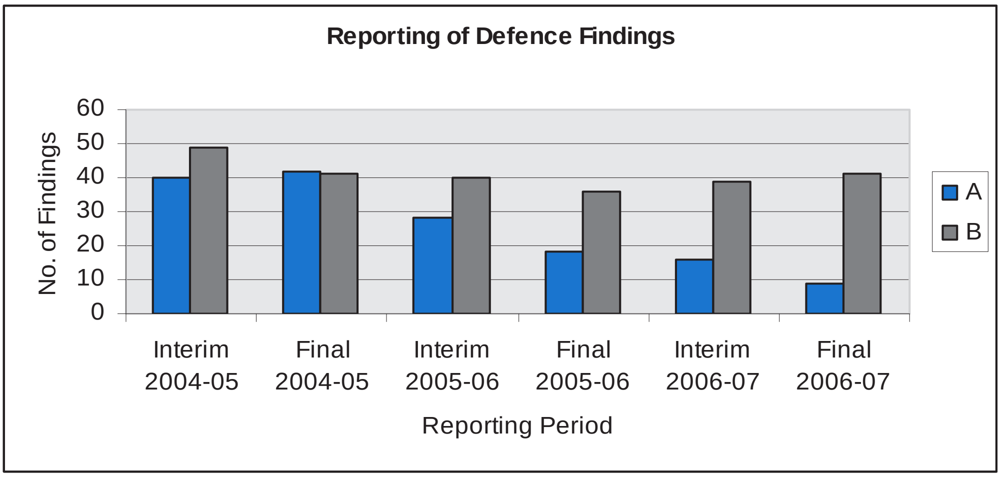
Status of audit issues raised by the ANAO[39]

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	16	(12)	5	9	(2)	0	7
B	39	(18)	20	41	(6)	5	40
Total	**55**	**(30)**	**25**	**50**	**(8)**	**5**	**47**

5.95 When the 2006–07 result is compared with comparative reporting periods, it is evident that Defence's focus on financial remediation has had a positive impact on the department's internal control environment and quality of financial reporting.

Figure 5.1

Analysis of audit findings over time



Source: ANAO

5.96 The above table indicates that Defence has been successful in the remediation of the majority of its most significant outstanding audit findings.

[39] At the time of preparation of this report, the 2007–08 interim audit was in progress. The final results will be included in the end of year report to the Parliament.

This is due to an increased focus that has been placed on the financial framework and the effect of maturing remediation strategies. A continued focus is required on the remediation of the moderate and lower risk issues which, in aggregate, have trended upwards over the past couple of reporting periods. It will also be important for Defence to continue to focus on its key risks, whilst ensuring that lower risk issues do not escalate over time.

5.97 During the interim phase of the 2007–08 audit, the ANAO observed that Defence had resolved two significant and six moderate risk issues.

Financial Management Framework

5.98 The Defence financial management framework encompasses ongoing monitoring of the controls and reporting processes in place over financial transactions and balances within Defence. At the completion of the 2006–07 audit, the ANAO reported two issues in relation to the Financial Management Framework, that remained unresolved. These issues related to:

- a need for greater oversight and management of the arrangements between the DMO and Defence; and
- deficiencies in quality assurance and reporting processes over financial transactions.

5.99 No new issues relating to the Financial Management Framework were noted during the 2007–08 interim audit.

Logistics Management General Stores Inventory and Specialist Military Equipment

5.100 The 2006–07 final audit identified the following issues relating to General Stores Inventory and Specialist Military Equipment (SME) management processes within Defence:

- a need for enhanced analysis and management of variances from the reconciliation process of SDSS with ROMAN (Defence's financial management information system);
- the need for improvements in the execution of third party assurance processes over RIs to validate the existence of items;
- the inappropriate netting and reporting of stocktake adjustments for RIs within the financial statements;

- a need to review the existing asset capitalisation policy for determining the point of consumption for GSI to ensure the completeness of the reported balance;
- a need to improve Defence's system for consolidating, reporting and monitoring of stocktake results;
- a need to reconcile SDSS with the fixed asset register for sensitive assets;
- a need to improve the management of the security of information and documentation in support of the reconciliation process of SDSS with ROMAN;
- the need to continue to improve processes for the return of unused Naval stocks to warehouses;
- the completeness and integrity of records of SME and commercial vehicles; and
- the need to enhance the execution of pricing validation exercises for GSI and RIs.

5.101 Defence has recently commenced comprehensive programs to assess GSI quantities and legacy pricing issues that contributed to the qualification of the 2006–07 financial statements. Key activities involved in the program include a third party assurance process over GSI quantities and a statistical sampling program over GSI pricing. These strategies and the results stemming from them are under review by the ANAO.

Logistics Management Explosive Ordnance

The 2006–07 final audit identified the following issues relating to the Explosive Ordnance (EO) management processes within Defence:

- discrepancies noted as a result of EO stocktakes performed across a number of sites;
- a lack of regular monitoring and control over items processed through EO disposal accounts, and a lack of supporting documentation and appropriate authorisation for EO disposals and destructions; and
- a lack of a documented and controlled environment for calculating the Provision for Obsolescence for EO, including a lack of formal review and analysis of movements and process documentation.

5.102 During the 2007–08 interim audit phase, the ANAO identified an improvement in the level of discrepancies noted as a result of EO stocktakes, across a number of the selected sites. The remaining issues are currently under review by the ANAO.

Purchase to Pay

5.103 At the completion of the 2006–07 audit significant control issues were noted in relation to a number of separate component groups that comprise the broader purchasing and payment system and business processes known as 'Purchase to Pay'. These issues related to accounts payable management, the Card Management System[40] (CMS), the Master Supplier Register[41] (MSR) and the Invoice Scanning and Imaging System[42] (ISIS). The issues that remained outstanding at the conclusion of the 2006–07 audit included:

- the need to strengthen the delegations and approvals procedures required to be completed during procurement and non-compliance with procurement policies;
- continued existence of duplicate invoices;
- a lack of adequate reconciliations of supplier payable accounts;
- a need to improve the data quality and management of vendor records;
- a need to improve compliance with policies and procedures for the management and use of purchase and travel cards;
- the need to strengthen the recovery testing process and business continuity planning for CMS;
- deficiencies in user access management, fraud control and the quality assurance framework within CMS;
- the currency of the approval to operate the MSR within the Defence systems environment;
- deficiencies in user access management and the change management framework for the MSR;

[40] The Card Management System (CMS) is the system used to manage Defence's corporate credit card transactions.

[41] The Master Supplier Register (MSR) is Defence's single authoritative source for vendor related data.

[42] The Invoice Scanning and Imaging System (ISIS) is the system used to increase the efficiency of payments made on invoices received by utilising data imaging technology.

- the management of business continuity processes for ISIS;
- deficiencies in the change management framework and user access management for ISIS; and
- business process weaknesses impacting on the effectiveness of ISIS.

5.104 The extent of the above issues limited the ANAO's ability to place reliance on purchasing controls and required the ANAO to conduct extended controls and substantive testing in 2006–07. For 2007–08, Defence has established the 'Purchase to Pay' Tiger Team to assist in the remediation of these issues. To date, Defence has provided documentation to support the approval to operate the MSR within the Defence systems environment, thereby resolving this issue. All other issues are currrently under review by the ANAO.

Human Resource Management

5.105 The Human Resource (HR) management systems for Defence are PMKeyS for all civilian personnel transactions and military leave processing and recording and ADFPay for military payroll processing. At the completion of the 2006–07 audit, the ANAO reported the following issues:

- the need to improve record keeping procedures, exception processing and payroll processes for civilian employees;
- the need to strengthen the approval, audit and record keeping procedures for long service leave transactions;
- inconsistent application of requirements over the review of annual leave transactions;
- deficiencies in the approval and reporting of payments that are made outside normal pay parameters;
- the need to reconcile records from the PMKeyS interface with ADFPay;
- insufficient password parameters and incorrect completion of access forms, creating the potential for unauthorised access to ADFPay; and
- issues surrounding the administration of security audits within PMKeyS.

5.106 In 2007–08, the ANAO noted improvements in the first four issues reported above resulting in the ANAO reducing the level of overall controls and substantive testing for year-end with the latter issues currently under review by the ANAO.

General Asset Management

5.107 During the 2006–07 final audit, an issue remained unresolved relating to the need to strengthen the processes of assessing impairment of general assets. This issue will be reassessed during the 2007–08 final audit.

Commitments and Leasing

5.108 At the completion of the 2006–07 financial statement audit, the ANAO noted the following issues:

- delays in the preparation and reporting of the Commitments schedule and insufficient quality assurance and documentation available to substantiate significant components;
- the completeness of Defence's contract register and a lack of reconciliation of the register to the general ledger; and
- the accuracy and completeness of Defence's master lease register.

The status of the above issues will be reassessed during the 2007–08 final audit.

General Controls Environment

5.109 The IT general control environment includes the management of a broad range of operating systems and process controls. In 2006–07, issues were noted in relation to a lack of an overarching Defence Business Continuity Plan, a need to improve the segregation of duties, and inappropriate programmer access within the access control facility that provides access to Defence's key financial and inventory systems. The 2007–08 interim audit identified that Defence had achieved improvements in the latter two issues.

Financial Management Information System

5.110 During the 2006–07 audit, the ANAO continued to identify inappropriate segregation of duties relating to user access management and insufficient review processes surrounding application security for the Financial Management Information System (FMIS). These issues are under review by the ANAO.

Budget and reporting system

5.111 The ANAO's 2006–07 audit of Defence's Budget and Reporting System identified issues in relation to change management, including the need for formalised sign-off and approval processes, and the retention of appropriate documentation and segregation of duties. These system issues are under review by the ANAO.

Conclusion

5.112 Defence's commitment to implementing the Financial Management Framework and a continued focus on developing its internal control environment, has resulted in a gradual improvement to the level of outstanding audit findings. Critical to the ongoing success of these activities is the need to maintain an enterprise-level focus on remediation activities and the implementation and maintenance of control activities.

Defence Materiel Organisation

Business operations

5.113 The Defence Materiel Organisation (DMO) – Australia's largest project management organisation – is the primary service delivery agency responsible for equipping and sustaining the Australian Defence Force (ADF), through the acquisition of capital equipment assets and their subsequent sustainment. In addition, the DMO provides industry and procurement policy, and advice to the Department of Defence (Defence) and the Government.

5.114 The DMO's business is principally driven by objectives set by the Australian Government, Defence policies and the operational requirements of the ADF. The DMO operates under developing delivery arrangements established with Defence groups, outlined in the Materiel Acquisition and Sustainment Agreements, which set the products and services to be delivered, pricing, timelines, and the responsibilities and accountabilities of each party. A review of the effectiveness of the acquisition agreements is being undertaken by the Defence Management Audit Branch (MAB), that provides internal audit services to DMO.

5.115 This is the DMO's third year of operation as a prescribed agency under the Financial Management and Accountability (FMA) Act 1997 and, in accordance with the FMA Act, DMO prepares annual financial statements for audit. The DMO is budgeting for a break-even result for the year ending 30 June 2008, with revenue and expenses equalling $8.46 billion. This neutral operating result reflects the funding model in place between Defence and the DMO producing an accounting rather than a performance oriented outcome and does not reflect the more business-like model suggested by the Kinnaird

Review (2003). The Kinnaird Review also recommended that the operating model be reviewed three years after prescription (1 July 2005), and this review has recently been announced by the Parliamentary Secretary for Defence Procurement, the Hon. Greg Combet MP

5.116 In addition, there are a number of other ministerial reviews being undertaken including those relating to:

- Air Combat Capability;
- legacy projects (valued at some $23 billion);
- current and future projects which include the Air Warfare Destroyer project, the Joint Strike Fighter project, the Land Transport Ships project, and the next generation submarines project; and
- Boeing's airborne early warning and control aircraft, the HF radio upgrade, and the Defence Force Command and Control System projects.

5.117 To date, as a result of the reviews being undertaken, the SeaSprite helicopter project has been cancelled[43], and the feasibility of continuing with the current Electronic Surveillance Measures (ESM) for the FFG upgrade is being considered.

5.118 The DMO's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	8 458	Nil
Total expenses	8 458	Nil
Total assets	2 361	Nil
Total liabilities	2 176	Nil

The DMO's estimated average staffing level for 2007–08 is 7326.

5.119 Of the DMO's total revenue of $8.46 billion, $8.25 billion (97.5 per cent) will be earned from Defence, $93.3 million (1.1 per cent) received through direct appropriations, and $118 million (1.4 per cent) earned from other sources.

43 Any financial impact of this decision will be reflected in Defence's 2007–08 financial statements.

Understanding the environment

5.120 As part of the DMO's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal control environment. Two of the important factors considered are the DMO's corporate governance arrangements and the financial management and reporting framework.

Corporate governance

5.121 Key elements that contribute to the DMO's corporate governance framework include:

- the creation of three executive (General Manager) positions during 2007–08 whose responsibilities are for the systems, programs and corporate functions respectively within the DMO;
- Materiel Assurance Boards – (Aerospace, Maritime, Land, Electronic, Explosive Ordnance Systems and Information Technology) provide review, advice, and assurance of acquisition and sustainment activities for each division. These boards report through the respective General Managers to the CEO on the adequacy of the governance framework, project or sustainment activity issues and risks including scheduling, cost and capability;
- Materiel Audit Committee (MAC) – the MAC oversees the preparation and audit of the financial statements and advises the CEO on the adequacy of the financial statements, prior to their signing. The MAC also reports to the CEO annually and the Procurement Advisory Board quarterly on matters relating to the governance framework, which includes enterprise risk management, fraud control, the efficiency and effectiveness of the existing control framework, external accountability, legislative compliance, internal and external audit. The MAC is comprised of five independent members and formally meets six to seven times per year;
- the DMO Fraud Control Plan, and the Chief Executive Instructions (CEI) on Fraud Control;
- a Risk Management Framework which includes six-monthly reports to the DMO Executive and MAC on implementation of the DMO Enterprise Risk Management Plan, the creation of Defence Materiel Instructions on Risk Management, and the completion of subordinate risk plans for each division in the DMO; and

- Acquisition and Sustainment Overview Reports, which provide information on a monthly basis on the delivery of Defence capability to Defence, the Defence Committee and the Procurement Advisory Board.

Financial Management and Reporting Framework

5.122 The DMO's financial management and reporting framework includes the provision of monthly financial reports to the CEO and the MAC on revenues, expenses, assets and liabilities and cash flows. The reports include explanations for variances from budgeted or expected outcomes and provide additional details on specific areas of interest to the CEO and the MAC. In addition, DMO reports separately to Defence on the accounting, monitoring and assurance processes performed on behalf of Defence over the department's assets and inventory.

5.123 In its first two years as a prescribed agency, the DMO received an unqualified audit opinion on their annual financial statements.

5.124 The DMO is reviewing its financial management, risk management, and control and reporting frameworks by introducing the Finance Function Transformation Program (FFTP), with the design phase of the FFTP scheduled for completion in June 2008. As part of this process DMO has commissioned an assessment of the financial reporting controls and assurance framework by an external party and is implementing the resulting recommendations.

Identifying financial reporting risks

5.125 The ANAO's understanding of the DMO and its environment has enabled the risk of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.126 The ANAO has assessed the risk of material misstatement in the DMO's 2007–08 financial statements as moderate. This is a reduction of the assessed risk level from the DMO's first year of operation and remains at the same level as 2006–07. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the utilisation of numerous IT applications across acquisition, sustainment and corporate activities, supporting the delivery of project management information throughout the DMO. The implications of which are:

- increased manual, rather than electronic, upload of information into the general ledger, increasing the risk of errors and/or omissions; and
- unnecessarily complex procedures to produce management and performance reports.

The DMO is progressively standardising IT applications, but until that is completed, there is an increased risk to management in relation to the accuracy and completeness of financial information within the general ledger;

- the need for a greater focus on reviewing, developing and delivering an appropriate Internal Audit program across the DMO. The DMO uses MAB and plans to engage external audit providers to complement the internal DMO audit program provided by MAB. MAB activity is continuing to deliver against the work plan, however allocations to the external providers are yet to be completed;
- complexities surrounding the assessment and implementation of various accounting treatments and service delivery arrangements between the DMO and Defence, including the enhancement of bureau service arrangements and 'free of charge' agreements to provide for the interaction between the DMO and Defence, particularly for:
  - the IT general control environment;
  - key financial information systems; and
  - personnel management;
- ongoing system and data integrity issues within the Standard Defence Supply System (SDSS), the key operational information system used to record and report General Stores Inventory and Repairable Items purchased on behalf of Defence, and which may subsequently impact the DMO's financial statements. The DMO, as the business process manager, continues to manage SDSS and as such, significant prior year Defence audit issues relating to various quantity and pricing issues will continue to be managed by the DMO;

- the need for a stronger commitment to deliver timely financial information, given ongoing delays in providing timely, accurate and current supporting documentation for management assurance and audit purposes;
- the requirement for further maturity of the financial control framework and the delegation structure for approvals of purchase orders;
- issues relating to the accuracy and completeness of the recording and reporting of financial commitments; and
- enhancements required in accounting for assets purchased and not capitalised and Assets Under Construction (AUC)[44].

5.127 The risk assessment was further informed by the following factors which, to some extent mitigate a number of the factors noted above:

- the development of the financial reporting controls and assurance framework by the Finance Division;
- further enhancement of management assurance obtained over financial reporting;
- rolling monthly Quality Assurance (QA) reviews over financial statement line items, and monthly and quarterly reporting on Assets Under Construction (AUC); and
- appraisal by Project Evaluation Reviews to mitigate risks and issues in a timely manner.

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[44] AUC balances are reported in Defence's financial statements as transactions are performed by the DMO on Defence's behalf.

Audit results

5.128 The following table provides a summary of the status of prior year issues as well as 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO[45]

Category	Findings outstanding (at end of 2006–07 final audit)	Findings resolved-merged (during 2007–08 interim audit)	New findings (during 2007–08 interim audit)	Findings reclassified (at end of 2007–08 interim audit)	Closing position (at end of 2008 interim audit)
A	1	–	–	–	1
B	14	(1)	–	(1)	12
Total	**15**	**(1)**	**–**	**(1)**	**13**

Significant Risk Matters — Category A

5.129 The following Category A issue reported in ANAO Audit Report No.18 2006–07, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2007*, has been reviewed in the context of the 2007–08 interim audit.

Financial management and reporting framework

5.130 The ANAO has raised concerns in relation to the financial management and reporting framework since the establishment of DMO. The following issues are ongoing and collectively represent a significant risk to the preparation of financial statements free from material misstatement:

- the utilisation of numerous project management systems across the AUC program within DMO, increasing the risk of errors and omissions in the compilation of the general ledger balances;
- delivery of the majority of the internal audit program at the end of 2007–08, mainly due to delays in the approval of the audit work plan, and non-performance of the component of the internal audit program planned to be allocated to outsourced providers, reducing the level of reliance that the ANAO can place on internal audit coverage; and
- delays in the provision of supporting documentation for management assurance and audit purposes.

[45] Delays in the provision of supporting documentation for management and audit purposes will require some areas of the interim audit to be completed during the final audit for 2007-08.

5.131 As part of the financial management and reporting framework, the DMO has progressively improved the quality of financial reporting by implementing a number of initiatives including:

- identifying key requirements relevant to the reporting of individual financial statement line items;
- documenting the key sources of information used in the compilation of financial statement balances;
- identifying key financial reporting controls for accurate and complete reporting of financial statement balances; and
- documenting current and proposed management assurance and monitoring activities, including the frequency of QA review activity designed to provide assurance on the reliability of controls and processes.

5.132 The key deliverable of these initiatives is a high-level framework document that will guide quality assurance activity in the preparation and delivery of the 2007–08 financial statements. At the date of preparation of this report, the ANAO was awaiting advice from the DMO regarding the results of the implementation and testing of controls identified in the framework.

Moderate Risk Matters — Category B

5.133 A number of Category B issues also reported in ANAO Audit Report No.18 2007–08, are currently being reviewed and will be reported on as part of the 2007–08 financial statement audit. These include:

- completeness, existence and accuracy issues around the commitments schedule;
- the DMO recognising revenues for which Defence has not been able to record a supply of assets;
- inconsistent approach to the allocation of costs within AUC projects, thereby increasing the risk of errors in calculation and compliance with capitalisation policies;
- timeliness, documentation and completeness of asset roll-out and write-off processes[46];

[46] Issues surrounding roll-out and write off processes impact Defence's financial statements, but are managed on behalf of Defence by the DMO.

- low compliance with key SDSS controls and inadequate access to reporting functionality;
- controls over the appropriate approvals/delegations for payments;
- general asset management, including assets purchased and not capitalised;
- the treatment of military workforce payments as employees expenses rather than supplier expenses; and
- management of bureau service arrangements to alleviate breakdowns in the control environment for the various IT systems.

5.134 During the 2006–07 audit, the ANAO noted a high number of rejected transactions occurring through the Naval Vessel interface between SDSS and the Naval inventory management system. The ANAO also noted there was no standardised process to review and resolve these rejected transactions. As a result there is a high risk of inaccurate or incomplete inventory and asset records in SDSS. At the completion of the interim audit, this issue remained outstanding and will be reviewed during the final audit phase of 2007–08.

Conclusion

5.135 The internal control issues identified reduce the level of confidence the DMO and the ANAO can place on information derived from the general ledger and resulting financial reports. This in turn increases the extent of substantive testing of balances and transactions required to be undertaken by the ANAO during the final audit of DMO's 2007–08 financial statements to obtain the required level of audit assurance.

5.136 At the date of this report, the ANAO was in consultation with the DMO regarding the findings and associated recommendations, including remediation of the identified control issues. The DMO will also need to continue to work closely with Defence to ensure that those findings that apply across both agencies are adequately addressed.

Department of Veterans' Affairs

Business operations

5.137 The Department of Veterans' Affairs (DVA) provides administrative support to the Repatriation Commission and the Military Rehabilitation and Compensation Commission, and is responsible for:

- advising both Commissions on Australian Government policies and programs for beneficiaries; and
- administering these policies and programs.

5.138 The Repatriation Commission is responsible under the *Veterans' Entitlements Act 1986* for granting pensions, allowances and other benefits, providing treatment and other services and generally administering the Act. The Military Rehabilitation and Compensation Commission is responsible for determining claims under the :

- *Military Rehabilitation and Compensation Act 2004* for serving and former members of the Australian Defence Force; and
- *Safety Rehabilitation and Compensation Act 1988* for serving and former members of the Defence Force and certain Australian Federal Police personnel with approved overseas service.

5.139 In addition to supporting both Commissions, DVA administers legislation such as the *Defence Service Homes Act 1918* under which housing assistance is provided.

5.140 DVA's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	348	14
Total expenses	377	11 030
Total assets	179	3 826
Total liabilities	103	2 648

DVA's estimated average staffing level for 2007–08 is 2296.

Understanding the environment

5.141 As part of DVA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DVA's corporate governance arrangements and financial reporting framework.

Corporate governance

5.142 The key elements that contributes to DVA's corporate governance structure include:

- an executive board that meets monthly to determine and evaluate progress on the agreed strategic directions of DVA. The group is supported by sub–committees that assess the overall performance of DVA's operations through a variety of reporting mechanisms;
- a governance committee framework, including an Audit Committee that oversees and provides direction to risk management activities and assesses outcomes of external reviews of programs including follow–up actions. The Committee also has a monitoring role in relation to the progress of internal audit and the financial statements preparation process;
- an internal audit function that develops an internal audit strategy, undertakes risk profiling across DVA and conducts an internal audit program that addresses business and financial risks; and
- a risk management policy supported by risk management strategies that is refreshed annually. The development of the fraud risk profile is undertaken every two years and is directly linked to DVA's fraud control activities.

Financial reporting framework

5.143 DVA has developed a financial reporting framework that includes monthly reports on administered and departmental revenues, expenses, assets, liabilities and cash flows. The reports include explanations for variances from budgeted or forecasted outcomes on both an accrual and cash basis, and provide additional details on specific areas of interest to the Executive.

5.144 The monthly reports include both financial and non-financial information. This information is used to assess performance against cost, quality and timeliness of information and outcomes as set by management.

Identifying financial reporting risks

5.145 The ANAO's understanding of DVA and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.146 The ANAO has assessed the risk of material misstatement in the 2007–08 DVA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the integration of revised organisational arrangements involving significant changes to structures and functions in different locations;
- the dependence of service delivery on IT systems;
- the diverse range of entitlements administered by DVA and the reliance placed upon voluntary disclosure by recipients;
- the complexity of contractual arrangements with supplier service providers, institutions, and state governments; and
- the large volume of legislative requirements that DVA must adhere to and the extent of changes to legislation.

Audit results

5.147 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	2	0	1	3	(2)	0	1
Total	**2**	**0**	**1**	**3**	**(2)**	**0**	**1**

Moderate Risk Matters — Category B

5.148 The ANAO recognises that DVA has put considerable effort into resolving prior year issues. This has resulted in the resolution or downgrading of two out of the three prior year Category B findings.

5.149 The audit finding relating to the IT application access management raised in prior year has now been addressed and the audit finding relating to the IT disaster recovery plan has been downgraded as processes are being implemented by DVA to address the risks and control weaknesses identified. DVA has also commenced work to resolve the remaining finding in relation to the capitalisation of internally developed software. DVA has indicated that it expects to resolve this matter by 30 June 2008.

5.150 The ANAO reported no new moderate control weakness during the interim phase of the 2007–08 audit.

Conclusion

5.151 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DVA can produce financial statements free of material misstatement.

Education, Employment, and Workplace Relations Portfolio

Department of Education, Employment and Workplace Relations

Business operations

5.152 The Department of Education, Employment and Workplace Relations (DEEWR), in conjunction with its other portfolio agencies, takes a national leadership role in education and training, and aims to maximise the ability of working age Australians to participate in the workforce and to improve the productive performance of enterprises in Australia. The Australian Government works with various industries, State and Territory Governments, other Australian Government agencies and a range of contracted service providers to provide high quality policy, advice and services for the benefit of Australia.

5.153 DEEWR was created as a result of the Administrative Arrangements Order (AAO) of 3 December 2007 and consists of the majority of functions from the former Department of Education, Science and Training (DEST) and Department of Employment and Workplace Relations (DEWR) and childcare related functions from the former Department of Families, Community Services and Indigenous Affairs.

5.154 DEEWR's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	1 094	404
Total expenses	1 094	38 230
Total assets	424	20 682
Total liabilities	248	4 152

DEEWR's estimated average staffing level for 2007–08 is 5490.

Understanding the environment

5.155 As part of DEEWR's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls, focussing in particular on the impact of the MOG changes of 3 December 2007.

5.156 At the time of the interim audit, DEEWR had put in place new high level corporate governance arrangements such as an executive governance group and an audit committee (see further details below). However at an operational level DEEWR continues to operate two separate financial and human resource systems and key business systems operate largely the same as prior to the MOG changes. As a result, the ANAO's audit approach for the 2007–08 interim audit has remained largely the same as previously. The ANAO will continue to monitor developments in DEEWR's business and systems environment, particularly as they impact on the agency's financial management responsibilities, and revise our audit approach as necessary.

5.157 The timely finalisation of DEEWR's 2007–08 financial statements will require the effective project management of a range of logistical and technical issues by both DEEWR and the ANAO.

Corporate governance

5.158 The key elements of DEEWR's corporate governance that contribute to good financial management by DEEWR include:

- an executive management group that meets weekly and addresses strategic issues, monitors DEEWR's financial performance and oversees the operational performance of divisions including bi-annual performance reviews;
- an Establishment Committee supported by an Establishment Taskforce with the aim of ensuring a well managed and inclusive transition to the new agency;
- an audit committee that meets at least quarterly and focuses attention on internal controls, management of risks, review of financial reports, control of public monies, legislative and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of DEEWR's activities; and
- a fraud control plan that is regularly monitored and reviewed.

Financial reporting framework

5.159 DEEWR has developed a high level financial reporting framework that includes monthly reports on departmental revenue and expenses and administered expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

5.160 The current reporting framework is quite complex and resource intensive. This situation is likely to continue until the department is able to utilise a single financial management information system.

Identifying financial reporting risks

5.161 The ANAO's understanding of DEEWR and its environment and internal controls, including the impact of the MOG changes outlined above, enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.162 The ANAO has assessed the risk of material misstatement in the 2007–08 DEEWR financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the significant management challenge of integrating the two former departments into one cohesive agency;
- a complex IT environment, supporting multiple business processes coupled with the need to maintain, in the immediate future, two IT environments including two financial management information systems;
- the magnitude and diversity of grant programs that are subject to a decentralised approval and review processes and paid through a number of different business systems;
- reliance on Centrelink's systems and processes to deliver personal benefit payments on behalf of DEEWR;
- reliance on third parties to provide information that is critical to support payments made under a variety of programs including employment services, child-care and grants;

- reliance on actuarial assessments for the valuation of complex administered balances; and
- complexities surrounding new disclosures in significant administered balances.

Audit results

5.163 There were no audit issues of a significant or moderate rating raised by the ANAO in 2007–08.

Conclusion

5.164 Based on audit work performed to date, internal controls are operating satisfactorily to provide reasonable assurance that DEEWR can produce financial statements free of material misstatement.

The Environment, Water, Heritage and the Arts Portfolio

Department of the Environment, Water, Heritage and the Arts

Business operations

5.165 The Department of the Environment, Water, Heritage and the Arts (DEWHA) advises the Australian Government on its policies as they affect Australia's environment and heritage and Australia's Antarctic interests and is responsible for establishing and monitoring the policy parameters to enable the more efficient and sustainable use of Australia's water resources. DEWHA is also responsible for promoting the development of rich and stimulating cultural sectors for all Australians including preservation, maintenance of and access to Australia's cultural activities, national cultural collections and buildings and indigenous languages.

5.166 DEWHA's operations were affected by the machinery of government changes that took effect on 3 December 2007 and 25 January 2008. Cultural affairs matters, including support for the Arts, was transferred from the former Department of Communications, Information Technology and the Arts. A number of climate change functions were transferred to the newly created Department of Climate Change and the Low Emission Technology Demonstration Fund was transferred into the Department of Resources, Energy and Tourism.

5.167 DEWHA's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	548	15
Total expenses	571	1 249
Total assets	529	7 050
Total liabilities	280	16

DEWHA's estimated average staffing level for 2007–08 is 2345.

Understanding the environment

5.168 As part of DEWHA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. To implement the MOG changes, DEWHA was required to update and re-issue drawing rights, delegations and authorisations across the agency to ensure that the Arts programs continued to be delivered.

5.169 In addition, DEWHA's FMIS required changes including the creation of a chart of accounts to accommodate the financial management requirements of the new Department of Climate Change. These issues, including the details of the financial data that is to be received or transferred subject to the MOG changes, were still the subject of negotiations with the relevant agencies at the time of the interim audit. Once negotiations have been finalised and all financial data are integrated into the FMIS, additional audit procedures will be necessary to validate the control environment and balances in the financial statements.

5.170 The other two important factors considered relating to DEWHA's control environment were the corporate governance arrangements and the financial reporting framework.

Corporate governance

5.171 The ANAO's audit approach considered DEWHA's corporate governance structure and noted the following key elements that contribute to financial management. They include:

- a senior executive committee that meets weekly to evaluate DEWHA's strategic direction, financial planning and operational results;
- an audit committee that meets at least quarterly and focuses on internal and risk management issues;
- an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives; and
- a structured framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan.

5.172 Following the MOG changes, DEWHA integrated the Arts function into its corporate governance arrangements. This required DEWHA to review and consider the risks previously identified for the Arts programs and to include them in the overall corporate risk profile. This process has led DEWHA to modify its risk management guidelines, the risk register and assessment matrix as part of preparing the 2008–09 Risk Management Plan.

Financial reporting framework

5.173 DEWHA has implemented a financial reporting framework that measures key financial and non–financial performance, promoting effective management of key business areas. DEWHA produce monthly reports on a timely basis and include variance analysis from budget and details specific areas that are of special interest to the Executive. The integration of the Arts programs into DEWHA's monthly reports was in progress at the time of audit.

5.174 Also up until the end of March, DEWHA processed financial transactions for the Department of Climate Change in accordance with a Memorandum of Understanding between the two agencies for the provision of financial and corporate services. In relation to the Arts programs, DBCDE was processing financial transactions on behalf of DEWHA up until the end of March while DEWHA's FMIS was being configured to accommodate the Arts outcome structure.

5.175 The ANAO's understanding of DEWHA and its environment, including the impact of MOG changes, has enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

Identifying financial reporting risks

5.176 The ANAO has assessed the risk of material misstatement in the 2007–08 DEWHA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused include:

- the nature of the grant programs processed by the department including the administration of a large grants process in relation to the Natural Heritage Trust;
- asset management, reporting and stocktake difficulties due to the remote localities of Antartic asset holdings;
- the complex valuation of make good obligations for Antartic assets;
- the integration of the Arts programs into DEWHA;
- complexities surrounding the initial recognition and reporting of water entitilements; and

- financial statement disclosure requirements to reflect the MOG changes of 3 December 2007.

Audit results

5.177 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
Total	**1**	**(1)**	**0**	**0**	**0**	**0**	**0**

5.178 In 2006–07 the ANAO reported one moderate control weakness in relation to controls over the payment of invoices without the raising of a purchase order. DEWHA implemented an interim measure to address this issue until a more permanent IT solution can be implemented.

5.179 There were no audit issues of a significant or moderate rating raised by the ANAO following the 2007–08 interim audit.

5.180 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.181 At the time of this report, DEWHA continues to work towards finalising the implementation of the MOG changes. ANAO will be required to perform additional audit procedures during the final audit to obtain an acceptable level of assurance on the department's financial statements. Based on the audit work performed to date, internal controls are operating satisfactorily to provide a reasonable assurance that DEWHA can produce financial statements free of material mis-statement.

Families, Housing, Community Services and Indigenous Affairs Portfolio

Department of Families, Housing, Community Services and Indigenous Affairs

Business operations

5.182 The Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) seeks to promote the economic and social well-being of all Australians, particularly those in need, through effectively implementing government policies.

5.183 There have been significant changes to FaHCSIA arising from the Administrative Arrangement Orders (AAOs) of 3 December 2007 and 25 January 2008. Responsibility for a range of functions relating to childcare, early childhood and youth were transferred to the new Department of Education, Employment and Workplace Relations (DEEWR). FaHCSIA gained the Disability Support Pension and Community Development and Employment Projects (CDEP) from the former Department of Employment and Workplace Relations. The Department's significant housing responsibilities are now included as part of the agency's name. Some minor functions have also been transferred to and from other agencies. Overall, these changes have resulted in a net reduction in staff numbers by approximately 300.

5.184 In aiming to contribute to creating a fair and cohesive Australian society, FaHCSIA focuses on groups with differing needs such as Indigenous people, the aged, carers, people with disabilities, women, people living in rural and remote areas and people from diverse cultural and linguistic backgrounds.

5.185 FaHCSIA achieves its purpose by:

- providing advice to government on social policy issues including whole-of-government coordination and collaboration in policy development and service delivery for Indigenous people;
- working in partnership with other Australian Government departments and agencies along with state, territory and local governments, non-government agencies, communities, the private sector and citizens; and

- managing the delivery of services through a wide range of external service providers, including Centrelink, other Australian Government agencies, non-government organisations, private providers and state, territory and local governments.

5.186 FaHCSIA's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	1 496	342
Total expenses	1 495	55 865
Total assets	334	3 575
Total liabilities	122	4 168

FaHCSIA's estimated average staffing level for 2007–08 is 2893.

Understanding the environment

5.187 As part of FaHCSIA's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls and the impact of the MOG changes outlined above. To assist in implementing the MOG changes, FaHCSIA established an executive committee to oversee the transfer of programs from the then DEWR and to the newly created DEEWR.

5.188 At an operational level FaHCSIA has had minimal changes to its business systems as the majority of the transferred functions are personal benefit payments that are processed by Centrelink. Some additional audit coverage may be necessary to validate the balances in the 2007–08 financial statements relating to the functions transferred to and from FaHCSIA resulting from the MOG changes.

5.189 Two of the important factors considered, relating to FaHCSIA's environment, were its corporate governance arrangements and financial reporting framework.

Corporate governance

5.190 The key elements that contribute to good financial management by FaHCSIA include:

- an Executive Management Group (EMG) that meets weekly. The EMG takes an active interest in the financial operations of FaHCSIA and receives monthly detailed reports from the Chief Financial Officer;
- establishment of a steering committee comprising FaHCSIA officers, to review and implement the necessary steps to address the transfer of functions and staff resulting from the MOG changes;
- a committee framework, including a Risk Assessment and Audit Committee (RAAC). The RAAC meets at least quarterly and focuses attention on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes, audit planning and reporting;
- an Internal Audit and Fraud Branch that undertakes a risk based audit coverage of FaHCSIA's activities;
- a fraud control plan covering 2007–09; and
- a risk management framework encompassing a Risk Management Unit, that is responsible for coordinating and developing FaHCSIA's risk management regime, and a Risk Management Toolkit that encourages staff to apply risk management principles.

Financial reporting framework

5.191 FaHCSIA's approach to financial reporting includes monthly performance reports to the EMG on actual results against budget and a performance scorecard in relation to departmental financials. The information provided to management includes high-level analysis of the financial position of FaHCSIA, an analysis of variances from budget, and monthly financial statements.

Identifying financial reporting risks

5.192 The ANAO has assessed the risk of material misstatement in the 2007–08 FaHCSIA financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the reliance on Centrelink's systems and processes to deliver personal benefit payments on behalf of FaHCSIA. These personal benefit payments are based on voluntary disclosures by recipients;
- the complex estimation of the Family Tax Benefit and Pension Bonus Scheme provisions, personal benefit overpayments and the provision for doubtful debts;
- complexities associated with the management of grant programs in the light of the requirement for recipients to comply with numerous grant payment conditions;
- the creation and management of new special accounts specifically relating to the Northern Territory emergency response which is administered by FaHCSIA for other agencies;
- management of appropriation funding following the changes to FaHCSIA's outcome structure in 2006–07 and any subsequent impact on its presentation and disclosure in 2007–08; and
- the management of the financial statement close process, particularly in light of the tight reporting deadlines for the completion of financial statements and transfer of functions resulting from the AAOs.

Audit results

5.193 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	5	(4)	1	2	(1)	0	1
Total	**5**	**(4)**	**1**	**2**	**(1)**	**0**	**1**

Moderate risk matters – Category B

Management of Commitments

5.194 For the 2004–05, 2005–06 and 2006–07 financial years, the ANAO identified weaknesses in the manual processes undertaken by FaHCSIA at the end of each financial year to collate information on commitments for reporting in the financial statements. FaHCSIA has reviewed this process and is implementing a number of procedures to improve the information collation process.

5.195 The audit finding relating to the management of the FaHCSIA Online Funds Management System (FOFMS) raised in the prior year has been resolved.

5.196 There were no audit issues of a significant or moderate rating raised by the ANAO following the 2007–08 interim audit.

5.197 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.198 The ANAO recognises that FaHCSIA has put considerable effort into resolving prior year issues. Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that FaHCSIA will be able to produce financial statements free of material misstatement.

Finance and Deregulation Portfolio

Department of Finance and Deregulation

Business operations

5.199 The Department of Finance and Deregulation (Finance) has responsibilities relating to the following areas:

- budget policy advice and process, and review of government programs;
- government financial accountability, governance and financial management frameworks, including procurement policy and services;
- shareholder advice on Government Business Enterprises (GBEs) and commercial entities treated as GBEs;
- reducing the burden of government regulation;
- general policy guidelines for Commonwealth statutory authorities;
- superannuation related to former and current members of parliament and Australian Government employees;
- asset sales;
- strategic management of non-Defence Commonwealth-owned property in Australia, including construction, major refurbishment, acquisition, ownership and disposal of real property;
- administration of parliamentarians' entitlements;
- administration of the Australian Government's elf-managed general insurance fund (Comcover);
- government on-line delivery and information technology and communications management;
- evaluation and audit of indigenous programs and operations;
- advice on the Future Fund; and
- the central advertising system.

5.200 Finance's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	500	1 939
Total expenses	412	5 818
Total assets	1 817	4 352
Total liabilities	243	71 744

Finance's estimated average staffing level for 2007–08 is 1342.

Understanding the environment

5.201 As part of Finance's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are Finance's corporate governance arrangements and financial reporting framework.

Corporate governance

5.202 The key elements of Finance's corporate governance that contribute to good financial management by Finance include:

- an executive board that meets weekly and addresses policy, program, strategic and management issues and provides oversight of Finance's operational and financial performance;
- an audit committee, chaired by an independent member, that meets at least quarterly and focuses on risk management, internal controls, compliance and financial reporting, and ANAO activities;
- a risk management process which includes an assessment of inherent and control risks, identification of the controls in place to address these risks both at an organisational and discrete activity level and an understanding of the residual risks that remain and how these can be managed to an acceptable level ; and
- a fraud risk assessment process and fraud control plan.

Financial reporting framework

5.203 Finance has developed financial reporting processes that provide monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows within seven days of month end. The reports provide actual versus budget information on an accrual basis, allowing Finance to assess its financial position and operating performance. The reports also provide non–financial information including overview of key performance indicators, human resource issues, and the impact of possible future adverse events.

Identifying financial reporting risks

5.204 The ANAO's understanding of Finance and its environment enabled the risks of material misstatement in the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.205 The ANAO has assessed the risk of material misstatement in the 2007–08 Finance financial statements as moderate. The factors that have contributed to this risk assessment, and that the financial statement audit is particularly focused on, include:

- the complexities and assumptions associated with the actuarial assessment of the public sector unfunded superannuation liability;
- risks associated with the application of assumptions to the valuation of the Australian Government's domestic property portfolio;
- the reliance on complex actuarial assessments in respect of the Australian Government's self-managed general insurance fund (Comcover);
- the validity and accuracy of entitlements paid to Parliamentarians and their staff, particularly in the light of increased separation and redundancy payments to ministerial staff as a result of the change of Government; and
- the complex reporting requirements of aspects of the Telstra 3 share sale.

Audit results

5.206 There were no audit issues of a significant or moderate rating raised by the ANAO in 2007–08, or in 2006–07.

Conclusion

5.207 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that Finance can produce financial statements free of material misstatement.

The Board of Guardians and the Future Fund Management Agency

Business operations

5.208 The *Future Fund Act* commenced on 3 April 2006 and established the Special Account (Fund Account), the Future Fund Board of Guardians (the Board) and the Future Fund Management Agency (the Agency), collectively referred to as the Future Fund.

5.209 The object of the Future Fund is to strengthen the Australian Government's long term financial position and make provision for unfunded Commonwealth superannuation liabilities. The Future Fund is aiming to grow the managed assets in order to meet an expected 2020 Commonwealth liability for unfunded superannuation liability of approximately $140 billion. The Fund's investments total more than $60 billion.

5.210 During 2007–2008, the Fund was also given the task of managing the investment of the $6 billion Higher Education Endowment Fund (HEEF). The objective of HEEF is to provide annual distributions to fund grants in the higher education sector, whilst maintaining the underlying capital asset base. HEEF is expected to be absorbed into the recently announced Education Investment Fund.

5.211 The Fund's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	14	3 821
Total expenses	14	2 037
Total assets	5	65 130
Total liabilities	5	7

The Fund has continued to expand during the financial year and now has some 40 staff.

Understanding the environment

5.212 Under the Future Fund Act, the Board of Guardians, supported by the Future Fund Management Agency, is required to seek to maximise the return earned on contributions to the Fund over the long term, consistent with international best practice for institutional investment and subject to any directions provided by the Responsible Ministers, being the Treasurer and Minister for Finance and Deregulation.

5.213 The Board's core focus is overseeing the development of an investment strategy which will enable the organisation to meet its objectives outlined above. The approval and continuous monitoring of the investment portfolio's target asset allocation is a key function of the Board.

5.214 The financial performance of the Future Fund and the Agency are reviewed each month by the Board of Guardians. The management accounts that are prepared for review include commentary on actual results to date.

5.215 The Agency has also developed a Risk Management Framework, including identification of the 'Top 20' risks within the Agency.

5.216 The Audit Committee has in place a formal Charter that clearly sets out its responsibilities in relation to oversight of the financial reporting process, internal audit and risk management. The performance of the Audit Committee and the Charter that governs its function will be subject to annual review.

Corporate governance

Internal control

5.217 The Agency is continuing to develop its internal control framework to support its expanding investment portfolio and associated Agency activity. The development of the Risk Management Framework supports the Agency in this regard. Based on our experience in previous audits, controls over key agency operations (such as payroll and expenditure) have been implemented.

5.218 Significant investment controls reside with the outsourced custodian. These controls are subject to an independent bi-annual internal controls audit as well as an substantive audit as at 30 June each year of the existence and valuation of the investment portfolio. The Fund's investment positions are also reconciled regularly on a three way basis between the custodian, the investment manager, and the Fund's own records. Amongst other things, our audit approach reviews these reconciliations and considers the processes involved in the Fund's monitoring of the performance of the external custodian against the service level agreement.

Fraud management

5.219 The Agency has developed a Fraud Control and Prevention Plan, which has been ratified by the Board of Guardians. The plan and the processes contained within them will be subject to periodic internal audit.

5.220 Responsibility for the oversight of the Fraud Control and Prevention Plan rests with the Audit Committee.

Internal Audit

5.221 Internal audit is fully outsourced. A plan for 2008 has been established and approved by the Audit Committee. Oversight of the internal audit responsibility rests with the Audit Committee.

5.222 The Internal Audit plan for 2008 contains a review of key investment operations controls and processes and the ANAO intends to place reliance on this work where possible.

5.223 The performance of Internal Audit will be measured against agreed Key Performance Indicators.

Identifying financial reporting risks

5.224 For audit purposes, the ANAO assesses the risk of material misstatement as moderate. Some of the factors that contribute to the risk assessment are:

- the recent volatility in world wide financial markets;
- the further establishment of the investment portfolio;
- the continuing development of the risk management framework and related controls; and
- the implementation this year of the newly introduced AASB 7 *Financial Instruments: Disclosures*.

5.225 Our audit approach has been designed to respond to these risks.

Audit results

5.226 At the time of preparing this report the interim audit of the Future Fund was still in progress.

Conclusion

5.227 The Future Fund continues to develop as an organisation, and implement its substantial investment program. Audit results for the 2007–08 financial statements audit will be reported in the ANAO's year end report to the Parliament.

Foreign Affairs and Trade Portfolio

Department of Foreign Affairs and Trade

Business operations

5.228 To advance the interests of Australia and Australians internationally, the Department of Foreign Affairs and Trade (DFAT) works towards achieving four outcomes:

- Australia's national interests protected and advanced through contributions to international security, national economic and trade performance and global cooperation;
- Australians informed about and provided access to consular and passport services in Australia and overseas;
- public understanding in Australia and overseas of Australia's foreign and trade policy and a positive image of Australia internationally; and
- efficient management of the Commonwealth overseas owned estate.

5.229 DFAT's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Budget estimate ($m)	**Administered** Budget estimate ($m)
Total income	928	312
Total expenses	845	264
Total assets	2 483	387
Total liabilities	218	106

DFAT's estimated average staffing level for 2007–08 is 3458.

Understanding the environment

5.230 As part of DFAT's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DFAT's corporate governance arrangements and financial reporting framework.

Corporate governance

5.231 The key elements of DFAT's corporate governance that contribute to good financial management by DFAT include:

- an executive committee that oversees the operational performance of divisions, reviews department-wide issues, monitors financial performance and considers reports prepared and referred by other internal committees;
- a governance committee framework including an audit and risk committee. This committee meets at least quarterly and focuses attention on the efficiency, effectiveness and probity of activities including risk assessment and management, internal audit planning and results, fraud control and ANAO audit activities;
- an internal audit strategy and plan that aligns with the department's risk assessment and management priorities; and
- a fraud control plan that is monitored and reviewed in line with the Government's Fraud Control Policy.

Financial reporting framework

5.232 DFAT has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor performance and financial management. Monthly reports are produced for the executive committee to identify and explain variances between budgeted and actual performance.

5.233 DFAT continues to improve the effectiveness of its financial management through the ongoing review of its financial management policy, procedures and measures. These reviews are focused on simplifying existing financial administration requirements to make sure that the framework in place has not become redundant or inappropriate as their control environment evolves and to further promote good governance and strong financial management accountability.

Identifying financial reporting risks

5.234 The ANAO's understanding of DFAT and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.235 The ANAO has assessed the risk of material misstatement in the 2007–08 DFAT financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the devolved and geographical spread of DFAT's operations. Australia's overseas missions are subject to decentralised review and approval processes, as well as being impacted by differing national labour and other employment laws for locally engaged staff;
- the complexities associated with the valuation of the Australian Government's overseas owned estate. The geographical spread of the estate, together with underlying movements in exchange rates, adds considerable complexity in determining fair value disclosures;
- the reliance on a third party for some passport application processing and revenue collection;
- the complexities in reporting on the administration and management of appropriations and special accounts;
- changes to reporting requirements, particularly the first-time application of AASB 7 *Financial Instruments: Disclosures*; and
- the operation of IT controls surrounding significant IT systems.

Audit results

5.236 There were no audit issues of a significant or moderate rating raised by the ANAO in 2007–08, or in 2006–07.

Conclusion

5.237 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DFAT can produce financial statements free of material misstatement.

Health and Ageing Portfolio

Department of Health and Ageing

Business operations

5.238 The Department of Health and Ageing's (DoHA) vision is for better health and active ageing for all Australians and DoHA works to achieve this through its policy advice, research and regulations activities, and partnerships with other government agencies, consumers and stakeholders.

5.239 DoHA's Corporate Plan 2006–09 sets out its current key priorities and goals with a view to achieving this vision.

5.240 The priorities for DoHA during 2007–08 include:

- supporting quality medical research into knowledge and technologies with the potential to prevent or treat diseases and improve the lives of Australians;
- continuing to improve the health and wellbeing of people with a mental illness, as well as their families and carers;
- providing better access to psychiatrists, psychologists, general practitioners and other health professionals through Medicare;
- addressing the need for a greater number of better skilled health professionals and the effective distribution of these professionals in areas of shortages across Australia;
- addressing the continuing challenges of an ageing population and the diverse needs of older Australians by the provision of community, residential and flexible care services and support for carers;
- strengthening the focus of the health system on the prevention and management of chronic diseases;
- providing funding to establish programs to combat illicit drug use particularly among young people, tackle alcohol misuse and support drug and alcohol treatment services around Australia;
- ensuring the community has access to affordable medicines through an effective and sustainable Pharmaceutical Benefits Scheme, as well as

improving the level of access to medical and pharmaceutical services for the rural and regional areas of Australia;

- continuing to improve and develop national systems for better health service delivery including the National Health Call Centre Network for the provision of advice to consumers, acceleration of the development of e-health systems for storage and transfer of patient information, expanding the current Australian Childhood Immunisation Register to also cover adults, and a National Pregnancy Support Telephone Helpline; and
- development of a stronger and internationally competitive Australian sports sector and encouragement of greater participation in sport by all Australians.

5.241 The department's consolidated financial statements include the Department of Health and Ageing, the Therapeutic Goods Administration (TGA), the National Industrial Chemicals Notification and Assessment Scheme (NICNAS) and the Office of the Gene Technology Regulator (OGTR).

5.242 The responsibilities of DoHA have increased as a result of the MOG changes announced on 3 December 2007. These changes include the transfer of the sports function from the former Department of Communications, Information Technology and Arts (DCITA). In addition, the Rural Medical Infrastructure Fund (RMIF) was transferred from the Department of Infrastructure, Transport, Regional Development and Local Government (DITRDLG).

5.243 During the 2007–08 interim audit phase, the ANAO confirmed that not all s32 determinations for the transfer of appropriations and other activities associated with the transfer of the RMIF from DITRDLG had been finalised. The ANAO will continue to review the situation in the context of its audit approach and coverage.

5.244 DoHA's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	699	372
Total expenses	704	45 789
Total assets	265	3 234
Total liabilities	178	2 501

DoHA's estimated average staffing level for 2007–08 is 4 514.

Understanding the environment

5.245 As part of DoHA's financial statement audit, the ANAO gains an understanding of the agency and its environment, and internal controls, including the impact of the MOG changes outlined above. Two of the important factors considered were DoHA's corporate governance arrangements and financial reporting framework.

Corporate governance

5.246 The key elements of DoHA's corporate governance that contribute to good financial management by DoHA include:

- an executive committee (chaired by the Secretary) that is responsible for the active management and oversight of all major departmental policy, financial and operational decision making;
- a governance committee framework including an Audit Committee. The audit committee, that includes two independent members, meets at least quarterly and provides advice and assistance on risk, control and compliance frameworks;
- an internal audit function that has primary responsibility for promoting and improving corporate governance within DoHA and operates under the direction of the Audit Committee and the executive committee;
- a risk management framework including Chief Executive Instructions, Procedural Rules, a Risk Management Policy and an Enterprise Risk Management Plan (ERMP). Risks identified in the ERMP are reported quarterly to the Executive Management Committee, Audit Committee and the Risk and Security Committee;

- a fraud control plan that is monitored and reviewed on a cyclical basis in line with the Government's Fraud Control Policy. Fraud risk is considered as part of the ERMP;
- a Certificate of Compliance regime that incorporates periodic control self assessments. This regime forms a key part of DoHA's corporate governance and compliance framework and enables managers to survey and report on their understanding of, and compliance with, DoHA's corporate governance and compliance framework; and
- governance arrangements with Medicare Australia to manage the relationship between the two entities regarding administered payments. The Memorandum of Understanding in place between the two agencies remains in draft.

5.247 In the context of the department's total responsibilities, the MOG changes were relatively minor and therefore have not significantly impacted on DoHA's corporate governance arrangements.

Financial reporting framework

5.248 DoHA has a sound financial reporting framework that incorporates key financial and non-financial measures to monitor performance and financial management. Monthly reports are distributed to the executive, division heads and state and territory managers to identify and explain variances between budgeted and actual performance, key drivers of costs and a summary of anticipated events that have an impact on financial performance.

Identifying financial reporting risks

5.249 The ANAO's understanding of DoHA and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.250 The ANAO has assessed the risk of material misstatement in the 2007–08 DoHA financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the significant size of the DoHA's administered payments ($45.7 billion);
- reliance on Medicare Australia's systems and processes to deliver personal benefits payments on behalf of DoHA;

- high value payments to State and Territory Governments relating to the Australian Health Care Agreements and the Home and Community Care program, and other payment to service providers and program recipients;
- the model used for estimating the year-end accruals that principally relate to the Medicare and Pharmaceutical Benefit Schemes and the timeliness of the data to enable Medicare Australia to finalise those accruals for inclusion in DoHA's financial statements;
- complex accounting and governance arrangement associated with the Mersey Community Hospital;
- the management of, and accounting for, the medical stockpile;
- a complex funding model and appropriation disclosure;
- complex estimation for the reporting for the Government's liabilities under the medical indemnity initiative;
- the administration and management of a large volume of grants to disparate recipients that range in scale and complexity; and
- consolidation of significant departmental business operations in DoHA's financial statements.

Audit results

5.251 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	2	0	0	2	(1)	3	4
Total	**2**	**0**	**0**	**2**	**(1)**	**3**	**4**

5.252 The 2007–08 audit highlighted the following issues that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

Information Technology Security

5.253 The ANAO reviewed the IT Security Policy and related security documents provided by DoHA and identified that there was no evidence that this documentation has been reviewed annually, with several key documents dated 2005 or earlier. These documents include the IT Security Policy and IT Security Standards.

5.254 Failure to maintain and monitor compliance with DoHA's security policy, standards and procedures, developed in response to risk management, increases the risk that management strategies to address or moderate weakness to the system and its information are not appropriately implemented.

SAP: Security and Configuration

5.255 User access management is a key control process that restricts access to information and functions to appropriate personnel. The ANAO identified several weaknesses in the access management practices relating to DoHA's FMIS. In particular, the FMIS password policy was not compliant with the DoHA IT Security Policy, there was inadequate management of inactive and terminated user accounts and access granted to users was inconsistent with the principles of segregation of duties. There was also inadequate audit logging and security monitoring and reporting was not being performed regularly and/or evidenced.

5.256 Failure to adequately manage user access to the FMIS may lead to unauthorised, incorrect or invalid transactions being processed and remaining undetected.

Business continuity and disaster recovery planning at TGA

5.257 The ANAO noted that TGA had finalised the development and documentation of the Information Technology (IT) Business Continuity Management framework, including Disaster Recovery Plans (DRP) and the identification of risks and mitigating factors for critical systems and business processes. A test strategy including a timetable had also been developed. However, the issue remains outstanding as TGA had not completed Business Continuity testing in accordance with this strategy. In particular, TGA has not addressed disaster recovery risk and mitigation strategies associated with the outsourced HRMIS.

5.258 As a consequence, in the event of a disaster or accident, TGA may be unable to appropriately manage and mitigate a major disruption to key financial business operations.

Security management of TGA's FMIS and HRMIS

5.259 The ANAO identified several weaknesses in access management practices relating to TGA's FMIS and HRMIS. These weaknesses include a lack of documented policy and procedures, including a security matrix, poor management of inactive and terminated user accounts, the existence of generic accounts with high level access, and an excessive number of users with privileges access that is inconsistent with their roles and responsibilities. Weaknesses in access management practices increase the risk that unauthorised, inaccurate and/or fraudulent transactions are processed.

Conclusion

5.260 The ANAO found that the majority of DoHA's key internal controls were operating satisfactorily. Our interim audit has identified a number of control issues that require management attention to reduce the risk of unauthorised or inappropriate access to departmental information that may result in a material misstatement in DoHA's financial statements. DoHA has responded positively to the ANAO's findings and associated recommendations.

Human Services Portfolio

Department of Human Services

Business operations

5.261 The Department of Human Services' (DHS) sole outcome is the effective and efficient delivery of social and health related services, including financial assistance to the Australian community. DHS is responsible for ensuring the Australian Government is able to get best value for money in service delivery while emphasising continuous service improvement and a whole-of-government approach.

5.262 DHS consists of the core department, the Child Support Agency (CSA) and CRS Australia. The core department is small and strategic. The role of the core department is to direct, coordinate and broker improvements to service delivery. CSA is responsible for ensuring that children of separated parents receive the financial support that both their parents are responsible for providing. CRS Australia assists people who have a disability or injury to return to work.

5.263 The following entities report through the Secretary of DHS to the Minister for Human Services:

- Centrelink;
- Medicare Australia;
- Australian Hearing; and
- Health Services Australia Limited.

5.264 DHS's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	Departmental Estimated actual ($m)	Administered Estimated actual ($m)
Total income	724	1 128
Total expenses	724	1 256
Total assets	283	575
Total liabilities	158	538

The estimated average staffing level for 2007–08 is 5858. These figures include the core department, CSA and CRS Australia.

Understanding the environment

5.265 As part of DHS's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DHS's corporate governance arrangements and financial reporting framework.

Corporate governance

5.266 The key elements of DHS's corporate governance that contribute to good financial management by DHS include:

- executive management committees in the core department, CSA and CRS Australia that meet weekly to oversee operations and performance and to provide strategic direction to the three operational divisions of DHS;
- a monthly head of agencies meeting that includes the Secretary and the heads of all six Human Services entities;
- committee structures in the core department, CSA and CRS Australia that provide direction in areas such as people and leadership, national operations, risk management, information technology and management, finance and security;
- an audit committee that meets every two months and focuses on matters relating to risk assessment and management, internal audit, external audit, fraud control and financial reporting and is supported by risk management committees in CSA and CRS Australia;
- an internal audit strategy and plan and internal audit programs in the core department, CSA and CRS Australia that address key business and financial risks and aim to assist line areas meet their key objectives;
- a strategic level risk management plan for DHS and individual risk management plans for CSA and CRS Australia, supported by risk managers and risk committees in each agency; and
- fraud control plans in the core department, CSA and CRS Australia and an over-arching fraud control plan for DHS, to identify and manage fraud risks.

Financial reporting framework

5.267 DHS has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business divisions, and for CSA and CRS, their regional operations. The monthly reports include explanations for variances from budget or expected outcomes and detail any areas that are of special interest to the executive committees of DHS and its respective entities.

Identifying financial reporting risks

5.268 The ANAO's understanding of DHS and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.269 The ANAO has assessed the risk of material misstatement in the 2007–08 DHS financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- complex and integrated governance and accountability arrangements between the agencies to support portfolio objectives;
- the accounting and reporting of administered revenues and expenses through the Child Support Agency Special Account based on financial information from a system primarily designed for child support case management purposes;
- the complex estimation of child support provision for doubtful debts and employee entitlement provisions;
- a significant change and reform program affecting CSA's IT systems, business processes and the application of capitalisation principles to system costs;
- changes to the Vocational Rehabilitation Service arrangements between the Department of Education, Employment and Workplace Relations and CRS Australia; and
- the impact of the discontinuation of the Office of Access Card.

Audit results

5.270 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	3	(1)	1	3	(3)	0	0
Total	**3**	**(1)**	**1**	**3**	**(3)**	**0**	**0**

5.271 There were no significant or moderate issues identified during the 2007–08 interim audit.

Moderate issues outstanding from the prior year

5.272 The Child Support Agency has taken action to address the three moderate issues outstanding from the prior year audit. CSA has strengthened its security controls over the FMIS to address the segregation of duties and SAP configuration issues and implemented improved processes to prevent the issue relating to the recognition of employee prior service from reoccurring.

Conclusion

5.273 The ANAO observed internal controls were operating satisfactorily to provide reasonable assurance that DHS can produce financial statements free of material misstatement.

Centrelink

Business operations

5.274 Centrelink has operated as an entity subject to the *Financial Management and Accountability Act 1997* since its establishment under the *Commonwealth Services Delivery Agency Act 1997* (CSDA Act). Centrelink is the principal service delivery organisation within the Human Services Portfolio and is responsible for the delivery of a number of Australian Government welfare services. Centrelink's customers include retired people, families, sole parents, unemployed people, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, Indigenous Australians and those from diverse cultural and linguistic backgrounds. Centrelink operates under a purchaser/provider framework and obtains the majority of its funding on a fee for service basis through business partnership arrangements with policy agencies that purchase Centrelink's services.

5.275 Centrelink's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	2 669	Nil
Total expenses	2 701	Nil
Total assets	925	Nil
Total liabilities	622	Nil

Centrelink's estimated average staffing level for 2007–08 is 25 230.

Understanding the environment

5.276 As part of Centrelink's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are Centrelink's corporate governance arrangements and financial reporting framework.

Corporate governance

5.277 The key elements of Centrelink's corporate governance that contribute to good financial management by Centrelink include:

- the Centrelink executive comprising the Chief Executive and the senior managers who report directly to him. Monthly executive meetings are held that are chaired by the Chief Executive;
- a national Business Plan detailing how Centrelink's business strategies will be achieved. This Business Plan is the basis for a range of other plans at the division and branch level;
- an audit committee chaired by an independent member, that provides assurance to the Chief Executive that Centrelink operates with appropriate financial management framework and complies with established internal controls by reviewing specific matters that arise from the audit process. The audit committee focuses on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes, audit planning and reporting;
- an internal audit function that undertakes a program of audits covering the main aspects of Centrelink's business. The Centrelink internal audit

plan is developed based on the endorsed risk management framework, Centrelink's strategic themes and past audit findings. The internal audit plan is reviewed and approved by the audit committee annually;

- a fraud control action plan that addresses fraud associated with welfare payments (payment fraud), benefits as a result of information held by Centrelink (information fraud) and Centrelink's assets, financial and human resources (administrative fraud);
- a review and monitoring framework that includes an assessment and compliance review of benefit payments; and
- a Business Assurance Framework that provides performance assurance to Centrelink's key stakeholders, including Government, policy agencies and customers.

Financial reporting framework

5.278 Centrelink has a monthly financial reporting regime that includes comparison to budget, variance analysis and commentary. The Budget and Management Accounting Branch prepares financial analysis and commentary on a monthly basis. In addition, Centrelink utilises a balanced scorecard to report on progress against key performance indicators.

Identifying financial reporting risks

5.279 The ANAO's understanding of Centrelink and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.280 The ANAO has assessed the risk of material misstatement in the 2007–08 Centrelink financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- voluntary disclosure by customers in relation to the assessment and payment of personal benefits;
- timely implementation of system changes in an environment of frequent legislative and policy changes in personal benefit programs;
- the complexity and dynamics of the IT environment, particularly relating to developing and managing internal systems for benefit payments; and

- the complexity of the process for the recognition and impairment of internally developed software which represents a significant portion of Centrelink's asset base.

Audit results

5.281 The following table provides a summary of the status of prior year issues as well as 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	3	0	0	3	(2)	2	3
Total	**3**	**0**	**0**	**3**	**(2)**	**2**	**3**

Prior year moderate risk matter - Category B

Monthly reconciliations

5.282 During the 2006–07 audit, a review of the reconciliation process between the FMIS and the Debt Management Information System (DMIS) identified a number of recurring variances that remained unresolved. Delays in actioning and clearing these variances may reduce the ability of the Commonwealth to collect amounts that are determined to be debts. This issue remains unresolved at the time of the 2007–08 interim audit.

2007–08 moderate risk matters – Category B

Delegated limits of authority to waive and write-off debt

5.283 Centrelink debt officers are granted the authority to either waive or write-off debt in the DMIS depending on the customer's circumstances and the authority limits delegated to them by the Chief Executive Officer in accordance with the relevant legislation. Our audit found that the delegation levels configured within the DMIS did not align with the instruments of delegation. Accordingly, debts may be waived and/or written off by officers acting outside their delegated authority.

Access management of payment allocation benefit payment datasets

5.284 Our audit identified that number of users had been granted inappropriate access to update benefit payment data. In addition, a monitoring control designed to periodically review the appropriateness of user access to modify these benefit payment files had not been implemented. Inappropriate access to these files increases the risk of erroneous and/or fraudulent modifications being made to these benefit payment files; and the absence of a monitoring control may result in any erroneous errors and/or fraudulent modifications remaining undetected.

Conclusion

5.285 The ANAO found that the majority of Centrelink's key internal controls were operating satisfactorily. Our interim audit has identified a small number of control issues that require management attention to reduce the risk of material misstatement in Centrelink's financial statements and financial information provided to other agencies. Centrelink has responded positively to the ANAO's findings and associated recommendations.

Medicare Australia

Business operations

5.286 Medicare Australia administers a range of health-related and other payment programs on behalf of its client agencies. Medicare Australia delivers approximately $31 billion in services on behalf of the Department of Health and Ageing (DoHA), Veterans' Affairs (DVA) and Families, Housing, Communities Services and Indigenous Affairs. It will receive appropriately $600 million in 2007–08 to administer services provided under these arrangements. The key services provided include:

- Medicare;
- Pharmaceutical Benefits Scheme (and Repatriation Pharmaceutical Benefits Scheme) including various payments under the Community Pharmacy Agreement;
- Aged Care;
- Family Assistance (with Centrelink and the Australian Taxation Office);
- Australian Organ Donor Register; and
- Australian Childhood Immunisation Register.

5.287 Medicare Australia administers a range of other programs and schemes including:

- programs supporting general practice, such as the General Practice Immunisation Incentives Scheme, the Practice Incentives Program, the Rural Retention Program, the General Practice Registrars' Rural Incentive Payment Scheme, and the Mental Health Nurse Incentive Program;
- community rebate and reimbursement schemes, such as the Higher Education Contribution Scheme Reimbursement Scheme, the Private Health Insurance Rebate and the LPG Vehicle Scheme;
- the Medical Indemnity Scheme; and
- specialised drugs programs, the National Bowel Cancer Screening Register and the Special Assistance Programs for victims of the Bali Bombings in 2002 and 2005, the Tsunami, and the United Kingdom and Egypt Bombings.

5.288 Medicare Australia is developing the Unique Healthcare Identifier (UHI) System under contract to the National E-Health Transition Authority (NEHTA). The UHI system will generate healthcare identifiers for patients, healthcare providers and healthcare locations, to assist the development of electronic health records in Australia.

5.289 Medicare Australia and the Department of Immigration and Citizenship have entered into an arrangement to administer citizenship testing. This activity will be administered through Medicare Australia's extensive network of offices.

5.290 Medicare Australia's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	688	0
Total expenses	695	1.4
Total assets	308	0.9
Total liabilities	176	0.9

Medicare Australia's estimated average staffing level for 2007–08 is 5457.

Understanding the environment

5.291 As part of Medicare Australia's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are Medicare Australia's corporate governance arrangements and financial reporting framework.

Corporate governance

5.292 The key elements of Medicare Australia's corporate governance that contribute to good financial management include:

- a Corporate Management Committee that meets monthly and addresses strategic issues, monitors Medicare Australia's financial performance and oversees the operational performance of the organisation including regular performance reviews;
- an executive committee that focuses on assessing the integrity of the payments administered by Medicare Australia on behalf of other government agencies;
- an audit committee that meets at least quarterly to discuss and assess Medicare Australia's internal control, management of risks, review of financial reports, control of public monies and regulatory compliance;
- an internal audit function that has a planned risk based audit coverage of Medicare Australia's activities;
- development and implementation of a quality assurance framework and annual compliance plan for key programs administered by Medicare Australia; and
- a fraud control plan that is regularly monitored and reviewed.

Financial reporting framework

5.293 Medicare Australia's financial reporting framework includes monthly reports on departmental revenue and expenses. The reports include explanations for variances from budgeted or expected outcomes and forecasts and provide additional details on specific areas of interest to the executive.

5.294 Medicare Australia also provides regular reports to the agencies on whose behalf it provides services. Given the volume of processing performed on behalf of DoHA, Medicare Australia provides reports to DoHA to reconcile information recorded by both agencies within their financial management systems.

Identifying financial reporting risks

5.295 The ANAO's understanding of Medicare Australia and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.296 The ANAO has assessed the risk of material misstatement in the 2007–08 Medicare Australia financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the relationship between Medicare Australia and its agencies;
- reliance on external parties to provide information to support significant financial statement balances such as medical indemnity;
- the complexity of the IT general and application controls, in a distributed operating environment, to support significant business operations;
- Medicare Australia's funding model and control framework supporting the recording and reporting of departmental revenue, including revenue received directly from other entities such as NEHTA;
- a significant increase in the level of compliance activity, in particular for Medicare and PBS payments; and
- prior year audit findings on the accuracy and completeness of key financial statement components, such as appropriations, supplier expenses, assets and employee expenses, and the financial statement close process.

Audit results

5.297 The following table provides a summary of the status of prior year issues as well as the 2006–07 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	0	0	2	2	0	0	2
Total	**0**	**0**	**2**	**2**	**0**	**0**	**2**

5.298 The 2007–08 audit identified the following issues that should be addressed to support the adequacy of the internal control and the reliability of information reported in the financial statements.

Moderate Risk Matters—Category B

5.299 Medicare Australia administers programs for other agencies including DoHA and DVA. The following moderate audit findings relate to these relationships.

Calculation of Outstanding Claims Liability for the Pharmaceutical Benefits Scheme

5.300 Medicare Australia has developed a statistical model to estimate the Pharmaceutical Benefits Scheme (PBS) outstanding claims provision at the end of each month. This model had not been reviewed or updated to reflect changes in claiming behaviour resulting from the introduction of weekly settlements for on-line claimers under the PBS. As a result, a significant adjustment was required to the figures reported to DoHA for inclusion in the department's administered financial statements for 2006–07.

5.301 Medicare Australia has undertaken a number of activities to resolve this finding, including an analysis of the impact of the PBS on-line claims history data, updating the methodology and commencing system development to support required data extraction. Once the data extraction sets are completed, the outstanding claims model for PBS claims will be finalised and available for review by the ANAO.

Calculation of expenditure leakage

5.302 In 2004–05, the Australian Bureau of Statistics (ABS) reviewed the methodology used to estimate PBS and Medicare expenditure leakages. The ANAO reviewed the application of the methodology during the 2006–07 audit and identified that the PBS and Medicare compliance teams were not strictly applying the methodology, potentially impacting the statistical validity of the leakage estimates.

5.303 Medicare Australia indicated that remediation activity had been completed. The ABS provided updated advice on the methodology and Medicare Australia has assessed the impact of the ABS advice and the changes required to the process for determining the 2007–08 leakage estimate. The ANAO will review this matter during the 2007–08 final audit.

Conclusion

5.304 The ANAO found that the majority of Medicare Australia's key internal controls were operating satisfactorily. Our interim audit identified no additional moderate control issues that require management attention.

Immigration and Citizenship Portfolio

Department of Immigration and Citizenship

Business operations

5.305 The Department of Immigration and Citizenship (DIAC) is responsible for enriching Australia through the well managed entry and settlement of people. DIAC's business is managing the permanent and temporary entry of people into Australia, enforcing immigration law, successfully settling migrants and refugees and promoting the benefits of citizenship and cultural diversity.

5.306 DIAC's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	1 411	671
Total expenses	1 411	296
Total assets	1 172	21
Total liabilities	355	37

DIAC's estimated average staffing level for 2007–08 is 7401.

Understanding the environment

5.307 As part of DIAC's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are DIAC's corporate governance arrangements and financial reporting framework.

Corporate governance

5.308 Significant organisational change in DIAC over recent years continues to result in initiatives that strengthen the corporate governance arrangements. The key elements of DIAC's corporate governance that contribute to good governance and financial management accountability by DIAC include:

- an executive committee, which assists the Secretary in setting corporate priorities, prioritisation of funding and determining the standards by which success in achieving its priorities are measured;

- a corporate leadership group which focuses on key strategic topics and the communication of key messages;
- governance committees with oversight of particular risk areas in DIAC, including fraud, integrity and security, people management, systems, performance management, and values and standards;
- an audit committee that meets at least quarterly, focusing on risk management and internal controls, in particular, over financial systems, accounting processes, audit planning and reporting; and
- a governance and assurance branch to oversee and strengthen the audit program and promote better governance practices throughout DIAC.

Financial reporting framework

5.309 DIAC has a monthly financial reporting process that provides reports to the divisions and the executive for review and analysis. The reports include a summary of the key financial issues to be considered by management, actual versus budgeted departmental revenue and expenditure by division, projected operating results, expenditure against capital budgets and a cash impact statement.

5.310 In 2007–08, the Department of Finance and Deregulation undertook a financial health review that examined the department's funding bases, its approach to financial management, funding pressure points and the funding model. The report and any recommendations will be reviewed by the ANAO during the final phase of the 2007–08 financial statement audit.

Identifying financial reporting risks

5.311 The ANAO's understanding of DIAC and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.312 The ANAO has assessed the risk of material misstatement in the 2007–08 DIAC financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- decentralised processing of visa revenue, in Australia and overseas locations, supported by multiple systems and involving other Australian Government agencies;

- the scope and complexity of the department's change program to complete the reforms arising from the findings and recommendations of the Palmer and Comrie Reports;
- significant changes in the IT environment as a result of the System for People program and support for existing core IT systems including electronic visas, border entry systems, and the Integrated Client System Environment; and;
- an increase in the number and complexity of contractual and procurement arrangements.

Audit results

5.313 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	1	1
B	6	(1)	1	6	(2)	7	11
Total	**6**	**(1)**	**1**	**6**	**(2)**	**8**	**12**

5.314 The 2007–08 interim audit identified one new significant risk issue and seven moderate risk issues. In addition, four moderate risk prior year matters remain unresolved, or partially resolved. DIAC continues to make significant progress on remediating three of these issues relating to Business Continuity Management, validation and reporting of business system transactions and balances, and the offshore visa receipting application, IRIS, and security and processing controls.

5.315 Two moderate risk issues reported in 2006–07 relating to onshore visa business system application security and general IT and application change management, have been resolved by DIAC.

Significant Risk Matters – Category A

SAP Application Management - Security Monitoring

5.316 DIAC's Financial Management Information System (SAP) system was upgraded in September 2007. As a result of weaknesses in project management arrangements, the SAP security and monitoring controls were compromised. Users were granted privileged access without authorisation, there was a failure to effectively manage segregation of duties, audit logging was not enabled between October 2007 and February 2008, and system access was not monitored during this period. In addition the System Security Plan is not current.

5.317 These control weaknesses increase the risk that inappropriate access and unauthorised activity, whether intentional or unintentional, may occur and not be detected by DIAC.

5.318 Discussions were held with DIAC to assess the impact on controls reliance for the preparation of materially correct financial statements. DIAC has responded positively to this issue with an increased program of transaction and data integrity testing over financial transactions within SAP designed to ensure that no inappropriate transactions were posted during the period in question.

Prior Year Moderate Risk Matters—Category B

Business continuity planning

5.319 DIAC has commenced a number of activities to address the development and implementation of Business Continuity Plans (BCPs) and associated Disaster Recovery (DR) arrangements. However, our interim audit identified that BCPs are still to be completed for nine airport sites and the development, implementation, and testing of DR arrangements for SAP, Systems for People and IRIS applications remain outstanding. The absence of current, integrated and tested BCPs and DR arrangements may prevent DIAC from restoring critical business processes and systems within an acceptable timeframe, if there is an interruption to operations.

Validation and Reporting of Business System Transactions and Balances in the FMIS

5.320 During 2007–08, DIAC has allocated significant resources to address weaknesses in the capture and reporting of transactions in business systems and the reporting of these transactions in the FMIS. These weaknesses have resulted in incomplete or invalid transactions being reported in management reports.

5.321 Progress in rectifying this issue will be reviewed by the ANAO during the 2007–08 final audit.

Offshore visa business system security and processing controls

5.322 The ANAO's review of offshore visa business system security and processing controls identified improvements in access management practices. DIAC has implemented planned system changes that have enhanced the overall management of user administration. Outstanding issues remain over the reporting and monitoring of user access and the currency of the IRIS System Security Plan.

Management of the SAP Financial Management Information System

5.323 In 2005–06 the ANAO raised a significant audit finding in relation to the robustness of controls within DIAC's FMIS, and in particular the alignment between DIAC's policies and business needs and the internal controls configured in the FMIS. Although DIAC has developed a number of remediation plans to address the FMIS security environment including system parameters and settings, the development of an overarching framework that assesses and documents DIAC's business needs and policies and the subsequent alignment of these business needs with the FMIS system parameters and settings remains outstanding.

2007–08 Moderate Risk Matters—Category B

Adult Migrant English Quality Assurance

5.324 The ANAO's review of financial controls relating to the Adult Migrant English Program (AMEP) identified weakness in management assurance processes over the validity and accuracy of the information entered by AMEP service providers into DIAC systems. As a result, there is a risk that AMEP service providers are paid for services that have not been provided. DIAC is addressing this risk through the development and implementation of a compliance program to provide additional assurance over the integrity of information provided by AMEP service providers. DIAC has advised that the compliance program is expected to be fully implemented by December 2008.

Credit Card Expenditure Processing

5.325 The ANAO's review of financial controls over DIAC's Australian Government Purchasing Cards and Diners Club cards identified weaknesses in acquittal processes. The weaknesses are primarily associated with service providers' arrangements and the resulting configuration, including the system workflow of SAP, to facilitate the acquittal process. Weaknesses in controls over the management of credit card expenditure increase the risk that inappropriate or fraudulent credit card transactions may occur and remain undetected.

Leave Liabilities Expenses

5.326 The ANAO identified weaknesses in accounting for the transfer of leave liabilities between Australian Government agencies. DIAC's accounting processes appropriately record employee expense and liabilities on the cessation or commencement of employees transferred between Australian Government agencies. However, no monitoring is performed over outstanding payments or receipts in relation to the transferred employees. Consequently, employee expenses or liability may be misstated each reporting period.

Offshore Visa Application Charge Revenue Reconciliations

5.327 DIAC has implemented a number of reconciliations to provide a reasonableness check between visa application data in key business systems and amounts recorded as visa application charge (VAC) revenue in the FMIS. Previous interim audits identified issues relating to the investigation and resolution of revenue variances in these reconciliations. While significant progress has been made in resolving this issue, DIAC continues to experience difficulties as a result of poor systems integration and reporting limitations of the two systems. DIAC has advised that a longer term systems solution is expected to be delivered in 2009–10 as part of a wider revenue service which will be integrated with DIAC's Systems for People project.

FMIS application management – Technical Upgrade

5.328 Over a number of years the ANAO has reported significant operational issues and risks with DIAC's FMIS, in particular issues associated with security, change management, and a misalignment between business and system requirements. DIAC continues to experience major change as a result of the implementation of the 'Systems for People' initiative, including the upgrade of its FMIS to support this initiative. The upgrade resulted in a range of significant management and operational issues.

5.329 In view of the importance of the FMIS in capturing, processing and reporting financial transactions, and the extent of the change program, the ANAO reviewed key controls in the FMIS. The audit included an assessment of specific change management controls and identified the following weaknesses:

- the failure to retain adequate documentation to demonstrate that change management processes had been performed in accordance with existing procedures. For selected change requests, the audit could not evidence that all the required procedures were performed in relation to the analysis of risks, the testing of system changes and approval to move changes from the development environment to the production environment; and

- the failure to maintain documentation to support the testing of change requests.

5.330 The weaknesses identified in the change management processes increase the risk that untested and unauthorised changes are made to computer programs or data, thereby impacting on the availability and integrity of financial information within the system.

5.331 As a result of the significant issues experienced after the upgrade of the FMIS, and the audit findings, DIAC engaged a number of external consultants to review the FMIS management and operating environment. These reviews, and resulting recommendations, are being actively addressed by DIAC.

User Access Management

5.332 A review of IT security controls identified a number of weaknesses in user access management over the eVisa application and the Local Area Network (LAN) including:

- the granting of access to eVisa that was inconsistent with the requirements of the eVisa System Security Plan;
- a significant number of terminated employees whose network access had not been deactivated; and
- the failure to retain access request documentation for network administrator accounts.

5.333 These control weaknesses increase the risk of inappropriate access and unauthorised access to these systems.

Management of Desktop Computers

5.334 The ANAO's review of arrangements for the management of DIAC's desktop computers identified weaknesses in the management of users with privileged administrative rights for some computers. These users are granted the right to install and execute non-standard computer programs on approximately 2000 computers. The failure to effectively manage users with privileged administrative rights increases the risk of:

- unauthorised software being installed on computers which may impact on DIAC's IT security environment;
- unauthorised and untested changes being made to computer programs or data; and
- DIAC staff being provided with such rights without a demonstrated business need.

Conclusion

5.335 The ANAO found that the majority of DIAC's key internal controls were operating satisfactorily. Our interim audit has, however, identified a number of control issues that require management attention to reduce the risk of material misstatement in the DIAC's financial statements. DIAC has responded positively to the ANAO's findings and associated recommendations.

Infrastructure, Transport, Regional Development and Local Government Portfolio

Department of Infrastructure, Transport, Regional Development and Local Government

Business operations

5.336 The Department of Infrastructure, Transport, Regional Development and Local Government (Infrastructure) was renamed as a result of the AAO of 3 December 2007. It was formerly named the Department of Transport and Regional Services (DOTARS).

5.337 The department provides a range of infrastructure, transport, regional development and local government services and information to, and in partnership with, government, industry and the broader community. The department has a strong policy development role, together with program administration and service delivery responsibilities; coordinates the planning and delivery of national infrastructure; conducts research, analysis and safety investigations; provides safety information, and provides advice based upon these investigations and performs regulatory functions.

5.338 The MOG changes as a result of the AAO of 3 December 2007, resulted in the administration of the Territories and Natural Disaster Relief Programs transferring to the Attorney–General's Department (AGD) and Infrastructure assuming responsibilities for two new functions, Infrastructure Planning and Coordination and Major Projects Facilitation.

5.339 To assist with the implementation of the MOG changes, interim arrangements were agreed between Infrastructure and AGD. The department continued to process administered and departmental payments and salaries on behalf of AGD for a period of time and these interagency transfers have now been finalised. As a result, the ANAO's audit strategy remained largely the same as for the former DOTARS.

5.340 Infrastructure's estimated key financial figures for the year ending 30 June 2008:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	245	241
Total expenses	246	5 492
Total assets	149	3 100
Total liabilities	54	21

Infrastructure's estimated average staffing level for 2007–08 is 1251.

5.341 As part of Infrastructure's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls and the impact of the MOG changes outlined above. Two of the important factors considered are Infrastructure's corporate governance arrangements and financial reporting framework.

Corporate governance

5.342 The key elements of Infrastructure's corporate governance that contribute to good financial management include:

- an audit committee that meets at least quarterly and focuses attention on internal controls, management of risks, review of financial reports, internal audit planning and results, fraud control, ANAO activities and regulatory compliance;
- an internal audit function that addresses key business and financial risks and aims to assist line areas to meet their key objectives;
- a dedicated governance centre that reports directly to the Secretary and audit committee and is responsible for oversight and monitoring of the application of risk management practices into broader management and business processes including the development of a fraud control plan; and
- an executive management group that meets weekly and takes an active interest in regulatory compliance and the financial operations of the department receiving detailed monthly financial and operational reports for decision making.

Financial reporting framework

5.343 Infrastrucuture has developed a financial reporting framework that includes monthly reports on departmental revenue and expenses and administered expenses. The reports include explanations for variances between actual, budget and forecast figures and provide additional details on specific areas of interest to the executive.

Identifying financial reporting risks

5.344 The ANAO's understanding of the department and its environment, including the impact of the MOG changes, have been considered when determining the risk of material misstatement in the financial statements, and in the design and performance of audit procedures.

5.345 The ANAO has assessed the risk of material misstatement in the Infrastructure's 2007–08 financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the impact of the MOG changes particularly relating to the transfer of the Territories and Natural Disaster programs to AGD;
- grant processing and management given the complexity and range of grant programs managed by the department;
- appropriation management, given the complexity of the department's appropriation movements and disclosures; and
- significant changes being made to business processes and systems.

Audit results

5.346 The following table provides a summary of the status of prior year issues as well as the 2006–07 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	1	1	0	0	1
Total	**1**	**(1)**	**1**	**1**	**0**	**0**	**1**

5.347 The 2007–08 audit has confirmed that the department has not fully resolved the matters raised in the prior year relating to grant management. There were no new significant or moderate audit issues raised by the ANAO as a result of the 2007–08 interim audit.

Moderate Risk Matters—Category B

Management of grants

5.348 During the final phase of the 2006–07 audit, the ANAO identified a moderate control weakness relating to the management of grants. Infrastructure have individual agreements with grant recipients which require the regular provision of financial reports detailing the status of projects and grant expenditure figures (to date and projected). The 2006–07 audit found no quarterly expenditure reports had been received for the supplementary AusLink Roads to Recovery Program, despite this being a requirement of the funding agreement. In other grant programs, the States, Territories and Local Governments had not always provided monthly and quarterly expenditure reports and had frequently submitted reports outside the timeframes specified in grant agreements. The ANAO considered that Infrastructure should manage the respective grant programs in accordance with agreed terms and conditions and in doing so, improve its management of the programs.

5.349 Our 2007–08 interim audit identified instances where expenditure reports were not received and where reports were received outside of the specified timeframes. These weaknesses were noted in a number of programs, in particular the supplementary AusLink Roads to Recovery Program. The department has recently implemented a new on-line business system, AusLink Program Management System (APMS) together with supporting guidance and training material, to make it easier for grant recipients to submit financial reports and to assist in the management of the programs. While the full benefits of this system are still to be realised, the ANAO acknowledges improvements in the administration of the National Projects and AusLink Improving the National Network programs since the introduction of the APMS in December 2007.

5.350 The ANAO's Audit Report No.14 2007–08, *Performance Audit of the Regional Partnerships Programme* identified weaknesses in the department's administration of the Regional Partnerships Program. The ANAO found a high proportion of instances where progress reports were not obtained by the department, or reports were obtained after the due date specified in the respective Funding Agreements. As a result, the department was not well informed about the extent and causes of project delays, which affected its ability to address the risk of projects not being delivered on time and within budget as well as to accurately report on overall program performance. In response to these issues, the department advised that improvements were being made to the departmental procedures for specifying and obtaining progress reports. In addition, a new information technology solution, the Regional eGrant IT system, was developed and implemented to support the ongoing case management of active Funding Agreements. The 2007–08 interim audit found improvements in this area.

5.351 In Audit Report No.18 2007–08, the ANAO referred to the former DOTARS accounting for grants, including the treatment of AusLink Supplementary Grants as prepayments. In the interim phase of the 2007–08 audit, the ANAO reviewed the grant accounting treatment and related grant agreements. After consultation with the Department of Finance and Deregulation it was considered appropriate to continue to account for AusLink Supplementary Grants as prepayments. The absence of an Australian or international accounting standard on grantor accounting has lead to a lack of clarity in relation to the preferred accounting treatment. The ANAO and the Department of Finance and Deregulation have engaged the Australian Accounting Standards Board and the Financial Reporting Council so that accounting for grants from the grantor perspective is addressed in future Australian Accounting Standards. In the interim, the Department of Finance and Deregulation is developing detailed guidance to clarify the requirements for accounting for grant programs by Australian Government agencies.

5.352 The ANAO is reviewing the accounting for appropriations by the department in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.353 The ANAO found that the majority of Infrastructure’s key internal controls were operating satisfactorily. However, issues referred to above in relation to the management of grants require management attention to reduce the risk of material misstatement in the department’s financial statements. The department has responded positively to the ANAO’s findings and associated recommendations, and advised it is addressing these issues.

Innovation, Industry, Science and Research Portfolio

Department of Innovation, Industry, Science and Research

Business operations

5.354 The Department of Innovation, Industry, Science and Research (DIISR) was created as part of the MOG changes that took effect on 3 December 2007. DIISR retained the functions of the abolished Department of Industry, Tourism and Resources (DITR) with the exception of the resources, energy and tourism functions that were transferred to the new Department of Resources, Energy and Tourism. DIISR also assumed responsibility for the science and research functions that were previously the responsibility of the then Department of Education, Science and Training (DEST).

5.355 DIISR's key priority is to encourage the sustainable growth of Australian industries by developing a national innovation system that drives knowledge creation, cutting-edge science and research, international competitiveness and greater productivity. DIISR is committed to developing policies and delivering programs in partnership with industries, other government bodies and other stakeholders, to provide lasting economic benefits ensuring Australia's competitive future.

5.356 DIISR's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	361	568
Total expenses	362	3,095
Total assets	198	2 294
Total liabilities	86	250

DIISR's estimated average staffing level for 2007–08 is 1913.

Understanding the environment

5.357 As part of DIISR's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls and the impact of the MOG changes outlined above. DIISR has initially adopted the governance framework and control environment of the then DITR as the majority of its functions were transferred from that department. DIISR is in the process of further enhancing its corporate governance framework including integrating functions from other agencies.

5.358 Two of the important factors considered in understanding the environment are DIISR's corporate governance arrangements and financial reporting framework.

Corporate governance

5.359 The key elements of DIISR's corporate governance that contribute to good financial management by DIISR include:

- regular meetings of the Secretary and senior managers to discuss key aspects of DIISR activities, including program management;
- establishment of a steering committee to review and implement the MOG changes;
- an audit committee that meets bi-monthly and focuses on the enhancement of the control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information; and
- an internal audit strategy and plan that examines key business and financial risks and aims to assist line areas to meet their key objectives.

5.360 The department's fraud control plan was in the final stages of preparation at the time of audit.

Financial reporting framework

5.361 DIISR has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas and programs. Monthly reports are produced promptly and include explanation of variances from budget or expected outcomes and detail areas that are of special interest to the executive.

Identifying financial reporting risks

5.362 Notwithstanding that DIISR was created as a new agency, it inherited the majority of its functions including systems, control procedures and resources from the then DITR. This has enabled the ANAO to identify and assess the risks of material misstatement of the financial statements and to design and perform the audit procedures, in the main on the basis of business as usual. The transfer of these functions has led to the conduct of additional audit coverage in relation to the integration of the science and research functions transferred from the former DEST.

5.363 The ANAO has assessed the risk of material misstatement in the 2007–08 DIISR's financial statements as moderate. The factors which have contributed to this risk assessment, and on which the financial statement audit is and will be further focused, include:

- complex administered programs that include the Automotive Competitiveness and Investment Scheme, and the Textile Clothing & Footwear Strategic Investment Program;
- complex structures for the management and accounting of the administered capital funding that include the Innovation Investment Fund and the Pre-seed Fund; and
- the impact of the MOG changes on the agency's operations and financial reporting requirements.

5.364 Determining the operational implications of the MOG changes, and then settling the revised staffing and appropriation arrangements with other related agencies, has taken some time in DIISR. The preparation of the 2007–08 financial statements incorporating disclosures relating to the former DITR in accordance with the Finance Minister's Orders, will require a number of logistical and technical issues being addressed in a timely manner by DIISR and the ANAO.

Audit results

5.365 The following table provides a summary of the status of prior year issues, transferred with the functions of DITR, as well as new audit issues raised by the ANAO following the 2007–08 interim audit.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	0	0	1	1	(1)[#]	0	0
Total	**0**	**0**	**1**	**1**	**(1)**	**0**	**0**

[#] includes one issue reclassified from Category B to Category C

5.366 The audit finding relating to the Automotive Competitiveness and Investment Scheme outstanding credit liability raised in the prior year has been downgraded as processes are being implemented to address the risks and control weaknesses identified.

5.367 To date there were no significant or moderate audit issues raised by the ANAO as a result of the 2007–08 interim audit.

5.368 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.369 Based on the audit work performed to date, key internal controls are operating satisfactorily to provide reasonable assurance that DIISR can produce financial statements free of material misstatement.

Prime Minister and Cabinet Portfolio

Department of the Prime Minister and Cabinet

Business operations

5.370 The Department of the Prime Minister and Cabinet (PM&C) is responsible for providing policy advice and administrative support to the Prime Minister and other ministers in the portfolio. This includes advice on economic, industry, social, international, national security, privacy and freedom of information policy and coordinating relevant portfolios and other stakeholders in the policy advising process. PM&C provides a range of support services for government operations, including:

- providing secretariat services to Cabinet and its committees and to the Executive Council;
- monitoring the implementation of Cabinet decisions;
- developing and coordinating the government's legislative program;
- advising on the coordination and promotion of national awards and symbols;
- providing support to official establishments, Ministerial offices, designated and former Governors-General;
- arranging and coordinating government hospitality and official ceremonial occasions; and
- support for Australia's hosting of the Asia-Pacific Economic Cooperation (APEC) meeting of leaders and other associated activities in 2007.

5.371 As a result of the MOG changes of 3 December 2007, PM&C gained the following functions:

- the Office of Work and Family to provide policy coordination and advice on work and family matters;
- the Office of National Security to provide coordinated and integrated whole of government advice on national security policy and strategic implementation oversight;

- the establishment of the Australian Social Inclusion Board and, within the department, a Social Inclusion Unit; and
- functions relating to freedom of information and privacy policy.

5.372 The following activities were transferred from PM&C as a result of the MOG changes:

- the abolition of the Government Communications Unit and the transfer of the aggregate media buying function to the Department of Finance and Deregulation; and
- the transfer of AUSPIC, the government photographic service, to the Department of Finance and Deregulation.

5.373 PM&C's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Budget estimate ($m)	**Administered** Budget estimate ($m)
Total income	155	9
Total expenses	147	11
Total assets	90	45
Total liabilities	28	12

PM&C's estimated average staffing level for 2007–08 is 528.

Understanding the environment

5.374 As part of PM&C's financial statements audit, the ANAO gains an understanding of the agency and its environment, including its internal controls and the impact of the MOG changes outlined above. Two of the important factors considered are PM&C's corporate governance arrangements and financial reporting framework.

Corporate governance

5.375 The key elements of PM&C's corporate governance that contribute to good financial management include:

- a Corporate Leadership Group (CLG) that reviews department wide policy issues which meets fortnightly to oversee the department's operational performance;

- an audit committee that meets quarterly and is focused on the appropriateness of PM&C's accountability and control framework and management of risks;
- an internal audit function that plans and conducts its work based on risk assessments of departmental activities and direction from the audit committee; and
- a fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines.

5.376 In the context of PM&C's total responsibilities, the MOG changes have not significantly impacted on the department's corporate governance arrangements.

Financial reporting framework

5.377 PM&C has a financial reporting framework that highlights performance against budget at the agency and divisional level for both departmental and administered functions. Reporting measures include an explanation of variances, financial projections for the full year and commentary on significant financial issues and recommendations, where appropriate. In addition, non-financial information is also provided to senior management.

Identifying financial reporting risks

5.378 The ANAO's understanding of PM&C and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.379 The ANAO has assessed the risk of material misstatement in the 2007–08 PM&C financial statements as moderate. The factors that have contributed to the risk assessment, and of particular focus of the financial statements audit, include:

- changes as a result of the MOG changes, particularly the financial reporting requirements relating to the additional functions gained by PM&C and the transfer of responsibility for special accounts relating to the whole of government media buying function;
- management and treatment of the 'Services for Other Governments and Non-Agency Bodies' Special Account, with a specific focus on ensuring that appropriate accounts and records have been maintained;

- complexities associated with the valuation of the Prime Minister's residences;
- the complexities associated with the administration, management and reporting requirements for appropriations;
- the financial statement close process, particularly in light of changes in key finance personnel;
- complexities surrounding the accounting for the wind up of the APEC project, particularly relating to asset disposals; and
- accounting for the capitalisation of the 2006–07 building refurbishment project as it moves from a work-in-progress stage to final capitalisation.

Audit results

5.380 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit)	Closing position (at end of 2008 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	1	1
Total	**1**	**(1)**	**0**	**0**	**0**	**1**	**1**

5.381 The 2007–08 audit highlighted the following issue that should be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

Moderate Risk Matters–Category B

5.382 The ANAO noted a number of weaknesses in PM&C's Business Continuity Plan (BCP). At the time of the interim audit, the BCP was in draft and had not been endorsed by management. In addition, the draft BCP did not include a business impact analysis, was not based on a current risk assessment and did not include a defined test strategy to assist in ensuring the operating effectiveness of the BCP.

Conclusion

5.383 The ANAO found that, with the exception of the control issue relating to the department's BCP, PM&C's key internal controls were operating satisfactorily. PM&C has responded positively to the ANAO's finding and associated recommendation.

Department of Climate Change

Business operations

5.384 The Department of Climate Change (DCC) was created by the Administrative Arrangement Order of 3 December 2007. The mission of DCC is to support the Australian Government by leading and co-ordinating the cost effective mitigation of climate change, adaptation to its impacts and to shape global solutions through advice to Government and effective delivery of programs and services to Australia.

5.385 The creation of DCC involved the transfer of functions and staff from the former Department of the Environment and Water Resources, the Department of the Prime Minister and Cabinet and the Department of Foreign Affairs and Trade. In addition, DCC assumed oversight responsibility for the Office of the Renewable Energy Regulator.

5.386 The Department of Climate Change has one outcome:

> The environment, especially those aspects that are matters of national environmental significance, is protected and conserved.

5.387 The activities which are performed to achieve their outcome are:

- the development and co-ordination of domestic and international climate change policy;
- design and the implementation of emissions trading;
- reporting of the greenhouse emissions energy consumption;
- responsibility in the mandating, regulation and co-ordination of renewable energy target policy;
- the co-ordination and adaption of climate change strategy and science activities; and
- undertake negotiations on international climate change.

5.388 DCC's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	29	0
Total expenses	29	19
Total assets	18	0
Total liabilities	3	0

DCC's estimated average staffing level for 2007–08 is 110.

Understanding the environment

5.389 As a new agency, DCC has been required, among other things, to: develop and implement all the elements of an effective governance framework to meet its legal, policy and administrative responsibilities; negotiate funding arrangements; recruit additional staff; make arrangements for corporate support including the payment of salaries and its suppliers and locate and occupy suitable accommodation for its workforce.

5.390 Some of these matters have taken some time to finalise and at the time of preparation of this report, DCC was in the process of finalising its audit committee arrangements, developing its risk management framework and drafting its fraud control plan. As an interim measure, the Department of the Environment, Water, Heritage and the Arts was providing a range of corporate support activities to DCC. The department has relocated its employees into new premises.

5.391 In view of this situation, the ANAO has delayed finalising its audit approach and the commencement of its 2007–08 interim audit. As a result, the required audit coverage will need to be undertaken in a compressed timeframe.

Audit results

5.392 As noted above, the commencement of the 2007–08 interim audit has been delayed and preliminary planning work has been undertaken at the time of preparing this report.

5.393 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.394 DCC's governance and financial reporting framework are progressively being developed and implemented. Audit results for the 2007–08 financial statement audit will be reported in the ANAO's year end report to the Parliament.

Resources, Energy and Tourism Portfolio

Department of Resources, Energy and Tourism

Business operations

5.395 The Department of Resources, Energy and Tourism (RET) was created as part of the MOG changes that took effect on 3 December 2007. The department received the resources, energy and tourism functions of the abolished Department of Industry, Tourism and Resources (DITR) as well as assuming responsibility for some functions from the then Department of Education, Science and Training and the Department of Environment and Water Resources.

5.396 The department is the key advisor to the government on policy options for Australia's resources, energy and tourism industries and liaises closely with the private sector, including major corporations and business associations. The department is responsible for policy development and program delivery by working with all its major stakeholders. To work effectively on issues relating to these industries and maintain relationships with stakeholders, staff work closely with all tiers of government, non-government organisations, business and the Australian public.

5.397 The department's estimated key financial figures for the period 3 December 2007 to 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	42	764
Total expenses	42	640
Total assets	11	353
Total liabilities	11	46

RET's estimated average staffing level for 2007–08 is 310.

Understanding the environment

5.398 As part of the financial statement audit, the ANAO gains an understanding of the department and its environment, including its internal controls.

5.399 With the inheritance of the resource, energy and tourism functions from the then DITR, RET received the staff directly assigned to the management of these functions. However, the department did not receive any staff to provide administrative support to these operational functions. As an interim measure, RET entered into an arrangement for the Department of Innovation, Industry, Science and Research (DIISR) to provide administrative support, including processing payments and providing information for management reporting purposes.

5.400 As a result of a sustained recruitment process, the department has now established its resource base to provide the administrative support for the functions transferred from other agencies.

5.401 As a new agency, there has also been a need to develop governance and reporting frameworks as soon as practicable. In the interim, RET has adopted the control framework from the then DITR, as the majority of its functions have been transferred from DITR.

Corporate governance

5.402 Significant efforts have been made to establish appropriate governance and reporting frameworks. However, some of these frameworks are still under development.

5.403 It is evident from the efforts to date that the department is implementing governance frameworks with reference to sound practice. At the time of audit, the department had established some elements of its corporate governance arrangements such as:

- regular meetings of the Secetary and senior managers to discuss key departmental activities;
- formation of an Audit Committee, with both internal and independent members, including the development of a charter; and
- appointment of a Chief Internal Auditor and the development of an internal audit charter.

Financial reporting framework

5.404 The department has, and is further developing, a financial reporting framework that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas and programs.

Identifying financial reporting risks

5.405 Based on the current corporate governance structure, operations, systems and controls, the ANAO has made a preliminary assessment of the risk of material misstatement in the department's 2007–08 financial statements as moderate. RET has gained a number of well established functions from the then DITR. The processing of the related transactions and management of the functions have not been affected by the MOG changes. The MOG changes have not had a significant impact on the audit approach. The factors which have contributed to our risk assessment, and on which the financial statement audit will particularly be focused, include:

- its reliance on DIISR for the day-to-day processing, recording of financial transactions and maintainance of the human resource and financial management information systems; and
- the impact of the MOG changes on the agency's operations and financial reporting requirements.

Audit results

5.406 As a result of the audit coverage undertaken to date no audit issues of a significant or moderate rating had been raised by the ANAO.

5.407 The ANAO is also reviewing the accounting for appropriations in the periods following the AAOs of 3 December 2007 and 25 January 2008. This issue will be finalised during the 2007–08 final audit.

Conclusion

5.408 At the date of this report, the 2007–08 interim audit was still in progress. However, based on the work performed to date, our audit found that key internal controls are operating satisfactorily to provide reasonable assurance that the department can produce financial statements free of material misstatement.

Treasury Portfolio

Department of the Treasury

Business operations

5.409 The Department of the Treasury (the Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury seeks to promote a sound macroeconomic environment; effective government spending arrangements; effective taxation and retirement income arrangements; and well functioning markets, by providing sound and timely advice to the Australian Government and assisting Treasury Ministers in the administration of their responsibilities and the implementation of Government decisions.

5.410 The Treasury's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Budget estimate ($m)	**Administered** Budget estimate ($m)
Total income	162	1 925
Total expenses	155	42 964
Total assets	92	16 307
Total liabilities	42	4 445

The Treasury's estimated average staffing level for 2007–08 is 920.

Understanding the environment

5.411 As part of the Treasury's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are the Treasury's corporate governance arrangements and financial reporting framework.

Corporate governance

5.412 The key elements of Treasury's corporate governance that contribute to good financial management include:

- an executive board that meets twice a month and is responsible for high level policy issues relating to the Treasury's strategic leadership and management;

- a committee framework including an audit committee. The audit committee meets at least six times a year and focuses attention on corporate governance, internal audit, external audit, fraud and risks faced by the Treasury;
- an internal assurance function that has a planned risk based coverage of the Department's activities; and
- a periodic fraud risk assessment is undertaken in line with the Commonwealth Fraud Control Guidelines.

Financial reporting framework

5.413 The Treasury has comprehensive and detailed monthly reporting processes, which are prepared and distributed within two weeks of month end. This report is provided to the executive board and outlines the departmental and administered financial position and performance by area or group, a capital management report, a variance review of the Treasury's departmental results against the year to date budget, and a quality assurance report.

Identifying financial reporting risks

5.414 The ANAO's understanding of the Treasury and its environment enabled the risks of material misstatement of the financial statements to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.415 The ANAO has assessed the risk of material misstatement in the Treasury's 2007–08 financial statements as moderate. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- the impact of fluctuations in the valuation of international related assets and liabilities;
- the processing and payment of GST grants to State and Territory Governments;
- changes to reporting requirements, particularly the first time application of AASB 7 *Financial Instruments: Disclosures*; and
- the administration and management of appropriations and special accounts.

Audit results

5.416 There were no audit issues of a significant or moderate rating raised by the ANAO in the current or prior year.

Conclusion

5.417 Based on audit work performed to date, internal controls are operating satisfactorily to provide reasonable assurance that the Treasury can produce financial statements free of material misstatement.

Australian Office of Financial Management

Business operations

5.418 The Australian Office of Financial Management (AOFM) is responsible for the management of the Australian Government's debt and financial assets entrusted to it. The AOFM aims to manage its net debt portfolio at least cost over the medium term, subject to an acceptable level of risk. It also contributes to the operation of financial markets by supporting efficient Treasury Bond and Treasury Bond futures markets. These markets allow participants to better manage their interest rate risks and to contribute to a lower cost of capital in Australia.

5.419 In carrying out its mission, the AOFM is responsible for one outcome:

> To enhance the Commonwealth's capacity to manage its net debt portfolio, offering the prospect of savings in debt servicing costs and an improvement in the net worth of the Commonwealth over time.

5.420 The AOFM's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	Departmental Estimated actual ($m)	Administered Estimated actual ($m)
Total income	9	2 961
Total expenses	8	5 343
Total assets	14	26 333
Total liabilities	2	59 223

AOFM's estimated average staffing level for 2007–08 is 33.

Understanding the environment

5.421 As part of the AOFM's financial statements audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered were AOFM's corporate governance arrangements and financial reporting framework.

Corporate governance

5.422 The key elements of the AOFM's corporate governance that contribute to good financial management by the AOFM include:

- an advisory board accountable to the Secretary to the Treasury that provides general counsel and guidance on all aspects of operational debt policy matters and the performance of the AOFM generally. The Board consists of executive and non-executive members;
- a liability management committee whose primary responsibility is to proactively monitor and assess the financial risks associated with the Commonwealth's portfolio of securities, derivatives and financial assets;
- an executive committee with responsibility for the oversight of the operational control environment;
- an audit committee that focuses attention on internal audit, external audit, fraud controls and the statutory financial statements;
- an operational risk committee whose role is to monitor the adequacy of internal controls, the prevention of fraud and the identification of operational risks;
- an internal assurance function that has a planned risk based coverage of the AOFM's activities; and
- a fraud control plan that is regularly monitored and reviewed.

Financial reporting framework

5.423 The AOFM has a comprehensive monthly financial reporting process. Full accrual monthly reports are prepared that include actual versus budgeted departmental revenue and expenditure results, variance analysis and commentary. In addition, detailed monthly reporting is undertaken to evaluate the financial results of the administered functions. These evaluations include review of the investment portfolio, interest cost projections, liquidity and cash management, long-term debt portfolio and credit risks.

Identifying financial reporting risks

5.424 The ANAO's understanding of AOFM and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.425 The ANAO has assessed the risk of material misstatement in the 2007–08 AOFM financial statements as moderate. The main factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused is the complexity of the reporting requirements for Financial Instruments.

Audit results

5.426 There were no audit issues of a significant or moderate rating raised by the ANAO in 2007–08, or in 2006–07.

Conclusion

5.427 Based on audit work performed to date, internal controls are operating satisfactorily to provide reasonable assurance that the AOFM can produce financial statements free of material misstatement.

Australian Taxation Office

Business operations

5.428 The Australian Taxation Office (ATO) is the Australian Government's principal revenue management agency. In 2007–08, the ATO is expected to collect 90.3 per cent of the Australian Government's revenue on behalf of the Australian community.

5.429 The ATO business operations include:

- management of Australia's taxation, excise and superannuation systems that fund services for Australians, giving effect to social and economic policy;
- addressing broader issues affecting Australia's revenue system, such as aggressive tax planning, persistent tax debtors, globalisation and the cash economy;
- supporting delivery of community benefits, with roles in other services, including private health insurance, family assistance, fuel grants and benefit schemes;

- cross agency support, such as working with Centrelink to reduce benefit fraud, with the Child Support Agency to ensure income transfer for the care of children, and with the Australian Bureau of Statistics to reduce the cost to the community of collecting statistical data; and
- overseeing the Australian Valuation Office.

5.430 In addition to optimising revenue collections and making payments under the law, the ATO's priorities for 2007–08 are:

- making compliance easier through the implementation of technological improvements through the Easier, Cheaper and More Personalised Program;
- reducing taxation debt and outstanding superannuation guarantee charge payments;
- expanding pre-filling of tax returns for individuals to include details of salaries, wages and allowances, dividend and interest income and payment of entitlements from Australian Government departments and agencies;
- implementing legislative changes, including superannuation simplification;
- reviewing taxation implications of increasing international transactions;
- providing further assistance and support to small business; and
- expanding current initiatives for compliance of high wealth individuals.

5.431 The ATO's estimated key financial figures for the year ending 30 June 2008 are:

Key financial figures for 2007–08	**Departmental** Estimated actual ($m)	**Administered** Estimated actual ($m)
Total income	2 873	278 330
Total expenses	2 932	13 564
Total assets	850	24 738
Total liabilities	814	6 639

ATO's estimated average staffing level for 2007–08 is 21 876.

Understanding the environment

5.432 As part of the ATO's financial statement audit, the ANAO gains an understanding of the agency and its environment, including its internal controls. Two of the important factors considered are the ATO's corporate governance arrangements and financial reporting framework.

Corporate governance

5.433 The ANAO's audit approach considers ATO's corporate governance structure. The key elements that contribute to good financial management by the ATO include:

- a strategic statement and plan that provide an overview of the ATO's directions for the future, including corporate outcomes and performance measures. The ATO implements strategies through a comprehensive planning process based on the ATO's corporate priorities;
- an executive board that meets at least monthly and has a formal bi-annual corporate governance assurance process;
- a governance committee framework, including an audit committee. The audit committee meets at least quarterly and focuses attention on risk assessment, fraud control and internal and external audit activities;
- an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;
- a Financial Assurance Branch that assists the Commissioner of Taxation and the Chief Finance Officer in providing a number of internal and external assurances around financial integrity including the effectiveness of internal controls that impact on the financial statements and the Commissioner's annual Certificate of Compliance;
- a structured framework for incorporating risk management into the broader management and business processes including the development of fraud control plans for each of the business service lines; and
- an internal Certificate of Assurance process that aims to better align ATO's changing priorities and business practices and provides assurance on the integrity of revenue management activities.

Financial reporting framework

5.434 The ATO has a financial reporting framework in place that incorporates key financial and non-financial measures to monitor the performance and financial management of key business areas. The ATO management reporting process includes internal financial reports prepared for distribution and discussion at monthly executive meetings. These reports include overall analysis of expenditure, operating performance of business lines, cash and capital positions, budget changes, and workforce information.

5.435 For administered items, a formal report is prepared for the executive meetings at the end of each month analysing the status of various revenue and expense items. The report focuses on cash collection and analysis of actual collection for the month against expectation.

Identifying financial reporting risks

5.436 The ANAO's understanding of the ATO and its environment enabled the risks of material misstatement of the financial report to be identified and assessed, and for appropriate audit procedures to be designed and performed.

5.437 The ANAO has assessed the risk of material misstatement in the 2007–08 ATO financial statements as high. The factors that have contributed to this risk assessment, and on which the financial statement audit is particularly focused, include:

- self-assessment by taxpayers in the collection and reporting of taxation revenues;
- the complexity and scale of the IT environment, including the implementation of new business systems;
- ATO's administered financial statements preparation process which is complex, uses data from a number of business systems and requires significant estimation to be made in calculating the balance of a number of financial statement items; and
- complexities associated with the administration of changing legislative requirements.

Audit results

5.438 The following table provides a summary of the status of prior year issues as well as the 2007–08 audit issues raised by the ANAO.

Status of audit issues raised by the ANAO

Category	Findings outstanding (at end of 2007 interim audit)	Findings resolved (as part of 2007 final audit)	New findings (during 2007 final audit)	Findings outstanding (at end of 2007 final audit)	Findings resolved (as part of 2008 interim audit)	New findings (during 2008 interim audit	Closing position (at end of 2008 interim audit)
A	2	(1)	0	1	(0)	0	1
B	7	(4)*	3	6	(3)#	1^	4
Total	**9**	**(5)**	**3**	**7**	**(3)**	**1**	**5**

* includes three issues reclassified from Category B to Category C

includes one issue reclassified from Category B to Category C

^ includes one issue reclassified from Category C to Category B

5.439 The 2007–08 audit highlighted the following issues that should be addressed to support the adequacy of internal controls and the reliability of information reported in the financial statements.

Significant Risk Matters—Category A

Security Classification

5.440 During the 2006–07 financial statement audit, the ANAO identified non-compliance with the *Australian Government Protective Security Manual* (PSM). During the 2007–08 interim audit, the ANAO has continued to observe instances where the ATO was not complying with its IT security policy and the requirements of the PSM with respect to the classification and storage of protected information. Weaknesses in the application of security classifications increase the risk that persons without the appropriate clearance or access rights may have access to information and/or information may be inappropriately distributed.

5.441 The PSM allows agency heads to waive requirements for a defined purpose until an agreed review date. The ATO has advised that the Commissioner of Taxation has issued a waiver against certain minimum standards of the PSM and the *Australian Government Information and Communications Technology Security Manual* (ACSI 33).

5.442 Progress is being made to address these security issues with several projects relating to security classifications in progress at the time of audit. In addition, an external review of information security has been completed and electronic scanning of outgoing emails is occurring. However, until these initiatives are completed, including the implementation of agreed recommendations of the external review, risks with respect to the classification and storage of protected information remain.

Moderate Risk Matters—Category B

Administered cash on hand

5.443 During the 2006–07 audit, the ANAO also noted shortcomings in the ATO's recognition of the Administered cash-on-hand at balance date. The variance resulted from a change in the ATO's methodology for recognising transactions recorded on or after 1 July 2007. The ANAO recommended the ATO revert to the methodology used in prior years for reporting cash on hand as at 30 June, to reduce the risk of financial information being misstated. The ATO's progress in resolving this issue will be reviewed during the final phase of 2007–08 financial statement audit.

IT security management

5.444 The ANAO has previously reported weaknesses in the coverage by the ATO's IT security policy of the management of IT security incidents, requirements for testing third party software, reviews of physical access to data centres, password settings and adequacy of internal compliance reviews. The ANAO's 2007–08 interim audit confirmed that, although the ATO had made substantial progress on resolving this issue, an updated IT security policy is yet to be endorsed or implemented. Lack of a comprehensive IT security policy and IT security processes increases the risk that critical security procedures are not implemented and ineffective responses to IT security incidents occurs.

Arrangements with other Australian Government agencies

5.445 The ATO has a number of agreements with other government agencies for the provision and receipt of services. The ANAO has previously raised concerns about the existence or adequacy of these agreements. During the 2007–08 interim audit, the ANAO observed that a framework for establishing agreements and reviewing existing agreements has been formulated and is being implemented. However, the ANAO identified that some agreements had expired and the ATO were still in the process of renegotiating them. The absence of up to date agreements increases the risk that the ATO may be receiving poor quality services, and may compromise the parties' accountabilities.

Process for estimation and subsequent validation of the provisions for non-scheme doubtful debts

5.446 As part of the financial statement preparation process the ATO calculates a provision for doubtful debts. In the 2006–07 financial statements, the ATO provided $4.5 billion for non-scheme doubtful debts less than $1 million. ATO's debt is classified as either scheme or non scheme. Scheme debts arise due to taxpayers' participation in schemes which are subsequently judged to be invalid mechanisms for reducing taxes. The schemes may be mass-marketed or boutique arrangements which are offered to a selected group of high wealth individuals. Non-scheme debts are all other debts. The ATO applies a methodology for the calculation of the provision for non-scheme doubtful debt less than $1 million which is based on assumptions made in consultation with the Australian Government Actuary (AGA). The methodology requires the assumptions to be subsequently validated against actual amounts collected. The timely completion of the validation process is critical to the continuing appropriateness of the methodology.

5.447 The ANAO noted that the validation process was still in progress and may not be completed and reviewed by the AGA prior to finalisation of the 2007–08 financial statements. In the absence of the completion of the validation process, the ATO will be required to undertake an alternative approach to providing assurance that the provision for doubtful debts is materially correct.

Conclusion

5.448 The ANAO found that the majority of the ATO's key internal controls were operating satisfactorily. Our interim audit identified a number of control issues that require management attention to reduce the risk of material misstatement in the ATO's financial statements. The ATO has responded positively to the ANAO's findings and associated recommendations.

Ian McPhee | Canberra ACT
Auditor-General | 25 June 2008

Appendices

Appendix 1: Agencies covered by this report[47]

Department of Agriculture, Fisheries and Forestry

Attorney–General's Department

Australian Customs Service

Department of Broadband, Communications and the Digital Economy

Department of Defence

Defence Materiel Organisation

Department of Veterans' Affairs

Department of Education, Employment and Workplace Relations

Department of the Environment, Water, Heritage and the Arts

Department of Families, Housing, Community Services and Indigenous Affairs

Department of Finance and Deregulation

The Board of Guardians and the Future Fund Management Agency

Department of Foreign Affairs and Trade

Department of Health and Ageing

Department of Human Services

Centrelink

Medicare

Department of Immigration and Citizenship

Department of Infrastructure, Transport, Regional Development and Local Government

Department of Innovation, Industry, Science and Research

Department of the Prime Minister and Cabinet

Department of Climate Change

Department of Resources, Energy and Tourism

Department of the Treasury

Australian Office of Financial Management

Australian Taxation Office

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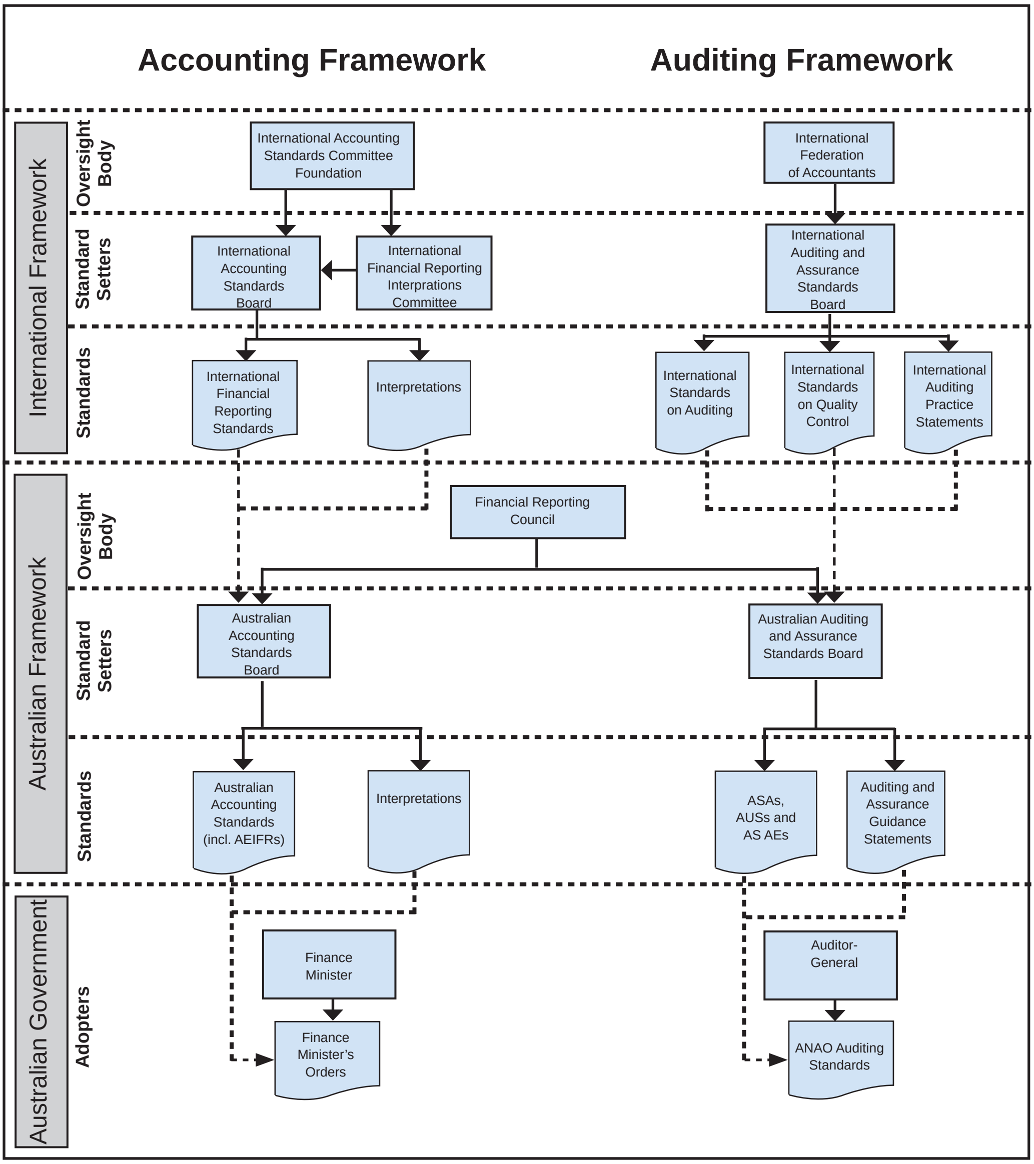
47 Agencies are grouped by portfolio.

Appendix 2: The Accounting and Auditing Standards Frameworks

The figure below depicts the standard setting framework, for accounting and auditing, in the Australian Government context.

Figure A 1

Standard Setting Framework

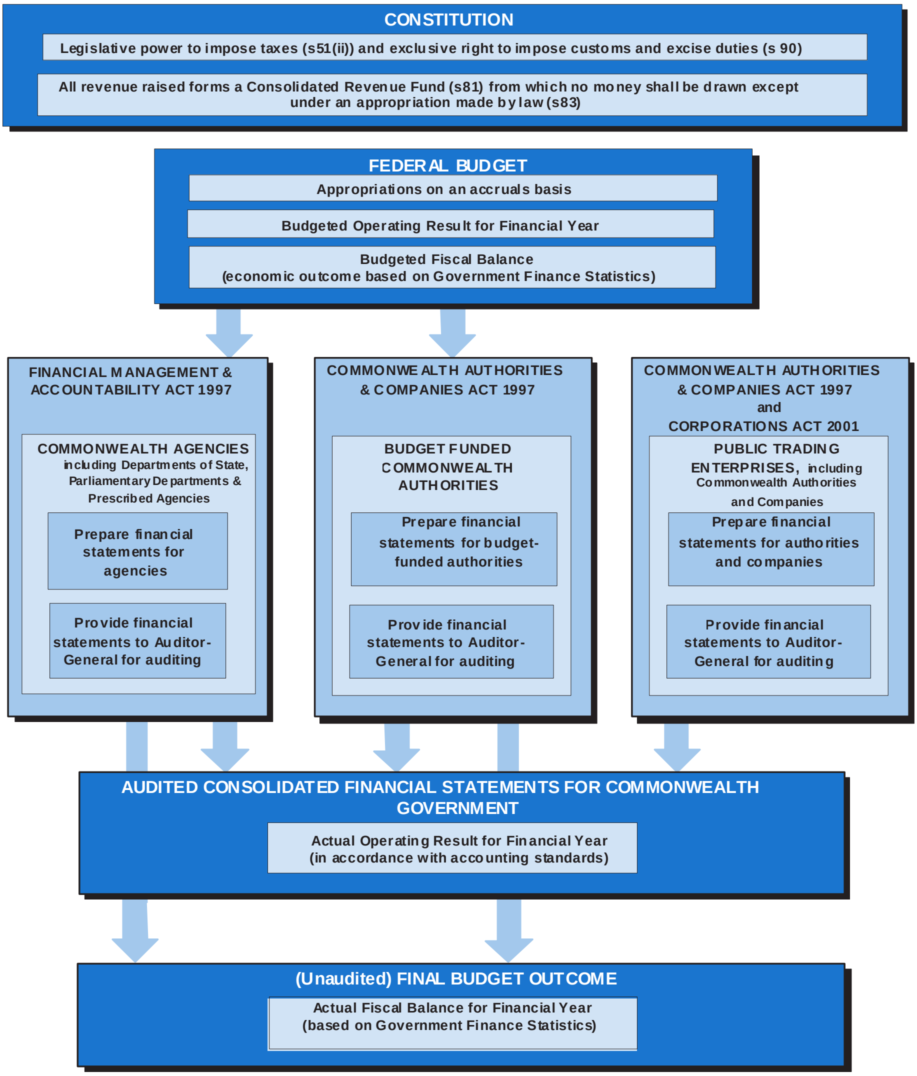


Appendix 3: The Financial Reporting Framework

Key elements of the Australian Government's financial reporting framework is outlined in the diagram below. Then follows an overview of the financial reporting requirements for the various types of Australian Government entities covered by the framework. Finally, the audit of the financial statements of these entities is briefly described.

Figure A 2

Key Elements of the Financial Reporting Framework



Source: ANAO

Australian Government Reporting Entities

Commonwealth Government of Australia

Section 55 of the FMA Act requires the Finance Minister to prepare annual financial statements for the Commonwealth Government of Australia. These financial statements are a general purpose financial report consolidating the financial activities and financial position of all agencies, authorities and other entities controlled by the Commonwealth Government.

Australian Government agencies

Australian Government agencies are subject to the provisions of FMA Act. They comprise departments of state, parliamentary departments and prescribed agencies.

The FMA Act requires agency Chief Executives to prepare financial statements for their agencies in accordance with FMOs. The FMOs include a requirement that the statements comply with accounting standards issued by the Australian Accounting Standards Board.

Australian Government authorities and subsidiaries

Australian Government authorities are bodies corporate that hold money on their own account and have been created by the Parliament to perform specific functions. Authorities operate under their own enabling legislation and also must comply with relevant provisions of the CAC Act.

The CAC Act requires the governing bodies of authorities to prepare financial statements in accordance with the FMOs. Directors must also ensure that subsidiaries prepare financial statements in accordance with the *Corporations Act 2001* (where applicable) and the CAC Act.

Australian Government companies and subsidiaries

Australian Government companies are companies in which the Australian Government has a controlling interest. Australian Government companies operate and prepare financial statements under the *Corporations Act 2001* and relevant provisions of the CAC Act.

Directors of an Australian Government company must ensure subsidiaries of the company prepare financial statements in accordance with the *Corporations Act 2001* and the CAC Act.

Other bodies

The ANAO also audits the financial statements of other bodies controlled by the Australian Government or where the Australian Government has significant influence. These consist primarily of trusts or joint ventures entered into by Australian Government controlled bodies.

Audit of the financial statements of Australian Government entities

Audit scope

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the truth and fairness of the financial statements and for the records, controls, procedures and organisation that support the preparation of those statements.

The ANAO conducts independent audits of these financial statements to form an opinion whether, in all material respects, the statements are true and fair. The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards (ASAs). The objective of an audit of an entity's financial statements is to form an opinion on whether the financial statements, in all material respects is in accordance with the Australian Government financial reporting framework.

Audit procedures include examination of an entity's records and its control environment, risk assessment processes, information systems, control activities and statutory disclosure requirements. Evidence supporting the amounts and other information in the statements is examined on a test basis, and accounting policies and significant accounting estimates are evaluated.

While entity control structures are evaluated as an integral part of the audit process, only those systems and controls, on which it is intended to place reliance for the purpose of determining audit procedures leading to audit opinions on the financial statements, are evaluated in detail. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include a detailed testing of systems and internal controls.

The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. An audit conducted in accordance with ASAs is designed to provide reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error.

The auditor's report on financial statements

The auditor's report on the financial statements includes a statement of the auditor's opinion as to whether the statements give a true and fair view of the entity's financial position, the results of its financial operations and its cash flows in accordance with Australian Accounting Standards and other statutory requirements, including the Finance Ministers Orders (FMOs).

If the auditor is not satisfied the financial statements are true and fair, the audit opinion is qualified, with the reasons being indicated. Audit reports may be qualified because of a disagreement between the auditor and management of the entity on the application of accounting standards or other reporting requirements, because the scope of the audit work needed to form an opinion has been limited in some way, or if there is a conflict between the requirements of the Accounting Standards and the FMOs.

An audit report may contain an 'emphasis of matter' to draw attention to a matter that is relevant to the readers of the financial statements. An 'emphasis of matter' does not qualify the audit opinion being given. In many cases, an 'emphasis of matter' relates to inherent uncertainty about an aspect of the financial statements, where the outcome is contingent upon future events, and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

The auditor's report may also report on 'other matters'. For example, Section 57 of the FMA Act requires that, in reporting to Ministers on the financial statements of agencies, the Auditor-General must report particulars where, in the Auditor-General's opinion, there has been a contravention of the requirement in section 48 of the FMA Act for agencies to keep proper accounts and records.

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