

The Auditor-General  
Audit Report No.54 2010–11  
Financial Statement Audit

**Interim Phase of the Audit of Financial  
Statements of Major General Government  
Sector Agencies for the year ending  
30 June 2011**

Australian National Audit Office

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Canberra ACT  
23 June 2011

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations of the accounts and records of major General Government Sector agencies as part of the audits of their 2010–11 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 Major General Government Sector Agencies for the year ending 30 June 2011*.

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

Yours sincerely

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

Ian McPhee  
Auditor-General

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

## AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office (ANAO). 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 Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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# Abbreviations and Acronyms

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AAO	Administrative Arrangements Order
AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
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	Australian Auditing and Assurance Standards Board
BCM	Business Continuity Management
BCP	Business Continuity Plan
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CEIs	Chief Executive's Instructions
CE	Chief Executive
CFO	Chief Finance Officer
CSA	Child Support Agency
Customs and Border Protection	Australian Customs and Border Protection Service
DAFF	Department of Agriculture, Fisheries and Forestry

DBCDE	Department of Broadband, Communications and the Digital Economy
DCCEE	Department of Climate Change and Energy Efficiency
Defence	Department of Defence
DEEWR	Department of Education, Employment and Workplace Relations
DEWHA	Department of Environment, Water, Heritage and the Arts
DFAT	Department of Foreign Affairs and Trade
DHS	Department of Human Services
DIAC	Department of Immigration and Citizenship
DIISR	Department of Innovation, Industry, Science and Research
DMO	Defence Materiel Organisation
DoHA	Department of Health and Ageing
DRARDLG	Department of Regional Australia, Regional Development and Local Government
DSEWPaC	Department of Sustainability, Environment, Water, Population and Communities
DVA	Department of Veterans' Affairs
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
Finance	Department of Finance and Deregulation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMIS	Financial Management Information System
FMOs	Finance Minister's Orders
GFS	Government Finance Statistics
GGs	General Government Sector

HRMIS	Human Resources Management Information System
Infrastructure	Department of Infrastructure and Transport
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	Department of the Treasury



# Summary

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## Introduction

1. The *Auditor-General Act 1997* establishes the mandate for the Auditor-General to undertake financial statement audits of all Australian Government entities including those of government agencies, statutory authorities and government business enterprises.

2. The preparation of audited financial statements in compliance with the Finance Minister's Orders<sup>1</sup> is a key element of the financial management and accountability regime applicable to Australian Government entities. It is generally accepted in both the private and public sectors that a good indicator of the effectiveness of an entity's financial management is the timely finalisation of its annual financial statements, accompanied by an unmodified audit opinion. Australian Government entities, in cooperation with the Australian National Audit Office (ANAO), devote considerable effort to achieving such an outcome.

3. Financial statement audits are an independent examination of the financial accounting and reporting of public sector entities. The results of the examination are presented in an auditor's report, which expresses the auditor's opinion on whether the financial statements as a whole and the information contained therein fairly present each entity's financial position and the results of its operations and cash flows. The accounting treatments and disclosures reflected in the financial statements by the entity are assessed against relevant accounting standards and legislative reporting requirements.

4. Under section 57 of the *Financial Management and Accountability Act 1997* (FMA Act) the Auditor-General is required to report each year to the relevant Minister, on whether the financial statements of agencies 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.

5. To assist agencies to manage their responsibilities, the ANAO periodically publishes better practice guides on a range of aspects of public

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<sup>1</sup> The Finance Minister's Orders (FMOs) made by the Minister for Finance and Deregulation set out the requirements for the preparation of financial statements of all reporting entities covered by the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

administration. During 2010–11, the ANAO published two Better Practice Guides, *Strategic and Operational Management of Assets by Public Sector Entities* and *Fraud Control in Australian Government Entities*. An updated guide on *Public Sector Audit Committees* is due to be released in the near future. Better Practice Guides are well received by agencies and contribute to agencies maintaining the maturity of their internal control systems.

6. 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. The ANAO's examination of these areas is designed to assess the reliance that can be placed on agencies' internal controls to produce complete and accurate information for financial reporting purposes.

7. The audit findings in this report have been reported to the management of each entity, and to the responsible Minister(s).

## Developments in accounting and auditing standards

8. The Australian Accounting Standards Board (AASB) continued to enhance the accounting standards framework during 2010–11 with a range of changes affecting public sector entities but these are not expected to have a significant financial effect.

9. Future changes to Australian accounting standards are being driven largely by major developments in accounting standards internationally. Significant changes to accounting standards and the conceptual frameworks used to develop standards are underway. A suite of new and revised standards is expected to come into effect from 2013–14, changing reporting requirements in important areas such as financial instruments, revenue, leases, fair value measurement and reporting by groups of entities. During 2010–11, work continued on new conceptual frameworks for financial reporting designed to provide a sound base for the development of future accounting standards.

10. The most significant development in relation to Australian auditing standards in 2010–11 saw the application for the first time of revised standards in 'clarity format' for most ANAO financial statement audits. This follows the release of revised and redrafted International Standards on Auditing (ISAs) in 2009 by the International Auditing and Assurance Standards Board, and the subsequent issue of revised Australian auditing standards by the Australian

Auditing and Assurance Standards Board in line with the ISAs, that are operative for audits of financial statements in Australia for reporting periods beginning on or after 1 January 2010.

## Summary of audit results

### Internal control in agencies

11. 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 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*. 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.

### Control environment

12. The ANAO assesses whether an agency's control environment includes 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. The ANAO observed that agencies have in place key elements of a 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.

### Risk assessment process

14. An understanding of an agency's risk assessment process 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 well-established risk assessment process, overseen by audit committees or other committees with specific risk management responsibilities.

15. Important elements of the risk assessment process common to all agencies are business continuity and fraud control management. Our audits identified a general improvement in the level of awareness and maintenance of business continuity and disaster recovery controls in agencies. However a number of agencies did not test their Business Continuity Plans (BCPs) as part of normal business practice. In relation to fraud control, all agencies have fraud control plans prepared in accordance with the Commonwealth Fraud Control Guidelines.<sup>2</sup> Consistent with our observations in previous years, a small number of agencies needed to improve mechanisms for assessing the effectiveness of their fraud control plans.

### **Information systems**

16. Information technology facilitates the way in which Australian Government agencies operate, and supports the business processes that deliver services to the Australian community.

17. During the 2010–11 interim audits, the ANAO assessed the design and operation of key IT controls to determine the effectiveness of these controls and their impact on reducing risks to the integrity of financial information presented in agencies' financial statements.

18. The ANAO noted improvements in elements of agencies' IT control environments during 2010–11, particularly in respect of incident and problem management controls. However, the management of user access, particularly the logging and monitoring of user activities for privileged users, remained an area requiring further attention in some agencies. This situation is consistent with previous years' findings.

19. The assessment of Financial Management Information Systems' (FMIS) and Human Resource Management Information Systems' (HRMIS) application controls identified that although the effectiveness of FMIS business continuity

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<sup>2</sup> The Fraud Control Plan for the Department of Regional Australia, Regional Development and Local Government (DRARDLG) was in draft form at the time of our audit.



arrangements has improved, the management of HRMIS business continuity required improvements in a number of agencies.

## **Control activities**

20. The results of the 2010–11 interim audits indicated that, overall, control activities relating to financial and accounting processes have been maintained at an effective level. The total number of significant and moderate audit findings has decreased, continuing the trend over recent years. Control issues identified by our audits related to areas such as: the management of inventory and assets, including stocktakes, controls relating to business systems; the management of user access to key financial systems; and business continuity management. A total of 158 Category A, B and C findings<sup>3</sup> were identified from our 2010–11 interim audits, a significant reduction compared with the 188 findings identified in 2009–10.

## **Monitoring of controls**

21. Many activities undertaken by agencies contribute to their regime of monitoring controls. These include quality assurance arrangements, internal and external reviews, control self-assessment processes, and internal audit. In particular, all agencies have in place arrangements to enable Chief Executives to provide an annual Certificate of Compliance.

22. The ANAO continues to include an assessment of compliance in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public moneys in its financial statement audits as a result of interest shown by the Joint Committee of Public Accounts and Audit in past years. Consistent with the results over the last three years, our 2010–11 audits found a high level of compliance in these areas.

## **Agency audit findings**

23. The results of our 2010–11 interim audits reflect a continuation of the reduction over recent years in the number of significant (Category A) and

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<sup>3</sup> The ANAO rates its audit findings according to a risk scale. Audit findings that pose a significant business or financial management risk to the entity are rated as 'A'. Findings that pose a moderate business or financial management risk are rated as 'B'. Findings that pose a low business or financial management risk are rated as 'C'.

moderate (Category B) audit findings. This reflects the general stability and maturity of the control regimes in the majority of agencies and actions taken by agencies to address prior year audit findings.

24. As noted above, our audits do, however, continue to identify control weaknesses in a number of areas particularly relating to: the management of inventory and assets, including stocktakes; controls relating to business systems; the management of user access to key financial systems; and business continuity management.

25. Generally, agencies have been positive and timely in their response to ANAO audit findings.

26. A summary of the trend in Category A and B audit findings between 2009–10 and 2010–11 is outlined below:

- there was one agency with Category A audit findings in 2010–11 and three agencies in 2009–10;
- the total number of Category A audit findings in 2010–11 is three, the same number as in 2009–10;
- the total number of Category B audit findings across all agencies decreased from 52 in 2009–10 to 31 in 2010–11; and
- there was a decrease in the number of Category B audit findings in 12 agencies; three showed an increase; the number of Category B audit findings in one agency remained the same as in 2009–10; and 11 agencies had no Category B findings in either 2009–10 or 2010–11.

27. A summary of Category A and B audit findings by agency is provided in Table 5.1 in Chapter 5.

## **Future audit coverage**

28. The ANAO will complete its assessment of the effectiveness of internal controls for the full financial year and its coverage of all areas of audit focus for each agency as part of the final audit of agencies' financial statements. The results of this work will be reported in the ANAO's end of year report to be tabled in December this year.

# 1. Introduction

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*This chapter provides background to the audits of the financial statement of Australian Government entities, sets out the structure of this report and acknowledges the contribution of staff of the ANAO and entities in the preparation of this report.*

## Background

**1.1** In addition to undertaking individual financial statement audits, the ANAO tables two reports annually addressing the outcomes of the financial statement audits of public sector entities. These reports also discuss contemporary issues and practices impacting on public sector entities' financial reporting responsibilities, and the ANAO's responsibilities. This report outlines the ANAO's assessment of audit findings relating to the internal controls of major agencies, including governance arrangements, information systems and control procedures. The findings summarised in this report are the results of the interim phase<sup>4</sup> of the financial statement audits of major General Government Sector agencies.

**1.2** This report is designed to provide assurance to the Parliament that the systems, controls and processes that are in place in Australian Government agencies<sup>5</sup> are operating in a way that allows agencies to prepare financial statements that give a true and fair view of their financial performance and position at year end.

**1.3** The report outlines the results of the interim audit coverage of key financial systems and controls in 27 agencies that represent some 95 per cent of total General Government Sector<sup>6</sup> (GGS) revenues and expenses. The audit coverage undertaken forms an integral part of our audit of the 2010–11

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<sup>4</sup> Financial statement audits are generally performed in two phases- interim and final. The interim phase focuses on an assessment of agencies' key internal controls; in the final audit phase the ANAO completes its assessment of the effectiveness of key controls for the full year, substantively tests material balances and disclosures in the financial statements, and finalises its opinion on the agencies' financial statements.

<sup>5</sup> 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.

<sup>6</sup> 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.

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.

**1.4** At the individual agency level, a report on the results of our audits is provided to each agency Chief Executive and audit committee. Where warranted, our reporting arrangements act as a catalyst for improvement and provide a stimulus to agency management for the resolution of issues.

**1.5** The preparation of audited financial statements in compliance with the Finance Minister's Orders<sup>7</sup> is a key element of the financial management and accountability regime applicable to Australian Government entities. It is generally accepted in both the private and public sectors that a good indicator of the effectiveness of an entity's financial management is the timely finalisation of its annual financial statements, accompanied by an unmodified audit opinion. Australian Government entities in cooperation with the ANAO devote considerable effort to achieving timeliness in financial reporting.

## Report structure

**1.6** The report is organised as follows:

- Chapter 2 of this report discusses a number of recent developments in accounting and auditing requirements and, in doing so, provides an overview of changes impacting on the Australian Government's reporting and accountability frameworks.
- 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 3. This chapter also includes a discussion of audit findings over the period 2007–08 to 2010–11.
- Findings relating to the audit of Information Technology (IT) systems focusing on the IT control environment, IT security, application controls in FMIS's, and HRMIS's are discussed in Chapter 4.

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<sup>7</sup> The Finance Minister's Orders (FMOs) made by the Minister for Finance and Deregulation set out the requirements for the preparation of financial statements of all reporting entities covered by the *Finance Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

- Chapter 5 outlines, for each agency, details of business operations that influence financial statement audit coverage; governance arrangements relevant to the agency's financial statements; areas of audit focus; and significant and moderate risk issues identified by our 2010–11 interim audits. The chapter is structured in accordance with the portfolio arrangements established by the Administrative Arrangements Order (AAO) of 14 October 2010.

## Acknowledgements

1.7 Based on the work completed during the interim audit phase, the ANAO is again well placed to complete the audits following the preparation by agencies of their financial statements after the close of the 2010–11 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 schedule, 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 Finance Officers and other relevant agency staff in the production of this report.

## 2. Financial Reporting and Auditing Frameworks

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*This chapter provides commentary on recent developments in the financial reporting and auditing frameworks relevant to the Australian Government and its reporting entities.*

### Introduction

**2.1** The Australian Government's financial reporting framework is based, in large part, on standards made independently by the Australian Accounting Standards Board (AASB). This framework is designed to support the decision-making and accountability needs of the Parliament and other external users. The financial reporting and auditing frameworks are illustrated at Appendices 2 and 3 of this Report.

**2.2** The AASB bases its accounting standards on the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). Because IFRS are designed for for-profit organisations, the AASB adds material to address the financial reporting needs of the public and not-for-profit private sectors. Additional financial reporting requirements for Australian Government agencies and authorities are prescribed by the Finance Minister in the Finance Minister's Orders for Financial Reporting.

**2.3** On 30 June 2011, the AASB released an additional accounting standards regime, under which certain entities may reduce the level of disclosure in their financial statements. This reduced disclosure regime provides an opportunity to reduce the length and complexity of financial statements. It is available to government-controlled entities, although the Minister for Finance has yet to approve its adoption by Australian Government entities.

**2.4** Another noteworthy change to accounting standards was the requirement that long-term leases of land should be assessed and, where they transfer substantially all the risks and rewards of ownership, the land be included as an asset on the lessee's balance sheet. Although a significant conceptual change, it is unlikely, in practice, to have a material impact on most Australian Government entities.

**2.5** While, for the foreseeable future, changes to Australian accounting standards will be driven mainly by major developments in accounting standards internationally, the AASB has also initiated a number of domestic projects. The project to harmonise reporting by government entities with the Australian Bureau of Statistics' Government Finance Statistics framework is continuing, the focus now turning from whole-of-Government reporting to Government-controlled entities. Australian accounting standards harmonising the financial reporting requirements of Australian and New Zealand for-profit entities have also been released. The AASB is also considering applying to not-for-profit entities the standards for related party and executive remuneration disclosure that already apply to for-profit entities, modified as necessary.

**2.6** At the international level, significant changes to accounting standards and the conceptual frameworks used to develop standards are underway. A suite of new and revised standards is expected to come into effect from 2013–14, changing reporting requirements in important areas such as financial instruments, revenue, leases, fair value measurement and reporting by groups of entities. During 2010–11, work continued on new conceptual frameworks for financial reporting designed to provide a sound base for the development of future accounting standards.

**2.7** International Auditing Standards are released by the International Auditing and Assurance Standards Board (IAASB). Australian Auditing Standards, issued by the Australian Auditing Standards Board (AUASB), are based on those of the IAASB. The ANAO adopts Australian Auditing Standards. The implementation of recent changes made by the AUASB to Australian Auditing Standards enhances their quality and maintains uniformity with International Auditing Standards.

## **Recent changes to the Australian public sector financial reporting framework**

### **Long-term leases of land**

**2.8** Assets are sometimes leased in a way that effectively transfers the risks and rewards of ownership to the lessee. Accounting standards have long required that such assets be included on the balance sheet of the lessee, with the lessor recognising the right to receive rentals, rather than the physical asset. Until recently, an exception was made for land on the basis that the risks and

rewards of land could never be fully transferred by a lease, since land has an unlimited life. However, because some leases of land can be for very long periods, accounting standard setters decided that it was possible to transfer substantially all the risks and rewards of ownership. The exception has therefore been removed<sup>8</sup> and all leases must now be assessed on the same basis. This means Australian Government entities will be required to review their leases of land and, if necessary, amend their 2010–11 balance sheets.

## **Relief from preparing two sets of financial statements**

**2.9** Prior to 2009–10, Australian companies with subsidiaries were required by the *Corporations Act 2001* (the Act) to present two types of financial statements: one showing the consolidated results for all companies in the group (consolidated statements) and another showing only the results for the company alone (parent statements). In 2009–10, the Act was amended to allow companies to omit the parent entity financial statements, on condition that certain information about the parent entity was included in the consolidated statements. From 2010–11, the Finance Minister has extended this relief, with the same conditions, to Australian Government agencies and authorities. This means that all Australian Government entities with subsidiaries may now choose to prepare a single, consolidated financial report.

### ***Use of ABS GFS Manual in Whole of Government Reporting***

**2.10** In May 2011, the AASB amended AASB 1049 *Whole of Government and General Government Sector Financial Reporting*<sup>9</sup>. The key amendment relates to the existing requirement to include information prepared in accordance with the Australian Bureau of Statistics' Government Finance Statistics (ABS GFS) Manual. The Manual is updated from time to time, and governments will now be permitted to use any version that was in force up to two years before reporting date. This amendment will give governments sufficient time to reflect changes to the Manual in their financial statements. This change is part

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<sup>8</sup> This change was made by Australian Accounting Standard AASB 2009-5 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project* (AASB 5, AASB 8, AASB 101, AASB 107, AASB 117, AASB 118, AASB 136 & AASB 139), effective from reporting periods beginning on or after 1 January 2010.

<sup>9</sup> The amendments were made by AASB 2011-2 *Amendments to Australian Accounting Standards – Orderly Adoption of Changes to the ABS GFS Manual and Related Amendments*, which may be adopted for annual reporting periods beginning from 1 January 2009.



of a broader post-implementation review of AASB 1049, which is expected to result in further amendments to the standard in the second half of 2011.

## Future developments in the Australian public sector financial reporting framework

### Transactions with related parties

**2.11** Australian for-profit entities must comply with AASB 124 *Related Parties*, which requires entities to disclose information about transactions with related parties. Related parties of an entity include those entities and persons that manage, control or significantly influence the entity, together with close family members of such persons. The AASB is currently considering proposals to extend these requirements to not-for-profit entities, with appropriate modifications. Depending on the final proposals, this could mean that all Australian Government entities would be required to disclose transactions with key management personnel and Ministers.

### Non-exchange transactions

**2.12** Since 2009, the AASB has been exploring alternatives to the current requirements for accounting for appropriations, taxes and grants, known collectively as non-exchange transactions. In February 2011, the AASB decided to broaden the focus of the project to revenue recognition by not-for-profit entities. The revenue recognition model for not-for-profit entities will be based on the IASB's work in developing an accounting standard on Revenue from Contracts with Customers (see below) but with modifications where necessary to address not-for-profit-specific issues. Appropriations, taxes and grants are major transactions for many Australian Government entities and changes to the accounting standards could have significant impact on the timing of revenue and expense recognised.

### GFS-GAAP Harmonisation

**2.13** As part of a post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, which applied for the first time in 2008–09, the AASB has sought comments on proposals to improve AASB 1049. The AASB proposals include:

- removing any ambiguity about whether financial reports are required for the General Government Sector (GGS);

- requiring GGS and whole-of-government reports to be made available at the same time and cross-referenced;
- clarifying the requirements for recasting budget information included in the GGS and whole-of-Government reports; and
- requiring all aggregates of government financial performance to be measured in accordance with Australian Accounting Standards and to clearly identify those that do not meet the definition of key fiscal aggregates in AASB 1049.

**2.14** The AASB has also progressed its project to apply the principles in AASB 1049 to the financial reports of not-for-profit entities within the GGS. As part of this project, the AASB is developing an exposure draft that would include the following key proposals:

- entities to recognise and measure assets in accordance with the GFS Manual, where a choice is permitted by other Australian Accounting Standards;
- presentation of financial information in line with the GFS Manual, to the extent this does not conflict with Australian Accounting Standards. The content may be presented as the main financial statements or as supplementary note disclosure. Both controlled items and administered items would be presented;
- a comparison of the original budget with the outcome for the year, explaining major variances from the budget; and
- a period of three years between the issue of the standard and when it becomes mandatory.

## **Differential financial reporting - reduced disclosure requirements**

**2.15** The AASB has implemented a differential financial reporting regime that provides an option for the majority of reporting entities to reduce their reporting burden. While the regime was legislated in late 2009–10, the relevant Standards do not come into effect until 2013–14.

**2.16** The regime distinguishes two tiers of reporting requirements. Entities in the first tier will prepare financial statements in accordance with the full suite of Australian Accounting Standards. Federal, state and territory governments are in the first tier. Entities in the second tier will prepare similar financial statements, but with substantially reduced disclosure requirements.

Government controlled entities and universities may opt for either tier, subject to the requirements of their regulator. The Finance Minister is the regulator for Australian Government entities.

**2.17** The differential reporting regime provides an opportunity to reduce the administrative workload of some Australian Government entities and make their financial reports easier to read, while preserving sufficient disclosures to satisfy the needs of the Parliament.

**2.18** As new accounting standards are developed, or existing standards are amended, the AASB considers which disclosures should not be required of Tier 2 entities.

**2.19** The introduction of the reduced disclosure regime has required an adjustment to accounting standards that affects not-for-profit entities with subsidiaries. Currently, entities that have subsidiaries and are themselves subsidiaries of another entity are exempt, in certain circumstances, from the requirement to prepare consolidated financial statements. This exemption has now been extended to Tier 2 or Tier 1 not-for-profit parent entities. In September 2010, the AASB released an exposure draft proposing this change.

**2.20** For the Australian Government, this would potentially mean that most not-for-profit entities, and most Tier 2 for-profit entities, would not be required by Australian Accounting Standards to prepare consolidated financial statements. However, this would require amendment of the Finance Minister's Orders, that currently require all Australian Government entities to prepare consolidated financial statements.

## International developments in accounting standards

### IASB - Second wave of changes

**2.21** The IASB is planning significant changes to its accounting standards; these changes are expected to come into effect over the next several years. Many of these changes are being developed jointly with the United States Financial Accounting Standards Board, in the interests of global harmonisation of accounting standards. Because Australian Accounting Standards are based on the IASB standards, this wave of major change is likely to have a significant impact on Australian financial reporting, including by the public sector.

## *Financial instruments*

**2.22** The IASB is progressing a project to improve the usefulness for users of financial statements by simplifying the classification and measurement requirements for financial instruments. Measurement rules for financial assets will be considerably simplified and more financial assets are likely to be measured at current market values, rather than historical cost. However, requirements for financial liabilities will be largely unchanged. The IASB is now developing requirements for writing down assets and accounting for hedging transactions.

**2.23** The IASB expects to finalise the new financial instruments standard by the end of 2011.

## *Leases*

**2.24** The IASB is conducting a project to develop a new approach to lease accounting that would ensure that all assets and liabilities arising under lease contracts are recognised in the balance sheet. Currently many shorter-term leases are not shown as assets or liabilities on the balance sheet, and lease payments are expensed over the lease term. Under the proposals, entities with shorter-term leases, including many Australian Government entities, would record the present value of lease payments as assets on their balance sheets, together with corresponding liabilities.

**2.25** The new accounting standard resulting from this project is expected to be released by the end of 2011.

## *Fair value measurement*

**2.26** Several accounting standards require entities to disclose the fair value of their assets and liabilities. However, guidance on measuring fair value is spread among several standards and is often high-level and sometimes inconsistent between standards. In May 2011, the IASB issued an accounting standard to provide a single source of fair value measurement guidance that clarifies the definition of fair value, provides a clear framework for measuring fair value and enhances the disclosures about fair value measurements.

## *Revenue*

**2.27** The IASB has initiated a project to provide clear principles on when revenue should be recognised from contracts with customers and how such revenue should be reported. These principles would apply to all contracts with customers except leases, financial instruments and insurance contracts.

**2.28** The main objectives of this project are to:

- remove inconsistencies and weaknesses in existing revenue recognition standards by providing clear principles for revenue recognition in a robust framework;
- provide a single revenue recognition model which will improve comparability over a range of industries, companies and geographical boundaries; and
- simplify the preparation of financial statements by reducing the number of requirements to which preparers must refer.

**2.29** The key principle on which the proposed model is based – revenue is recognised on transfer to the customer, measured at transaction price generally consistent with current Australian practice.

**2.30** A new standard is expected to be released by the end of 2011.

### *Consolidation*

**2.31** In May 2011, the IASB released three accounting standards tightening up the reporting requirements for the consolidation of subsidiaries and special purpose vehicles and requiring the substance of joint arrangements to be revealed. The changes are intended to give investors a clearer picture of the nature and extent of a entity's involvement with other entities. The AASB will consider whether it is necessary to modify these standards for application to the public and not-for-profit sectors in Australia.

### *Conceptual frameworks*

**2.32** AASB standards comprise mainly Australian equivalents to IFRS. The conceptual framework that underpins AASB standards is also largely based on the IASB's conceptual framework.

**2.33** The IASB conceptual framework is currently under review by the IASB in partnership with the United States Financial Accounting Standards Board (FASB). The Conceptual Framework project aims to update and refine the existing concepts to reflect the changes in markets, business practices and the economic environment that have occurred in the two or more decades since the concepts were first developed. Its overall objective is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged.

**2.34** The project is progressing in eight phases. To date, the IASB has released updated chapters dealing with the objective of general purpose financial reporting and the qualitative characteristics of useful financial information. The revised chapters state that the objective of financial statements is to provide information to assist investors, lenders and creditors in making decisions about providing resources to the entity.

**2.35** The AASB has decided that the revised chapters will be applicable to all Australian reporting entities, although the project's primary focus is on for-profit entities. The AASB will add to the framework so that it can be applied by not-for-profit entities. It is only in the latter stages of the project that the IASB will consider the applicability of the framework to not-for-profit entities. In light of this, the International Public Sector Accounting Standards Board (IPSASB), in conjunction with the AASB and other national accounting standards boards, has embarked on a separate project for developing a Public Sector Conceptual Framework. IPSASB has to date released a range of consultation papers addressing: the objectives and scope of financial reporting; the qualitative characteristics of financial information; the nature of the reporting entity; and the recognition and measurement of elements of the financial statements.

### *Australia-New Zealand convergence*

**2.36** Following an agreement between the Australian and New Zealand governments to promote single market outcomes between the two countries, the AASB and New Zealand Financial Reporting Standards Board (FRSB) plan to remove differences between their respective suites of accounting standards. The initial focus is on accounting standards relating to the for-profit sector; consideration will also be given to existing not-for-profit differences at a later date.

**2.37** In May 2011, the AASB and the FRSB released new accounting standards<sup>10</sup> as a first step towards full harmonisation. These standards remove many of the differences between Australian and New Zealand accounting standards for for-profit entities.

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<sup>10</sup> The Australian Standards are AASB 2011-1 *Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project*, AASB 2011-2 *Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project – Reduced Disclosure Requirements* and AASB 1054 – *Australian Additional Disclosures*

**2.38** Among the changes is a clause permitting entities to depart from an Australian Accounting Standard where compliance with the Standard would be so misleading that it would conflict with the objective of financial statements, provided that the relevant regulatory framework does not prohibit departure. However, this clause is not available to entities reporting under the Corporations Act, not-for-profit entities, including governments, and entities using Tier 2 of the reduced disclosure regime.

### *Developments in auditing standards*

**2.39** Section 24 of the *Auditor-General Act 1997* requires the Auditor-General to set auditing standards with which persons performing ANAO audits must comply. The ANAO Auditing Standards establish mandatory requirements and provide explanatory guidance for persons performing the functions specified in section 24, including the statutory audits of the financial statements of Australian Government bodies.

**2.40** The Auditor-General issued the current ANAO Auditing Standards on 25 June 2009.

**2.41** The ANAO Auditing Standards incorporate, by reference, the current versions of standards set by the AUASB including those for the auditing of financial statements (Australian Auditing Standards or 'ASAs'). As a result, financial statement audits conducted by the ANAO are in conformance with standards that apply to the broader auditing profession in Australia.

**2.42** The AUASB uses International Standards on Auditing (ISAs) as the basis for making ASAs. ISAs are made by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

**2.43** Previous reports have commented on the IAASB Clarity Project, a comprehensive program to enhance the quality and uniformity of International Auditing Standards and to encourage greater consistency in their application worldwide. The redrafted ISAs in 'clarity format' were released in 2009, with approximately half of the standards being substantively revised.

**2.44** In line with the strategic direction provided by the IAASB, the AUASB revised and redrafted the ASAs using the equivalent ISA as the underlying standard. The revised standards are operative for audits of financial statements in Australia for reporting periods beginning on or after 1 January 2010.



**2.45** For most ANAO financial statement audits, the first application of the revised standards is for annual reporting periods commencing on 1 July 2010, i.e. the 2010–11 financial year. The standards were already applied in a small number of audits of entities with reporting periods that commenced on or after 1 January 2010, including audits of entities that came into existence from this date and entities that report on a calendar year basis.

**2.46** The ANAO's financial statement audit methodology and associated policies have been updated to reflect the re-issued standards.

**2.47** In its 2010 Annual Report, the IAASB identified a number of future directions following completion of its Clarity Project. In relation to financial statements, these directions include:

- A continued focus on audit quality and the role of standards as an important element in achieving audit quality. A paper *Audit Quality: An IAASB Perspective* was released in early 2011.
- Other projects linked to audit quality, including work to enhance auditor communication. In May 2011, the IAASB released a consultation paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, to obtain views on enhancing internationally the quality, relevance and value of auditor.
- Consideration of the auditing implications of having disclosures in financial statements that are highly relevant and more detailed, but may be more subjective and less reliable. Such disclosures include disclosures of assumptions, models, alternative measurement bases and sources of estimation uncertainty. In January 2011, a Discussion Paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* was released for comment.
- The substantive revision of standards that, while redrafted to meet the new clarity requirements had not been subject to any substantive review. Since ISA 610 *Using the Work of Internal Auditors* was last revised in March 1994, there have been developments in the internal audit environment and audit practices that are not currently addressed, including changes in the organizational status of the internal audit function, the activities performed by internal auditors, and the manner of interaction between internal auditors and external auditors. There are also perceptions of undue reliance by external auditors on the work of internal auditors and, therefore, that the framework for the external



auditor's judgments regarding when, where, and how to use work of the internal auditor should be strengthened. A proposal to revise the standard was released in mid 2010.

**2.48** The IAASB's work program also includes the development of new and revised standards and guidance for assurance and related services engagements other than financial statement engagements. These include:

- A proposal for a new International Standard on Assurance Engagements (ISAE) 3410 *Assurance Engagements on Greenhouse Gas Statements* was released in January 2011.
- A proposal to revise ISAE 3000 *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* was released in April 2011. Like the existing standard, this is an overarching document that would apply to a broad range of engagements providing assurance, for example, on the effectiveness of internal control, value for money or corporate social responsibility reporting. The proposed ISAE 3000 also introduces guidance on the nature of reasonable and limited assurance engagements.

**2.49** The AUASB consults formally with organisations representing stakeholders, including users of financial statements, regulators and the accounting profession, in the development of Australian auditing and assurance standards and guidance. This due process is timed so that the AUASB can consider stakeholder views in making submissions on proposals from the IAASB such as those mentioned above.

**2.50** The AUASB's planned work in relation to auditing standards and guidance is detailed in its Annual Regulatory Plan for 2010–11. The Plan includes the provision of guidance to auditors in areas relevant to financial statement auditing in the public sector, including the application of auditing standards to smaller audits, auditing complex financial instruments and auditing grant acquittals.

**2.51** The AUASB expects the proposed guidance in relation to the audit of smaller entities to draw mainly on material in the Australian Auditing Standards and to provide, for example, details of the nature and level of documentation in such audits. The guidance on auditing complex financial instruments will be issued in conformity with a revised IAASB Practice Statement currently being developed. The new guidance on grant acquittals is proposed because of the variety of grant arrangements in Australia.

## Conclusion

**2.52** Ongoing developments in accounting and auditing frameworks and standards continue to have an impact on the financial reporting responsibilities of public sector entities and on the ANAO's auditing methodology. The ANAO continues to devote significant resources to the implementation of revised auditing and accounting requirements.

**2.53** The ongoing changes made and proposed by the AASB are aimed at improving the quality and relevance of financial reports as well as reducing the reporting burden on many entities. Looking to the future, the change with the most potential to affect the public sector is the differential reporting regime: if adopted by the Australian Government public sector this regime would improve the readability and reduce the cost of preparation of public sector financial statements while preserving sufficient disclosures to satisfy the needs of the Parliament.

**2.54** The Clarity Project revisions to Australian Auditing Standards took full effect in 2010–11. The ANAO has made significant adjustments to its audit methodology and delivered extensive staff training to support full implementation of the re-issued standards.

## 3. Summary of Audit Findings and Related Issues

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*This chapter provides a summary of the ANAO's review of internal controls as part of the audit of the financial statements of major agencies. It also provides an analysis of the internal audit arrangements of major agencies.*

### Introduction

**3.1** The Chief Executives of General Government Sector entities subject to the FMA Act are required to prepare annual financial statements and present them to the Auditor-General for audit.<sup>11</sup> For large entities, the audit is conducted in two main phases, interim and final. The interim phase focuses on an assessment of agencies' key internal controls; in the final audit phase the ANAO completes its assessment of the effectiveness of key controls for the full year, substantively tests material balances and disclosures in the financial statements, and finalises its audit opinion on the agencies' financial statements. This report focuses on the results of the interim audit phase of the 2010–11 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.

**3.2** Chief Executives of FMA Act agencies are required to manage their affairs in a manner that promotes the efficient, effective, economical and ethical use of resources.<sup>12</sup> 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.<sup>13</sup>

**3.3** The overall objective of an audit of an agency's financial statements, as identified in the Australian Auditing Standards, is to form an opinion on

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<sup>11</sup> *Financial Management and Accountability Act 1997.*

<sup>12</sup> *Financial Management and Accountability Act 1997*, section 44.

<sup>13</sup> *Financial Management and Accountability Act 1997*, section 49.

whether the financial statements, in all material<sup>14</sup> respects, are in accordance with the Australian Government financial reporting framework.<sup>15</sup> In planning the audit, 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. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole.<sup>16</sup>

**3.4** A central component of the ANAO's financial statement 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 misstatement 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 agency's key internal controls to assess their capacity to prevent and detect errors that may result in a material misstatement of the financial statements. 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. The auditor's understanding of the agency, its environment and its internal controls, helps the auditor design the work needed and respond to significant risks that bear on financial reporting.<sup>17</sup> Broad areas of audit focus determined as a result of this planning approach are discussed in Chapter 5 for each agency covered by this report.

**3.5** In accordance with generally accepted audit practice, the ANAO accepts a low level of risk that the audit procedures will fail to detect that 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

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<sup>14</sup> 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 statements or affect the discharge of accountability by the management or governing body of the entity.

<sup>15</sup> The key elements of this framework are set out in Appendix 2.

<sup>16</sup> Australian Auditing Standard ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, paragraph 6.

<sup>17</sup> Significant risks are those risks of material misstatement of the financial statements that, in the auditor's judgement, require special audit consideration.

risk. Specific audit procedures are 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.

## Internal control

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

- control environment;
- risk assessment process;
- the information system, including the related business processes, relevant to financial reporting, and communication;
- control activities relevant to the audit; and
- monitoring of controls.

**3.7** This chapter discusses each of these elements and outlines our observations in relation to each one, based on our review of relevant aspects of each agency's control environment and the results of our interim audits.<sup>18</sup> As such it includes, where relevant, summary comments on Category A, B and C audit findings.<sup>19</sup>

## Control environment

**3.8** An entity's business and operations influence the control environment, which needs to be carefully reviewed as part of the audit process when assessing the risk of material misstatement in financial systems and reports. ASA 315 at paragraph A69 states:

<sup>18</sup> As noted at paragraph 5.346, DRARDLG, as a department established in the last 12 months, continues to develop key aspects of its control environment.

<sup>19</sup> Category A findings are significant audit issues. Category B findings are moderate audit issues, and Category C findings are minor audit issues. These categories are explained in Chapter 5, page 89.

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.

**3.9** 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:

- **governance 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 involves the preparation of financial reports, including comparison of actual results to budgets, variance analysis and relevant commentary to provide assurance about the financial performance of the agency.

**3.10** 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 obtains for financial statement purposes.

### *Observations*

**3.11** Agencies have governance arrangements in place to provide direction, guidance and control over the financial management of their organisations.

Executive management committees met regularly to plan and monitor strategic direction and performance. Agencies had produced a corporate plan or similar document that outlines the agency's goals and objectives, and thereby facilitate measuring agencies' progress in meeting them. Chief Executives, their senior management group, and audit or risk committees continued to give attention to financial management and audit matters, risk management and performance outcomes.

**3.12** All agencies have mature audit committee arrangements. These include a formal charter that outlines each committee's composition, roles, responsibilities and reporting lines, and processes for the regular reporting to the Chief Executive and the periodic self-assessment of performance. In two agencies, the ANAO's attendance at Audit Committees is restricted to agenda items relating to the financial statements and internal audit activities. The ANAO considers it is in the interests of both agencies and the ANAO for the ANAO to attend the full agenda of audit committee meetings to contribute to the Committee's deliberations and facilitate meeting the requirements of ASA 315.

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

**3.14** Consistent with previous years, consideration of the financial position regarding current and future operations is included on the agenda of agencies' executive management committee meetings. These meetings are usually held monthly, but some agencies have weekly or fortnightly meetings. Financial performance reports to agencies' executives included budget forecasts and commentary on performance. The financial information provided to the agencies' executives was generally supplemented by non-financial operational information, to provide a balanced view of performance.

## **Compliance with financial legislation**

**3.15** The financial framework for the Australian Government agencies included in this report is established by the FMA Act and its subsidiary legislation. The key feature of the framework is that the Chief Executive of each agency is responsible for the financial management of their agency, including compliance with applicable laws and associated policies.



**3.16** 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.

**3.17** In recent years, 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 the above-mentioned 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*

**3.18** The 2010–11 interim audits identified that, generally, agencies continue to maintain listings of the laws, regulations and associated government policies that are relevant to their responsibilities. Agencies also now have well-established 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 to their Minister.

**3.19** Generally, audit committees are responsible for overseeing the effectiveness of legislative compliance arrangements, particularly in relation to financial management requirements. The internal audit function often assists with monitoring.

**3.20** Agencies also have established a variety of mechanisms to communicate the importance of compliance with legislation through documents such as Chief Executive Instructions, corporate plans, fraud control plans and delegation instruments, as well as through the conduct of targeted training and induction courses.

**3.21** The Certificate of Compliance process for FMA Act agencies was introduced in 2006–07 to improve compliance with the Australian Government's financial management framework and to ensure that ministers are kept informed of compliance issues within their portfolios. Through the Certificate, agency Chief Executives certify to their Portfolio Minister the



agency's compliance with the components of the government's financial management framework for the previous financial year.

**3.22** The Certificate requirement that Chief Executives sign-off on compliance with the financial management framework and report identified instances of non-compliance has heightened the focus of agencies on compliance.

**3.23** The ANAO tabled a performance audit titled *Management of the Certificate of Compliance Process in FMA Act Agencies* in April 2011. The audit concluded that overall, the Certificate process for FMA Act agencies has been effective notwithstanding the inherent limitations of the self assessment process employed.

**3.24** In general, the audit identified that the audited agencies' Certificate processes were appropriate in light of each agency's size, financial activities and financial management arrangements. Key aspects of these agencies' Certificate processes involved self-assessments of compliance by responsible officials and/or business areas; internal audit activity covering compliance with the financial management framework; audit committee involvement; and targeted remediation activities to address identified non-compliance.

**3.25** The main area for improvement identified by the audit concerned the need for more targeted quality assurance activity by agencies in regard to compliance with the financial management framework. The ANAO considered that self-assessments by agency officials are unlikely of themselves to consistently provide a high level of assurance to an agency's Chief Executive, and audits undertaken by the ANAO show there can be misunderstanding of the requirements of the framework by agency officials. Well-targeted quality assurance activity, focusing on higher risk, more significant, or high volume transactions in the agency's context, complements self-assessments, thereby helping to reinforce financial management compliance and provide greater confidence in Certificate results. Such quality assurance activities commonly involve risk-based reviews of some financial transactions, tests of key internal controls and review work of business areas such as the central procurement unit.

## Risk assessment process

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

**3.27** The ANAO found that the majority of agencies have well established arrangements in place that involve developing and updating risk management plans at the organisational and work area levels. Oversight of the process is provided by the agency's audit committee or a separate committee with specific responsibility for risk management.

**3.28** 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

**3.29** Business continuity management (BCM) is an essential business practice and an integral component of effective public sector governance. It is a unified process encompassing both business and management disciplines to provide resilience to business processes.<sup>20</sup>

**3.30** BCM involves the development, implementation, and maintenance of those policies, frameworks and procedures to assist an agency manage a business disruption. This capability assists in managing, and recovering from the impacts of a disruptive event.

**3.31** Defining the approach to preventing and managing a break in business operations is a major role of BCM, requiring non-routine management practices. BCM involves designing business processes and information architecture to limit points of failure, and developing contingency procedures and the steps the agency will take to recover and return to normality. It also

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<sup>20</sup> In June 2009, the ANAO published a Better Practice Guide, *Business Continuity Management: Building resilience in public sector entities*, to assist agencies in managing their business continuity responsibilities.

includes defining escalation protocols, and obtaining contact details for key personnel and other entities where an important interdependency exists.

**3.32** There are two key elements to BCM, supported by a number of activities that interrelate to identify, analyse, and treat continuity risks and deal with the consequences should preventative treatments fail. The two elements are a:

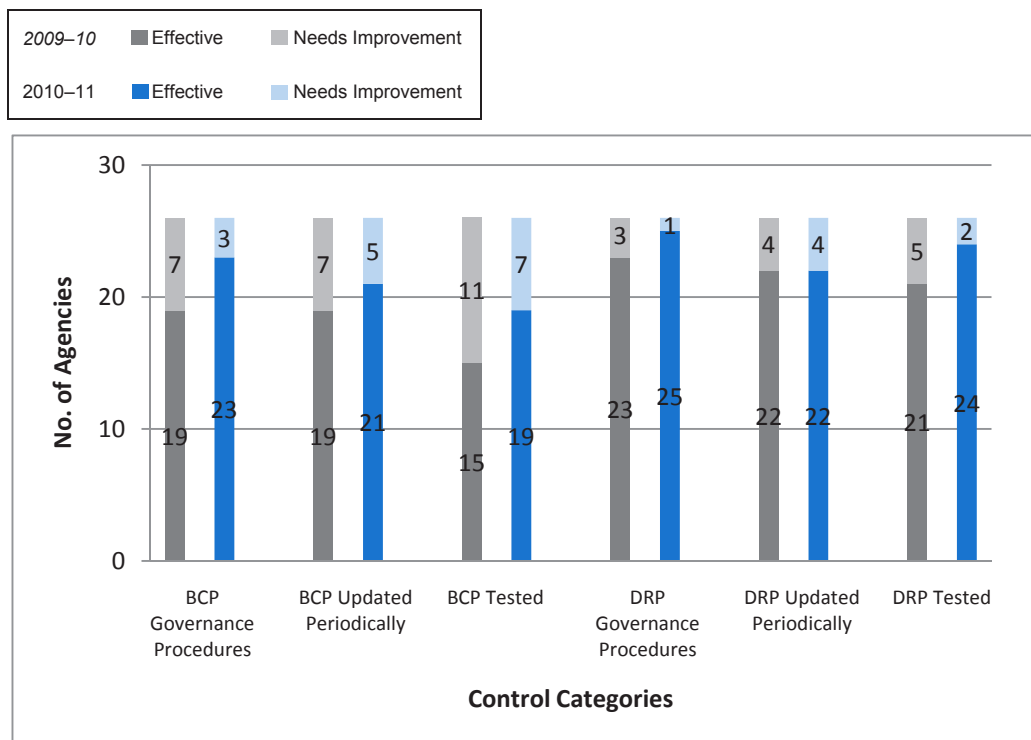
- Business Continuity Plan (BCP): a body of procedures and information for maintaining service delivery, that is developed, compiled and maintained in readiness for use in a business disruption event; and
- IT Disaster Recovery Plan (DRP): the mechanism for recovering computer systems and associated infrastructure following a disruption to services, in line with the needs of the entity.

### *Observations*

**3.33** Planning for business continuity continues to be essential in underpinning an agency's ability to maintain key business functions and deliver services. As part of the interim phase of our 2010–11 financial statement audits, and in line with past practice, the ANAO assessed key BCM control activities in the context of an agencies' ability to recover its key financial information that supports the financial statements. The summarised results of our review of BCM controls in 2010–11 compared with 2009–10 are illustrated in Figure 3.1 below.

**Figure 3.1**

**Assessment of business continuity and disaster recovery controls**



**3.34** As illustrated in Figure 3.1, our audits identified a general improvement in the level of awareness and maintenance of business continuity and disaster recovery controls. However, over 25 per cent (seven agencies) did not test BCP's as part of normal business practice. While this is an improvement compared with the position in 2009-10, further attention to this matter by some agencies is required. The absence of a properly tested BCP has the potential to put at risk an agency's capacity to deal effectively with a disruptive event.

**3.35** Agencies are addressing the need to establish effective governance procedures in relation to BCPs and DRPs, with almost all agencies achieving a high level of governance. However, around 20 per cent (five agencies) had not implemented arrangements for the regular updating of BCPs and DRPs and, as mentioned above, over 25 per cent (seven agencies) had not implemented arrangements to test BCPs. This compares to only seven per cent (two agencies) that had not implemented a DRP testing process.

**3.36** Agencies that are not regularly testing their BCP and DRP are not well placed to identify aspects of their plans that require attention, or to integrate lessons learned into revised and updated plans. Regular testing of the operation of BCPs and DRPs assists agencies to establish and maintain appropriate training, effective recovery processes, and up to date BCP and DRP documentation.

**3.37** Overall, our assessment of business continuity management indicated agencies were aware of the importance of BCP and DRP to the continuing delivery of their services. However, some agencies have still not fully embedded the establishment, maintenance, and testing of business continuity and disaster recovery plans into their normal business activities. These agencies face a continued risk of being unable to recover effectively from a disruptive event unless these matters are addressed as part of a core business as usual process.

## **Fraud control management**

**3.38** The *Commonwealth Fraud Control Guidelines* (the Guidelines) outline the principles for fraud control within the Australian Government and set minimum standards to assist agencies in carrying out their responsibilities to combat fraud<sup>21</sup> against their programs.

**3.39** 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. All agencies are required to provide the Australian Institute of Criminology (AIC) with fraud control information for its annual report on fraud against the Australian Government, and fraud control arrangements within Australian Government agencies. This report is titled the *Annual Report to Government: Fraud against the Commonwealth*.

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<sup>21</sup> 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.

**3.40** The 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 2010 showed that:

- the Australian Federal Police investigated 94 referrals of complex cases in 2009–10 and estimated the cost of fraud for these cases to be \$38.7 million;
- 5 010 defendants were referred to the Commonwealth Director of Public Prosecutions for prosecution; and
- 4 180 convictions for fraud were achieved during 2009–10 and there were 29 acquittals for fraud during 2009–10.

**3.41** These results continue to highlight the risk of fraud and the importance of agencies effectively managing their fraud control responsibilities.

**3.42** An explanation of an auditor's responsibility for preventing and detecting fraud is provided in Australian Auditing Standard ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, which notes in paragraph 4:

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

**3.43** 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. These include making enquiries of agencies regarding their risk assessment process for identifying and responding to the risks of fraud and the internal controls that management has established to mitigate those risks.

**3.44** In March 2011, the ANAO published an updated Better Practice Guide, *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.

**3.45** 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*

**3.46** Our enquiries as part of our 2010–11 interim audits identified that agencies continue to place importance on their adherence with the Guidelines, with fraud control planning being well established in the majority of agencies. Notwithstanding this, the monitoring of the effectiveness of fraud control plans is a key area of fraud control management that continues to require attention by some agencies.

## **Information systems**

**3.47** 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*

**3.48** The ANAO observed that the majority of agencies had effective IT general controls and IT application controls that support the preparation of agencies' financial statements. A detailed commentary on the results of the ANAO's review of information systems that underpin the financial transactions processing within major Australian Government agencies is provided in Chapter 4.

## **Control activities**

**3.49** Australian Auditing Standard ASA 315 at paragraph A88 states:

Control activities are the policies and procedures that help ensure that management directives are carried out.

**3.50** The auditor is required to obtain an understanding of control activities relevant to the audit, being those that the auditor considers it is necessary to understand in order to assess the risks of material misstatement. Further audit procedures responsive to these risks then need to be designed.

**3.51** To illustrate trends in audit findings over time, aggregate details of Category A, B and C findings over the last four years have been grouped into the following categories:

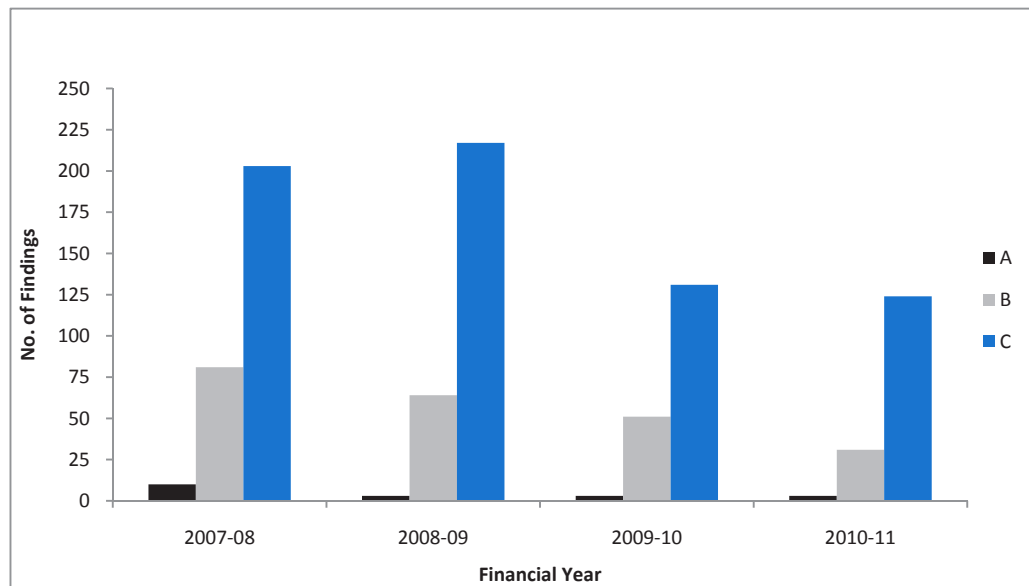
- IT control environment;
- purchases and payables;
- grant accounting;
- accounting and control of non-financial assets;
- revenues, receivables and cash management;
- human resource management processes; and
- other control matters.

### Aggregate audit findings

**3.52** Aggregate audit findings for the last four years are outlined in Figure 3.2 below.

**Figure 3.2**

#### Aggregate audit findings – all categories



**3.53** Over the last four years the ANAO's interim audits have identified 921 audit findings. There has been a progressive reduction in the total number of findings over this period with the majority (73 per cent) of findings being



Category C findings. The number of Category A and B findings has decreased from 55 in 2009–10 to 34 in 2010–11. Category C findings have also reduced from 133 in 2009–10 to 124 in 2010–11. The general reduction in findings is reflected in the analysis of findings by category outlined below.

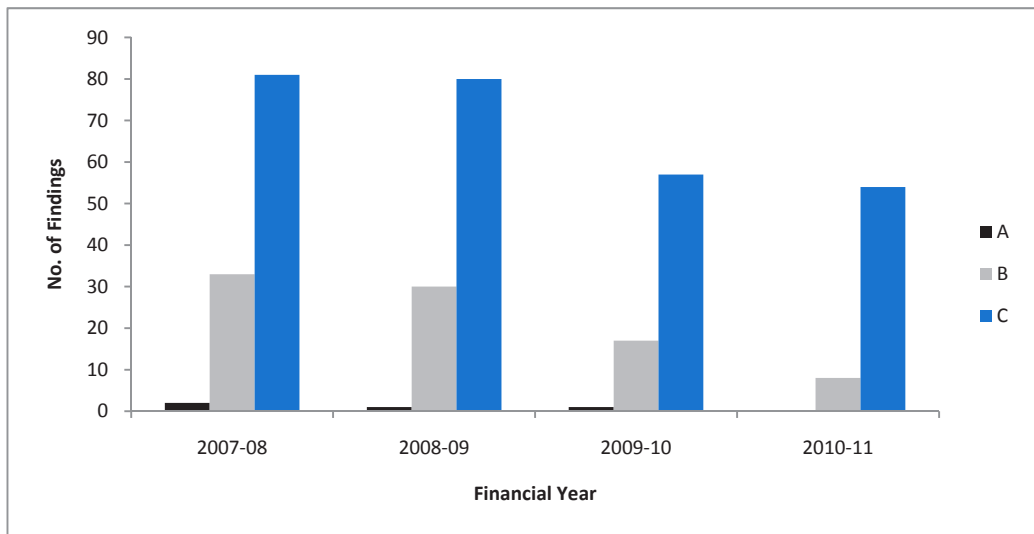
## IT control environment

**3.54** As mentioned above, the review of information systems and their related controls are an integral part of an agency's internal control environment. The main components reviewed are: IT general controls that encompass an agency's IT infrastructure, policies, procedures and standards that support accounting and business processes; and IT application controls that validate, authorise, monitor and report financial and human resource transactions.

**3.55** The number of audit findings over the last four years are outlined in Figure 3.3 below.

**Figure 3.3**

### IT control environment - aggregate audit findings



**3.56** Findings in relation to agencies' IT controls environments represent 40 per cent of all findings, with 364 findings in total over four years. The ANAO observed an overall improvement in the management of IT controls over the past four years, with a gradual reduction in the total number of Category A, B and C category findings over this period, most notably in 2009–10.

**3.57** Common issues noted over the four years include controls to manage IT incidents and problem management, and the regular review and updating of change management processes. Areas where our 2010–11 interim audits have identified the need for improvement are HRMIS business continuity, and the logging and monitoring of user activities for FMIS and HRMIS privileged users.

**3.58** A detailed commentary on the results of the ANAO's review of information systems that underpin the financial transactions processing within major Australian Government agencies is provided in Chapter 4.

### **Purchases and payables**

**3.59** The main component of purchases and payables is payments to suppliers, including contractor and consultancy expenses, lease payments and general administrative and utility payments. Payments to suppliers generally represent a significant percentage of total departmental expenses incurred by agencies.

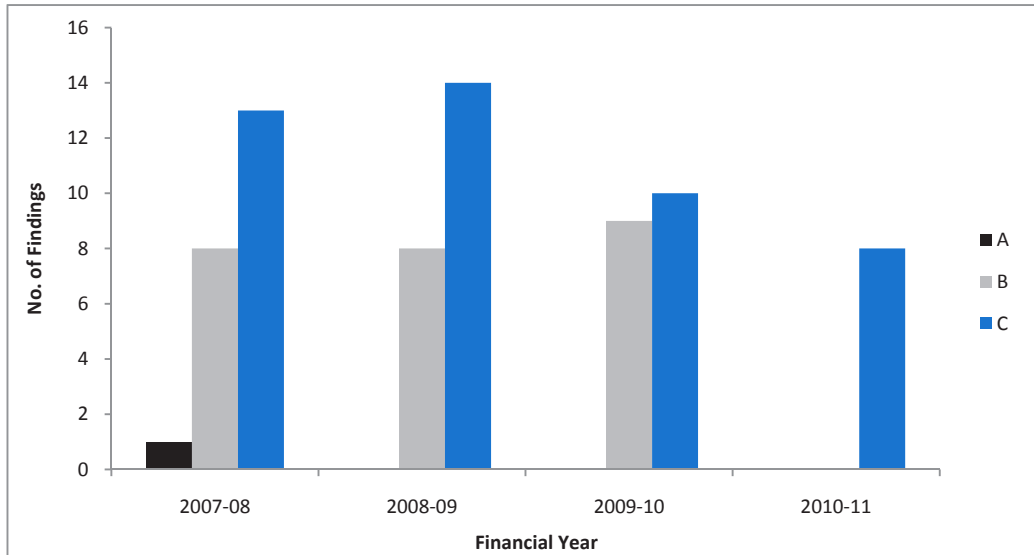
**3.60** In 2009–10, the Consolidated Financial Statements (CFS) reported total expenses for the payments of goods and services of \$68.2 billion.

**3.61** The main controls over purchases and payables which are given particular focus in our interim audits include: approval of the commitment and expenditure of public monies in accordance with delegations and authorisations; segregation of duties; controls to prevent duplicate payments; reconciliations between the general ledger and subsidiary accounts; and controls over credit card expenditure.

**3.62** The number of audit findings over the last four years are outlined in Figure 3.4 below.

**Figure 3.4**

**Purchases and payables - aggregate audit findings**



**3.63** Over the last four years, agencies' controls over purchases and payables subjected to audit review have been generally effective with a relatively small number of audit findings, representing some eight per cent of total audit findings. The results of our 2010–11 interim audits indicate that the majority of issues identified in previous audits have been addressed by agencies. These include: a lack of reconciliations of the general ledger with other accounts or key systems; inadequate segregation of duties; inadequate controls designed to prevent duplicate payments; weaknesses in controls designed to ensure the appropriate approval of the payment of public moneys; and lack of controls over credit card expenditure.

## Grant accounting

**3.64** Many agencies administer grant programs that involve the provision of funds to eligible recipients in accordance with legislative and policy requirements. Grant recipients include state and local governments and community organisations.

**3.65** The main controls over the accounting of grant expenditure include: approval of the commitment and expenditure of grants to eligible recipients;

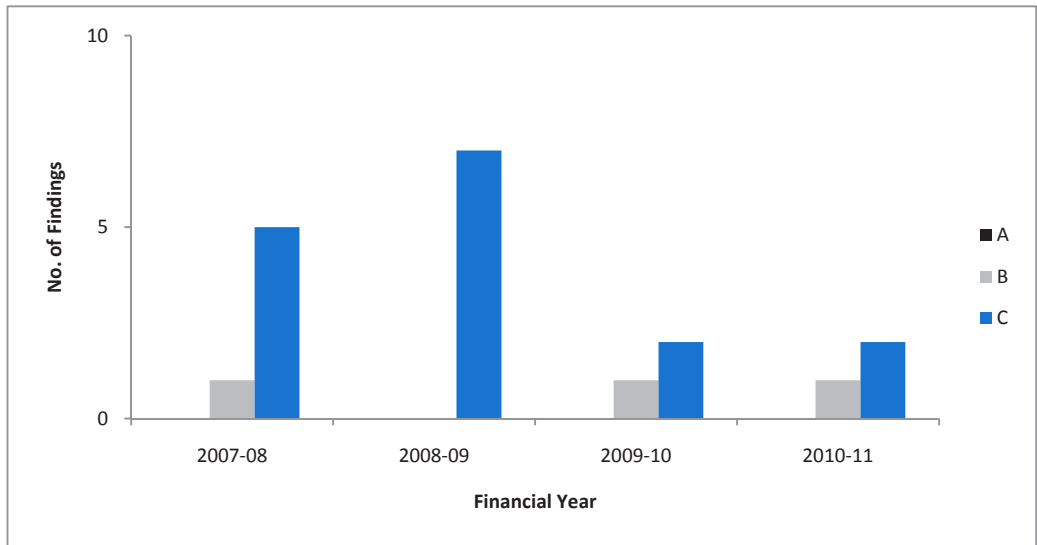
the payment of grants in accordance with funding agreements; and controls over grant acquittals. Our interim audit work reviewed these control areas.

**3.66** In 2009–10, the Consolidated Financial Statements reported total grant expenditure of \$124.9 billion.

**3.67** The number of audit findings over the last four years are outlined in Figure 3.5 below.

**Figure 3.5**

**Grant accounting - aggregate audit findings**



**3.68** Agencies’ controls over the payment of grants have been generally effective, with a very small number of audit findings representing two per cent of total audit findings.

**3.69** Audits of the general administration and the effectiveness of grant programs by agencies are included in the ANAO’s performance audit program. These audits generally include: assessment of processes by which grant applications are sought, received and assessed; the processes for the development and management of funding agreements with grant recipients; and how agencies assess and monitor the achievement of project and program outcomes. Our performance audits continue to identify the need for an improvement in a number of aspects of the administration of grants by agencies, including the assessment and approval of grant applications and the management of funding agreements.

**3.70** Since December 2007 the financial framework applying to the management of grants has been progressively enhanced, with a revised legislative and policy framework for grants administration coming into full effect on 1 July 2009. The new framework has a particular focus on the establishment of transparent and accountable decision-making processes for the awarding of grants. It involves:

- the continued application of the general requirements set out in the financial management framework regulating the expenditure of public money;
- new specific requirements under the financial management framework in relation to grants administration established through amendment of the FMA Act Regulations; and
- Commonwealth Grant Guidelines (CGGs) issued under the FMA Act Regulations. The CGGs list mandatory actions for Ministers and FMA Act officials, and set out seven principles<sup>22</sup> for sound grant administration that underpin the enhanced grants administration framework.

**3.71** An updated ANAO Better Practice Guide, *Implementing Better Practice Grants Administration*, was issued in June 2010 to assist agencies in their administration of grants.

## **Accounting and control of non-financial assets**

**3.72** The accounting and control of non-financial assets represents an important aspect of agencies' financial management responsibilities. Agencies control a diverse range of non-financial assets on behalf of the Commonwealth, with the main classes of assets being land and buildings, leasehold improvements, infrastructure plant and equipment, inventory and internally developed software.

**3.73** In 2009–10, the Consolidated Financial Statements reported total non-financial assets of some \$109 billion.

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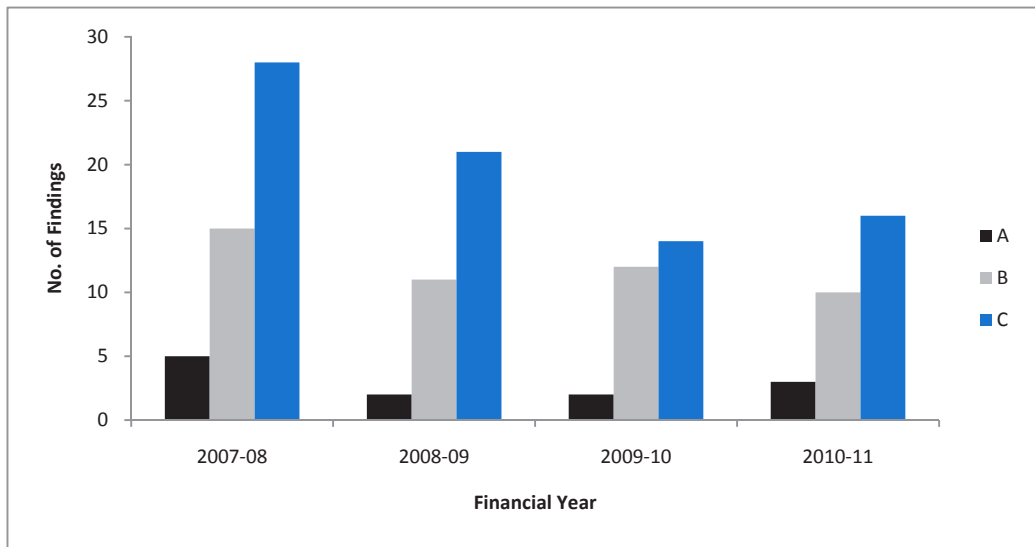
<sup>22</sup> The seven principles are: robust planning and design; an outcomes orientation; proportionality; collaboration and partnership; governance and accountability; probity and transparency; and achieving value with public money.

**3.74** The main controls over assets that are given particular focus in our interim audits include: the approval of the commitment and expenditure of public monies in accordance with authorisations and delegations; reconciliations between the general ledger and subsidiary asset accounts; the maintenance of a reliable asset register that includes information about assets acquired, disposed of, and asset locations; physical security over assets including asset identification numbers; the appropriateness of depreciation rates and useful lives; approval of, and the accounting for, the disposal of assets; and the periodic conduct of stocktakes. The valuation of assets is covered as part of our final audits.

**3.75** The number of audit findings over the last four years are outlined in Figure 3.6 below:

**Figure 3.6**

**Asset accounting and control of non-financial assets - aggregate audit findings**



**3.76** Over the last four years there have been 139 audit findings relating to the accounting and control of non-financial assets, representing approximately 15 per cent of the total number of audit findings. Overall, there has been a gradual reduction in total findings over this period. Common issues identified over the 4 years include: reconciliations between agencies' asset registers and 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

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.

## **Revenue, receivables and cash management**

**3.77** The main components of revenue and receivables consist of Parliamentary appropriations, taxation revenue, customs and excise duties and levy revenue. Other revenue is also generated by agencies from the sale of goods and services and a range of other sources including from interest earned from cash funds on deposit. Cash management involves the collection and receipt of public monies and the management of official bank accounts.

**3.78** In 2009–10, the Consolidated Financial Statements reported total taxation revenues of \$268 billion, and non-taxation revenues of \$30.9 billion and reported cash holdings totalling \$5.5 billion.

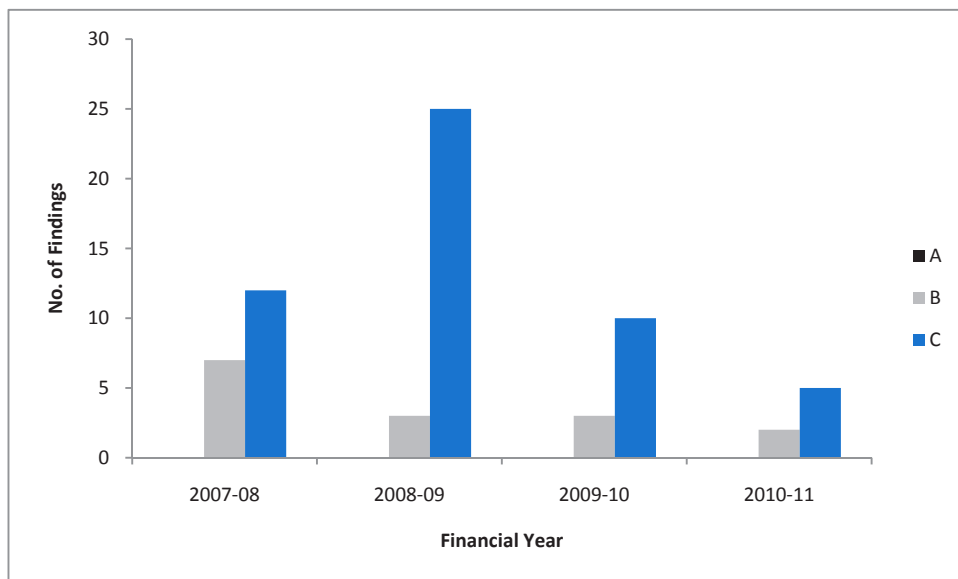
**3.79** The main controls over revenue and receivables that are given particular focus in our interim audits include: policies for the recognition of bad and doubtful debts; the regular review of receivables; and the segregation of receipting and recording of cash functions.

**3.80** The main controls over the management of cash that are given particular focus in our interim audits include: the approval to open and close bank accounts; the exercise of delegations; monitoring of budgeted cash inflows and outflows; and the preparation of bank reconciliations on a regular basis.

**3.81** The number of audit findings over the last four years are outlined in Figure 3.7 below.

**Figure 3.7**

**Revenue, receivables and cash management- aggregate audit findings**



**3.82** Over the last four years, our interim audits have identified that agencies' key controls over revenue, receivables and cash have generally been effective, with audit findings in respect of these areas representing approximately seven per cent of total findings.

### **Human resource management processes**

**3.83** Human resource management processes encompass the day-to-day management and administration of employee entitlements and payroll functions. The main components of employee expenses consist of salary and wages, leave and other entitlements, employer superannuation contributions, separation and redundancy payments and workers compensation expenses. These items represent a significant proportion of departmental expenditure for most agencies. Employee entitlement liabilities, particularly relating to annual and long service leave, generally are also one of the larger liabilities on an agency's balance sheet.

**3.84** In 2009–10, the Consolidated Financial Statements reported \$36 billion in employee benefits expenses.

**3.85** The main controls over human resource management processes that are given particular focus in our interim audits include: approvals over new employees processes; independent checks of employee salary and personnel

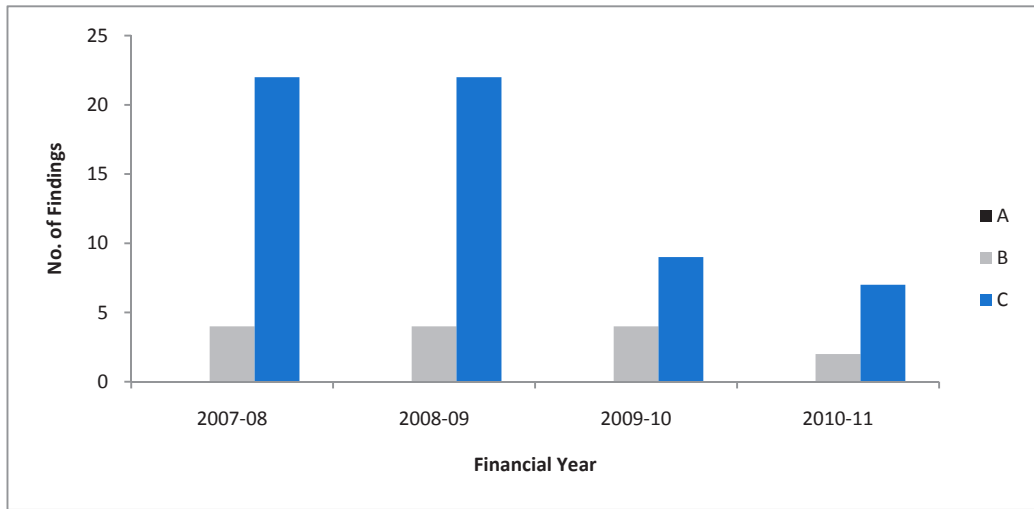


details entered into the HRMIS; approval of changes of key HRMIS data; independent checks over payroll processes; the accuracy of leave entitlement calculations; and the approval of leave final termination payments by the delegated officer.

**3.86** The number of audit findings over the last four years are outlined in Figure 3.8 below.

**Figure 3.8**

**Human resource management process - aggregate audit findings**



There have been 74 findings in this category, representing approximately eight percent of total audit findings.

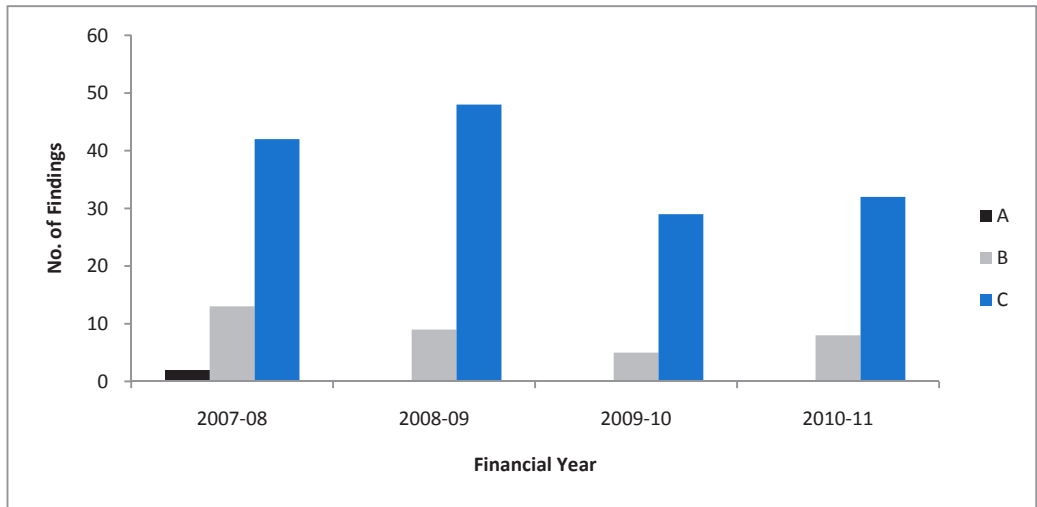
**Other control matters**

**3.87** Our audits also include a review of agencies' general control environments, particularly when they impact on agencies' financial statements. Issues considered include such matters as Business Continuity Management, the management of service level agreements and memoranda of understanding, and risk management and quality assurance processes.

**3.88** The number of audit findings over the last four years are outlined in Figure 3.9 below.

**Figure 3.9**

**Other control matters- aggregate audit findings**



**3.89** There have been 188 findings in this category, representing approximately 20 per cent of total audit findings. Common issues noted over the four years include: weaknesses in Business Continuity Management, particularly a lack of a comprehensive, agency-wide business continuity plans and the absence of established arrangements for the review and testing of plans (the results of our 2010–11 review of BCM are outlined at paragraphs 3.29 to 3.37 above); control weaknesses across a range of business processes; and the absence of, or delays in, conducting reconciliations in respect of a number of accounts or key processes.

**Monitoring of controls**

**3.90** Australian Auditing Standard ASA 315 at paragraph A98 states:

Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. Management accomplishes 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.

**3.91** 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 internal audit function to Australian Government agencies, and the requirements of Australian Auditing Standards, this function is reviewed by the ANAO each year to gain an understanding of its contribution to the overall controls environment.

## Monitoring of controls

### Internal audit function

**3.92** In the public and private sectors, internal audit has long been recognised by better practice entities as a valuable resource, and entities have given internal audit a key role in their governance arrangements.<sup>23</sup>

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

**3.94** 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 of a well performing Internal Audit function. The presence of these characteristics will provide confidence and assurance to Chief Executives and, where relevant, Boards that those financial and operational controls, which manage organisational risks, are operating in an efficient and effective manner.

**3.95** As part of the ANAO's 2010–11 interim audits of major agencies, a number of aspects of the internal audit arrangements for the agencies covered by this report were reviewed.

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<sup>23</sup> ANAO Better Practice Guide *Public Sector Internal Audit* September 2007, page 1.

### *Independence of the internal audit function*

**3.96** The effectiveness of internal audit is enhanced when the internal function is operationally independent from the activities it audits and reviews. This helps to ensure internal audit acts in an objective, impartial manner and avoids any conflicts of interest or inherent bias or undue external influence. Operational independence is enhanced when the head of internal audit reports functionally to the Audit Committee and is accountable to the Chief Executive.

**3.97** Our inquiries identified that in all<sup>24</sup> agencies the internal audit function is operationally independent, generally being functionally responsible to the Audit Committee and being accountable to the agency Chief Executive. While in a small number of agencies the head of internal audit reports to a line manager, the internal audit charter for these agencies provided for the head of internal audit to have access to the Chief Executive when required.

### *Internal audit standards*

**3.98** While not mandated in the public sector, it is generally accepted that internal audits should be conducted in accordance with professional standards. Such standards assist in:

- providing confidence in the quality and consistency of the work that has been conducted;
- guiding the work of auditors;
- delivering auditing services in an effective and efficient way; and
- establishing standards and benchmarks against which to measure the performance of internal audit.<sup>25</sup>

**3.99** Our analysis identified that the majority of agencies had specified the standards to be used in the conduct of internal audits. In most cases this was included in the Internal Audit charter or in the contract(s) with the external service provider(s) where internal audit services are outsourced. The most common standards specified were those issued by the Institute of Internal

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<sup>24</sup> Twenty-seven agencies are covered in this report. The analysis does not include the situation in the Department of Regional Australia, Regional Development and Local Government that was established on 14 September 2010, as the internal audit arrangements were still being finalised at the time of our audit enquiries.

<sup>25</sup> ANAO Better Practice Guide *Internal Audit in the Public Sector* September 2007, p. 6.

Auditors and those issued by the Australian Auditing and Assurance Standards Board.

**3.100** However, a small number of agencies did not specify the standards to be used in the conduct of internal audits and documentation of the standards applied was not evident.

**3.101** We also identified that only a small number of agencies identified the standards used in the conduct of the audit in individual audits reports.

**3.102** The ANAO considers it is important that all internal audits are conducted in accordance with professional standards and that the standards to be used are specified in the Internal Audit Charter and, where applicable, contracts with external service providers. Individual audits reports should also include a specific reference to the standards that have been complied with in the conduct of the audit.

**3.103** The ANAO notes the Department of Finance and Deregulation envisages changes to FMA Regulation 22C (Terms of reference for audit committees)<sup>26</sup> that include the requirement for an agency's audit committee to advise the agency Chief Executive on the professional standards to be applied in the conduct of internal audits.

#### *Planning and coverage of internal audit activity*

**3.104** To be most effective, internal audit activity should be properly planned and be aligned with the agency's risk management plan.

**3.105** Our inquiries identified that for all agencies that had prepared an internal audit plan, the plan aligned with the agency's risk management plan. While there was some variation in the nature and period covered by internal audit plans, the majority of agencies had developed a strategic longer term plan, in addition to an annual work plan that covered planned audit coverage for the next 6 to 18 months. In a small number of agencies, internal audit planning consists solely of an annual plan. In all agencies internal audit plans are subject to periodic review and approval by the audit committee.

**3.106** In broad terms, internal audit coverage can be grouped into four categories: compliance and assurance audits; performance related audits;

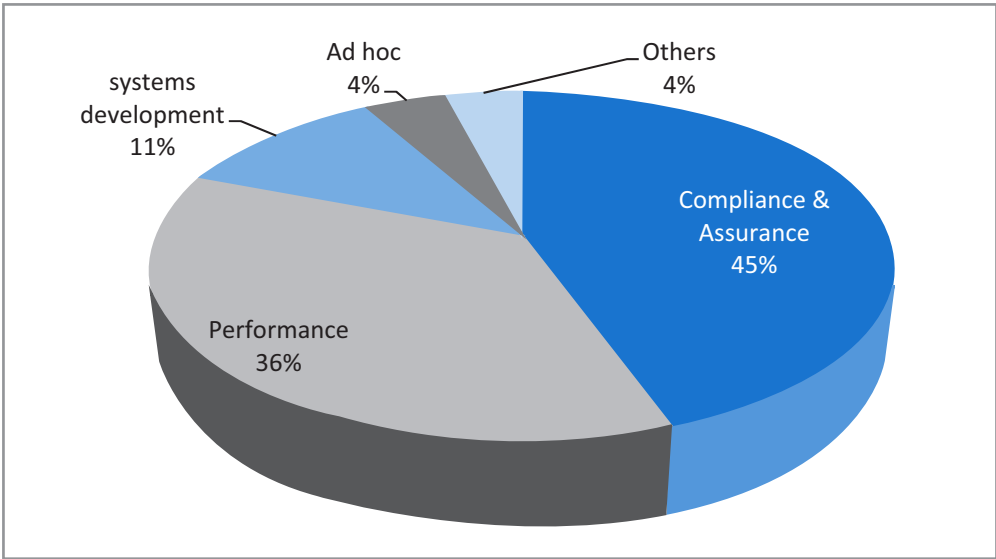
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<sup>26</sup> The revised Regulation is scheduled to take effect on 1 July 2011

system development audits; and ad hoc reviews or other services. An analysis of the internal audit plans is shown in the following figure:

**Figure 3.10**

**Analysis of internal audit coverage**



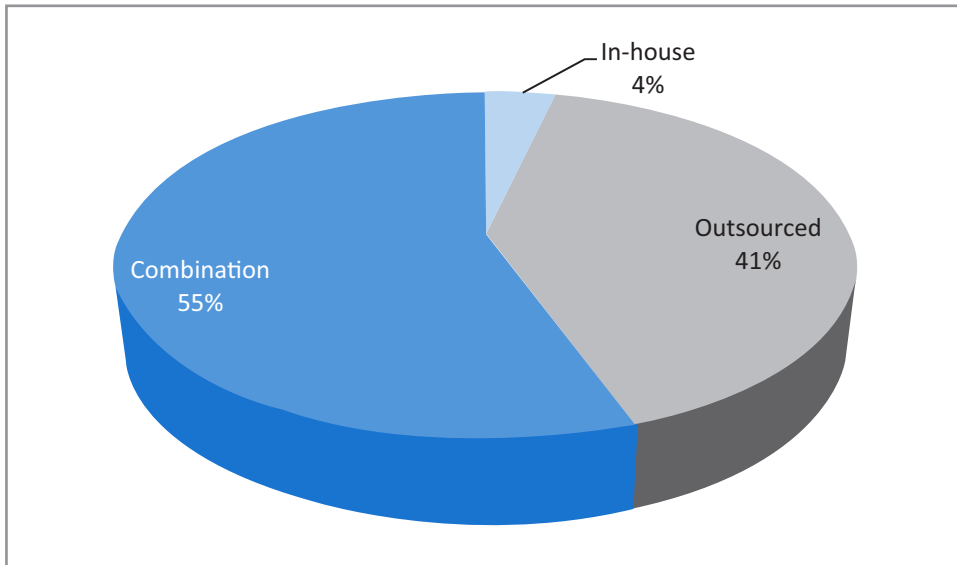
**3.107** Our analysis also found that in most agencies, internal audit was involved in the certificate of compliance process, as referred to at paragraph 3.24 above. This involvement ranged from direct involvement, whereby internal audit conducted audits with the objective of providing assurance over the agency’s certificate process, to indirect involvement, whereby internal audit reported potential legislative breaches identified during the course of its internal audits.

**3.108** The ANAO considers that internal audit can have a useful role in assessing agencies’ progress for meeting their certificate of compliance responsibilities. A number of better practice suggestions for agencies to consider are outlined in ANAO Audit Report No 38 *Management of the Certificate of Compliance Process in FMA Act Agencies*.

***Internal audit delivery methods***

**3.109** Agency internal audit services are delivered by: utilising in-house resources; utilising third party service providers; or a combination of both.

**3.110** The chart below provides a breakdown of the method of internal audit delivery for the entities covered in this report.

**Figure 3.11****Analysis of internal audit delivery models**

**3.111** The method of delivering internal audit services has remained stable over the last two years.

***Reliance on the work of internal audit***

**3.112** As part of its financial statement audit coverage, the ANAO reviews the activities of internal audit in accordance with Australian Auditing Standard ASA 610 *Using the Work of Internal Auditors*. The ANAO approach takes into account the work completed by internal audit, and, where appropriate, places reliance 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.

**3.113** The extent of the reliance on internal audit coverage depends on a range of factors including the nature, timing and quality of the work. The ANAO has planned as part of the 2010–11 financial statement audits to rely to some extent on work of internal audit in 16 agencies. The extent of reliance will depend on the final scope of internal audit work program and the timing and quality of the internal audit work undertaken.

### *Assessing internal audit performance*

**3.114** The periodic assessment of the performance of internal audit using a balanced set of indicators is an important responsibility of an agency's audit committee.

**3.115** The ANAO observed that the majority of agencies had evaluated the performance of their internal audit function in the last two years. These evaluations varied from the use of relatively simple client surveys, to more comprehensive processes involving the reporting of performance against a set of key performance indicators. The ANAO encourages agencies to regularly assess the performance of the internal audit function using a balanced set of agreed indicators.

### *Summary*

**3.116** It is encouraging to note that internal audit organisational and reporting arrangements in all agencies are designed to ensure the operational independence of internal audit. Audit committees regularly review internal audit plans, and the focus of internal audit covers compliance and assurance, performance and systems development work. This position, coupled with the proposed requirement in relation to the professional standards used to conduct internal audits provides a solid basis for internal audit to contribute positively to agencies' internal control framework and, in turn, agencies' financial statements.

## **Conclusion**

**3.117** The results of our 2010–11 interim audits identified that the effectiveness of controls over finance and accounting processes in the majority of agencies supports the production of reliable financial statement information, reflecting the general maturity of agencies' control environments. This situation is reflected in the progressive decrease in audit findings over recent years. The ongoing responsibility of agencies to monitor the effectiveness of their systems and related controls to be confident of the integrity of the financial information reported to management and in their financial statements will underpin a continuation of the situation.



## 4. Information Technology Controls

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

### Introduction

**4.1** Information Technology (IT) facilitates the way in which Australian Government agencies operate and support the business processes that deliver services to the Australian community. A review commissioned by the federal government estimated that the total government IT expenditure across the General Government Sector is in excess of \$5 billion.<sup>27</sup>

**4.2** The business processes that underpin financial statement preparation and reporting require the support of IT systems. As these processes form a key component of agencies' control environments, the ongoing evaluation of the IT control environment is a core component of the overall audit process. The ANAO reviews both IT general controls<sup>28</sup> and application controls<sup>29</sup> within these environments as part of its annual financial statement audits.

**4.3** This year's report continues our practice of including a review of key IT general control categories across agencies. It provides a broad perspective of the effectiveness of the implementation and operation of key IT controls, having regard to our focus on risks to the material misstatement of agencies' financial statements.

**4.4** The chapter also includes a discussion on trends observed in the four year period 2007–08 to 2010–11 in relation to a number of IT control categories.

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<sup>27</sup> 'Review of the Australian Government's Use of Information and Communication Technology', Sir Peter Gershon, August 2008, p. 46, estimated total government expenditure across the General Government Sector in 2007–08 was \$5.3 billion.

<sup>28</sup> 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 make sure IT application controls work as intended throughout the financial year.

<sup>29</sup> 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 provides a means to confirm the accuracy and integrity of agencies financial statements, particularly high transaction volume accounts.

## IT control environment

**4.5** The ANAO assesses the design, implementation and operation of key IT controls to determine their effectiveness in reducing risks to the integrity of financial information presented in agencies' financial statements. The ANAO undertakes this assessment in accordance with the Australian Auditing Standards each year<sup>30</sup>. The accuracy, completeness and validity of agencies' financial transactions and information are important considerations in formulating agencies' overall audit risk profile and, as such, it is important that controls are well designed and operated effectively.

### Changes to the IT control environment

**4.6** As part of our overall audit approach, a key step each year is an assessment of significant changes to agencies' control environments. By its nature, the IT control environment is subject to change and modification on a regular basis. For some agencies, changes to their IT systems, applications and processes represent major business change initiatives. Such changes can often have a fundamental impact on the underlying IT control environment.

**4.7** As part of our 2010–11 audits, the ANAO assessed, where applicable, major technology change activities within agencies. One example of this is agencies' ongoing responses to the *Review of the Australian Government's Use of Information and Communications Technology* (the Gershon Review)<sup>31</sup> and the *Data Centre Strategy 2010–2025*.<sup>32</sup> The purpose of this assessment was to understand the impact, if any, of these activities on agencies' IT control environments and, where necessary, tailor our audit procedures accordingly. Our focus was on aspects of the IT control environment that could result in the material misstatement of agencies' financial statements.

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<sup>30</sup> Australian Auditing Standards, ASA 315 *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*.

<sup>31</sup> *Review of the Australian Government's Use of Information and Communication Technology*, Sir Peter Gershon, August 2008. The Gershon Review was undertaken in 2008 at the request of the Australian Government to identify areas for efficiency improvement in the management of IT within and between agencies. The review's recommendations were all subsequently agreed to by the Government. In implementing these recommendations, agencies are proposing, or are in the process of implementing, a number of major IT initiatives to deliver improved IT efficiencies. These initiatives could result in significant changes to the future management and operation of technology environments in some agencies.

<sup>32</sup> *Australian Government Data Centre Strategy 2010 – 2025*, AGIMO. This strategy proposes a whole-of-Government approach to future data centre requirements.

## Elements of the IT Control Environment

4.8 Table 4.1 below outlines the elements of the IT control environment<sup>33</sup> reviewed by the ANAO as part of the 2010–11 financial statement audits of agencies covered by this report. A more detailed discussion of each element follows.

**Table 4.1**

### Elements of the IT control environment

Control Area	Control Element	Control Categories
<b>Environmental IT general controls</b>	IT security management	Network Security Physical Security Security Awareness and Training Security Governance Security Monitoring and Reporting User Access Management
	IT incident and problem management	Analysis and Reporting Configuration Management Tools Incident Management Processes Link to Change Management Problem Management Processes Service Desk
	IT change management	Approval and Tracking Backout Procedures Change Logs and Reporting Emergency Changes Policy and Governance Frameworks Release Management

<sup>33</sup> Given the extensive number of individual controls assessed by the ANAO each audit, for the purposes of this report we group controls into a series of elements, for example IT security or IT change management, and then into control categories within each element.

Control Area	Control Element	Control Categories
<b>Application specific IT general controls</b>	Financial Management Information System	Application Change Management Business Continuity Masterfile Maintenance Payment Processing Reconciliations Privileged User Management User Access Management User Support and Training
	Human Resource Management Information System	Application Change Management Business Continuity Masterfile Maintenance Payroll Processing Privileged User Management User Access Management User Support and Training

Source: ANAO compilation

**4.9** The charts and associated commentary that follow reflect our assessment of the integrity of environmental IT general and application specific IT general controls, as set out in Table 4.1 above, of 26 agencies.<sup>34</sup> Where comparative figures have been included, those for 2009–10 are for 26 agencies, 2008–09 are for 25 agencies, and the figures for 2007–08 are for 23 agencies.<sup>35</sup>

## IT general controls

**4.10** General controls are the foundation of agencies' IT control structures. They commonly affect all information systems and establish the environment in which application systems and controls operate. The ANAO's review of general controls focused on the controls present in the IT environment surrounding those systems that process financial transactions and information.

<sup>34</sup> The Board of Guardians and the Future Fund Management Agency is not included in this analysis.

<sup>35</sup> This report focuses on the results of the interim audit phase of the financial statements audit of all portfolio departments and other major General Government Sector agencies that collectively represent some 95 per cent of total GGS revenues and expenses. The total number of agencies in this category can vary from year to year.

## IT security management

**4.11** The administration of government programs often involves agencies managing, protecting, and preserving large amounts of financial and personal information. The integrity of such data can be threatened by an IT security event, and risk the accuracy and completeness of agencies' financial information. Some events can also pose a risk to the legal, privacy, and operational responsibilities of agencies, and may result in loss of public confidence.

**4.12** IT security management is the primary mechanism used to protect information and information systems from unauthorised access, use, disclosure, modification, or destruction. The minimum standards for the protection of Australian Government information and data that agencies must meet are detailed in the Protective Security Policy Framework (PSPF)<sup>36</sup> and the *Australian Government Information and Communications Technology Security Manual (ISM)*<sup>37</sup>.

**4.13** The ANAO reviewed the following categories of IT security management that are fundamental to safeguarding the security and confidentiality of agencies' financial information:

- network security processes and procedures;
- physical security processes and procedures;
- security awareness and training;
- security governance frameworks, policies and procedures;
- security monitoring and reporting; and
- user access management, identification and segregation of duties.

<sup>36</sup> The *Protective Security Policy Framework (PSPF)* is the source of policies, procedures, and minimum standards for agencies in setting their protective security arrangements.

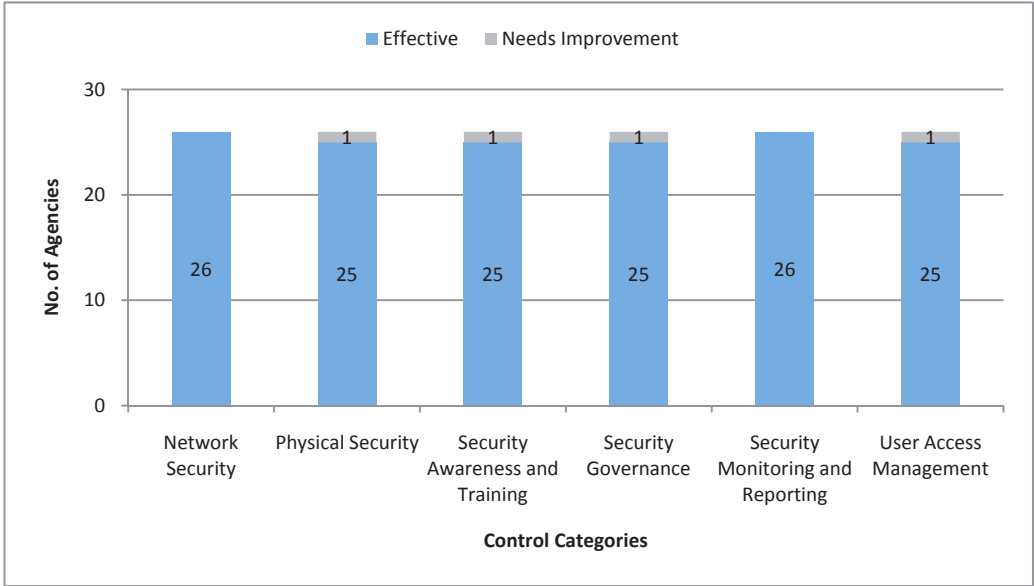
<sup>37</sup> The *Australian Government Information and Communications Technology Security Manual* complements the PSPF by providing policies and guidance to assist Government agencies to achieve an assured IT security environment. The *Australian Government Protective Security Manual (PSM)* previously set out the policies, practices, and procedures that provide for an appropriate protective security environment but has been superseded by the Protective Security Policy Framework. The status of the PSM was changed to that of a supporting document in June 2010. There is a 12-month transition period between the introduction of the new PSPF and the phasing out of the PSM.

Observations

4.14 A summary of the ANAO’s assessment of the effectiveness of security control categories within agencies, in the context of how they affected the ability to maintain the reliability and integrity of data, systems and services that support the preparation of financial statements, is provided in Figure 4.1 below.

Figure 4.1

2010–11 Assessment of IT security management



4.15 Overall, the ANAO found the security management controls implemented by agencies were effective. In particular, almost all agencies had established effective security governance frameworks, and had implemented effective controls for managing their IT security responsibilities. The areas requiring improvement were minor, and, in most cases, were progressively being addressed by agencies.

4.16 The ANAO also observed effective controls in most agencies in the areas of security incident monitoring and reporting, and security awareness and training. In addition to the financial statement audit work, a recent ANAO Audit Report No. 33, 2010–11 *The Protection and Security of Electronic Information held by Australian Government Agencies* reported that the processes used to protect and secure electronic information were generally operating in accordance with Government protective security requirements.

**4.17** No systematic security governance or management failures were observed, although our audits identified specific operational security weaknesses in some agencies, such as user access management within FMIS and HRMIS applications, which are discussed later in this chapter.

## **IT incident and problem management**

**4.18** In the normal course of business operations, agencies will be affected from time to time by IT system incidents. These incidents may interrupt the availability of an IT system, which in turn may affect the quality and accuracy of system data. If the handling of these incidents is not effective, they may affect an agency's level of service delivery. Incident management refers to the methods and procedures used for handling and resolving these incidents.

**4.19** Agencies may also encounter IT problems in their operations. An IT problem is defined as an event that affects a system's operations. This can be as a result of a single incident, or multiple incidents that had a common source. Problem management is the process of finding and resolving the underlying causes of related incidents.

**4.20** Agencies commonly use a service desk<sup>38</sup> approach to establish centralised and structured processes for collecting, managing, and responding to incidents and problems.<sup>39</sup> Effective implementation of a service desk assists agencies to minimise adverse impacts to service delivery from IT incidents and problems.

**4.21** The following control categories for incident and problem management were examined by the ANAO:

- incident and problem analysis and reporting.
- incident management processes;
- link to change management processes;
- problem management processes;
- service desk procedures; and
- use of configuration management tools.

<sup>38</sup> Also commonly referred to as an IT Helpdesk.

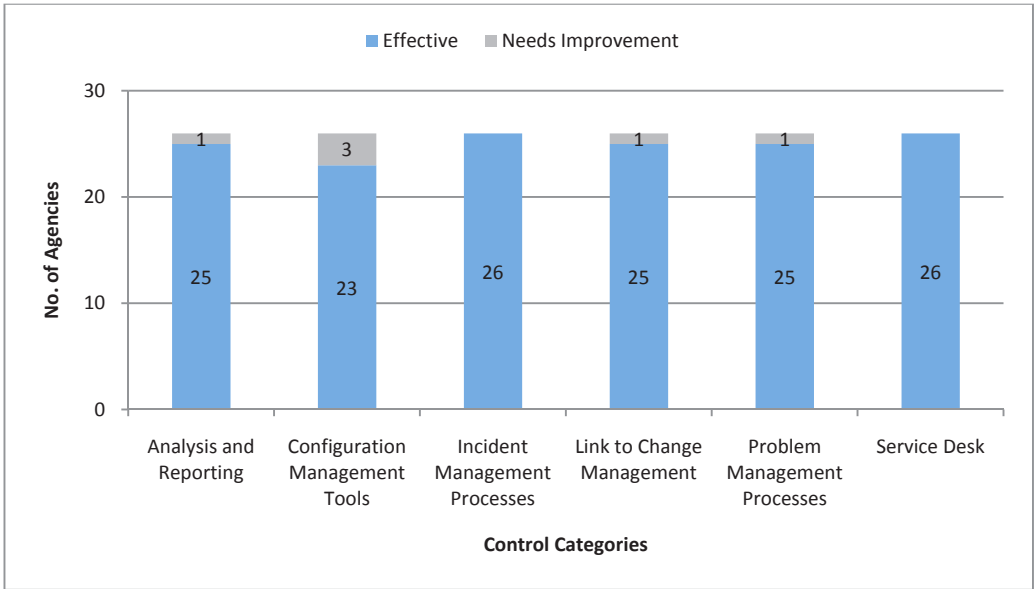
<sup>39</sup> IT incidents and problems are generally daily events and are 'business-as-usual' or routine matters that every agency encounters and must manage.

Observations

4.22 A summary of the results of our assessment of the control categories for incident and problem management is outlined in Figure 4.2 below.

Figure 4.2

2010–11 Assessment of IT incident and problem management



4.23 Overall, our 2010–11 audits identified that agencies have implemented effective incident and problem management controls. In particular, the use of a service desk as a central management point for IT incidents and problems is now well established across all agencies reviewed, with only minor improvements being required in some agencies.

4.24 The most common weakness identified related to the implementation of an integrated configuration management tool, with around 12 per cent (three agencies) not having implemented this control. Configuration management tools are used to store system hardware and software information in a central location, and in a common format. A lack of centralised information about the IT environment may complicate the installation of new hardware, software, or affect the capacity to recover from a business continuity or disaster recovery event.



## IT change management

**4.25** The IT change management process is a standardised approach for agencies making general changes to an IT environment. A change management process covers changes to all technology and communications components, including networks, hardware platforms, application software, and requires appropriate supporting process and procedure documentation. The aim of the change management process is to manage changes in a controlled and timely manner, with a minimal number of incidents or problems occurring on release to the production environment.

**4.26** The ANAO tested controls supporting the change management process, in the context of changes made to the key financial systems supporting the preparation of an agency's financial statements, in the following key categories:

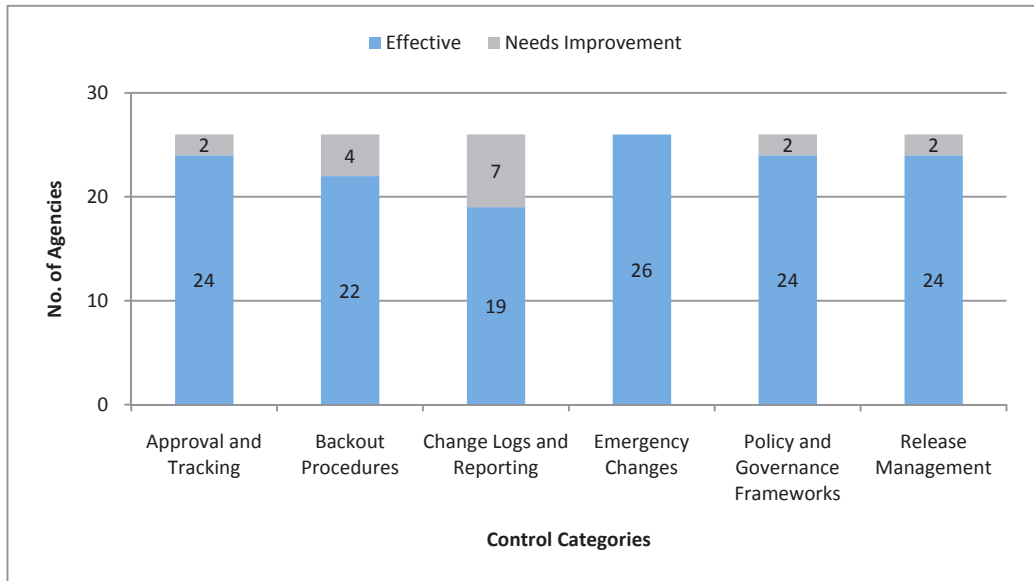
- change approval, prioritisation and tracking;
- change backout procedures.
- change logs and reporting;
- change management policy and governance frameworks;
- emergency change procedures; and
- release management procedures.

### *Observations*

**4.27** The findings from our testing of IT change management controls are summarised in Figure 4.3 below.

**Figure 4.3**

**2010–11 Assessment of IT change management**



**4.28** While most agencies had effective change management policies and governance frameworks, over 25 per cent (seven agencies) had not fully implemented audit logging and reporting over their change management process. This situation reduces the level of management oversight and control over system changes, and increases the risk of system changes being implemented that may affect the integrity of financial information.

**4.29** In addition, over 15 per cent (four agencies) had not established consistent back-out procedures for the release of changes to the production environment, presenting additional risks to system availability or integrity. Back-out procedures provide a key mitigating control to return a system and its information to its previous state, if required.

**4.30** Overall, no systematic change management weaknesses were observed, although our audits did identify specific weaknesses in some agencies, which are reported in Chapter 5.

## Application specific IT related controls

**4.31** Australian Government agencies generally rely on two key financial reporting systems in the preparation of financial information. These are the Financial Management Information System (FMIS) and the Human Resource Management Information System (HRMIS)

**4.32** Due to their importance for financial reporting, the ANAO reviews the key FMIS and HRMIS controls across all agencies. While there is a range of application systems utilised by agencies, similar sets of controls are required to help preserve the reliability and integrity of financial information.

**4.33** The ANAO has recently published a Better Practice Guide, *Human Resource Information Systems: Risks and Controls*, to assist agencies in managing the risks involved in these functions.

**4.34** The figures below detail the various FMIS and HRMIS financial reporting applications used by the agencies covered by this report.

Figure 4.4

Summary of FMIS applications 2007–08 to 2010–11

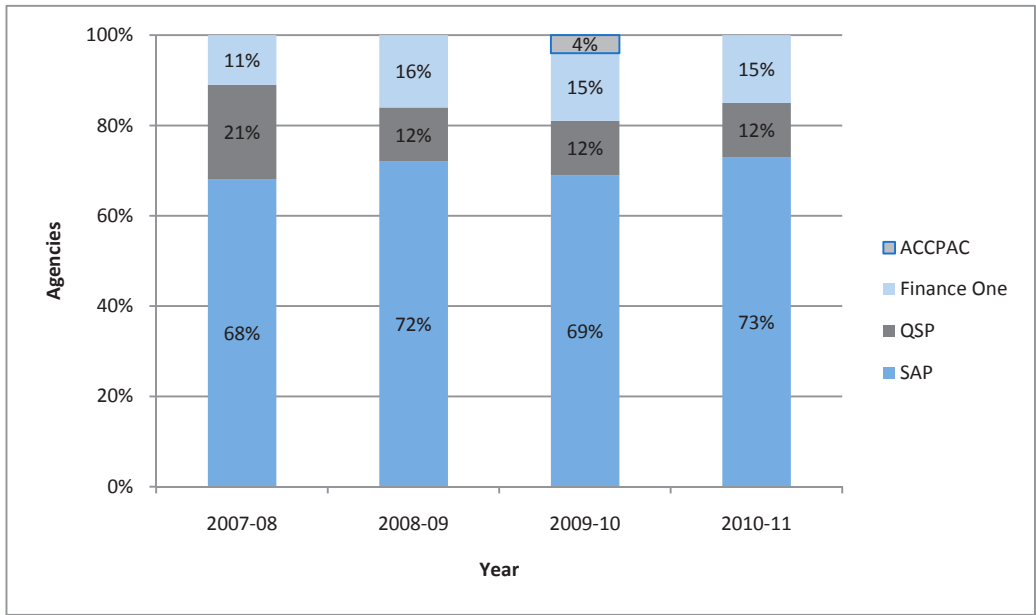
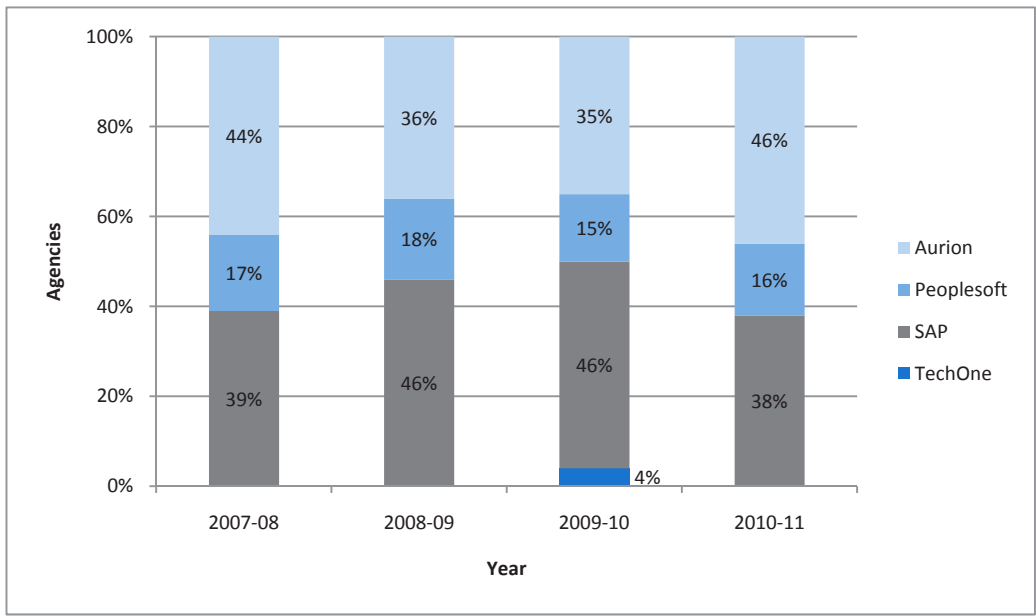


Figure 4.5

Summary of HRMIS applications 2007–08 to 2010–11



**4.35** The ANAO observed that there has been little change in the range of applications utilised by agencies over the past four years, although ACCPAC and TechOne are not being used in 2010–11 by any agencies in this report.

## **Financial Management Information Systems**

**4.36** The FMIS is the IT application that processes financial transactions and summarises financial information. It supports financial management decision-making, budget and financial planning, and the preparation of agency financial statements.

**4.37** The following FMIS control categories were reviewed as part of the 2010–11 financial statement audits:

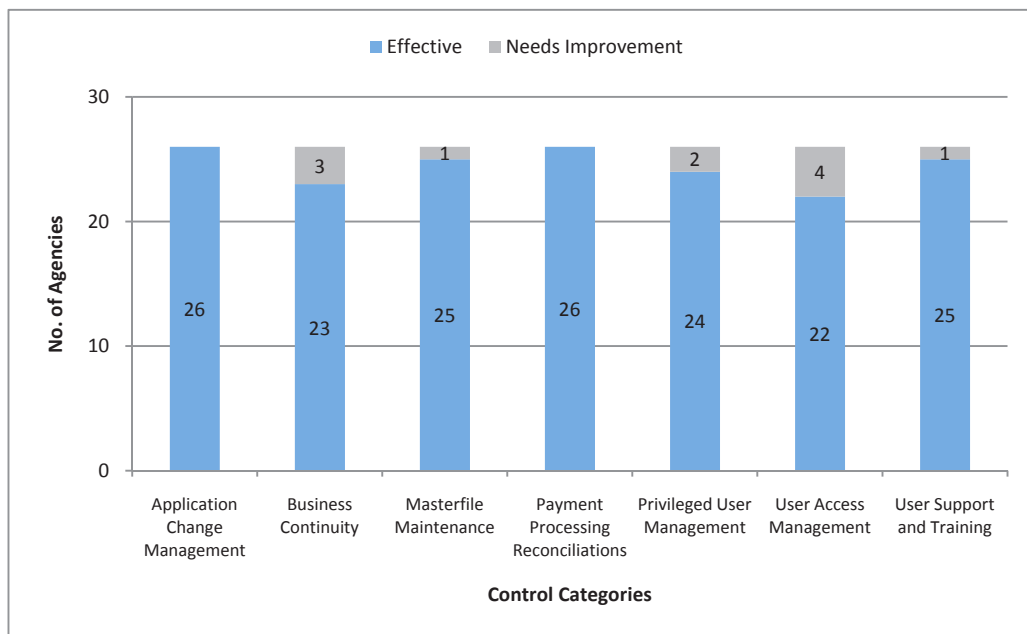
- application change management;
- business continuity;
- maintenance of masterfile reference information;
- payment processing reconciliations;
- privileged user management;
- user access management; and
- user support and training.

### *Observations*

**4.38** The ANAO assessment of the key FMIS control categories integral to effective financial management and reporting, in the context of agencies' financial statements, is summarised in Figure 4.6 below.

**Figure 4.6**

**2010–11 assessment of FMIS's**



**4.39** The ANAO found the key FMIS controls used to support the preparation of financial statements were generally effective in most agencies. In particular, all agencies had systems in place to verify that the reconciliation of payment processing files occurred. This is a key control for maintaining the integrity of financial information.

**4.40** However, the ANAO's audits identified that FMIS user access controls required improvement in over 15 per cent (four agencies). This includes weaknesses in the segregation of duties. When there is not adequate segregation, such as the ability to both enter and authorise a payment, it is possible for individuals to undertake actions that may undermine the integrity of financial systems and information.

**4.41** In addition, around 12 per cent (three agencies) did not have a comprehensive and tested business continuity plan in place for their FMIS. Any failure in the FMIS resulting from a business disruption event could have significant consequences for an agency's capacity to maintain the completeness, accuracy, and availability of financial information. While FMIS applications should be part of an agency's business continuity plan, their critical importance means that the FMIS business continuity plan should be subject to regular testing and updating when required.

## Human resource management information systems

**4.42** The HRMIS is the IT application that facilitates strategic and operational decision-making for payroll and human resource management. The data held in the system is a major component of the financial reporting process.

**4.43** The key categories of HRMIS controls reviewed as part of the 2010–11 audit coverage were:

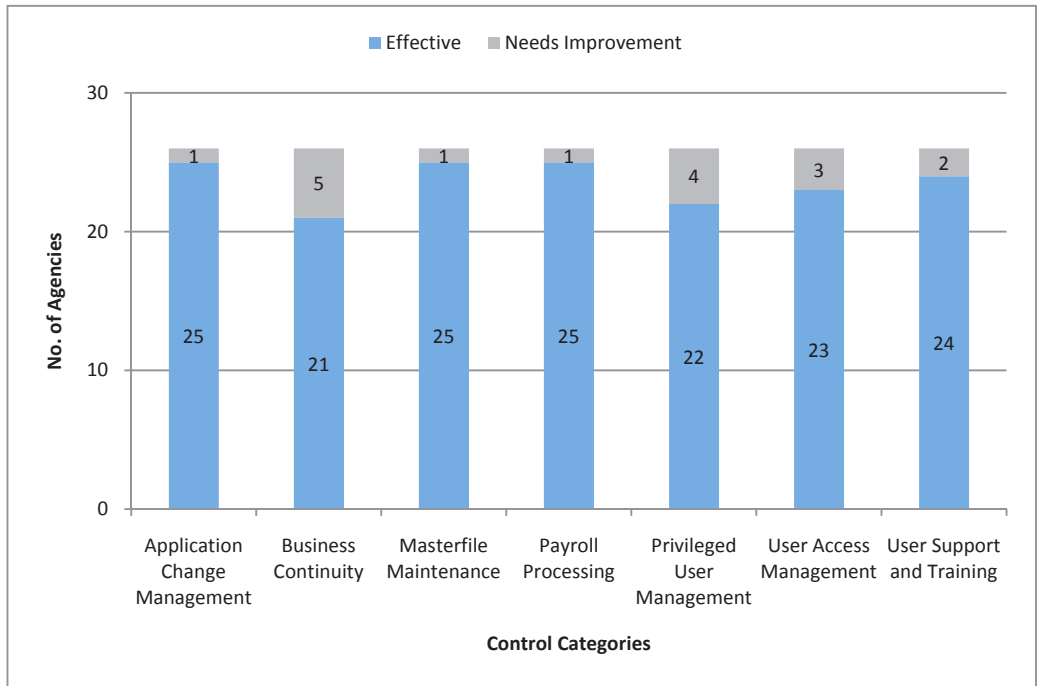
- application change management;
- business continuity;
- maintenance of masterfile reference information;
- payroll processing management;
- privileged user management;
- user access management; and
- user support and training.

### *Observations*

**4.44** The ANAO assessment of key HRMIS control categories that enhance the completeness and accuracy of HR financial information, in the context of agencies' financial statements, is outlined in Figure 4.7 below.

**Figure 4.7**

**2010–11 assessment of HRMIS’s**



**4.45** The ANAO found the key HRMIS controls used to support the preparation of agency’s financial statements were also generally effective in most agencies. However, the ANAO identified inadequate privileged and user access management controls in some agencies. Appropriately managing HRMIS system administrators and other users who have high levels of access to HRMIS financial transactions and information is required to manage the risk of inappropriate access.

**4.46** In addition, management of HRMIS general user access, involving situations where users are making changes to human resources data, is an area requiring improvement in some agencies. Poor practices in relation to general user management, such as insufficient activity logging, present a risk to the reliability and integrity of agencies’ HR-related financial information.



## Trends over the period 2007–08 to 2010–11

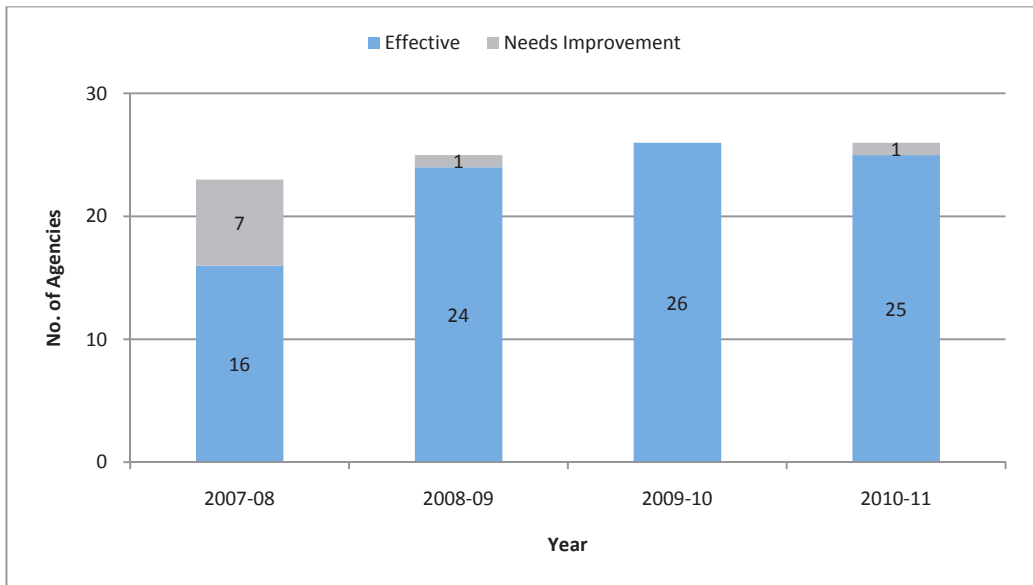
**4.47** The ANAO's ongoing assessment of agencies' IT control environments has identified a number of trends over the period 2007–08 to 2010–11 for particular control categories. Some trends point to areas that have improved over the last four years, while others suggest that further management attention is required in a number of agencies. The most significant of these trends is discussed below.

### IT security governance

**4.48** IT security governance frameworks are an overarching set of structures, policies and procedures that address security matters within an agency. As illustrated in Figure 4.8 below, over the last four years, a positive trend has been identified in respect of IT security governance within agencies.

**Figure 4.8**

#### IT security governance: 2007–08 to 2010–11



**4.49** Over the past four years, there has been an improvement in the effectiveness of agency security frameworks. In 2007–08, over 30 per cent (seven agencies) did not have effective security governance frameworks; in 2010–11, all but one agency had effective controls in place.

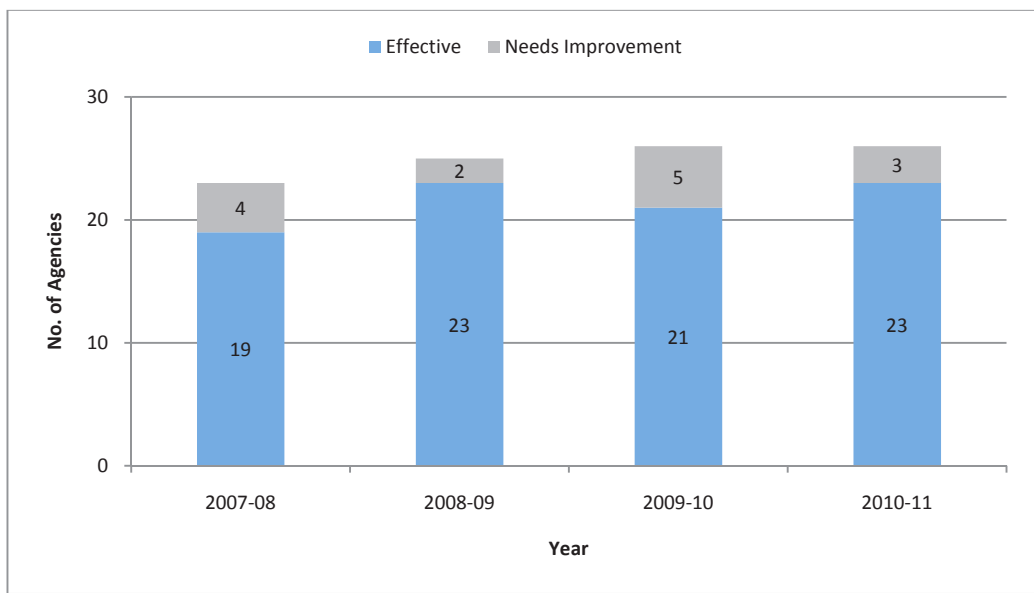
**4.50** The sustained improvement indicates that agencies have implemented procedures to establish, regularly maintain, and update their security governance frameworks, and positions agencies well to remain current with technical innovations, and organisational changes.

**Configuration management tools**

**4.51** Configuration management tools, such as a Configuration Management Database (CMDB), assist agencies to maintain the integrity of technology systems by storing information about system attributes in a central location and in a common format. The ANAO observations regarding configuration management tools over the last four years are summarised in Figure 4.9 below.

**Figure 4.9**

**Configuration management tools: 2007–08 to 2010–11**



**4.52** There has been a steady improvement in the adoption and use of these tools since 2007–08, although in 2010–11 around 12 per cent (three agencies) still did not utilise such a tool, or had not implemented a process for regularly updating the tool. While some agencies had initiated projects to create and populate a CMDB, until these processes have been implemented, and the CMDB is regularly updated, procedures for managing incidents and problems may be less efficient and effective.

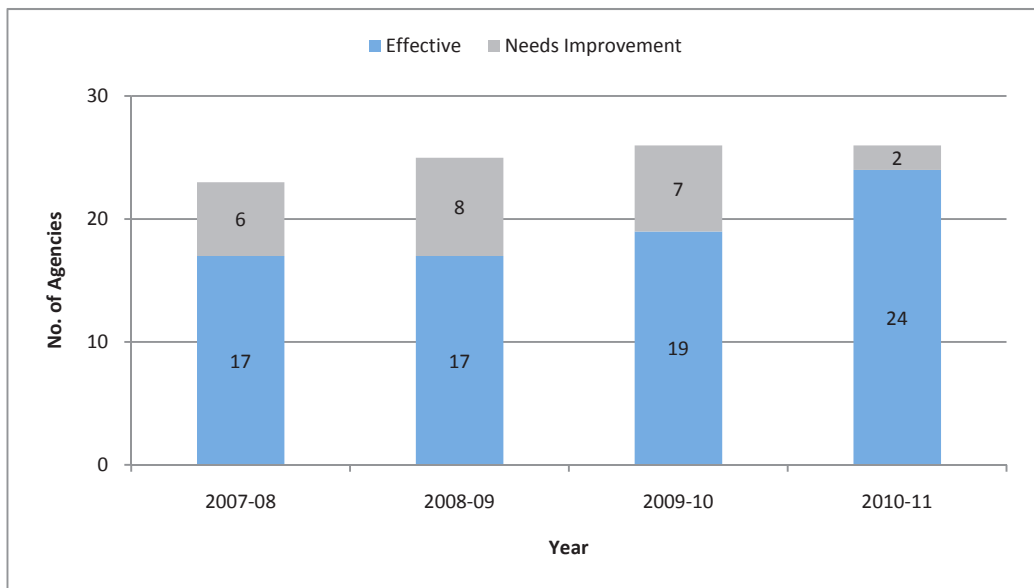
## IT change management policy and governance frameworks

**4.53** IT change management policy and governance frameworks assist agencies to create a consistent and reliable approach to making changes in their IT environment.

**4.54** Due to the continually changing nature of the IT environment, the controls surrounding change management require regular review to maintain their currency and applicability. The ANAO observations regarding change management policy and governance frameworks over the past four years are summarised in Figure 4.10 below.

**Figure 4.10**

**Change management policy and governance frameworks: 2007–08 to 2010–11**



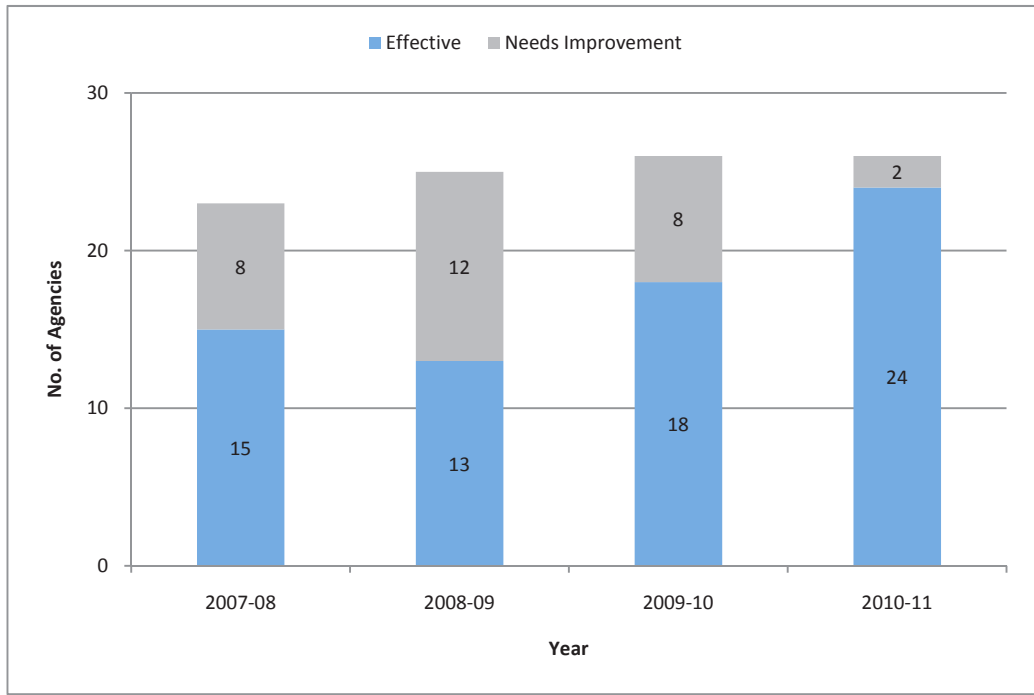
**4.55** The policy and governance structures that support change management processes have shown a marked improvement in the past year. From 2007–08 to 2009–10, 25 per cent or more of agencies did not regularly review and maintain their change management policy and governance frameworks. Our testing identified that in 2010–11, that had reduced to fewer than 10 per cent (two agencies).

# FMIS privileged user management

4.56 FMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and change data within the FMIS. The ANAO observations regarding FMIS privileged user management over the past four years are summarised in Figure 4.11 below.

Figure 4.11

FMIS privileged user management: 2007–08 to 2010–11



4.57 The administration of FMIS privileged user accounts has also shown marked improvement in 2010–11 compared with the previous three years. In 2010–11 fewer than 10 per cent (two agencies) were not effectively managing the risks arising from this level of access to financial information, compared with over 30 per cent (eight agencies) in 2009–10.

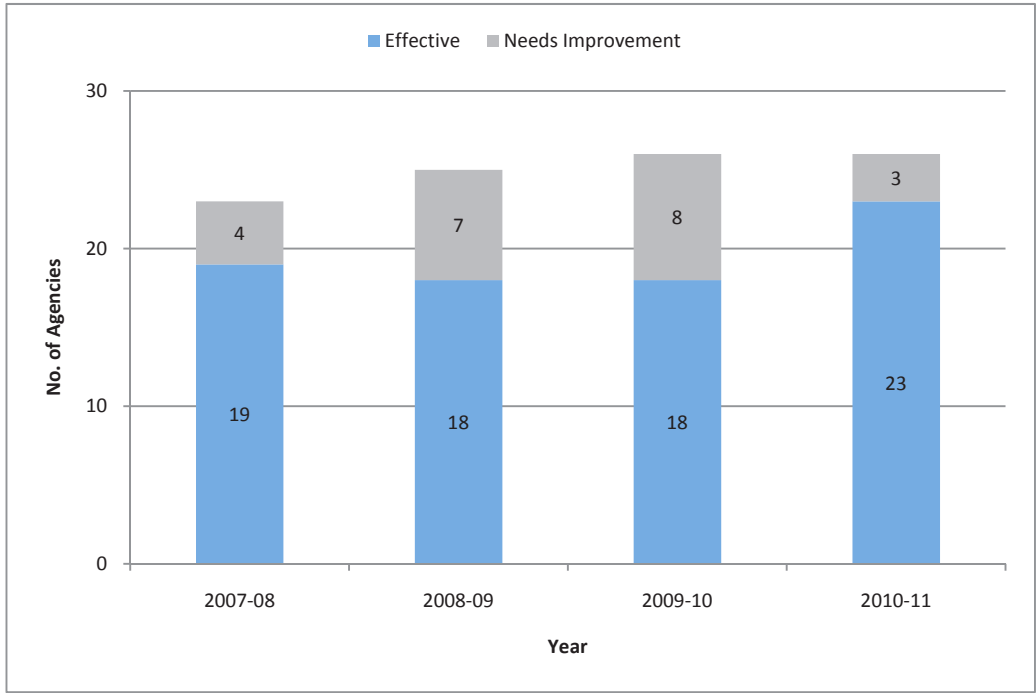
4.58 This improvement indicates that most agencies are now managing, logging, and properly monitoring privileged user activities. These are important controls to prevent or detect inappropriate use of the greater access afforded to these users.

**FMIS business continuity**

**4.59** In view of the key role of the FMIS in the effective management of an agency, it is important to have a business continuity plan for the FMIS in place. The ANAO observations regarding the management of FMIS business continuity risks over the past four years are summarised in Figure 4.12 below.

**Figure 4.12**

**FMIS business continuity: 2007–08 to 2010–11**



**4.60** The effectiveness of FMIS business continuity arrangements has improved significantly in the past year. In 2009–10, over 30 per cent (eight agencies) were not effectively implementing controls to manage business continuity risks. In 2010–11, this has reduced to around 12 per cent (three agencies).

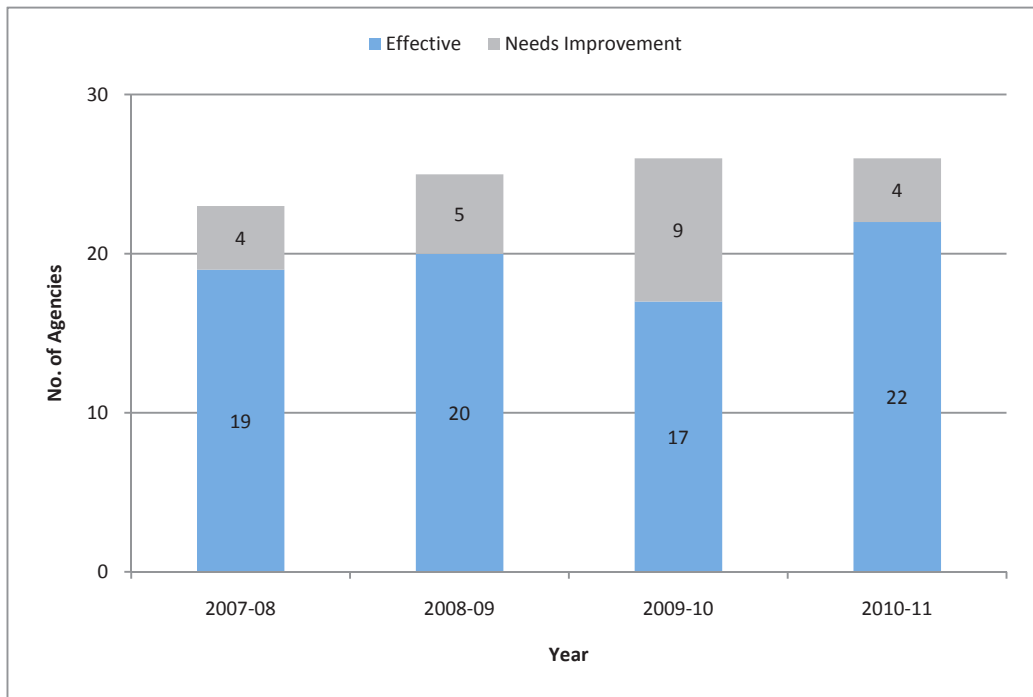
**4.61** The ongoing management of business continuity risks requires business continuity plans to be well designed, regularly tested, and updated as required. The improvements identified indicate that there is an improved likelihood that agencies will be able to recover financial information if a business disruption occurs.

**HRMIS privileged user management**

**4.62** HRMIS privileged user management involves implementing a regime of system restrictions on users in respect of their access rights to edit and change data within the HRMIS. The ANAO observations regarding HRMIS privileged user management over the past four years are summarised in Figure 4.13 below.

**Figure 4.13**

**HRMIS privileged user management: 2007–08 to 2010–11**



**4.63** In 2010–11 there was a significant improvement in the administration of HRMIS privileged user accounts. In 2009–10, almost 35 per cent (nine agencies) needed to improve their controls in this area. In 2010–11, this has reduced to around 15 per cent (four agencies). As these users typically have full access to all HRMIS financial transactions and information, there remains a risk to the integrity of financial and other information in the HRMIS for these agencies.

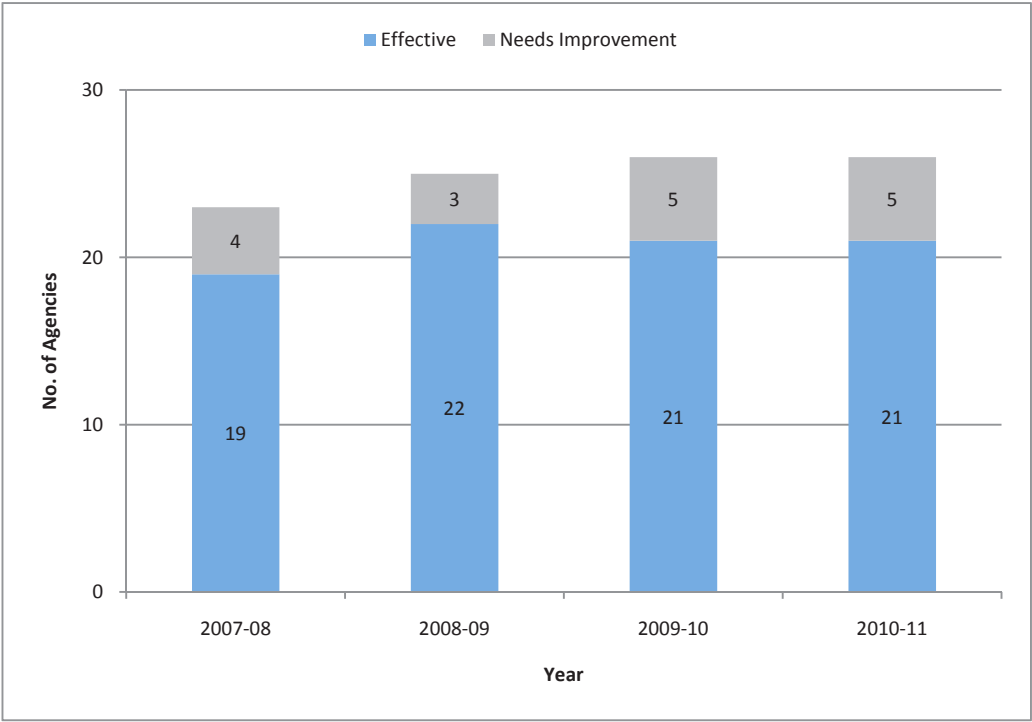
**HRMIS business continuity**

**4.64** In view of the key role of the HRMIS in the effective management of an agency, it is important that agencies have a business continuity plan for the HRMIS. The ANAO observations regarding the management of HRMIS

business continuity risks over the past four years are summarised in Figure 4.14 below.

**Figure 4.14**

**HRMIS business continuity: 2007–08 to 2010–11**



**4.65** The effectiveness of HRMIS business continuity arrangements has remained relatively constant over the past four years. In 2010–11, around 20 per cent (five agencies) did not have effective business continuity arrangements, which is similar to the situation in 2009–10.

**4.66** Management of business continuity risks requires business continuity plans to be well designed, regularly tested, and updated as required. In agencies that do not have effective business continuity arrangements, there is a continuing risk that some agencies will not be able to fully, or effectively, recover human resources information if a business disruption occurs.

## Conclusion

**4.67** The effective implementation and operation of general and application specific general controls assists agencies to provide services in a reliable, timely and consistent manner. Such controls also reduce the risk of financial information being inaccurate, incomplete, or stored insecurely.

**4.68** The overall improvements in agencies' incident and problem management controls have been a positive development observed during the 2010–11 audits. Agencies have generally been able to demonstrate effective incident and problem management processes.

**4.69** However, the ANAO has identified areas that warrant improvement within other key IT general controls. Our assessment of FMIS and HRMIS business continuity arrangements has identified that the effectiveness of these arrangements had improved for FMIS, but that this improvement was not matched in the management of HRMIS business continuity. As a result, in the event of a business disruption, there is a continued risk that some agencies may not be able to fully, or effectively, recover their human resources information in a timely manner.

**4.70** The management of user access, particularly the logging and monitoring of user activities for privileged users, remains an area that requires further attention in some agencies. The ongoing effectiveness of user access controls is an important element in maintaining the integrity of agencies' financial information. To address these weaknesses, agencies should have appropriate user access policies and procedures in place across the entire IT environment. Such policies and procedures should align with agencies' information security policies.

**4.71** In future audits, the ANAO will focus attention on business continuity and disaster recovery arrangements, and FMIS and HRMIS user access and privileged user access management. The ANAO will also continue to assess the impact on the IT controls environment of changes arising from major change initiatives, such as the *Data Centre Strategy 2010–2025* and the *Cloud Computing Strategic Direction Paper*.

**4.72** The ANAO will also continue to monitor any technology trends and their potential impact on the control environments of Australian Government agencies.



## 5. Interim Audit Results by Agency

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*This chapter summarises the results of the interim phase of the 2010–11 financial statement audits of the 27 agencies, grouped by portfolio, covered by this report.*

### Introduction

**5.1** This chapter summarises the results of the ANAO's 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 2011. 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 progressively to allow agencies to submit audit cleared financial information to the Department of Finance and Deregulation (Finance)<sup>40</sup> for the purposes of informing the government of the General Government Sector's financial outcome for the 2010–11 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 for the year ended 30 June 2011, expected to be tabled in December 2011.

**5.4** This chapter outlines the following information for each agency:

- a summary of the agency's business operations and the key characteristics of these operations that shape the ANAO's 2010–11 audit coverage;
- key financial figures and staffing levels for 2009–10 and 2010–11<sup>41</sup>;
- governance arrangements relevant to the agency's financial management responsibilities;

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<sup>40</sup> The deadlines for the submission of audit cleared information are 15 August for material agencies and 31 August for non-material agencies.

<sup>41</sup> These figures are sourced from each agency's 2011–12 Portfolio Budget Statements, audited 2009–10 financial statements, or as advised by agencies.

- the key areas of audit focus for the audit of the 2010–11 financial statements; and
- any significant and moderate (Category A and B) audit findings, and the conclusion relating to the audit coverage undertaken to date.

**5.5** Category C audit findings reported to management relate to relatively 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 identified during our audits are rated in accordance with the seriousness of the particular matter. The assigned rating also reflects the priority the agency needs to give to remedial action. The ratings are:

- Category A: issues that pose a significant business or financial management risk to the entity; these include issues that could result in the material misstatement of the entity's financial statements;
- Category B: issues that pose moderate business or financial management risk to the entity; these may include prior year issues that have not been satisfactorily addressed; and
- Category C: issues that pose a low business or financial management risk to the entity; these may include accounting issues that, if not addressed, could pose a moderate risk in the future.

5.8 The following table provides details of the number of Category A and B findings relating to each agency identified in our 2009–10 and 2010–11 interim audits.

**Table 5.1**

**Significant and moderate findings of agencies grouped by portfolio covered by this report**

Entity	2010–11 Rating		2009–10 Rating	
	A	B	A	B
Department of Agriculture, Fisheries and Forestry	0	0	0	0
Attorney–General’s Department	0	1	0	0
Australian Customs and Border Protection Service	0	2	0	4
Department of Broadband, Communications and the Digital Economy	0	0	0	1
Department of Climate Change and Energy Efficiency	0	0	0	0
Department of Defence	3	14	1	20
Defence Materiel Organisation	0	3	0	7
Department of Veterans’ Affairs	0	2	0	4
Department of Education, Employment and Workplace Relations	0	0	0	1
Department of Families, Housing, Community Services and Indigenous Affairs	0	0	0	2
Department of Finance and Deregulation	0	0	0	1
The Board of Guardians and the Future Fund Management Agency	0	0	0	0
Department of Foreign Affairs and Trade	0	1	0	0
Department of Health and Ageing	0	0	0	0
Department of Human Services	0	0	0	0
Centrelink	0	1	0	0
Medicare Australia	0	0	0	0
Department of Immigration and Citizenship	0	0	0	2
Department of Infrastructure and Transport*	0	0	0	0
Department of Innovation, Industry, Science and Research	0	0	0	1
Department of the Prime Minister and Cabinet	0	0	0	0
Department of Regional Australia, Regional Development and Local Government**	0	0	-	-

Entity	2010–11 Rating		2009–10 Rating	
	A	B	A	B
Department of Resources, Energy and Tourism	0	0	1	0
Department of Sustainability, Environment, Water, Population and Communities ***	0	0	0	1
Department of the Treasury	0	1	0	1
Australian Office of Financial Management	0	0	0	0
Australian Taxation Office	0	6	1	7
<b>Total</b>	<b>3</b>	<b>31</b>	<b>3</b>	<b>52</b>

\* Formerly the Department of Infrastructure, Transport, Regional Development and Local Government

\*\* The Department was established on 14 September 2010.

\*\*\* Formerly the Department of the Environment, Water, Heritage and the Arts

Source: ANAO

# Agriculture, Fisheries and Forestry Portfolio

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## Department of Agriculture, Fisheries and Forestry

**5.9** The Department of Agriculture, Fisheries and Forestry (DAFF) is the primary policy and advisory body to the Australian Government on agriculture, fisheries, forestry and food issues. DAFF's role is to contribute to the overall portfolio aims of enhancing the sustainability, profitability and competitiveness of Australia's agricultural, fisheries and forestry industries. The department aims to achieve this by:

- maintaining existing markets and developing new trading opportunities;
- ensuring Australia plays a strong role in efforts to tackle global food security;
- helping primary industries prepare for climate change, droughts and extreme weather events;
- boosting productivity by investing in research and development, skills and training, innovation, and promoting the use of new technologies; and
- reforming its biosecurity system to help prevent pests and diseases being introduced, and to prepare for future challenges, such as climate change and the increased movement of people and goods.

**5.10** The key characteristics of DAFF's operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a self assessment regime for the collection and reporting of levy revenue;
- a Business Partnership Agreement DAFF has in place with Centrelink concerning personal benefit payments processed by Centrelink on behalf of DAFF;
- a Memorandum of Understanding between DAFF and the Australian Customs and Border Protection Service (Customs and Border Protection) that establishes arrangements whereby Customs and Border

Protection collect the Australian Quarantine and Inspection Service (AQIS) import fees on behalf of DAFF; and

- a dependency on IT business systems and associated processes, particularly those that support grant payments and levy revenue collection.

## Financial overview

**5.11** DAFF's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	349	323		
Appropriation revenue	354	352		
Administered income			383	376
Administered expenses			1 022	1 039
Total assets	282	262	272	264
Total liabilities	202	201	73	75

DAFF's estimated average staffing level for 2010–11 is 4 524 (2009–10: 4 377)

## Governance arrangements

**5.12** The department has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DAFF's business objectives. These arrangements are designed to support the achievement of DAFF's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.13** The key elements of DAFF's governance arrangements include:

- an Executive Management Team (EMT) that meets monthly and provides leadership to DAFF's divisions on administrative and operational aspects and provides advice to the Secretary on strategic policy, budgets and performance;
- various governance committees that support the EMT, including an audit committee which meets a minimum of five times a year and focuses on financial reporting, internal control structures, risk

management systems, internal and external audit functions, and fraud control;

- a financial statements audit sub-committee that meets at least five times a year and oversees the preparation of the annual financial statements;
- an internal audit function that provides planned risk-based audit coverage of DAFF's operations, including its quarantine and biosecurity functions;
- a Corporate Plan that provides an overview of DAFF's future directions, including corporate outcomes and strategies to address challenges and pressures; and
- a fraud control plan and risk management plan which detail DAFF's approach to identifying, monitoring and managing risk, including the risk of fraud.

## Areas of audit focus

**5.14** In the light of the ANAO's understanding of DAFF's environment and governance arrangements, including its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DAFF's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- levies revenue and receivables, and the operation of an associated compliance program designed and implemented by DAFF to provide assurance over the completeness and accuracy of levies received;
- AQIS revenue systems, including revenue collected by Customs and Border Protection on behalf of DAFF;
- personal benefits expenses and payables that are processed by Centrelink on behalf of DAFF; and
- the valuation of intangible assets, particularly software development relating to DAFF's quarantine import conditions database; and
- the valuation of non-financial assets, including the use of an independent valuer to conduct the valuation.

**5.15** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**5.16** The ANAO has assessed the risk of material misstatement in DAFF's 2010–11 financial statements as moderate.

## **Audit results**

**5.17** Based on audit coverage of the areas of audit focus to date, no significant or moderate issues have been identified. Further audit coverage of the areas of audit focus, including a review of the valuation of DAFF's assets, will be undertaken at or near year-end as part of the 2010–11 final audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.18** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to support the preparation of financial statements that are free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2010–11 final audit.



# Attorney-General's Portfolio

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## Attorney-General's Department

**5.19** The Attorney-General's Department (AGD) is the central policy and coordinating department of the Attorney-General's portfolio. AGD contributes to the Australian Government's commitment to a stronger and fairer Australia by striving to achieve a just and secure society through one outcome: A just and secure society through the maintenance and improvement of Australia's law and justice framework and its national security and emergency management system.

**5.20** As a result of machinery of government (MOG) changes on 14 September 2010 the responsibility for the Australian territories was transferred to the Department of Regional Australia, Regional Development and Local Government with effect from 1 October 2010.

**5.21** Further MOG changes took effect on 14 October 2010 transferring responsibility for natural disaster recovery policy and the Australian Government Disaster Recovery Payments (AGDRP) from the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) to AGD.

**5.22** The key characteristics of AGD's business operations that shape the 2010–11 financial statement audit coverage include:

- the significant impact of MOG changes including the responsibility to administer personal benefits in relation to the AGDRP and the transfer of administered assets to the Department of Regional Australia, Regional Development and Local Government;
- the significant increase in the level of payments in relation to the AGDRP in light of recent natural disasters; and
- the moderate audit finding in 2009–10 in relation to AGD's financial statement preparation process.

## Financial overview

5.23 AGD's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	237	237		
Appropriation revenue	219	236		
Administered income			30	121
Administered expenses*			1 528	597
Total assets**	218	232	527	1 202
Total liabilities	60	67	23	42

AGD's estimated average staffing level for 2010–11 is 1 434 (2009–10: 1 515)

\*The increase in administered expenses is attributable to the AGDRP made in light of recent natural disasters. Responsibility for these payments was transferred from FaHCSIA to AGD during 2010–11.

\*\*The decrease in administered assets reflects the transfer of responsibility for the Australian territories to the Department of Regional Australia, Regional Development and Local Government during 2010–11.

## Governance arrangements

5.24 AGD has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of AGD's business objectives. These arrangements are designed to support the achievement of AGD's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

5.25 The key elements of AGD's governance arrangements include:

- a strategic plan that provides an overview of AGD's strategic priorities and goals, including AGD's planning and performance framework;
- the Secretary's Leadership Group the meets regularly to consider key strategic matters of corporate importance and sets AGD's strategic direction. The group comprises the Secretary and three Deputy Secretaries;
- an audit committee that meets quarterly and is chaired by an external member. The audit committee is responsible for oversight of the department's approach to risk management, including AGD's overall control framework and internal audit function;

- an internal audit unit that develops an internal audit strategy and plan that addresses key business and financial risks;
- a risk management framework and risk management plan that addresses a broad range of operational risks; and
- a fraud control plan that is updated and reviewed in line with the Commonwealth Fraud Control Guidelines.

## **Areas of audit focus**

**5.26** In the light of the ANAO's understanding of AGD's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of focus that have the potential to impact on AGD's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the impact of MOG changes in 2010 that resulted in a change to AGD's structure and operations;
- AGD's management of the AGDRP and the Disaster Income Relief Subsidy in light of recent natural disasters;
- management of the Queensland Premier's Flood Appeal funding through a newly established special account; and
- AGD's financial statement preparation process, in light of the moderate audit finding in 2009–10.

**5.27** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**5.28** The ANAO has assessed the risk of material misstatement in AGD's 2010–11 financial statements as moderate.

## **Audit results**

**5.29** The ANAO has completed a review of internal controls relevant to the preparation of the department's financial statements. The ANAO has also commenced work in relation to the areas of audit focus identified above. No significant or moderate issues have been identified. Work in relation to these areas will be completed during the 2010–11 final audit.

**5.30** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	1	1	0	0	1
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>

#### *Moderate audit issues*

Prior year issue

#### *Financial statement preparation process*

**5.31** The ANAO reported one moderate finding during the 2009–10 final audit in relation to AGD’s financial statement preparation process. At that time, AGD did not have adequate resources and processes in place to facilitate the timely and accurate preparation of the annual financial statements. The 2010–11 interim audit identified that additional resources have been recruited, and improved processes have been implemented to address this issue. The ANAO will complete its review of this issue as part of the 2010–11 final audit.

### Conclusion

**5.32** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that AGD can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## Australian Customs and Border Protection Service

**5.33** The Australian Customs and Border Protection Service (Customs and Border Protection) protects the safety, security and commercial interests of Australians through border protection designed to support legitimate trade and travel. Customs and Border Protection administers trade measures and certain government industry schemes as well as collecting trade-related statistics. The collection of border-related revenue such as customs duty, passenger movement charges and the import processing and depot charges is also undertaken, as is the assessment and collection, where appropriate, of

Goods and Services Tax (GST) on imported goods, Wine Equalisation Tax and Luxury Car Tax. The Tourist Refund Scheme is also managed by Customs and Border Protection on behalf of the Australian Taxation Office (ATO). From 1 July 2010, responsibility for the administration of excise equivalent goods (EEG) that are warehoused moved from Customs and Border Protection to the ATO, however Customs and Border Protection has retained responsibility for recording the duty on these items.

**5.34** In 2010–11 Customs and Border Protection received additional funding for the replacement of the Bay Class patrol vessels used for maritime surveillance.

**5.35** The key characteristics of Customs and Border Protection's operations that shaped the planned 2010–11 financial statement audit coverage include:

- the self-assessment nature of customs duty and the complexity of the IT infrastructure facilitating the collection of duty and other border related revenue;
- the change in responsibilities relating to the management of warehoused excise equivalent goods from Customs and Border Protection to the ATO, with Customs and Border Protection still responsible for recording the duty on these items;
- the significant amount of customs duty and GST revenue collected; and
- the large number and value of assets controlled by Customs and Border Protection in undertaking their activities.

## Financial overview

5.36 Customs and Border Protection's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	1 020	1 024		
Appropriation revenue	934	1 028		
Administered income			6 820	6 456
Administered expenses			4	1
Total assets	687	664	207	130
Total liabilities	260	257	8	8

Customs and Border Protection's estimated average staffing level for 2010–11 is 5 320 (2009–10: 5 489).

## Governance arrangements

5.37 Customs and Border Protection has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about Customs and Border Protection's business objectives. These arrangements are designed to support the achievement of Customs and Border Protection's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

5.38 The key elements of Customs and Border Protection's governance arrangements include:

- a risk management framework that has a whole of agency focus and aims to connect the strategic, operational and tactical levels of risk management;
- a strategic outlook document that considers the global context in which border management activities occur and looks in detail at the impact on border management developments;
- the preparation of an annual plan that directs the development of divisional and branch business plans. The plans identify major processes and risks which flow from the strategic outlook document described above;

- monthly executive meetings to evaluate performance, complemented by a bi-annual meeting of senior executives from central and regional offices to discuss strategic management issues and future directions;
- a Customs and Border Protection Business Practice Statement Framework which is used to define and implement the agency's national policies;
- an audit committee, with two independent members, that meets at least quarterly and focuses on internal audit and risk management issues;
- an internal audit function that has a planned risk based audit coverage of Customs and Border Protection's activities, including IT system management; and
- a comprehensive fraud control and corruption prevention framework which includes strategies for fraud and corruption preparedness, prevention, detection and resolution.

### **Areas of audit focus**

**5.39** In the light of the ANAO's understanding of Customs and Border Protection's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Customs and Border Protection's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the Customs and Border Protection measures that provide assurance over the completeness of customs duty revenue on warehoused Excise Equivalent Goods (EEGs) administered by the ATO;
- the accuracy and completeness of customs duty collections and refunds in the light of the self-assessment nature of customs duty and the complexity of the related IT infrastructure;
- the completeness of Passenger Movement Charge (PMC) collections particularly as a result of the self-assessment nature of PMC;
- the recognition and management of administered receivables that are controlled on a geographically dispersed basis and relate to multiple revenue sources; and

- the accuracy of Customs and Border Protection's assets register, particularly in relation to IT assets and operational equipment that is often portable and has a high dollar value.

**5.40** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.41** The ANAO has assessed the risk of material misstatement in Customs and Border Protection's 2010–11 financial statements as moderate.

## Audit results

**5.42** The ANAO has undertaken a review of general IT controls and the management of selected administered revenue, including the PMC. The work undertaken during the 2010–11 interim audit identified no new significant or moderate issues. Two moderate issues from prior years relating to the management of administered receivables and the PMC remain outstanding. One moderate issue from prior years has been downgraded to a minor matter and another prior year moderate issue has been resolved. These matters are detailed below. The ANAO will review selected application controls within the Integrated Cargo System (ICS) prior to year end, as well as reviewing compliance activity over EEGs.

**5.43** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	4	0	0	4	(2)*	0	2
<b>Total</b>	<b>4</b>	<b>0</b>	<b>0</b>	<b>4</b>	<b>(2)</b>	<b>0</b>	<b>2</b>

\*One matter downgraded to a Category C finding



## *Moderate audit issues*

Prior year audit issues - unresolved

### *Management of administered receivables*

**5.44** The 2009–10 audit identified that Customs and Border Protection did not have a centralised administered receivables system to ensure that receivables were recognised and consistently managed. As a result, data on administered receivables was only collated and measured at year end as part of the financial statements preparation process. The sources of potential administered receivables are spread throughout the operations of Customs and Border Protection as well as being geographically spread across Australia. Without a centralised administered receivables system in place, the ANAO considered there was an increased risk that these receivables would not be appropriately recognised and consistently followed up in a timely manner. Our 2010–11 audit identified that Customs and Border Protection are in the process of improving their systems to better identify and capture administered receivables. This matter will be reviewed again as part of our 2010–11 final audit.

### *Passenger Movement Charge (PMC)*

**5.45** The PMC is a charge levied on each departing passenger from Australia. Customs and Border Protection reports PMC revenue of approximately \$565 million as administered revenue in its financial statements. It is applied and collected by airline carriers under the *Passenger Movement Charge Act 1978* and the *Passenger Charge Collection Act 1978*. Our 2009–10 audit identified a number of weaknesses in the management of PMC, including a lack of analysis related to a threshold used to assess variances between amounts estimated to be received by Customs and Border Protection and the amounts actually remitted by carriers. The ANAO also identified that audit activity had not been undertaken in accordance with Customs and Border Protection's policies and procedures. Customs and Border Protection has advised that a review of its management of PMC was in progress.

Prior year audit issues - resolved

### *IT security controls*

**5.46** The 2008–09 audit identified a number of weaknesses in the management of Customs and Border Protection's IT Security Policy, including insufficient complexity of passwords, a lack of monitoring of privileged users and instances where there was inappropriate approval of new users. In

2009–10, Customs and Border Protection undertook an internal audit of its user access management that identified weaknesses remained. The internal audit also identified issues with user access management, and processes for removing access from terminated staff to the cargo management system and the local area network. These weaknesses increased the risk of system compromise and may have lead to unauthorised and inappropriate access to financial systems. In 2010–11, Customs and Border Protection has taken action to partially resolve these issues, resulting in the ANAO downgrading this finding to a Category C finding.

#### *Documentation of financial statement processes*

**5.47** Customs and Border Protection functions in a complex operational environment particularly in relation to its administered transactions. The 2009–10 audit identified that there were no documented procedures to assist staff in the preparation of the administered statements and describe the flow of administered transactions through Customs and Border Protection's operations. Without documented procedures, there is an increased risk that the financial statements will not be complete and accurate, or there may be delays in the preparation of the financial statements. Customs and Border Protection advised it was preparing procedures relating to the preparation of its administered financial statements in conjunction with internal audit. Our 2010–11 audit identified that Customs and Border Protection have made significant improvements to policies and procedures to assist in the preparation of the administered statements. This has resulted in the issue being resolved.

## **Conclusion**

**5.48** The ANAO has identified that, based on our audit coverage to date and subject to the outstanding issues referred to above, Customs and Border Protection's key internal controls were operating satisfactorily to provide reasonable assurance that Customs and Border Protection will be able to prepare financial statements free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Broadband, Communications and the Digital Economy Portfolio

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## Department of Broadband, Communications and the Digital Economy

**5.49** The Department of Broadband, Communications and the Digital Economy (DBCDE) works with industry, consumer groups and regulatory authorities to develop a sustainable and internationally competitive broadband, broadcasting and communications sector that promotes the digital economy for the benefit of all Australians. The department provides strategic advice and support to the Australian Government on a wide range of significant and rapidly changing policy areas including broadband, the switch over to digital television, spectrum management and post and telecommunications.

**5.50** The key characteristics of DBCDE's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a legislative environment that is subject to ongoing change;
- the significance of administered activities including programs such as the Digital Television Switchover; and
- the significant administered asset balances relating to Australian Government investments in portfolio entities reported in the department's financial statements.

## Financial overview

5.51 DBCDE's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	132	148		
Appropriation revenue	125	154		
Administered income			79	173
Administered expenses			1 351	1 311
Total assets	98	99	4 957	3 641
Total liabilities	32	38	14	40

DBCDE's estimated average staffing level for 2010–11 is 661 (2009–10: 640).

## Governance arrangements

5.52 DBCDE's corporate governance arrangements and financial reporting framework are key factors for consideration by the ANAO in undertaking the financial statement audit of the department. The department's governance arrangements, along with its financial reporting framework are designed to assist in providing reasonable assurance about the achievement of DBCDE's strategic objectives, financial reporting requirements and compliance with relevant legislative requirements.

5.53 The key elements of DBCDE's governance arrangements include:

- 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;
- a performance management committee that meets six times a year and oversees the risk management of each of the department's major departmental programs and administered expense items;
- an audit committee that meets at least s times a year and focuses attention on internal controls, internal and external audit activity, the management of risks, the review of financial reports, fraud control, and regulatory compliance;

- a financial statements sub-committee that meets at least four times a year and assists with the review of the department's financial statements and other related financial matters as requested by the audit committee.
- an internal audit function that undertakes a risk-based audit coverage of DBCDE's activities;
- a Certificate of Compliance regime which forms a integral part of DBCDE's corporate governance and compliance framework;
- fraud control and risk management plans that are regularly monitored and updated;
- integrated strategic and business planning, and internal budgeting; and
- a 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.

## Areas of audit focus

**5.54** In the light of the ANAO's understanding of DBCDE's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to impact on DBCDE's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- administered grants and subsidies expenses;
- the valuation of administered assets, which include significant investments in Australian Government portfolio entities;
- administered Regional Backbone Blackspots Program;
- appropriations reporting and disclosure; and
- significant changes made to the IT systems supporting the preparation of the financial statements.

**5.55** As outlined in Chapter 4, the ANAO continues to review DBCDE's IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.56** The ANAO has assessed the risk of material misstatement in the 2010–11 financial statements as moderate.

## Audit results

**5.57** The ANAO has completed its interim audit coverage to assess the effectiveness of internal controls in the areas which had been identified as significant to the financial statements, including administered grants and subsidies expenses and review of significant IT changes. The remaining areas of audit focus relate to work that will be undertaken as part of the 2010–11 final audit. No significant or moderate audit issues have been identified during the 2010–11 interim audit.

**5.58** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## Conclusion

**5.59** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DBCDE can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Climate Change and Energy Efficiency Portfolio

## Department of Climate Change and Energy Efficiency

**5.60** The Department of Climate Change and Energy Efficiency (DCCEE) is responsible for policy advice, policy implementation and program delivery in the areas of climate change and energy efficiency. DCCEE’s primary objectives are to assist in reducing Australia’s greenhouse gas emissions, promote energy efficiency, and help shape a global climate change solution including adapting to climate change.

**5.61** The key characteristics of DCCEE’s business operations and activities that shape the ANAO’s 2010–11 financial statement audit coverage are the ongoing management of the Household Insulation Program (HIP) and the related remediation programs, the Foil Insulation Safety Program (FISP) and the Home Insulation Safety Program (HISP).

### Financial overview

**5.62** DCCEE’s key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	221	129		
Appropriation revenue	218	122		
Administered income				
Administered expenses			1 019	493
Total assets	140	105	84	9
Total liabilities	64	44	152	299

DCCEE’s estimated average staffing level for 2010–11 is 905 (2009–10: 640)

### Governance arrangements

**5.63** DCCEE has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DCCEE’s business objectives. These arrangements are designed to support the achievement of DCCEE’s

financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.64** The key elements of DCCEE's arrangements include:

- a strategic business plan that provides an overview of DCCEE's future directions, including corporate outcomes and performance measures;
- a structured risk management process that is used to develop and update risk management plans at the organisational and work area levels;
- a financial reporting framework endorsed by the audit committee;
- an executive board that meets fortnightly to consider the key strategic, operational and system requirements of the department;
- a governance committee framework, including an audit committee that meets at least quarterly;
- an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives; and
- regular certificate of compliance reviews.

### **Areas of audit focus**

**5.65** In the light of the ANAO's understanding of DCCEE's environment and governance arrangements, including its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DCCEE's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- administered grants processing; and
- the implementation of a new HRMIS.

**5.66** In addition, the ANAO will continue its audit focus on the HIP's remediation costs, HISP and FISP expenditure commitments, and overpayment recoveries. The HISP and FISP, established in 2009–10, were designed to remediate the safety issues identified with the HIP. The calculation of the provision for payment of remediation and related costs will be subject to additional audit procedures due to complexities inherent in the estimation of the provision.



**5.67** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.68** The ANAO has assessed the risk of material misstatement in DCCEE's 2010–11 financial statements as moderate.

## **Audit results**

**5.69** No significant or moderate audit issues have been identified during the 2010–11 interim audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.70** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DCCEE can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit as will be the provision relating to the HIP remediation costs.

# Defence Portfolio

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## Department of Defence

**5.71** The Department of Defence's (Defence) primary objective is to protect and advance Australia's strategic interests by providing military forces for the direct defence of Australia and its unique strategic interests. To meet this objective Defence prepares for and conducts military operations and other tasks directed by the Government.

**5.72** Defence is responsible for delivering three outcomes to:

- maintain the capacity to support current commitments and provide response options to the Government to meet the range of potential future security contingencies, including working collaboratively with our neighbours and the broader international defence community, and contributing to coalition operations in support of Australia's national interests;
- undertake a range of military operations at the Government's direction to ensure the defence of Australia and its national interests. The Australian Defence Force's military operations and other tasks contribute to the achievement of the Government's strategic objectives, contributing to the security of the immediate neighbourhood and supporting wider interests; and
- provide emergency and non-emergency assistance to the Government and the Australian community in non-combat related roles. These responsibilities may include emergency assistance, search and rescue, disaster recovery, surveillance, security or non-emergency law enforcement roles and be directed by the Government or requested by other civil authorities, government departments or agencies.

**5.73** In 2009, Defence launched the *Strategic Reform Program: Delivering Force 2009 (SRP)*, a plan to comprehensively and fundamentally improve the management of Defence. The SRP comprises a comprehensive set of reforms designed to make Defence more efficient and effective, and generate expected savings of \$20 billion over ten years to be reinvested into military capability. A joint media release by the Minister for Defence and the Minister for Defence Materiel on 6 May 2011 announced additional Strategic Reform Program initiatives including Defence accountability and procurements reforms.

**5.74** The key characteristics of Defence's business operations that shaped the 2010–11 financial statement audit coverage include:

- a diversified business structure that has a significant geographical spread both nationally and overseas, and is governed by an operational tempo that demands capability to deploy resources efficiently;
- the devolved nature of Defence's operations, which comprises logistics and asset management storage and distribution, significant property estate management, technology research and development, and project management in specialised fields;
- the material and varied nature of assets managed by Defence, including specialist military equipment, inventory, land and buildings, and heritage and cultural assets. The valuation of these assets is complex;
- a financial statements preparation process that involves consolidating financial information from numerous business systems, services and business groups, the Defence Materiel Organisation (DMO), and involves significant estimation in the calculation of a number of balances; and
- complex arrangements between Defence and the DMO in relation to the maintenance, acquisition, construction, and modification of equipment and systems.

## Financial overview

**5.75** Defence's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	21 352	20 970		
Appropriation revenue	21 352	21 504		
Administered income			1 195	1 163
Administered expenses			3 756	3 663
Total assets	67 842	65 080	2 477	2 404
Total liabilities	4 946	4 844	44 192	48 283

Defence's estimated average staffing level for 2010–11 is 96 670: 59 023 permanent forces, 21 850 reserves, 15 146 civilian staff and 651 professional service providers (2009–10: 94 671 comprising 57 777 permanent forces, 21 574 reserves, 14 622 civilian staff and 698 professional service providers.)

## **Governance arrangements**

**5.76** Defence has designed and implemented governance arrangements, a financial reporting regime, and an internal control system to provide reasonable assurance about the achievement of Defence's business objectives. These arrangements are designed to support the achievement of Defence's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

**5.77** The key elements of Defence's governance arrangements include:

- a structure that reflects individual responsibilities and accountabilities of the Secretary and the Chief of the Defence Force for the joint delivery of Defence's outcomes. Under this structure the Secretary and Chief of the Defence Force (CDF) are guided by a joint Ministerial directive setting out the expectations of the Minister;
- the Defence Committee, which is chaired by the Secretary, supports the Secretary and the CDF in meeting their joint responsibilities;
- the Chiefs of Service Committee, which is chaired by the CDF, provides military advice to assist the CDF to discharge his responsibilities in command of the Defence Force and as principal military adviser to the Government;
- a governance committee framework, including the Defence Audit and Risk Committee (DARC), the Defence Capability and Investment Committee and the Workforce and Financial Management Committee;
- an internal audit function, which performs a range of internal audits across Defence and the DMO (a major provider of goods and services to Defence) and reports findings to the DARC and the Defence Executive; and
- the Financial Professionalisation, Controls and Skilling Branch which is responsible for documenting financial management risks, controls and processes, and assigning accountability for effective operation and monitoring of financial controls.

## **Areas of audit focus**

**5.78** The ANAO's audit approach identifies areas that have the potential to impact on the 2010–11 audit of Defence's financial statements. The following areas have been identified for specific audit coverage in 2010–11:

- inventory and asset management due to the material nature of the inventory and asset balances and outstanding prior year issues. These relate to weaknesses in management and supply chain business controls, supporting documentation, and management of inventory and assets holdings at material Defence and DMO sites;
- the implementation and operation of the new Defence inventory and asset management system, the Military Integrated Logistics Information System (MILIS) and the Materiel Logistics Financial Framework (MLFF). The implementation and operation of MILIS which is critical to the financial reporting of assets and inventory;
- the valuation and classification of Specialist Military Equipment (SME). SME assets are a material asset balance and involves a high level of judgement and technical expertise to assess asset values; and
- the accurate and complete recording of operational and capitalised expenditure associated with specialist military assets under construction (AUC). The financial and operational management of AUC is dispersed across a wide variety of projects that have complex contractual arrangements and project management requirements.

**5.79** In addition, the ANAO will continue to undertake audit coverage in areas previously identified as significant to the financial statements including:

- remediation activities to address weaknesses in the Financial Management Framework;
- the complex estimations involved in calculating a number of balances in Defence's financial statements, including provisions for: decommissioning of SME; and decontamination and restoration in relation to the large number of Defence sites both nationally and overseas;
- the calculation and reporting of current and future commitments that are complex and highly dependent on devolved management activities across Defence and DMO;
- management of Explosive Ordnance, due to the sensitive and material nature of these assets and Defence's remediation activities to address previously reported audit issues;
- Defence's management of complex and diversified HRMIS; and

- the design and effectiveness of key controls over the purchase of goods and services.

**5.80** The ANAO continues to review Defence's IT general and application controls, relating to the financial statements, as an integral part of the interim audit. The outcome of the ANAO's review is outlined in Chapter 4.

**5.81** The ANAO has assessed the risk of material misstatement in Defence's 2010–11 financial statements as high.

## **Audit results**

**5.82** Our interim audit coverage to date has included a review of the implementation and operation of MILIS, including Defence's MILIS remediation activities. The ANAO identified two new significant audit issues, relating to MILIS project governance and IT change management, and one new moderate audit issue, relating to data quality. These are detailed below.

**5.83** Other interim audit coverage includes Defence's purchasing expenditure, civilian and military employee expenditure, cash management, appropriations management, IT general controls, and specific application controls testing for key financial and business systems. No new significant or moderate audit issues were identified in these areas.

**5.84** Two moderate audit issues relating to the management of user access to the financial management information system (ROMAN) have been resolved. The ANAO has also closed two moderate audit issues relating to the legacy inventory and logistics systems (SDSS) and associated processes that have been replaced by MILIS.

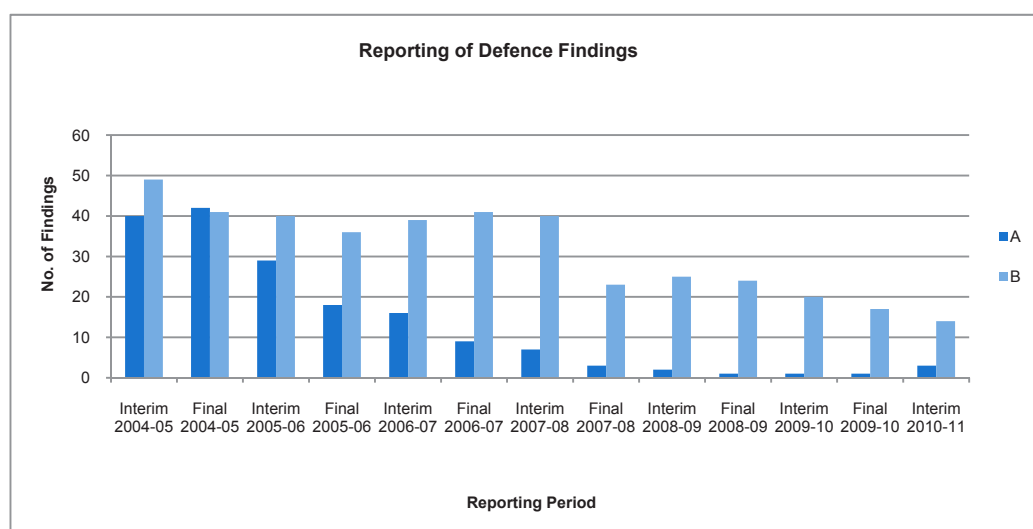
**5.85** The other areas of audit focus will be examined as part of the 2010–11 final audit.

**5.86** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	1	0	0	1	0	2	3
B	20	6	3	17	4	1	14
<b>Total</b>	<b>21</b>	<b>6</b>	<b>3</b>	<b>18</b>	<b>4</b>	<b>3</b>	<b>17</b>

**5.87** The following graph illustrates the number of significant and moderate risk audit issues reported, by audit phase, for the audit of Defence's financial statements over the last six years.



**5.88** Over recent years, there has been a reduction in the severity and number of audit issues. However, there has been an increase in the current year in significant findings, associated with the implementation and operation of MILIS. These findings are outlined below.

### *Significant and moderate audit issues*

#### *Inventory and Asset Management – GSI and RI*

**5.89** At the completion of the 2009–10 audit, one significant and seven moderate audit issues remained outstanding. These related mainly to:

- strengthening controls, documentation and the reporting of the cyclical stock-take program of inventory and assets;

- improving IT and business process controls necessary to ensure the timely and accurate processing of inventory returns;
- addressing deficiencies in the underlying controls that affect the quality of data within the inventory system;
- improving the analysis and management of variances as a result of the reconciliation of the inventory system and the financial management information system (ROMAN);
- strengthening controls over the pricing of general stores inventory;
- improving the retention of supporting documentation relating to the approval to dispose of certain Defence assets; and
- strengthening the estimation processes for obsolete inventory items.

**5.90** In 2010–11, Defence and the ANAO continued to perform resource intensive activities to gain assurance that the inventory and asset balances are materially correct.

**5.91** As mentioned above, the ANAO has closed two moderate audit issues relating to the legacy inventory and logistics systems (SDSS) and associated processes replaced by the MILIS and MLFF. MILIS is now Defence’s primary system for managing military inventory and assets. Its functions include financial reporting, demand management, purchasing, warehousing, and distribution and maintenance.

**5.92** The implementation of MILIS, and its operation throughout the current financial year was an area of focus in the 2010–11 audit. The impact of the implementation is wide ranging as the system underpins Defence’s logistics support to operations, as well as supporting the financial reporting of inventory and assets balances.

**5.93** The ANAO’s audit of the implementation and operation of MILIS, the MLFF, and stocktake activities identified two new significant audit issues relating to MILIS project governance and change management arrangements, and one new moderate audit issue relating to data quality.

**5.94** The audit identified significant weaknesses in MILIS project governance and management arrangements considered fundamental to the success of IT projects of this size, complexity, and nature. These weaknesses included insufficient testing in an environment representative of MILIS’s future operating environment; the failure to deliver critical functionality;



underestimating the level of resources and problem resolution required for known defects; insufficient preparedness for the impact of the defects on the user environment and financial statements; and non-adherence with project management procedures.

**5.95** The ANAO also identified other significant weaknesses in MILIS change management practices such as the absence of an analysis of the effect on business operations in the change assessment and prioritisation procedures, and inadequate or incomplete documentation supporting the approval and testing of changes. The audit also identified non-adherence matters including insufficient segregation of duties, an incomplete record of changes made to the system for the first half of the financial year, and failure to retain documents to support approval and testing of MILIS changes.

**5.96** The ANAO's 2010–11 stocktake program for inventory and asset holdings at Defence and contractor managed sites confirmed that MILIS functionality issues had an adverse impact on the accuracy and completeness of MILIS financial records and the Defence inventory assurance program. The disruption to Defence's inventory assurance program, that includes procurement activities and stocktaking, reduces the ANAO's level of reliance on the effectiveness of management controls for the inventory and assets balances.

**5.97** Since the implementation and operation of MILIS, Defence has undertaken intensive remediation activities to resolve critical operational and functionality issues. These issues include stocktaking functionality and the reporting of stocktake results, financial reporting; and functionality not delivered or unavailable to support Defence's inventory assurance programs.

**5.98** In response to these issues, Defence has implemented the MILIS Inventory Assurance Program (MIAP) Phase 1 and Phase 2. These programs are aimed at remediating known system deficiencies including MILIS change and release management, clearing the associated backlog of transactions, rectifying the MILIS stocktake functionality and reporting, and expanding inventory and asset management controls testing.

**5.99** The MIAP Phase 1 program is substantially complete, with Phase 2 expected to be complete by the 30 June 2011. The ANAO's review and assessment of the MIAP Phase 1 and 2 programs will continue and the results reported as part of the 2010–11 final audit.

**5.100** At the completion of the 2009–10 audit, one moderate audit issue regarding SDSS data quality was outstanding. This matter has been closed as a result of the system being replaced. However, the ANAO's data analysis continues to identify a number of anomalies in MILIS data. Defence has advised the ANAO that remediation activity is underway to address either the cause of the data anomaly or establish detective controls to address the data anomalies.

**5.101** Subject to the successful completion of Defence's remediation activities, the ANAO considers that Defence's response to the MILIS implementation and operational issues are appropriately designed to provide assurance over the completeness, existence, and accuracy of the inventory and asset balances.

**5.102** In this light, the progress of the continuing remediation work will be critical to the successful completion of the audit. The extent of these issues limits the level of assurance that management and the ANAO can obtain from inventory and purchasing controls. As a result, additional controls and substantive testing is being undertaken as part of the 2010–11 financial statements audit.

**5.103** The ANAO will be in a position to report on the results of the completed inventory and asset remediation program following the 2010–11 final audit.

#### *Inventory and asset management – Explosive Ordnance*

**5.104** At the completion of the 2009–10 audit, one moderate audit issue was outstanding related to weaknesses in documentation to support the approval of disposal of explosive ordnance (EO) and its destruction.

**5.105** Defence has advised that: EO disposal procedures have been updated; new monitoring arrangements over EO disposals have been established; and a quality assurance program over contractors undertaking disposal and destruction of EO has been implemented. This matter will be reviewed as part of the 2010–11 final audit.

#### *Financial management framework*

**5.106** The Defence financial management framework includes the monitoring of controls and reporting of financial transactions and balances. At the completion of the 2009–10 audit, one moderate issue relating to weaknesses in the monitoring and oversight of financial transactions and business processes, undertaken by DMO on behalf of Defence, was outstanding.

**5.107** Defence is conducting a review of financial risks, control design, and testing methods of management controls and financial transactions. The results of the review will contribute to the design of a fully integrated financial assurance framework intended to provide Defence with increased confidence in the integrity of the financial statements. This matter will be reviewed as part of the 2010–11 final audit.

*Defence's Financial Management Information System: ROMAN*

**5.108** At the completion of the 2009–10 audit, three moderate audit issues relating to Defence's Financial Information Management System were outstanding. These related to the high number of users with inappropriate access that could lead to unauthorised, incorrect or invalid transactions being processed; and weaknesses in ROMAN configuration settings.

**5.109** The 2010–11 interim audit confirmed that Defence has strengthened the management of user security. As a result, two moderate audit issues have been resolved.

**5.110** Defence has advised that remediation of the remaining audit issue relating to ROMAN configuration is complete. This matter will be reviewed as part of the 2010–11 final audit.

*IT Governance*

**5.111** In 2009–10, the ANAO reported a moderate audit issue in relation to business continuity management including:

- group level Business Impact Analysis (BIA) being incomplete; and
- business continuity planning requirements to be completed and endorsed.

**5.112** The issue remains outstanding. Defence has advised that it has commenced a major business continuity project, including the preparation of business impact analyses by group and business continuity plans, that is scheduled to be completed by December 2011.

*Human resource management*

**5.113** The Human Resource Management systems utilised by 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 2009–10 audit, one moderate audit issue remained unresolved in relation to reconciliation controls between PMKeyS and ADFPay.

**5.114** Defence has implemented a technical solution to reconcile the records between PMKeyS and ADFPay. The ANAO will review the reconciliation control arrangements as part of the 2010–11 final audit.

#### *Asset management*

**5.115** Defence's assets are significant and varied in nature, and are managed in a wide number of locations nationally and overseas. At the completion of the 2009–10 audit, the ANAO reported three moderate audit issues in relation to the management of assets. These matters related to:

- improving controls for specialist military equipment to better identify the location of the assets, maintain appropriate accounting information, remove duplicate asset records, and include these assets in Defence's cyclical stocktake program;
- improving the identification of assets under construction accruals in the financial statements;
- improving supporting documentation for assets transferred between classes of assets;
- the timeliness of the transfer of assets between assets under construction to specialist military equipment and general assets; and
- the timeliness of the recording of non-specialist military equipment asset disposals and write-downs.

**5.116** The ANAO expects to finalise its review of asset management as part of the 2010–11 final audit.

## **Conclusion**

**5.117** Defence has continued to improve key internal controls across many of the areas of focus for the 2010–11 financial statement audit. Notwithstanding, significant deficiencies were identified in the internal controls over the inventory and assets balances.

**5.118** Subject to the successful completion of critical inventory and assets remediation work, the ANAO consider that Defence will be able to prepare financial statements free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2010–11 final audit.

## Defence Materiel Organisation

**5.119** The Defence Materiel Organisation (DMO) is the primary service delivery agency responsible for the effective support of Australian Defence Force operations through the acquisition of equipment and supplies, sustainment of Australian Defence Force, and deployment of specialist staff. The DMO also provides industry and procurement policy and advice to the Department of Defence (Defence) and the Australian Government.

**5.120** The DMO employs over 7 200 staff and contractors in over 70 locations within Australia and overseas. It budgets for a break even operating result. This budgeted operating result reflects the DMO's funding model whereby it is funded for the activities performed. These activities are principally determined by objectives set by the Australian Government, Defence policies and the operational requirements of the Australian Defence Force.

**5.121** The DMO receives the majority of its funding from Defence, operating under a number of purchase-provider arrangements. The funding arrangements are formalised in agreements covering key operational areas including acquisition, sustainment, military workforce and shared services. In addition to these funding arrangements, DMO receives an appropriation for its workforce and operating expenses.

**5.122** In 2010–11, expenditure for acquisition activities is expected to decrease from \$5 963 million in 2009–10 to \$5 221 million and sustainment activities are expected to increase from \$4 623 million to \$5 079 million.

**5.123** The key characteristics of DMO's business operations that shape the ANAO's financial statement audit coverage include:

- DMO's diversified corporate and project management IT applications that operate in a number of locations nationally and overseas;
- the number of significant financial statement balances;
- the effect of the implementation of the Military Integrated Logistics Information System (MILIS) on the purchase of inventory and assets on behalf of Defence;
- a complex financial statement process that involves data from numerous business systems and processes, and involves significant judgement in the calculation of a number of balances; and
- a number of the financial and human resource business processes, managed by Defence, that are utilised by DMO.

**5.124** Under the Strategic Reform Program (SRP), DMO is implementing changes to business processes and procurement strategies in order to increase DMO's ability to deliver and support Australian Defence Force assets and operations more efficiently and effectively. Areas of the SRP that have the potential to influence financial management and the financial statements include:

- changes to the design and operation of controls for the approval and monitoring of capital acquisition projects, including an increase in project oversight and assurance activities by capability managers;
- changes to sustainment activities, in particular, new contractual arrangements and processes to achieve delivery of lower cost outputs; and
- new accountability arrangements between Defence and the DMO directed towards improving procurement and delivery outcomes.

## Financial overview

**5.125** DMO's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services*	772	793		
Appropriation revenue	847	899		
Administered income			2	3
Administered expenses			0	0
Total assets	2 172	2 203	0	0
Total liabilities	1 680	1 786	0	0

\* Net cost of services includes payments from and on behalf of Defence of \$ 9 263m (2009–10: \$ 9 772m)

The DMO's total estimated average staffing level is 5 534 (2009–10: 5 818). This staffing level does not reflect an additional 1 732 staff secondments from Defence to DMO.

## Governance arrangements

**5.126** The DMO has implemented governance arrangements, a financial reporting regime and an internal control system that are designed to provide reasonable assurance that the financial statements are free from material misstatement. These arrangements are designed to support DMO's financial reporting processes and compliance with FMA requirements.

**5.127** The key elements of DMO's governance arrangements include:

- a Materiel Audit and Risk Committee (MARC). The MARC is comprised of three independent members and formally meets six to seven times per year. The MARC oversees the preparation of the financial statements prior to their signing. It formally reports to the CEO annually on matters relating to the governance framework, including:
  - enterprise risk management;
  - the efficiency and effectiveness of the existing acquisition and sustainment and financial control frameworks;
  - external accountability;
  - legislative compliance; and
  - internal and external audit activity.
- an Internal Audit function that is responsible for providing an independent, objective and systematic evaluation of risk management, control and governance within the DMO. Individual internal audit activities are mainly delivered by external providers in accordance with a program that is managed by the Chief Audit Executive;
- an Assurance Rationalisation Program managed by the Director-General Governance and Assurance, that aims to improve the effectiveness of self assurance activities within DMO and reduce the duplication of effort across the organisation;
- a Projects of Concern Unit that monitors projects that encounter significant and unanticipated issues. The unit is responsible for devising strategies to address the issues, to examine and report on performance remediation and advise the CEO and Government throughout the process;
- a range of boards that monitor and report on key areas of accountability within DMO, including:
  - the Defence Strategic Reform Advisory Board (DSRAB), established to oversee the broader SRP in Defence and comprising public sector officials, independent members, the CEO DMO, and the chair of the MARC (observer);



- Gate Review Assurance Boards that conduct formal project reviews before selected key project milestones with the aim of assuring a project's status and prospects of achieving the capability required; and
- Project Manager Stakeholder Groups that regularly review the status and progress of major capital acquisition projects.
- a Fraud Control Plan supported by fraud risk assessments, an ethics awareness policy, training and Chief Executive Instructions (CEIs) on Fraud Control; and
- regular management reports to the CEO that detail the status of acquisition and sustainment, in support of Defence, these are also provided on a monthly basis to Defence and central agencies.

**5.128** DMO has advised that the Risk Management Framework is being redesigned to align risks to key objectives across the organisation. In preparation for the implementation of the framework, consultation continues with individual process owners to determine accountability within the framework. The framework implementation is being managed by the Director-General Governance and Assurance with regular progress updates to the MARC.

## **Areas of audit focus**

**5.129** The ANAO's audit approach identifies areas that have the potential to impact on DMO's financial statements for particular audit focus. The following areas have been highlighted for specific audit coverage in 2010–11:

- the redesign and implementation of the financial control framework that is being progressively implemented across the organisation;
- the recording, accounting treatment and reporting of over \$ 5 billion in new assets under construction. The accounting for these transactions involves a high number of transactions, and a significant level of complexity in terms of contractual arrangements and project management requirements given the wide variety of projects involved;
- the design and effectiveness of key controls over purchases of inventory and assets recorded in Defence's new inventory management system (MILIS), including consideration of the related controls and processes that are not directly controlled by the DMO;



- management activities that identify, assess and manage related party transactions;
- the management of internal controls where inter-dependencies between DMO and Defence systems and processes exist that may impact on financial transactions of the DMO;
- the aggregation of financial information from different operational areas, processes and systems; and
- the accounting treatment and accurate reporting of transactions processed through the Special Account. Over \$9 billion in financial transactions associated with Defence sustainment and acquisition activities are processed through this account.

**5.130** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as an integral part of the interim audit.

**5.131** The ANAO has assessed the risk of material misstatement in the DMO 2010–11 financial statements as moderate.

## Audit results

**5.132** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	7	(4)	0	3	0	0	3
<b>Total</b>	<b>7</b>	<b>(4)</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>0</b>	<b>3</b>

#### *Moderate audit issues*

Prior year issues - unresolved

#### *Financial Management and Reporting Framework*

**5.133** The DMO performs assurance activities to substantiate the aggregation of financial information from geographically dispersed business units and the completeness and accuracy of balances reported in the financial statements. In 2009–10, a moderate audit issue was identified in relation to weaknesses in the

assurance activities, including the design, implementation and testing of specific controls over the financial transactions. As a result additional audit procedures were performed to provide reasonable assurance that financial transactions were accurate and complete.

**5.134** The DMO continues to implement a revised quality assurance program to remediate the identified weaknesses in the Financial Management and Reporting Framework. DMO has advised that key aspects of the quality assurance program are yet to be finalised and will be completed by the 2010–11 final audit. The ANAO will assess the overall effectiveness of the revised quality program during the final stages of the 2010–11 financial statements audit.

#### *Commitments*

**5.135** Current and future commitments need to be accurately determined and appropriately managed. Delays occurred in the preparation and quality assurance review of commitments schedules prepared as part of the preparation of the DMO's 2009–10 financial statements. Given the material nature of the procurement activities carried out on behalf of Defence, these delays also affected reporting timeframes for the Department of Defence.

**5.136** The DMO has advised that planning has commenced for the detailed review of significant commitments and the year end preparation process. This earlier commencement of DMO's review activities should minimise delays in the preparation of the commitment schedule. During the final stages of 2010–11 audit, the ANAO will review the preparation process, substantiate DMO's commitment review activities, and audit the completeness and accuracy of the commitments disclosed.

#### *IT bureau service arrangements between Defence and the DMO*

**5.137** In June 2010, Defence and the DMO signed a shared services agreement relating to IT Bureau services. This shared services agreement outlines the broad arrangements to support the shared IT services agreement.

**5.138** The DMO has advised that supporting detailed arrangements have not been finalised with Defence. Such arrangements are required to assist DMO to obtain assurance over the effectiveness and adequacy of controls in the financial management information systems, human resource management systems and the supporting IT general controls, such as systems security and change management.

**5.139** The ANAO has identified significant issues relating to the project governance of the implementation of the Military Integrated Logistics Information System (MILIS) and with the IT general controls of the system. The MILIS system supports supply chain processes, including the procurement of General Supply Inventory and Repairable Items on behalf of Defence.

**5.140** These MILIS issues affect the level of management assurance on the supply chain system and processes supporting Defence's inventory balance and DMO's Cost of Goods Sold to Defence (General Supply Inventory and Repairable Items) balance.

**5.141** The DMO's 2010–11 assurance program includes new and updated processes and activities to support management assurance and compliance activities as a result of the MILIS implementation issues. The assurance program includes activities designed to ensure that inventory and assets purchase information is accurately reflected in the new system, that the financial information in MILIS reconciles to the financial management information system, and any issues identified with the supply chain system and processes are reviewed to assess the risk of material misstatement to DMO's financial statements.

**5.142** In addition to the issues associated with MILIS, the ANAO has identified moderate audit issues relating to the financial management information and the human resource management systems. The issues relate to the system settings within the financial management information system, and the complete and accurate transfer of information between Defence's civilian and military human resource management systems.

**5.143** A 6 May 2011 joint media release by the Minister for Defence and the Minister for Defence Materiel announced additional Strategic Reform Program initiatives and a set of accountability and procurement reforms. These additional initiatives include further shared service reform to commence in August 2011.

**5.144** It is important that DMO continue to work with Defence to achieve an efficient and well-defined controls assurance framework that integrates recently announced reforms. Further consideration is also required of the arrangements by which DMO provides assurance to Defence over the effectiveness and adequacy of controls for the inventory and assets systems and processes managed by DMO that affect Defence's financial statements.

## Conclusion

**5.145** While the number of outstanding issues has progressively diminished, the remaining issues continue to reduce the level of reliance the DMO and the ANAO can place on the financial information generated from the general ledger and related IT systems. Accordingly, the ANAO continues to perform a greater level of substantive testing of transactions and balances in order to obtain the required level of audit assurance.

## Department of Veterans' Affairs

**5.146** The Department of Veterans' Affairs (DVA) is the primary service delivery agency responsible for developing and implementing programs that assist the veteran and defence force communities. DVA also provides administrative support to the Repatriation Commission and the Military Rehabilitation and Compensation Commission.

**5.147** DVA's responsibilities include:

- maintaining and enhancing the financial wellbeing and self-sufficiency of eligible persons and their dependants through access to income support, compensation, and other support services, including advice and information about entitlements;
- maintaining and enhancing the physical wellbeing and quality of life of eligible persons and their dependants through health and other care services that promote early intervention, prevention and treatment, including advice and information about health service entitlements; and
- acknowledging and commemorating those who served Australia and its allies in wars, conflicts and peace operations through promoting recognition of service and sacrifice, preservation of Australia's wartime heritage, and official commemorations.

**5.148** The key characteristics of DVA's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a complex legislative environment surrounding the provision of benefits to veterans and defence personnel;
- the diverse range of entitlements administered by DVA and reliance placed upon voluntary disclosure of information by recipients;

- complex IT systems, including a number of legacy systems, to process a significant number of high volume, low value transactions on a regular basis; and
- extensive contractual arrangements with service providers, institutions, and state governments.

## Financial overview

**5.149** DVA's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	319	309		
Appropriation revenue	290	316		
Administered income			10	10
Administered expenses			11 901	11 888
Total assets	216	194	1 257	1 535
Total liabilities	133	125	3 106	3 206

DVA's estimated average staffing level for 2010–11 is 1 971 (2009–10: 1 942).

## Governance arrangements

**5.150** DVA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DVA's business objectives. These arrangements are designed to support the achievement of DVA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.151** The key elements of DVA's governance arrangements include:

- the 2010–11 Corporate Plan that sets out DVA's focus and direction as well as the risks and challenges facing DVA. In order to assess progress against the priorities identified in the Corporate Plan, DVA has a monthly report card process, which includes financial, operational and strategic analysis;
- an executive management group 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 financial reporting framework that involves monitoring the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports;
- an information and communication technology strategic plan aimed at developing the future DVA business model and programs and corresponding IT requirements;
- a governance committee framework, including an Audit and Risk Committee that provides independent assurance and assistance in relation to all matters relating to risk management, the control and compliance framework and external accountability. 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;
- a fraud risk profile, which is undertaken every two years and a framework for incorporating risk management into DVA's broader management and business processes; and
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance.

## **Areas of audit focus**

**5.152** In the light of the ANAO's understanding of DVA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DVA's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the significant amount of high volume, low value transactions being processed on a regular basis by complex and ageing information systems;
- the quality assurance framework over benefit payments; and
- the complexity of assumptions and calculations underpinning the actuarial assessment of the military compensation provision.

**5.153** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.154** The ANAO has assessed the risk of material misstatement in DVA's 2010–11 financial statements as moderate.

## Audit results

**5.155** The ANAO has commenced its review of controls relating to personal benefit and health care payments, including the information systems supporting these payments. Audit work on the military compensation provision and associated future claims will be undertaken as part of the 2010–11 final audit. The audit has identified one moderate issue in relation to payroll reconciliation procedures that is detailed below.

**5.156** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	4	(3)*	0	1	0	1	2
<b>Total</b>	<b>4</b>	<b>(3)</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>2</b>

\*Two moderate audit issues relating to residential aged care payments and the electronic purchasing process were downgraded to Category C audit findings.

### *Moderate audit issues*

#### *Payroll reconciliation procedures*

**5.157** During the interim phase of the 2009–10 audit, the ANAO identified reconciliations to support payroll balances within the general ledger were not always completed and reviewed in a timely manner, with large variances remaining unresolved for a significant period of time. These weaknesses led to the Official Departmental Payroll Settlement Account being in overdraft for an extended period. The 2009–10 final audit confirmed the resolution of the interim audit findings.

**5.158** The 2010–11 interim audit however identified the reoccurrence of the payroll reconciliation issues identified in 2009–10. Reconciliations were not always completed and reviewed in a timely manner and variances remaining unresolved for significant periods of time.

Prior year issue

*Quality assurance framework*

**5.159** In 2009–10, the ANAO identified an issue in relation to DVA's quality assurance framework over benefit payments to veterans. The ANAO considered that the quality assurance framework over the payments made under the *Military Rehabilitation and Compensation Act* and *Safety Rehabilitation and Compensation Act* required strengthening by addressing business risks, completing reviews and reporting results to management in a timely manner. This issue will be assessed during the final phase of the 2010–11 audit.

## **Conclusion**

**5.160** The ANAO has identified that, based on our audit coverage to date and subject to the issue referred to above, DVA's key internal controls were operating satisfactorily to provide reasonable assurance that DVA will be able to prepare financial statements free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2010–11 final audit.



# Education, Employment and Workplace Relations Portfolio

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## Department of Education, Employment and Workplace Relations

**5.161** The Department of Education, Employment and Workplace Relations (DEEWR) provides advice and administers programs to achieve the Government's objectives for education and workplace training, transition to work, and conditions and values in the workplace.

**5.162** DEEWR's responsibilities include:

- program management and delivery aimed at providing universal access to high quality education, world-class teaching and learning in schools and effective training and learning opportunities through education providers;
- investment in employment and training services for the unemployed and disadvantaged to support the Government's workforce participation and social reform agendas; and
- the delivery of personal benefits, including child care benefit, child care rebate, youth allowance, parenting allowance and Austudy/Abstudy payments that aim to remove barriers to employment and education opportunities.

**5.163** The key characteristics of DEEWR's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the significance and diversity of administered activities, including personal benefits and employment service payments, a large number of diverse grants programs, the Higher Education Loan Program - the largest non-taxation receivable in the Commonwealth and unfunded university superannuation;
- reliance on critical data from third parties to support payments, including those relating to employment services, child care grants and university superannuation liabilities; and
- a complex financial statement process that involves using data from a number of business systems, including those of other agencies.

## Financial overview

5.164 DEEWR's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	835	884		
Appropriation revenue	738	850		
Administered income			1 495	1 930
Administered expenses			42 887	42 181
Total assets	480	497	19 431	18 072
Total liabilities	277	279	6 422	6 226

DEEWR's estimated average staffing level for 2010–11 is 4 975 (2009–10: 5 520)

## Governance arrangements

5.165 DEEWR has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DEEWR's business objectives. These arrangements are designed to support the achievement of DEEWR's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislation requirements.

The key elements of DEEWR's governance arrangements include:

- an executive management group that meets fortnightly and addresses strategic issues; monitors DEEWR's financial performance; and oversees the operational performance of groups and programs;
- a governance committee framework, including an audit committee and program implementation steering committee;
- a structured system of internal control;
- an internal audit function providing a risk based audit coverage of DEEWR's activities;
- mechanisms to facilitate internal and external assurances in relation to financial integrity, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance;

- a framework for incorporating risk management and the consideration of fraud risk into DEEWR's broader management and business planning processes; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## Areas of audit focus

**5.166** In the light of the ANAO's understanding of DEEWR's environment and governance arrangements, that includes a financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DEEWR's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- compliance activities and assurance processes underpinning personal benefits, child care and employment related payments;
- actuarial estimates in DEEWR's financial statements;
- the financial management and reporting of grant expenditure;
- the completeness and accuracy of accrual elements of administered programs required to be reported at year end; and
- the final phase of the integration of the previous two IT environments.<sup>42</sup>

**5.167** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.168** The ANAO has assessed the risk of material misstatement in DEEWR's 2010–11 financial statements as moderate.

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<sup>42</sup> At the time of the establishment of DEEWR in December 2007, two separate complex IT environments from the former Department of Employment and Workplace Relations and the former Department of Education, Science and Training were used to support the activities of DEEWR.

## Audit results

**5.169** The ANAO has commenced work in the areas of compliance activities and assurance processes relating to personal benefits and child care related payments, as well as grant financial management processes. No significant or moderate issues have been identified.

**5.170** The remaining areas of audit focus relate to work that will be undertaken as part of the 2010–11 final audit. Any issues identified as part of this work will be reported in the ANAO's year end report to the Parliament.

**5.171** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	1	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## Conclusion

**5.172** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DEEWR can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Families, Housing, Community Services and Indigenous Affairs Portfolio

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## Department of Families, Housing, Community Services and Indigenous Affairs

**5.173** The Department of Families, Housing, Community Services and Indigenous Affairs' (FaHCSIA) role is to support Australian families and work towards closing the gap between Indigenous and non-Indigenous Australians. Central areas of focus include; improving the availability and affordability of housing; relieving pressures on carers, seniors, people with disability and parents; strengthening communities; and providing national leadership to protect children from abuse and neglect.

**5.174** FaHCSIA has four key modes of business delivery:

- payments to individuals—FaHCSIA makes direct payments to individuals through Centrelink and other agencies. Primary examples include the Age Pension, the Disability Support Pension and the Family Tax Benefit;
- working with the states and territories—FaHCSIA works with the states and territories to achieve outcomes in a number of shared policy areas including housing, disability services, Indigenous reforms, concessions, and the welfare of children;
- payments for community services—FaHCSIA funds community based organisations to deliver a range of local services including Family Relationship Services, Emergency Relief and Disability Employment Services; and
- policy development, leadership, advice and coordination—FaHCSIA supports Ministers in their policy roles by providing advice on social policy, building the evidence base for action, and in whole of government policy coordination for Indigenous affairs and for women.

**5.175** The key characteristics of FaHCSIA's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- reliance on other government agencies to deliver personal benefit payments that are reported in FaHCSIA's financial statements;
- significant judgement estimation involved in calculating material financial statement balances, such as the Family Tax Benefit provision;
- the need to comply with numerous grant payment conditions, and a decentralised grant management function; and
- the legislative and accounting standards compliance regime relating to its high value and complex transactions.

## Financial overview

**5.176** FaHCSIA's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	575	583		
Appropriation revenue	520	573		
Administered income			178	727
Administered expenses			72 010	67 790
Total assets	372	392	4 873	4 763
Total liabilities	131	132	7 564	7 577

FaHCSIA's estimated average staffing level for 2010–11 is 2 686 (2009–10: 2 743).

## Governance arrangements

**5.177** FaHCSIA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance on the achievement of FaHCSIA's business objectives. These arrangements are designed to support the achievement of FaHCSIA's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.178** The key elements of FaHCSIA's governance arrangements include:

- an Executive Management Group (EMG) that meets fortnightly. The EMG takes an active interest in the financial operations of FaHCSIA and receives monthly detailed reports from the Chief Financial Officer;
- 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 and related controls. A financial statements sub-committee, comprising an independent RAAC member, the Chief Financial Officer and a FaHCSIA Branch Manager, monitors and reviews FaHCSIA's financial reporting requirements;
- an Internal Audit and Fraud Branch that undertakes a risk based audit coverage of FaHCSIA's activities;
- a fraud control plan covering the period 2009 to 2011; 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.

### **Areas of audit focus**

**5.179** In the light of the ANAO's understanding of FaHCSIA's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on FaHCSIA's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- personal benefits payments and related debts that are processed by Centrelink;
- FaHCSIA's management controls over the personal benefit payments as it has ultimate responsibility for administration, funding and reporting of the benefit payments; and
- the valuation of personal benefit related asset and liability balances.

**5.180** We will continue audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- the financial management of grants, including the adequacy of supporting documentation on action taken on grant acquittals;
- the identification and valuation of investments in fixed deposits and government securities; and
- accounting processes and controls designed to ensure that transactions relating to various special accounts comply with their legislative purpose.

**5.181** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.182** The ANAO has assessed the risk of material misstatement in FaHCSIA's 2010–11 financial statements as moderate.

## **Audit results**

**5.183** The audit coverage to date has focused on the assessment of Centrelink's internal controls over the personal benefits payments made on behalf of FaHCSIA. Audit work on FaHCSIA's management assurance of personal benefit and grant payments processes has also commenced with no significant or moderate audit issues identified to date. Further audit work on these items and other key focus areas will be completed during the 2010–11 final audit.

**5.184** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.



## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	2	(2)*	0	0	0	0	0
<b>Total</b>	<b>2</b>	<b>(2)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

\* One audit issue relating to grants administration was downgraded to a Category C finding.

## Conclusion

**5.185** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that FaHCSIA can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Finance and Deregulation Portfolio

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## Department of Finance and Deregulation

**5.186** The Department of Finance and Deregulation (Finance) assists the Government to achieve its outcomes in a variety of policy and program areas, particularly with regard to its fiscal and economic plans, deregulation reform and the operations of government. Services delivered by Finance include assisting government to make informed decisions on government finances and regulation making through: budgetary management and advice; transparent financial reporting; implementation of a robust financial framework; and best practice regulatory processes. Finance is also focussed on improving government administration and operations through policy, systems and advice on: procurement; Commonwealth property management and construction; government enterprises; risk management; and the application of information and communications technology. Finance also provides support for Parliamentarians, organisations and others with entitlements as approved by government, through the delivery of entitlements and targeted assistance.

**5.187** The key characteristics of Finance's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a number of financial statement balances that require significant judgement or the use of specialists to estimate; and
- a complex financial statement process that involves using data from a number of business systems.

## Financial overview

**5.188** Finance's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	221	243		
Appropriation revenue	240	231		
Administered income			2 958	2 520
Administered expenses			9 185	8 288
Total assets <sup>43</sup>	2 172	1 971	21 978	24 097
Total liabilities	418	452	85 476	93 411

Finance's estimated average staffing level for 2010–11 is 1 560 (2009–10: 1 415)

## Governance arrangements

**5.189** Finance has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Finance's business objectives. These arrangements are designed to support the achievement of Finance's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.190** The key elements of Finance's corporate governance that contribute positively to the financial management regime of the department include:

- an executive board that meets monthly and addresses policy, program, strategic and management issues and oversights 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, financial reporting and ANAO activities;

<sup>43</sup> The 2010–11 balance of Estimated Administered Assets excludes the cash held in the Official Public Account as this is not included in Finance's estimate. The 2009–10 balance of Actual Administered Assets includes the cash held in the Official Public Account at 30 June 2010.

- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements and Finance's annual Certificate of Compliance;
- a risk management process that 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;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas, and the preparation and monitoring of monthly financial reports; and
- a fraud risk assessment process and a fraud control plan.

## **Areas of audit focus**

**5.191** In the light of the ANAO's understanding of Finance's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Finance's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the complexity of the assumptions and calculations underpinning the actuarial assessment of the public sector unfunded superannuation liability;
- the valuation of the Australian Government's domestic property portfolio and the adequacy of asset management procedures;
- the financial management of the Australian Government's self-managed general insurance fund (Comcover); and
- the controls over entitlements paid to Parliamentarians and their staff.

**5.192** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.193** The ANAO has assessed the risk of material misstatement in Finance's 2010–11 financial statements as moderate.

## Audit results

**5.194** There were no new significant or moderate audit issues identified during the interim audit phase.

**5.195** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	1	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## Conclusion

**5.196** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Finance can prepare financial statements that are free of material misstatement. The effectiveness of these internal controls for the full financial year will be completed during the 2010–11 final audit.

## The Board of Guardians and the Future Fund Management Agency

**5.197** The Future Fund Management Agency (FFMA) was established by the *Future Fund Act 2006* to support and advise the Future Fund Board of Guardians (Board) in its task of investing the assets of the Future Fund.

**5.198** The FFMA's responsibilities include:

- continued development and implementation of an investment strategy for the Future Fund and the three Nation Building Funds – the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund, agreed by the Board and consistent with the investment mandate from government;

- investing the assets of the Future Fund and the three Nation Building Funds in accordance with the relevant investment strategies; and
- maximisation of returns earned on contributions to the Future Fund over the long term, in line with the investment mandate.

**5.199** The key characteristics of the FFMA's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- complexities associated with the valuation of different investment instruments;
- the use of external service providers to support the investment management function; and
- a complex organisational structure involving a number of subsidiaries used as special purpose investment vehicles, and its associated tax implications.

## Financial overview

**5.200** FFMA's key financial figures\* are:

Key financial balances	Budget Estimated (\$m) 2010–11	Actual (\$m) 2009–10
Total income	8 259	6 660
Total expenses	241	340
Operating result	8 018	6 320
Total assets	75 356	70 601
Total liabilities	56	3319

\* The Future Fund presents its financial statements in a format consistent with that used in the funds management industry.

\* The funding of the FFMA is drawn from the investment special account. For 2010–11 this funding is estimated to be \$31.5 million.

FFMA's estimated average staffing level for 2010–11 is 78 (2009–10: 65).

## Governance arrangements

**5.201** The Board, supported by the FFMA, has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of the Board's business objectives. These arrangements are designed to support the achievement of the organisation's (Board and FFMA) financial reporting

requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

**5.202** The key elements of the FFMA's governance arrangements include:

- a strategic asset allocation that provides an overview of the Board's investment plan;
- meetings of the Future Fund Board of Guardians at least 10 times per year;
- a governance committee framework, including a Board audit committee and a FFMA operational risk and compliance committee;
- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks and is approved by the Board Audit Committee;
- mechanisms to facilitate internal and external assurances around financial integrity, including the effectiveness of internal controls that impact on the financial statements;
- the use of a Risk and Control matrix to support the FFMA in monitoring the key risks of the organisation;
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas including the preparation of monthly financial reports; and
- significant operational controls that reside with the outsourced custodian. These controls are subject to an independent bi-annual internal controls audit which tests that the controls are appropriately designed and are operating effectively. A substantive independent audit is also undertaken at 30 June each year to confirm the existence and valuation of investment assets.

## **Areas of audit focus**

**5.203** In the light of the ANAO's understanding of the FFMA environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on FFMA financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the valuation of investments from the perspectives of governance, financial accuracy and regulatory oversight;
- the compliance function that reinforces internal assurance procedures;
- the processes for monitoring external service providers, including the custodian; and
- tax implications relating to wholly owned subsidiaries.

**5.204** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.205** The ANAO has assessed the risk of material misstatement in the FFMA 2010–11 financial statements as moderate.

## **Audit results**

**5.206** At the time of preparing this report, the interim audit was still in progress.

**5.207** No significant or moderate audit issues were identified during the 2009–10 audit.

## **Conclusion**

**5.208** Audit results for the 2010–11 financial statements audit will be reported in the ANAO's year end report to the Parliament.



# Foreign Affairs and Trade Portfolio

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## Department of Foreign Affairs and Trade

**5.209** The Department of Foreign Affairs and Trade's (DFAT) role is to advance the interests of Australia and Australians internationally.

**5.210** DFAT's outcomes include:

- the advancement of Australia's international strategic, security and economic interests including through bilateral, regional and multilateral engagement on Australian government foreign and trade policy priorities;
- the protection and welfare of Australians abroad and access to secure international travel documentation through timely and responsive travel advice, and consular and passport services in Australia and overseas; and
- a secure Australian Government presence overseas through the provision of security services and information and communications technology infrastructure, and the management of the Commonwealth's overseas owned estate.

**5.211** The key characteristics of DFAT's business operations taken into account in the design of the ANAO's 2010–11 financial statement audit coverage include:

- the geographical spread of operations;
- a complex and changing IT environment; and
- the reliance on external service providers for key operations and financial information. Under service level arrangements with DFAT, the Australian Postal Corporation provides revenue collection services for passport applications and UGL Services Pty Ltd undertakes a range of property, financial and facilities management services for the overseas estate.

## Financial overview

**5.212** DFAT's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	860	805		
Appropriation revenue	881	894		
Administered income			410	383
Administered expenses			287	346
Total assets	2 849	2 880	499	425
Total liabilities	252	252	173	106

DFAT's estimated average staffing level for 2010–11 is 3 807 (2009–10: 3 577)

## Governance arrangements

**5.213** DFAT has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DFAT's business objectives. These arrangements are designed to support the achievement of DFAT's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.214** The key elements of DFAT's governance arrangements include:

- an executive committee that oversees the operational performance of divisions and posts, reviews departmental wide issues, monitors financial performance and considers reports prepared and referred by other management 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;
- a risk management framework and plan that identifies and manages risk at the strategic, business and project levels, and also at specific locations overseas; and
- an internal audit strategy and plan that aligns with the department's risk assessment and management priorities.

## Areas of audit focus

**5.215** In the light of the ANAO's understanding of DFAT's environment and governance arrangements, including the financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that are significant in DFAT's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the accounting treatment and disclosure of the National Interest Account (NIA) transactions. The NIA manages transactions undertaken by the Export Finance and Insurance Corporation as directed by the Minister after consideration of whether they are in the national interest;
- revenue from passport operations;
- overseas property valuation and operations;
- the determination of the defined benefit pension scheme balances relating to locally engaged staff; and
- the overseas post operations.

**5.216** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**5.217** The ANAO has assessed the risk of material misstatement in DFAT's 2010–11 financial statements as moderate.

## Audit results

**5.218** To date, our audit coverage of, IT general and application controls and overseas operations, has not identified any significant or moderate audit issues. Our audit coverage of passport operations noted one moderate audit issue detailed below. The overseas property revaluation process, measurement and disclosure of NIA administered balances and defined benefit pension schemes will be reviewed as part of the 2010–11 final audit.

**5.219** The following table summarises the status of audit issues raised by the ANAO in 2010–11 and 2009–10.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

**5.220** The 2010–11 audit highlighted the following issue, categorised as moderate, that needs to be addressed to support the adequacy of the internal controls and the reliability of information reported in the financial statements.

### *Moderate audit issue*

#### *Controls over passport revenue*

**5.221** DFAT will collect approximately \$360 million in passport revenue in 2010–11. There are a number of passport reconciliations undertaken which provide assurance that the completeness of passport revenue collections is appropriately monitored. The ANAO identified weaknesses in the reconciliation process, including delays in their completion.

## Conclusion

**5.222** The ANAO has identified that, based on our audit coverage to date, DFAT's key internal controls were operating satisfactorily to provide reasonable assurance that DFAT will be able to prepare financial statements free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2010–11 final audit. DFAT has responded positively to the ANAO's finding and associated recommendation and is working to address this issue.

# Health and Ageing Portfolio

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## Department of Health and Ageing

**5.223** The role of the Department of Health and Ageing (DoHA) is to achieve better health and active ageing for all Australians. DoHA works to achieve this through its policy advice, management of programs, research and regulation activities, and working closely with other governments, government agencies, consumers and other stakeholders.

**5.224** DoHA's responsibilities relate to: population health; pharmaceutical services; medical services; aged care and population ageing; primary care; rural health; hearing services; Indigenous health; private health; health system capacity and quality; mental health; health workforce capacity; acute care; and biosecurity and emergency response.

**5.225** DoHA's consolidated financial statements include a business operation, the Therapeutic Goods Administration Special Account, and two other departmental special accounts, the National Industrial Chemicals Notification and Assessment Scheme and the Office of the Gene Technology Regulator.

**5.226** The key characteristics of DoHA's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a complex operating environment that involves working with multiple government jurisdictions and agencies;
- the significant size of DoHA's administered payments, which include high volume, large value and complex personal benefits expenses and liabilities processed by Medicare Australia, and significant grants and subsidy payments to State and Territory governments, other service providers and program recipients;
- the management of, accounting for and sensitivity of, disclosures of some account balances such as the National Medical Stockpile;
- a complex funding model and extensive appropriations disclosure;
- actuarial estimation for the reporting for the Government's liabilities under the medical indemnity program; and
- the consolidation of significant departmental business operations in DoHA's financial statements.

**5.227** In 2010–11, the staged implementation of the Government’s structural changes under the National Health and Hospitals Network reforms included the establishment of the Australian National Preventive Health Agency in the Health and Ageing Portfolio. In addition, the following entities are expected to be operational from 1 July 2011:

- the Australian Commission on Safety and Quality in Health Care;
- the National Performance Authority; and
- the Independent Hospital and Pricing Authority.

The ANAO will continue to monitor the implementation of the reforms and assess the implications on DoHA’s financial statement audit.

## Financial overview

**5.228** DoHA’s key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	619	582		
Appropriation revenue	600	585		
Administered income			1 396	788
Administered expenses			45 399	41 390
Total assets	476	378	967	1 115
Total liabilities	279	270	2 750	2 789

DoHA’s estimated average staffing level for 2010–11 is 4 753 (2009–10: 4 559).

## Governance arrangements

**5.229** DoHA has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of DoHA’s business objectives. These arrangements are designed to support the achievement of DoHA’s financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.230** The key elements of DoHA's governance arrangements include:

- an executive committee, chaired by the Secretary, that is responsible for the management and oversight of all major department policy, financial and operational decision making;
- a governance committee framework including an Audit Committee that includes two independent members, one of whom is the Chair, 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 Secretary and the Audit Committee;
- a risk management framework including Chief Executive Instructions, Procedural Rules, a Risk Management Policy and an Enterprise Risk Management Plan (ERMP). Risks, including fraud risks, identified in the ERMP are reported quarterly to the executive committee, Audit Committee and the Finance, 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;
- a Certificate of Compliance regime that incorporates semi-annual control self assessments, that 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 agencies regarding significant administered payments.

## **Areas of audit focus**

**5.231** In the light of the ANAO's understanding of DoHA's environment and governance arrangements, that includes a financial reporting regime and a system of internal control, the ANAO's audit approach identified particular areas of audit focus that have the potential to impact on DoHA's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- administered grants and subsidies expenses, including aged care payments;

- high volume, high value and complex administered personal benefits expenses and liabilities;
- appropriations reporting and disclosure, as DoHA has 14 outcomes, making the preparation and audit of the appropriation note in the financial statements complex;
- the planned upgrade to the software used to manage and report aged care payments;
- accounting for the administered National Medical Stockpile due to planned replenishment of expired inventory; and
- accounting for fixed assets due to increased investment in infrastructure and software assets as part of the measures related to the National Health and Hospitals Network reform.

**5.232** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.233** The ANAO has assessed the risk of material misstatement in DoHA's 2010–11 financial statements as moderate.

## **Audit results**

**5.234** The ANAO has completed its interim audit coverage to assess the effectiveness of internal controls in the areas which had been identified as significant to the financial statements, including administered grants, personal benefits, subsidies and software upgrades. The remaining areas of audit focus relate to work that will be undertaken as part of the 2010–11 final audit.

**5.235** No significant or moderate audit issues have been identified during the 2010–11 interim audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.236** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DoHA can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.



# Human Services Portfolio

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## Department of Human Services

**5.237** The Department of Human Services (DHS) includes the Child Support Program and CRS Australia. Together with its Human Services portfolio agencies (Medicare Australia, Centrelink and Australian Hearing), DHS works to improve government social and health-related services to all Australians.

**5.238** DHS provides a central policy and coordination role for the delivery of services across the Human Services portfolio as well as being the delivery agency for child support and vocational rehabilitation services.

**5.239** The Child Support Program helps separated parents transfer payments for the benefit of their children. CRS Australia provides vocational rehabilitation services to people with a disability, injury or health condition, and helps employers keep their workplaces safe.

**5.240** In December 2009, the former Minister for Human Services announced reforms to government service delivery aimed at developing a modern, flexible, whole-of-government service delivery system, including the integration of Medicare Australia and Centrelink into DHS, scheduled for 1 July 2011.

**5.241** The *Human Services Legislation Amendment Act 2010*, which outlines legislative amendments to integrate Medicare Australia and Centrelink into DHS, takes effect on 1 July 2011.

**5.242** To guide and facilitate the service delivery reforms, a number of portfolio governance committees have been established to provide assurance to the Secretary of DHS and the Chief Executive Officers (CEOs) of Medicare Australia and Centrelink on the implementation of the service delivery reform agenda. A number of change processes have also been introduced across the portfolio, including: changes to organisational structures; changes to the provision of certain corporate services to better reflect proposed future service delivery responsibilities; and the development and implementation of consistent financial management policies and processes by DHS, Medicare Australia and Centrelink.

**5.243** Until the revised arrangements take effect, the CEOs of Medicare Australia and Centrelink will continue to exercise their responsibilities under

the FMA Act for their respective organisations, including the preparation of financial statements and maintaining an audit committee.

**5.244** The key characteristics of DHS's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the complexity of child support arrangements, particularly in relation to child support assessments that are subject to complex legislative requirements;
- transactions relating to CRS Australia, which are processed on separate financial systems to that of DHS; and
- the nature of departmental expenditure that mainly consists of salaries, property, and information technology, which forms a significant proportion of DHS's financial statements.

## Financial overview

**5.245** DHS's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	613	551		
Appropriation revenue	504	558		
Administered income			1 300	1 252
Administered expenses			1 285	1 230
Total assets	352	363	668	663
Total liabilities	248	181	659	655

DHS's estimated average staffing level for 2010–11 is 5 625 (2009–10: 5 850).

## Governance arrangements

**5.246** DHS has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance on the achievement of DHS's business objectives. These arrangements are designed to support the achievement of DHS's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.247** The key elements of DHS's governance arrangements include:

- a Management Board supported by a number of corporate and operational committees;
- an audit committee that focuses on matters relating to risk assessment and management, internal audit, external audit, fraud control and financial reporting; and a financial statement sub-committee that meets regularly, focussing on financial statement issues, risks and deliverables;
- an internal audit function that delivers a strategic risk based internal audit plan designed to assist line areas meet their key objectives via a combination of performance and compliance based audits;
- a fraud control plan that identifies, and assists in the management of, fraud risks; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### **Areas of audit focus**

**5.248** In the light of the ANAO's understanding of DHS's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DHS's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- child support payments and related transactions, specifically focusing on child support assessment controls and IT business systems controls;
- CRS Australia accounting for and recognition of revenue received under arrangements with other Commonwealth entities; and
- the accounting for services and functions delivered by DHS's on behalf of Medicare Australia and Centrelink.

**5.249** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.250** The ANAO has assessed the risk of material misstatement in the DHS 2010–11 financial statements as moderate.

## **Audit results**

**5.251** The ANAO has completed the work in relation to child support payments and related IT controls. No significant or moderate issues have been identified.

**5.252** The audit coverage relating to CRS accounting for revenue and service delivery reform transactions will be completed during the final phase of the 2010–11 audit.

**5.253** No significant or moderate audit issues have been identified during the 2010–11 interim audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.254** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DHS can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## **Centrelink**

**5.255** Centrelink is a key service delivery agency within the Human Services Portfolio which is responsible for providing Australian Government welfare services. Centrelink's customers include retired people, families, sole parents, people looking for work, people with disabilities, illnesses or injuries, carers, widows, primary producers, students, young people, Indigenous people, people from diverse cultural and linguistic backgrounds, and people affected by natural disasters.

**5.256** Centrelink distributes approximately \$90 billion in personal benefit payments on behalf of a range of government agencies, including the Attorney-General's Department, the Department of Agricultural, Fisheries and Forestry, Education, Employment and Workplace Relations, Families, Housing, Community Services and Indigenous Affairs, under either bilateral or multilateral management arrangements. This financial year Centrelink is also processing payments to those affected by wide spread flooding in Queensland on behalf of the Queensland Department of Premier and Cabinet.

**5.257** Centrelink continues to work across the Human Services Portfolio to build partnerships for the delivery of quality outcomes for the Government and the Australian community through its business operations which include:

- providing services to the Australian community which includes developing and maintaining relationships across government and the Australian community;
- contributing to the development and delivery of relevant government priorities, such as Social Inclusion, Closing the Gap, Welfare Reform and COAG Emergency Management programs;
- maintaining a service that is convenient, accessible and meets the diverse needs of the Australian community;
- improving the integration of new technology in accordance with Government's Information Communication Technology reform agenda; and
- progressively implementing the service delivery reforms, referred to at paragraphs 5.240 to 5.242 above, and supporting staff in the transition to the proposed new portfolio arrangements.

**5.258** The key characteristics of Centrelink's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- voluntary disclosure of information by customers in relation to the assessment and payment of personal benefits;
- the need for the timely implementation of system changes in an environment of frequent legislative and policy changes in personal benefit programs;
- the complexity of the IT environment, particularly relating to developing and managing internal systems for benefit payments;
- the management of agreements with agencies relating to service delivery responsibilities; and
- the impact of the service delivery reforms on Centrelink's business operations referred to at paragraphs 5.240 to 5.242.

## Financial overview

5.259 Centrelink's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	2 747	2 786		
Appropriation revenue	2 520	2 810		
Administered income				
Administered expenses				
Total assets	1 117	1 147		
Total liabilities	800	796		

Centrelink's estimated average staffing level for 2010–11 is 24 030 (2009–10: 25 580).

## Governance arrangements

5.260 Centrelink has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Centrelink's business objectives. These arrangements are designed to support the achievement of Centrelink's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.261 The key elements of Centrelink's corporate governance that provides a positive contribution to the financial management regime include:

- the Centrelink's executive group, comprising of the Chief Executive and the senior managers that meets fortnightly;
- 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 an appropriate financial management framework and complies with established internal controls. The Audit Committee focuses on risk management and the effectiveness of the control environment, particularly in relation to financial systems, accounting processes and related controls;

- an internal audit function that undertakes a program of audits covering the main aspects of Centrelink's business;
- a fraud control action plan that addresses fraud associated with welfare payments;
- 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.

## Areas of audit focus

**5.262** In the light of the ANAO's understanding of Centrelink's environment and governance arrangements that include its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of focus that have the potential to impact on Centrelink's financial statements. Areas highlighted for specific audit coverage in 2010–11 that relate to service delivery reform activities impacting the 2010–11 financial statements, are:

- the accounting for services and functions delivered by Centrelink on behalf of DHS and Medicare Australia in the lead up to the proposed integration of these agencies; and
- a revaluation of non-financial assets and an actuarial review of employee benefit provisions with the aim of achieving the consistent application of relevant accounting policies across the portfolio at year end and subsequent financial reporting periods, following the proposed integration of Centrelink and Medicare Australia into DHS.

**5.263** The ANAO will continue to provide audit coverage of the following areas that are significant to Centrelink's financial statements:

- assessment of the cost of internally developed software; and
- valuation of non-financial assets relating to asset under construction and revaluation of leasehold improvements.

**5.264** The ANAO will also continue to provide audit coverage of the following areas that are significant to the financial statements of the policy agencies on behalf of which Centrelink processes personal benefit payments:

- the non-disclosure of changes in circumstances by customers that may affect the integrity of personal benefit payments disclosed in the financial statements of relevant policy agencies. The review of compliance and quality assurance processes and random sample surveys, forms a significant part of the ANAO's audit examination of internal controls so that assurance can be provided in the context of the audit of policy agencies' financial statements; and
- changes in policy and legislation that could result in delays in unplanned changes to relevant IT systems and reports to policy agencies. The ANAO focuses on gaining an understanding of the business processes that encourage regular communication with policy agencies, designed to ensure that accurate and timely information is received from Centrelink.

**5.265** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**5.266** The ANAO has assessed the risk of material misstatement in the 2010–11 financial statements as moderate.

## **Audit results**

**5.267** The ANAO has substantially completed the work relating to the personal benefit payments delivered on behalf of other policy agencies including the processes for updating IT systems as a result of changes to policy and legislation. The remaining work in this area will be completed before year end. The work regarding the accounting for services and functions delivered by Centrelink on behalf of DHS and Medicare Australia is ongoing and will be finalised at year end as part of the 2010–11 final audit. The other areas of audit focus will also be completed during the 2010–11 final audit.

**5.268** The following table provides a summary of the status of prior year issues as well as the 2010–11 audit issues raised by the ANAO in the interim phase of the audit.



## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	0	0	0	0	0	1	1
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>

### *Moderate audit issue*

#### *Security Access Management System*

**5.269** Centrelink has implemented a Security Access Management System (SAMS), which facilitates the administration of access to personal benefit payment and debt management systems. SAMS manages the approval of access and updates user access privileges to these systems. The ANAO identified that, in some instances, SAMS was failing to correctly update user access privileges. This introduced discrepancies between access listed in SAMS and the approved user access privileges allocated to these systems. This has resulted in inappropriate access being granted to these systems, increasing the risk of errors or fraudulent transactions being processed.

**5.270** To reduce the number of users with inappropriate access, Centrelink has implemented a process that reviews the discrepancies in user access between SAMS, and the personal benefit payment and debt management systems. However, the reviews were performed only for a sample of user accounts and on an ad hoc basis. In addition, there was no documentation to evidence that the reviews had been undertaken and any discrepancies actioned. Centrelink has advised appropriate action is being taken to address the issues identified by the ANAO.

## Conclusion

**5.271** Based on our audit coverage to date, the ANAO identified that key elements of internal control, except for the issue outlined above, were operating satisfactorily to provide reasonable assurance that Centrelink can prepare financial statements free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## Medicare Australia

**5.272** Medicare Australia is a service delivery agency that administers a broad range of health-related and other payment programs totalling over \$40 billion annually on behalf of the Australian Government. It plays an integral role in the Australian health sector by providing services to the Australian public, health professionals, private health organisations, State and Territory Governments and Australian Government agencies.

**5.273** Medicare Australia delivers services for a range of Government agencies, including the Departments of Health and Ageing, Veterans' Affairs, Families, Housing, Community Services and Indigenous Affairs, Defence, Climate Change and Energy Efficiency, Innovation, Industry, Science and Research, the Australian Taxation Office and Centrelink.

**5.274** Medicare Australia's business operations include:

- improving Australia's health through the delivery of Australian Government payments and information services;
- providing accurate and reliable information and payments;
- ensuring the integrity of the government programs it delivers;
- delivering agreed health and other Government initiatives, including service delivery reform;
- contributing to and implementing proposals to reduce Government red tape; and
- continuing to enhance convenience, ease of access and cost effectiveness of services by increasing the availability and use of electronic channels for claiming and service provision.

**5.275** The key characteristics of Medicare Australia's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the complexity of the IT environment to support significant business operations;
- the need to rely on external parties to provide information to support significant financial statement balances;
- a program of compliance activities relating to Medicare Australia's legislative and program requirements;

- the management of agreements and relationships for the key programs Medicare Australia delivers on behalf of the Australian Government; and
- the impact of the service delivery reforms on Medicare Australia's business operations referred to at paragraphs 5.240 to 5.242.

## Financial overview

5.276 Medicare Australia's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	652	614		
Appropriation revenue	619	652		
Administered income			0	0
Administered expenses			0	4
Total assets	411	407	0	0
Total liabilities	205	210	0	0

Medicare Australia's estimated average staffing level for 2010–11 is 5 184 (2009–10: 5 089).

## Governance arrangements

5.277 Medicare Australia has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Medicare Australia's business objectives. These arrangements are designed to support the achievement of Medicare Australia's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.278 The key elements of Medicare Australia's governance arrangements include:

- a corporate management committee that meets monthly to provide strategic advice to the Chief Executive Officer, including ensuring that Medicare Australia's business proceeds efficiently during the service delivery reform process;

- a business management committee that provides governance and decision making for strategic issues that impact on business and operational performance in Medicare Australia;
- a compliance committee that provides governance and decision making for Medicare Australia's compliance responsibilities, including protecting the integrity of the programs administered by Medicare Australia;
- an audit committee, chaired by an independent external member, providing independent assurance and assistance to the Chief Executive Officer in relation to Medicare Australia's risk, control and compliance framework and its external accountability obligations;
- an internal audit function that has a planned risk based audit coverage of Medicare Australia's activities;
- an annual compliance plan for key programs administered by Medicare Australia; and
- a fraud control program that complies with the Commonwealth Fraud Control Guidelines.

## **Areas of audit focus**

**5.279** In light of the ANAO's understanding of Medicare Australia's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Medicare Australia's financial statements. One area highlighted for specific audit coverage in 2010–11 relates to service delivery reform activities impacting the 2010–11 financial statements, including:

- the accounting for services and functions delivered by Medicare Australia on behalf of DHS and Centrelink; and
- a revaluation of non-financial assets and an actuarial review of employee benefit provisions, with the aim of achieving the consistent application of relevant accounting policies across the portfolio.

**5.280** The ANAO will continue to provide audit coverage of the following areas that have previously been identified as significant to the financial statements:

- calculation and disclosure of appropriations in the financial statements;
- programs and related payments delivered by Medicare Australia on behalf of other agencies, including the Department of Health and Ageing and the Department of Veterans' Affairs;
- accounting for Medicare Australia's lease transactions, including makegood provision and lease incentives;
- capitalisation of intangible assets; and
- Medicare Australia's national compliance program that focuses on the integrity of Government programs it delivers.

**5.281** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.282** The ANAO has assessed the risk of material misstatement in Medicare Australia's 2010–11 financial statements as moderate.

## **Audit results**

**5.283** The ANAO has substantially completed the work relating to the payments delivered on behalf of other agencies. The remaining work in this area will be completed before year end. The work regarding the accounting for services and functions delivered by Medicare Australia on behalf of DHS and Centrelink is ongoing and will be finalised at year end as part of the 2010–11 final audit. The other areas of audit focus will also be completed during the final audit phase.

**5.284** No significant or moderate audit issues have been identified during the 2010–11 interim audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.285** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Medicare Australia can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Immigration and Citizenship Portfolio

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## Department of Immigration and Citizenship

**5.286** The Department of Immigration and Citizenship (DIAC) is responsible for the delivery of a range of programs and services for the purpose of building Australia's future through the well-managed entry and settlement of people into Australia.

**5.287** DIAC's responsibilities include:

- administering the Australian Government's immigration laws and migration programs;
- development of migration policy;
- contributing to border management; and
- the delivery of services to support migrants and refugees to settle into the Australian community and participate in Australian society.

**5.288** The key characteristics of DIAC's operations that shape the ANAO's 2010–11 financial statement audit include:

- the expansion of the immigration detention network as a result of an increase in the number of people in immigration detention;
- the planned completion of DIAC's major business transformation program, called *Systems for People*, which has resulted in significant changes in DIAC's information technology and business information systems;
- fluctuating business activity, which impacts DIAC's appropriation revenue and, in turn, affects staffing and property requirements; and
- the decentralised processing of visa application charge revenue across DIAC's Australian and overseas offices, supported by multiple IT systems with the involvement of the Department of Foreign Affairs and Trade, and to a lesser extent the Australian Trade Commission.

## Financial overview

5.289 DIAC's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	1 195	1 179		
Appropriation revenue	1 121	1 184		
Administered income			1 022	969
Administered expenses			1 035	663
Total assets	803	1 269	781	40
Total liabilities	368	359	205	189

DIAC's estimated staffing level for 2010–11 is 7 907 (30 June 2010: 6 998)

## Governance arrangements

5.290 DIAC has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance over the achievement of DIAC's business objectives. These arrangements are also designed to support the achievement of DIAC's financial reporting requirements, the effectiveness and efficiency of its operations, and compliance with applicable legislative requirements.

5.291 The key elements of DIAC's governance arrangements include:

- an executive management committee, which assists the Secretary in setting corporate priorities 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 focuses on matters relating to risk management, internal audit, external audit, fraud control and financial reporting;
- a financial statement sub-committee that meets regularly, focussing on financial statement issues, risks and deliverables; and

- an internal audit function that delivers a strategic risk-based internal audit plan designed to assist line areas meet their key objectives via a combination of performance and compliance based audits.

**5.292** DIAC has a monthly financial reporting process that provides reports to the executive and divisions 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.

## **Areas of audit focus**

**5.293** In the light of the ANAO's understanding of DIAC's environment and governance arrangements, including its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DIAC's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the transfer of DIAC's detention centre assets from its departmental balance sheet to its administered schedule of assets and liabilities;
- accounting for expenditure incurred as a result of the expansion of the immigration detention network;
- appropriation revenue recognised under DIAC's funding agreement with the Department of Finance and Deregulation; and
- the valuation of internally developed software, particularly in view of the expected finalisation of the *Systems for People* program.

**5.294** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.295** The ANAO has assessed the risk of material misstatement in DIAC's 2010–11 financial statements as moderate.

## **Audit results**

**5.296** The ANAO has commenced work on each of the areas of audit focus, except in relation to the valuation of the *Systems for People* software. No significant or moderate issues have been identified to date. Audit coverage of



the areas of audit focus will be completed at or near year-end as part of the 2010–11 final audit.

**5.297** The following table provides a summary of the status of issues identified by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	2	(2)*	0	0	0	0	0
<b>Total</b>	<b>2</b>	<b>(2)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

\* ANAO Report No.22 2009–10, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2010* reported that one Category B finding was downgraded to a Category C finding.

### Conclusion

**5.298** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to support the preparation of financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Infrastructure and Transport Portfolio

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## Department of Infrastructure and Transport

**5.299** The Department of Infrastructure, Transport, Regional Development and Local Government became the Department of Infrastructure and Transport (Infrastructure), as a result of the Administrative Arrangements Order (AAO) of 14 September 2010. The AAO transferred:

- the regional development and local government functions from the former department to the new Department of Regional Australia, Regional Development and Local Government (DRARDLG); and
- the Office of the Commonwealth Coordinator-General, which is responsible for coordinating the Australian Government's Nation Building-Economic Stimulus Plan, from the Department of Prime Minister and Cabinet to Infrastructure.

**5.300** The department provides a range of programs that support infrastructure, through investment in the coordination of transport and other infrastructure and services, regulation and monitoring of the transport system, and information to, and in partnership with, government, industry and the broader community.

**5.301** The key characteristics of Infrastructure's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the level of complexity of the large number of grant and subsidy programs administered by the department; and
- the significant administered asset balances reported in the department's financial statements, particularly the Australian Government's investments in portfolio agencies.

## Financial overview

5.302 Infrastructure's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	200	209		
Appropriation revenue	188	209		
Administered income			1 062	689
Administered expenses			2 014	3 909
Total assets	120	126	3 911	3 561
Total liabilities	61	59	18	65

Infrastructure's estimated average staffing level for 2010–11 is 953 (2009–10: 1 089).

## Governance arrangements

5.303 Infrastructure has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of Infrastructure's business objectives. These arrangements are designed to support the achievement of Infrastructure's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.304 The key elements of Infrastructure's governance arrangements include:

- an executive management group that meets weekly and addresses strategic issues, monitors Infrastructure's financial performance, and oversees the operational performance of divisions;
- a governance committee framework, including an audit committee that meets regularly 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 addresses key business and financial risks, and aims to assist line areas meet their key objectives;
- a fraud control plan that is in line with the Commonwealth Fraud Control Guidelines;

- mechanisms to facilitate internal and external financial integrity assurances, including the effectiveness of internal controls that impact on the financial statements and the Secretary's annual Certificate of Compliance;
- a framework for incorporating risk management into Infrastructure's broader management and business processes; and
- a financial reporting framework that involves monitoring the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## **Areas of audit focus**

**5.305** In the light of the ANAO's understanding of Infrastructure's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on Infrastructure's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the financial management and reporting of grant and subsidy programs administered by the department;
- the carrying value of administered investments, which represent a significant balance in Infrastructure's financial statements; and
- the financial reporting relating to the Machinery of Government changes.

**5.306** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.307** The ANAO has assessed the risk of material misstatement in Infrastructure's 2010–11 financial statements as moderate.

## **Audit results**

**5.308** The ANAO's interim audit has focussed on the financial management and reporting of grant and subsidy programs, and IT general and application controls as they relate to the financial statements. Audit work on IT general controls is complete, while work continues in the remaining areas. Audit coverage of the carrying value of administered investments and financial

reporting of restructures will be undertaken as part of the 2010–11 final audit, when the related assessments and reporting have been completed by Infrastructure.

**5.309** No significant or moderate audit issues have been identified during the 2010–11 interim audit. The 2009–10 audit also did not identify any significant or moderate audit issues.

## **Conclusion**

**5.310** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Infrastructure can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Innovation, Industry, Science and Research Portfolio

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## Department of Innovation, Industry, Science and Research

**5.311** The Department of Innovation, Industry, Science and Research (DIISR) strives to create an environment where new ideas are nurtured and innovation drives productivity, economic growth and social well being, by strengthening the links between science, research and industry. DIISR is responsible for developing policies and delivering programs in partnership with stakeholders, designed to provide lasting economic benefits ensuring Australia's competitive future.

**5.312** DIISR's responsibilities include:

- the sustainable development and growth of Australian industry – particularly the manufacturing, services and small business sectors – by encouraging business to innovate, collaborate and commercialise ideas, and by delivering business advice, assistance and services; and
- the production, use and awareness of science and research knowledge, by supporting research activity; training and infrastructure; science communication; skill development, and collaboration, within the research sector and between researchers and industry, domestically and internationally.

**5.313** The key characteristics of DIISR's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the complexity and number of administered programs. The number and extent of programs is also continually changing as a result of new Government initiatives and the winding down of existing programs;
- the complex ownership structures for administered investments, including the Innovation Investment Fund; and
- the integration of the operations of the Australian Astronomical Observatory (AAO) and National Trade Measurement (NTM) transferred to DIISR during the year.

## Financial overview

**5.314** DIISR's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	327	298		
Appropriation revenue	306	301		
Administered income			415	429
Administered expenses			4 075	4 013
Total assets	334	251	3 085	2 944
Total liabilities	120	105	319	343

DIISR's estimated average staffing level for 2010–11 is 2 276 (2009–10: 1 973)

## Governance arrangements

**5.315** DIISR has designed and implemented governance arrangements and a financial reporting framework to provide reasonable assurance about the achievement of DIISR's business objectives. These arrangements are designed to support the achievement of DIISR's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.316** The key elements of DIISR's governance arrangements include:

- a strategic plan that provides an overview of DIISR's future directions;
- meetings of the Secretary and senior managers held regularly to discuss key aspects of DIISR activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes, including the development and maintenance of a fraud control plan;
- 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;

- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports; and
- an internal audit function that addresses key business and financial risks and aims to assist line areas meet their key objectives.

## Areas of audit focus

**5.317** In the light of the ANAO's understanding of DIISR's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DIISR's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the implementation of a new Grant Management Information System;
- the valuation of property, plant and equipment;
- the transition of the subsidy for the Automotive Competitiveness Investment Scheme (ACIS) to new arrangements under the Automotive Transformation Scheme, including the final allocation of subsidy credits under ACIS; and
- the accounting for the acquisition and ongoing operations of AAO and NTM.

**5.318** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.319** The ANAO has assessed the risk of material misstatement in DIISR's 2010–11 financial statements as moderate.

## Audit results

**5.320** The ANAO has commenced its review of the areas of audit focus discussed above. No significant or moderate audit issues have been identified during the 2010–11 interim audit.

**5.321** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.



## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	(1)	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## Conclusion

**5.322** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DIISR can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Prime Minister and Cabinet Portfolio

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## Department of the Prime Minister and Cabinet

**5.323** The principal functions of the Department of the Prime Minister and Cabinet (PM&C) are to provide advice and support to the Prime Minister, the Cabinet Secretary and the Cabinet, and to achieve a coordinated and innovative approach to the development and implementation of government policies.

**5.324** PM&C is also responsible for:

- advising on legislation programming, legal and constitutional matters;
- providing oversight and management of the sports and recreation and arts and culture functions (as a result of Machinery of Government (MOG) changes during 2010–11);
- coordination of and arrangements for official ceremonial occasions; and
- staffing and administrative services to former Governors-General.

**5.325** MOG changes that took effect on 14 September 2010 resulted in a significant change to the structure and operations of PM&C. These changes have resulted in:

- the transfer of responsibility for the sports and recreation and arts and culture function to PM&C;
- the establishment of the Office of the Not-for-Profit Sector;
- the addition of a coordination and advice role in relation to cyber safety;
- the transfer of the responsibility for ownership and property management of the Prime Minister's official establishments to the Department of Finance and Deregulation and the transfer of the Office of the Commonwealth Coordinator-General to the Department of Infrastructure and Transport; and
- the establishment of the Office of the Australian Information Commissioner on 1 November 2010.

**5.326** The key characteristics of PM&C's business operations that shape the 2010–11 financial statement audit coverage include:

- the significant impact of the MOG changes on the structure and operations of the department, including the responsibility to administer a sizeable grants program in relation to the sports and arts functions;
- the relatively non-complex nature of PM&C's IT systems; and
- our prior assessment of the overall effectiveness of PM&C's internal controls.

## Financial overview

**5.327** PM&C's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	162	111		
Appropriation revenue	155	115		
Administered income			1	0
Administered expenses			416	9
Total assets	230	73	7 284	43
Total liabilities	227	32	12	12

PM&C's estimated average staffing level for 2010–11 is 780 (2009–10: 657).

## Governance arrangements

**5.328** PM&C has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance of the achievement of PM&C's business objectives. These arrangements are designed to support the achievement of PM&C's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.329** The key elements of PM&C's arrangements include:

- an executive group comprising the Secretary and associate and deputy secretaries that deals with issues in the department and corporate management decisions. The group considers strategic issues that

impact on PM&C, and also monitors the performance and budget in delivering PM&C's outcomes;

- a senior management group that meets weekly to discuss key business issues for PM&C, including business priorities and key commitments. The group comprises the Executive Group and division heads;
- an audit committee that is chaired by the Deputy Secretary Governance and meets quarterly. The audit committee is responsible for the oversight of the department's approach to risk management, including PM&C's overall control framework;
- an internal audit function that plans and conducts audits based on risk assessments of departmental activities and direction from the audit committee;
- a risk management framework and plan that identifies and assists in the management of risk at the strategic, business and project level;
- a fraud policy statement and fraud control plan that is updated and reviewed in line with Commonwealth Fraud Control Guidelines; and
- a governance unit that oversees PM&C's governance arrangements.

## **Areas of audit focus**

**5.330** In light of the ANAO's understanding of PM&C's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on PM&C's financial statements.

**5.331** An area highlighted for specific audit coverage in 2010–11 is the new responsibilities of the department referred to above that have resulted in a significant change to PM&C's structure and operations.

**5.332** The ANAO will continue to provide audit coverage of the management and financial reporting of the Commonwealth Heads of Government Meeting (CHOGM) that will be held in October 2011.

**5.333** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.334** The ANAO has assessed the risk of material misstatement in PM&C's 2010–11 financial statements as moderate.

### **Audit results**

**5.335** The ANAO has commenced a review of internal controls relevant to the preparation of the department's financial statements and no significant or moderate findings have been identified. Work in relation to the new responsibilities of the Department and the expenditure relating to CHOGM will be finalised as part of the 2010–11 final audit.

**5.336** The 2009–10 audit also did not identify any significant or moderate audit issues.

### **Conclusion**

**5.337** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that PM&C can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## **Department of Regional Australia, Regional Development and Local Government**

**5.338** The Department of Regional Australia, Regional Development and Local Government (DRARDLG) was established by the Administrative Arrangements Order (AAO) of 14 September 2010. Functions from the former Department of Infrastructure, Transport, Regional Development and Local Government (DITRD LG) and the Attorney-General's Department were transferred to DRARDLG and appropriations were amended on 1 October 2010 to effect the transfer of funding under section 32 of the FMA Act.

**5.339** DRARDLG's primary role is to improve the social, economic and environmental outcomes for Australia's regions through advice to the Government and the administration of targeted regional programs and investments.

**5.340** The principal responsibilities of the department are:

- regional development, and the delivery of regional and rural specific services;
- regional Australia policy and co-ordination;
- support for Ministers and Parliamentary Secretaries with regional responsibilities;
- administration of the Jervis Bay Territory, the Territory of Cocos (Keeling) Islands, the Territory of Christmas Island, the Coral Sea Islands Territory, the Territory of Ashmore and Cartier Islands, and Commonwealth responsibilities on Norfolk Island;
- constitutional development of the Northern Territory and the Australian Capital Territory;
- planning and land management in the Australian Capital Territory; and
- matters relating to local government, including financial assistance grants to councils and shires.

**5.341** The department also supports the priorities of the Regional Australia and Regional Development Committee of Cabinet, and assists in the delivery of the *Commitment to Regional Australia* agreed on 7 September 2010 between the Government and two independent members of Parliament.

**5.342** The key characteristics of DRARDLG's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the functions, staff and related financial reporting balances transferred from the former DITRD LG and the Attorney-General's Department;
- the establishment and operation of shared service arrangements with the Department of Infrastructure and Transport and the Attorney-General's Department;
- the geographical spread of operations and the large number of grant programs administered by the department; and
- development of the department's maturing control environment.

## Financial overview

5.343 DRARDLG's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	38			
Appropriation revenue	38			
Administered income			18	
Administered expenses			2 540	
Total assets	12		790	
Total liabilities	9		5	

DRARDLG's estimated average staffing level for 2010–11 is 311.

## Governance arrangements

5.344 DRARDLG continues to develop and implement its governance arrangements, financial reporting regime and an internal control system to provide reasonable assurance about the achievement of business objectives. The department is committed to establishing arrangements designed to support the achievement of financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

5.345 Governance arrangements developed by DRARDLG to date include:

- a draft business plan that identifies organisational risks, underpinned by divisional business plans;
- an executive management group that meets weekly to address strategic issues, monitor financial performance, and oversees the operational performance of divisions;
- Chief Executive Instructions that are consistent with related instructions from the Department of Infrastructure and Transport and the Attorney-General's Department;
- a governance committee framework, including a risk and audit committee that meets at least quarterly which focuses attention on internal controls, management of risks, review of financial reports, control of public monies and regulatory compliance;

- a financial statements sub-committee that provides advice to the risk and audit committee regarding the preparation and certification of the financial statements;
- draft fraud control plan and draft financial statements risk plan;
- the on-going development of a risk management framework and plan that identifies, and assists the management of, risk at various levels of the entity; and
- establishment of an internal audit division.

## **Areas of audit focus**

**5.346** In the light of the ANAO's understanding of DRARDLG's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the department's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the operation of shared service arrangements with the Department of Infrastructure and Transport and the Attorney-General's Department;
- implementation of control activities and financial reporting arrangements in respect of employee entitlements and payroll, large and complex grant programs administered by the department, and the department's administered asset portfolio, characterised by asset holdings in disperse locations; and
- the impact of Machinery of Government changes, including the transfer of appropriations, staff, and establishment of delegations.

**5.347** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.348** The ANAO has assessed the risk of material misstatement in DRARDLG's 2010–11 financial statements as moderate.

## **Audit results**

**5.349** Since the establishment of the department on 14 September 2010, audit activity has progressed steadily as DRARDLG continues to develop key aspects of its control environment. The ANAO has completed interim audit



coverage in relation to controls testing of the department's IT systems controls and controls relating to major grant and subsidy programs.

**5.350** Completion of the interim audit in relation to the areas of audit focus is subject to final confirmation by the department of its opening account balances, including details of payroll migration from the Attorney-General's Department and the Department of Infrastructure and Transport, and the completion of assets stocktakes.

**5.351** No significant or moderate audit issues have been identified during the 2010–11 interim audit to date.

## **Conclusion**

**5.352** The ANAO will continue to assess the effectiveness of the department's internal controls to provide reasonable assurance that DRARDLG can prepare financial statements that are free of material misstatement. The effective operation of internal controls up to year-end will be assessed during the 2010–11 final audit.

# Resources, Energy and Tourism Portfolio

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## Department of Resources, Energy and Tourism

**5.353** The Department of Resources, Energy and Tourism (RET) has objectives to enhance Australia's economic prosperity by improving the productivity, competitiveness, security and sustainability of the resources, energy and tourism sectors. RET achieves these objectives by providing high quality advice and program delivery services for the Australian Government.

**5.354** RET's business operations include:

- provision of advice to the Australian Government on the impact of policies in the resources, energy and tourism sectors;
- provision of assistance to State and Territory governments for resources and energy; and
- development of policies and the delivery of programs to provide resources, energy and tourism related initiatives.

**5.355** The key characteristics of RET's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- management of a large range of administered programs; and
- the department's responsibility for the collection of petroleum and uranium royalties. These royalty collections are generally managed by other government jurisdictions on behalf of RET.

## Financial overview

5.356 RET's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	81	86		
Appropriation revenue	81	86		
Administered income			1 576	1 507
Administered expenses			944	566
Total assets	40	39	790	775
Total liabilities	38	38	20	20

RET's estimated average staffing level for 2010–11 is 471 (2009–10: 440).

## Governance arrangements

5.357 RET has designed and implemented governance arrangements and a financial reporting framework to provide reasonable assurance about the achievement of RET's business objectives. The key elements of RET's governance arrangements include:

- an Executive Board of Management that meets regularly to discuss key aspects of RET activities, including program management and financial performance;
- a structured framework for incorporating risk management into the broader management and business processes, including the development and maintenance of a fraud control plan;
- an audit committee that meets quarterly and focuses on the enhancement of the department's control framework and risk management arrangements to improve the objectivity and reliability of externally published financial and other information; and
- an internal audit function that examines key business and financial risks and aims to assist line areas to meet their key objectives.

## Areas of audit focus

**5.358** In the light of the ANAO's understanding of RET's environment and governance arrangements, that includes its financial reporting framework and system of internal controls, the ANAO's audit approach identifies particular areas of audit focus that have the potential to significantly impact on RET's financial statements. Areas highlighted for specific audit coverage in 2010–11 include:

- the valuation of the Commonwealth's investment in the Snowy Hydro Limited (SHL) that is recognised as an administered investment in RET's financial statements; and
- accrued revenue relating to petroleum royalties, given the volatility of revenue streams and their material impact on the financial statements.

**5.359** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.360** The ANAO has assessed the risk of material misstatement in RET's 2010–11 financial statements as moderate.

## Audit results

**5.361** The ANAO has undertaken testing of the key elements of RET's internal control and audit coverage of the areas of audit focus outlined above. No significant or moderate issues have been identified in 2010–11. The ANAO will complete its review of internal controls and the valuation of the Commonwealth's investment in SHL during the 2010–11 final audit.

**5.362** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	1	(1)	0	0	0	0	0
B	0	0	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## Conclusion

**5.363** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that RET can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full year will be assessed during the 2010–11 final audit.

# Sustainability, Environment, Water, Population and Communities Portfolio

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## Department of Sustainability, Environment, Water, Population and Communities

**5.364** The Department of Sustainability, Environment, Water, Population and Communities (DSEWPaC) provides policy advice and administered programs to achieve the Government's objectives in the areas of the environment, water availability, heritage and culture as well as housing supply, affordable housing and the development of the sustainable population strategy. DSEWPaC is also responsible for supporting Australia's Antarctic activities.

**5.365** Machinery of Government changes that took effect on 14 September 2010 and 14 October 2010, changing the department's name from the Department of the Environment, Water, Heritage and the Arts (DEWHA) to the Department of Sustainability, Environment, Water, Population and Communities, changed the structure and responsibilities of the department. These changes included:

- the transfer of responsibility for cultural affairs matters, including support for the arts, to the Department of the Prime Minister and Cabinet;
- the transfer of housing supply and affordability policy matters from the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) to DSEWPaC; and
- the transfer of sustainable population responsibilities from the Department of the Treasury to DSEWPaC.

**5.366** DSEWPaC's responsibilities include:

- conserving and protecting Australia's terrestrial and marine biodiversity and ecosystems, through supporting research, developing information, supporting natural resource management, regulating matters of national environmental significance and managing Commonwealth protected areas;
- improving the capacity of Australian communities and industry to protect the environment by promoting waste reduction and regulating

hazardous substances, wastes, pollutants, ozone depleting substances and synthetic greenhouse gases;

- advancing Australia's strategic, scientific, environmental and economic interests in the Antarctic by protecting, administering and researching the Antarctic region;
- developing strategies in relation to climate change including wise water use, securing water supplies and improving health of rivers, waterways and freshwater ecosystems by supporting research, and reforming the management and use of water resources;
- facilitating participation in, and access to, Australia's culture and heritage through developing and supporting cultural expression, and protecting and conserving Australia's heritage;
- advancing the sustainability of Australia's population, communities and environment, through coordination and development of sustainable population and communities policies and supporting affordable housing; and
- increasing protection, awareness and appreciation of Australia's heritage through the identification, conservation and celebration of natural, indigenous and historic places of national and world heritage significance.

**5.367** The key characteristics of DSEWPac's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- significant administered asset balances reported in DSEWPac's financial statements, particularly the Australian Government's investments in water assets;
- the significant and diverse grant programs administered by DSEWPac; and
- changes in the department's structure and responsibilities.

## Financial overview

5.368 DSEWPac's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	460	584		
Appropriation revenue	404	495		
Administered income			23	61
Administered expenses			1 298	3 835
Total assets	452	634	2 592	9 129
Total liabilities	438	439	13	47

DSEWPac's estimated average staffing level for 2010–11 is 2 406 (2009–10: 3 108).

## Governance arrangements

5.369 DSEWPac has designed and implemented governance arrangements, a financial reporting regime and an internal control system designed to provide reasonable assurance about the achievement of DSEWPac's business objectives.

5.370 The key elements of DSEWPac's governance arrangements include:

- a strategic plan that provides an overview of DSEWPac's strategic priorities and goals, including DSEWPac's planning and performance framework;
- a management board, which includes the Secretary and the Deputy Secretaries, that meets weekly to evaluate DSEWPac's strategic direction, financial planning and operational results;
- an audit committee that includes four independent members including the chair. The audit committee meets regularly and focuses on risk management, the control environment, review of financial reports and DSEWPac's compliance to laws and regulations;
- a framework for incorporating risk management into the broader management and business processes including the development of a fraud control plan that is being refreshed based on learnings from recent reviews of the department's operations; and



- an internal audit function that plans and conducts audits based on risk assessments of departmental activities.

## Areas of audit focus

**5.371** In the light of the ANAO's understanding of DSEWPaC's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on DSEWPaC's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the accounting and valuation of water assets;
- the financial management and reporting of grants, including those related to the Housing Affordability program, Caring for Our Country program and the Sustainable Rural Water Use and Infrastructure program;
- the model adopted by DSEWPAC to estimate the make good obligations for the Antarctic bases — particularly the appropriateness of assumptions used in the model; and
- the stock take and valuation of DSEWPaC's departmental assets, including those related to the Antarctic asset holdings.

**5.372** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.373** The ANAO has assessed the risk of material misstatement in DSEWPaC's 2010–11 financial statements as moderate.

## Audit results

**5.374** The ANAO has completed its interim audit to assess the effectiveness of internal controls relevant to the preparation of the financial statements. The ANAO's interim audit work has mainly focused on internal controls in the areas which had been identified as significant to the financial statements particularly the asset management procedures, administered grants and water assets. No significant or moderate issues have been identified.

**5.375** The remaining areas of audit focus relate to work that will be undertaken as part of the 2010–11 final audit. Any issues identified as part of this work will be reported in the ANAO's year end report to the Parliament.

**5.376** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	1	1	(1)*	0	0
B	1	(1)	0	0	0	0	0
<b>Total</b>	<b>1</b>	<b>(1)</b>	<b>1</b>	<b>1</b>	<b>(1)*</b>	<b>0</b>	<b>0</b>

\* The category A finding was closed due to transfer of functions from DSEWPaC to the Department of Climate Change and Energy Efficiency (DCCEE).

### Significant audit issue

Prior year issue

#### Home Insulation Program

**5.377** The ANAO audit of the then DEWHA's 2009–10 financial statements concluded that there was evidence to support, with a reasonable level of confidence, that payments made under Home Insulation Program (HIP) were consistent with claims received by Medicare from installers registered for the program. However, there was a risk that payments for fraudulent claims and for services not delivered in accordance with program guidelines occurred. The ANAO raised a significant audit finding in relation to the administration of this program.

**5.378** The remediation actions related to HIP are now the responsibility of the Department of Climate Change and Energy Efficiency (DCCEE), see paragraph 5.61 above.

### Conclusion

**5.379** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that DSEWPaC can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

# Treasury Portfolio

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## Department of the Treasury

**5.380** The Department of the Treasury (the Treasury) is the primary advisory body to the Australian Government on economic policy and development. The Treasury develops and implements policies to improve the wellbeing of the Australian people, including by achieving strong, sustainable economic growth, through the provision of advice to the Australian Government and the efficient administration of federal financial relations.

**5.381** The Treasury's business operations include:

- supporting a sound macroeconomic environment through monitoring and assessing economic conditions and prospects, both in Australia and overseas, and providing advice on the formulation and implementation of effective macroeconomic policy, including monetary and fiscal policy, and labour market issues;
- providing advice on budget policy issues, trends in Commonwealth revenue and major fiscal and financial aggregates, major expenditure programmes, taxation policy, retirement income, Commonwealth-State financial policy and actuarial services;
- addressing effective taxation and retirement income arrangements through the provision of advice and assisting in the formulation and implementation of government taxation and retirement income policies and legislation as well as providing information on material changes to taxation revenue forecasts and projections; and
- providing advice on policy processes and reforms that promote a secure financial system and sound corporate practices, removing impediments to competition in product and services markets and safeguarding the public interest in matters such as consumer protection and foreign investment.

**5.382** The key characteristics of the Treasury's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- the Council of Australian Governments (COAG) federal financial relations framework reflected in the *Federal Financial Relations Act 2009* (FFR Act). Under this framework, individual policy agencies continue

to be responsible for the non-financial performance of programs and periodically advise the Treasury of details of specific purpose payments and amounts payable under National Partnership Agreements;

- the Treasury's responsibility for monitoring the guarantees of deposits and wholesale funding and the temporary and voluntary guarantees over State and Territory Government borrowings that were first put in place following the global financial crisis. From 31 March 2010 no new wholesale funding arrangements have been entered into and from the 31 December 2010 the Australian Guarantee of State and Territory borrowings closed to the new issuance of guaranteed liabilities; and
- the COAG reform aimed at reducing the regulatory burden facing business. The Standard Business Reporting project (SBR) is a multi-agency initiative led by the Treasury, which has been implemented progressively from July 2010.

## Financial overview

**5.383** The Treasury's key financial figures are:

<b>Key financial balances</b>	<b>Departmental Estimated (\$m) 2010–11</b>	<b>Departmental Actual (\$m) 2009–10</b>	<b>Administered Estimated (\$m) 2010–11</b>	<b>Administered Actual (\$m) 2009–10</b>
Net cost of services	170	160		
Appropriation revenue	158	166		
Administered income			3 297	12 532
Administered expenses			82 103	88 000
Total assets	132	133	21 704	23 839
Total liabilities	55	53	11 056	14 102

The Treasury's estimated average staffing level for 2010–11 is 1 010 (2009–10: 1 007)

## Governance arrangements

**5.384** The Treasury has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance over the achievement of the Treasury's business objectives. These arrangements are designed to support the Treasury in meeting its financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative arrangements.

**5.385** The key elements of the Treasury's corporate governance arrangements include:

- an executive board that meets at least monthly and is responsible for high level policy issues relating to the Treasury's strategic leadership and management;
- a committee framework including an audit committee that meets at least six times a year and focuses attention on corporate governance, internal audit, external audit, fraud and risks faced by the Treasury;
- a comprehensive and coordinated framework for incorporating risk management into broader management and business processes;
- an internal assurance function that has a planned risk based coverage of the Treasury's activities; and
- a periodic fraud risk assessment undertaken in line with the Commonwealth Fraud Control Guidelines.

### **Areas of audit focus**

**5.386** In the light of the ANAO's understanding of the Treasury's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the Treasury's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- National Partnership payments (NPPs);
- Australian Government Deposit and Wholesale Funding Guarantees and Guarantees over State and Territory borrowings;
- General Revenue Assistance (GRA) payments; and
- impairment assessment of the Standard Business Reporting (SBR) software.

**5.387** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.388** The ANAO has assessed the risk of material misstatement in Treasury's 2010–11 financial statements as moderate.

## Audit results

**5.389** To date, our audit coverage of NPPs; Australian Government Deposit and Wholesale Funding Guarantees and Guarantees over State and Territory borrowings; and General Revenue Assistance (GRA) payments have not identified any new significant or moderate audit issues. Our audit coverage of the impairment assessment of the Standard business Reporting software will be reviewed as part of the 2010–11 final audit.

**5.390** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

### Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
A	0	0	0	0	0	0	0
B	1	0	1	2	(1)	0	1
<b>Total</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>(1)</b>	<b>0</b>	<b>1</b>

\* One category B finding has been downgraded to a Category C finding.

### Moderate audit issues

#### Prior year issues

#### National Partnership payments

**5.391** The 2009–10 interim audit identified that the Treasury did not maintain a central register of agreements and associated plans to support the NPPs and reporting obligations under the FFR Act. Audit testing undertaken during 2010–11 noted that the Treasury has commenced a project to develop a central register. As a result, the ANAO has downgraded this issue to a category C finding.

#### Financial statement preparation

**5.392** The 2009–10 final audit identified that the financial statement preparation process could be improved through better coordination of year-end reporting of accruals relating to Commonwealth payments to the States.

**5.393** The Treasury has commenced work to address this issue and the ANAO will review progress during the 2010–11 final audit.

## Conclusion

**5.394** Based on our audit coverage to date, the ANAO identified that key elements of internal control, except for the issues outlined above, were operating satisfactorily to provide reasonable assurance that the Treasury will be able to prepare financial statements free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## Australian Office of Financial Management

**5.395** The Australian Office of Financial Management (AOFM) is responsible for the management of Australian Government debt and financial assets. The AOFM also manages the Government's cash balance and invests in financial assets. Over the years, the government has issued Treasury Bonds to maintain liquid and efficient Bond and Bond futures markets, reflecting the important role that these markets play in the Australian financial system.

**5.396** The AOFM's business operations include:

- managing the Australian Government's daily cash balances through short term borrowings and investments;
- undertaking investments in financial assets in accordance with Government policy objectives;
- managing its portfolio of debt and financial assets cost effectively, subject to acceptable risk; and
- supporting the efficient operation of Australia's financial system.

**5.397** The key characteristics of AOFM's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- an increase in the volume of investment activity of financial assets and issuance of financial liabilities, that are material to both the agency and the Consolidated Financial Statements;
- continuation of the issuance of Treasury Indexed bonds to meet Government's funding needs; and
- material and complex financial assets and liabilities and their associated fair value assessment.

## Financial overview

**5.398** The AOFM's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	13	14		
Appropriation revenue	16	13		
Administered income			1 417	1 437
Administered expenses			9 286	6 348
Total assets	18	15	27 581	33 405
Total liabilities	2	2	200 588	157 376

AOFM's estimated average staffing level for 2010–11 is 42 (2009–10: 36).

## Governance arrangements

**5.399** AOFM has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of AOFM's business objectives. These arrangements are designed to support the achievement of AOFM's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.400** The key elements of AOFM's corporate governance that provides a positive contribution to the financial management regime of the agency include:

- an advisory board accountable to the Secretary of the Treasury that meets at least quarterly and provides general counsel and guidance on debt management policy, operational strategy and performance of the AOFM;
- a governance committee framework, including an audit committee which focuses attention on internal and external audit; fraud control and the statutory financial statements. Other committees include:
  - an Executive Committee that coordinates the overall management of the agency, including the consideration of strategic issues;



- an Asset and Liability Committee that advises the Chief Executive Officer on operational debt policy and financial management issues; and
  - an Operational Risk Committee that manages operational risk of the agency. This committee recommends and determines compliance priorities and control procedures and oversees the identification, categorisation and prioritisation of operational risks.
- an internal audit function that provides a risk based coverage of AOFM's activities;
  - a framework for incorporating risk management into AOFM's broader management and business processes; and
  - a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

## Areas of audit focus

**5.401** In the light of the ANAO's understanding of AOFM's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on AOFM's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- the complex fair value measurement of financial assets and liability securities; and
- financial instrument presentation and disclosures, including the impact of AASB 7 *Fair-value Hierarchy* and changes to AASB 139 *Financial Instrument: Measurement and Recognition*.

**5.402** We will continue to provide audit coverage of the following areas which have previously been identified as having a significant impact on the financial statements:

- AOFM's control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;

- capacity of AOFM to manage the issuance of debt instruments, Treasury Bond and Notes; and
- AOFM's internal assurance activities, including the Certificate of Compliance process, and fraud prevention activities.

**5.403** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls relating to the financial statements as an integral part of the interim audit.

**5.404** The ANAO has assessed the risk of material misstatement in the 2010–11 financial statements as moderate.

## **Audit results**

**5.405** No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage to date of the areas of audit focus.

**5.406** The areas of financial instruments and fair value measurements, including presentation and disclosures in the financial statements, will be reviewed as part of the 2010–11 final audit.

## **Conclusion**

**5.407** Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that AOFM can prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed during the 2010–11 final audit.

## **Australian Taxation Office**

**5.408** The Australian Taxation Office (ATO) is the Australian Government's principal revenue management agency. In 2010–11, the ATO is expected to collect some \$280 billion in revenue, representing approximately 90 per cent of the Australian Government's revenue.

**5.409** The ATO's responsibilities 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 and fuel grants schemes;
- providing cross agency support by working with: Centrelink to reduce benefit fraud; the Child Support Agency to ensure income transfer for the care of children; and the Australian Bureau of Statistics to reduce the cost to the community of collecting statistical data; and
- overseeing the Australian Valuation Office.

**5.410** The key characteristics of ATO's business operations that shape the ANAO's 2010–11 financial statement audit coverage include:

- a complex legislative environment that is subject to ongoing change;
- extensive IT based business systems and associated processes;
- a self assessment regime for the collection and reporting of taxation revenues;
- a complex financial statement process that involves using data from a number of business systems and requires significant estimations in calculating the balances of a number of financial statements items; and
- financial reporting pressures and budgetary constraints that impact the ATO's financial control framework.

## Financial overview

**5.411** ATO's key financial figures are:

Key financial balances	Departmental Estimated (\$m) 2010–11	Departmental Actual (\$m) 2009–10	Administered Estimated (\$m) 2010–11	Administered Actual (\$m) 2009–10
Net cost of services	3 122	2 965		
Appropriation revenue	3 016	3 007		
Administered income			282 046	260 215
Administered expenses			15 379	15 772
Total assets	1 073	1 036	26 183	25 261
Total liabilities	962	985	7 179	6 747

ATO's estimated average staffing level for 2010–11 is 21 908 (2009–10: 21 457)

## Governance arrangements

**5.412** ATO has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the achievement of ATO's business objectives. These arrangements are designed to support the achievement of ATO's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements.

**5.413** The key elements of the ATO's governance arrangements include:

- a strategic statement and plan that provides 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 committee that meets at least monthly and has a formal bi-annual corporate governance assurance process;
- a governance committee framework, including an audit committee. Some of these committees are sub committees of the executive committee;
- an internal audit function providing an internal audit strategy and plan that addresses key business and financial risks and aims to assist line areas meet their key objectives;

- mechanisms to facilitate 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 framework for incorporating risk management into ATO's broader management and business processes; and
- a financial reporting framework that involves the monitoring of the performance and financial management of key business areas and the preparation and monitoring of monthly financial reports.

### Areas of audit focus

**5.414** In the light of the ANAO's understanding of the ATO's environment and governance arrangements, that includes its financial reporting regime and system of internal control, the ANAO's audit approach identifies particular areas of audit focus that have the potential to impact on the ATO's financial statements. Areas highlighted for specific audit coverage in 2010–11 are:

- ATO's reliance on IT business systems and associated processes particularly in relation to system interfaces;
- valuation risks including inaccurate write-down of taxation receivables, and the impact of economic conditions on major items in the financial statements;
- legislative compliance, including the implementation of measures designed to ensure compliance with financial aspects of *The Constitution*, in light of breaches of section 83 of *The Constitution* identified in previous years;
- complex estimation and allocation processes associated with financial reporting where there is the application of judgement and specialist knowledge; and
- administration of the collection and reporting of taxation revenues, including processes associated with self assessment and voluntary compliance.

**5.415** We will continue to provide audit coverage of the following areas which have previously been identified as significant to the financial statements:

- ATO's control environment and the establishment of adequate controls to enable compliance with aspects of relevant financial management legislation;
- ATO's internal assurance activities including the Certificate of Compliance process, internal audit, integrity assurance, and fraud prevention activities; and
- IT business systems from which a number of financial statement balances are sourced.

**5.416** As outlined in Chapter 4, the ANAO continues to review agencies' IT general and application controls as they relate to the financial statements as an integral part of the interim audit.

**5.417** The ANAO has assessed the risk of material misstatement in the ATO's 2010–11 financial statements as high.

## **Audit results**

**5.418** The ANAO's interim audit has focused on ATO's control environment, taxation administration for the collection and reporting of taxation revenue, internal assurance activities, and key IT systems used as the source of data for financial statement balances. We have also reviewed actions taken by the ATO to address prior year audit findings.

**5.419** The ANAO will complete audit coverage of areas identified as significant to the financial statements, matters associated with legislative compliance and the valuation of provisions relating to non-collectable receivables, and estimation processes during the 2010–11 final audit.

**5.420** The following table summarises the status of audit issues reported by the ANAO in 2010–11 and 2009–10.

## Status of audit issues raised by the ANAO

Category	Findings outstanding (at the end of the 2009–2010 interim audit)	Findings resolved (at the time of the 2009–2010 final audit)	New findings (during the 2009–2010 final audit)	Findings outstanding (at the end of the 2009–2010 final audit)	Findings resolved (at the time of the 2010–2011 interim audit)	New findings (during the 2010–2011 interim audit)	Closing position (at the end of the 2010–2011 interim audit)
L1	1	0	0	1	0	0	1
A	1	(1)	0	0	0	0	0
B	7	(2)	3	8	(2)	0	6
<b>Total</b>	<b>9</b>	<b>(3)</b>	<b>3</b>	<b>9</b>	<b>(2)</b>	<b>0</b>	<b>7</b>

### *Legislative audit finding from prior years*

#### *Breaches of The Constitution*

**5.421** The 2009–10 financial statements made reference, in Note 25C, to a number of breaches of section 83 of *The Constitution*. These breaches were identified by the ATO during the 2009–10 Certificate of Compliance process. The note to the financial statements indicates that, from time to time, as a result of processing errors outside the assessment process, incorrect payments are made by the ATO. In these circumstances a payment is made to a taxpayer without any legislative basis, representing a breach of section 83 of *The Constitution* which requires that no money shall be drawn from the Treasury of the Commonwealth except under an appropriation made by law.

**5.422** A total of 604 incorrect payments totalling \$5.4 million were identified during 2009–10 comprising a very small percentage of some 13 million payments made during the year. At the time of signing the 2009–10 financial statements, over 85% of the incorrect payments had been recovered.

**5.423** The audit opinion on the financial statements was unqualified as the financial statements fairly presented the financial operations and position of the ATO at year end. However, the opinion did include a reference to the breach of section 83 of *The Constitution* under “Other Legal and Regulatory Requirements”. The ATO, in conjunction with the Treasury and the Department of Finance and Deregulation, is reviewing available legislative measures to address this issue.

#### *Moderate audit issues*

##### *Prior year issues*

**5.424** In the final phase of the 2009–10 audit the ANAO reported eight moderate audit issues. During the 2010–11 interim audit, the ANAO observed

that the ATO had effectively addressed the moderate audit findings in relation to:

- the risk of inappropriate or unauthorised access being granted to certain categories of mainframe users. The Resource Access Control Facility (RACF) provides access control and audit functionality for the ATO's mainframe. This facility maintains critical management information that is used to manage and monitor all mainframe users. In 2009–10, the ANAO observed that RACF access was only being reviewed on a monthly basis. The ATO advised that it now alerts, and subsequently reviews, conflicting RACF access on a daily basis. The ANAO's review during the 2010–11 interim audit confirmed that ATO's monitoring activities were effective; and
- system defects which had resulted in an overpayment of the superannuation co-contribution and non compliance with existing superannuation co-contributions legislation. The ATO has implemented a number of changes to systems, forms, information collection and business processes to enable compliance with existing superannuation co-contribution legislation. The ANAO's review of these changes identified no instances of overpayment of the superannuation co-contribution since the changes became effective.

#### *Ongoing moderate audit issues from prior years*

**5.425** Our 2010–11 interim audit identified that reasonable progress was being made to address six ongoing moderate risk matters. The status of each of these issues is outlined below.

#### *IT security and access findings*

**5.426** During the 2010–11 interim audit, a review of the IT general controls noted four continuing moderate issues relating to: the ATO's management of security classified information; privileged user access rights; password change management; and the operating effectiveness of reconciliation processes that provide assurance over the transfer of data through various system components. The ANAO will review progress on the resolution of these issues during the 2010–11 final audit.



*Change Program—control weaknesses in the Integrated Core Processing system (ICP)*

**5.427** The ATO Change Program involved the development and implementation of the ICP system which is used to process income tax returns. ICP requires manual intervention where errors are identified on taxpayer returns. During the 2009–10 interim audit, the ANAO identified that the ICP system did not maintain a visible audit trail of errors once corrected. In addition, the ANAO was unable to confirm appropriate quality assurance processes were in place to assess the accuracy of the tax return processing. As part of the 2010–11 interim audit, the ANAO performed extensive testing on manually corrected returns and noted continuing incidences of manual processing errors. A number of these errors resulted in incorrect payments to taxpayers, which the ATO advised were being corrected. The ATO also advised that system and quality assurance processes are being developed and are scheduled for implementation in December 2011.

*Change Program—ICP cash reconciliations*

**5.428** The ATO performs reconciliations between ICP and legacy IT systems to confirm the accuracy and completeness of the financial data ICP processes. During the 2009–10 final audit the ANAO identified that these reconciliations were not performed in a timely manner due to a lack of functionality to generate reports from the ICP system, and the inherent differences between ICP and legacy IT systems. At the time of the 2010–11 interim audit, the ATO advised that system and process changes were expected to be finalised in June 2011 to allow timely reconciliations to be performed.

## Conclusion

**5.429** Based on our audit coverage to date, the ANAO identified that key elements of internal control, except for the issues outlined above, were operating effectively to provide reasonable assurance that the ATO can prepare financial statements that are free of material misstatement. The effective operation of internal controls for the full financial year will be assessed during the 2010–11 final audit.



Ian McPhee  
Auditor-General

Canberra ACT  
23 June 2011



# Appendices



## Appendix 1: Agencies covered by this report<sup>44</sup>

Department of Agriculture, Fisheries and Forestry

Attorney-General's Department

Australian Customs and Border Protection Service

Department of Broadband, Communications and the Digital Economy

Department of Climate Change and Energy Efficiency

Department of Defence

Defence Materiel Organisation

Department of Veterans' Affairs

Department of Education, Employment and Workplace Relations

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 Australia

Department of Immigration and Citizenship

Department of Infrastructure and Transport

Department of Innovation, Industry, Science and Research

Department of the Prime Minister and Cabinet

Department of Regional Australia, Regional Development and Local Government

Department of Sustainability, Environment, Water, Population and Communities

Department of Resources, Energy and Tourism

Department of the Treasury

Australian Office of Financial Management

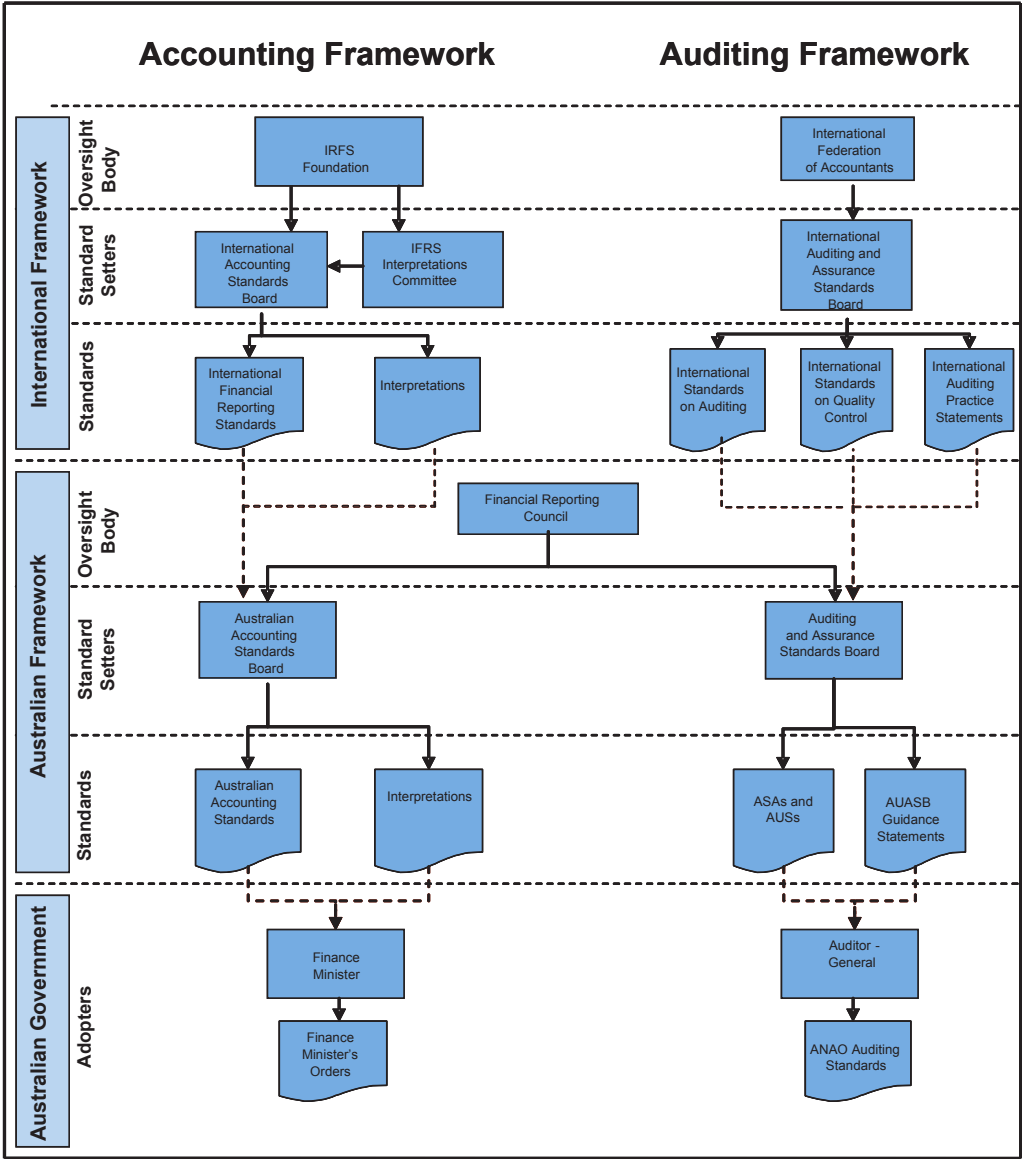
Australian Taxation Office

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<sup>44</sup> 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.



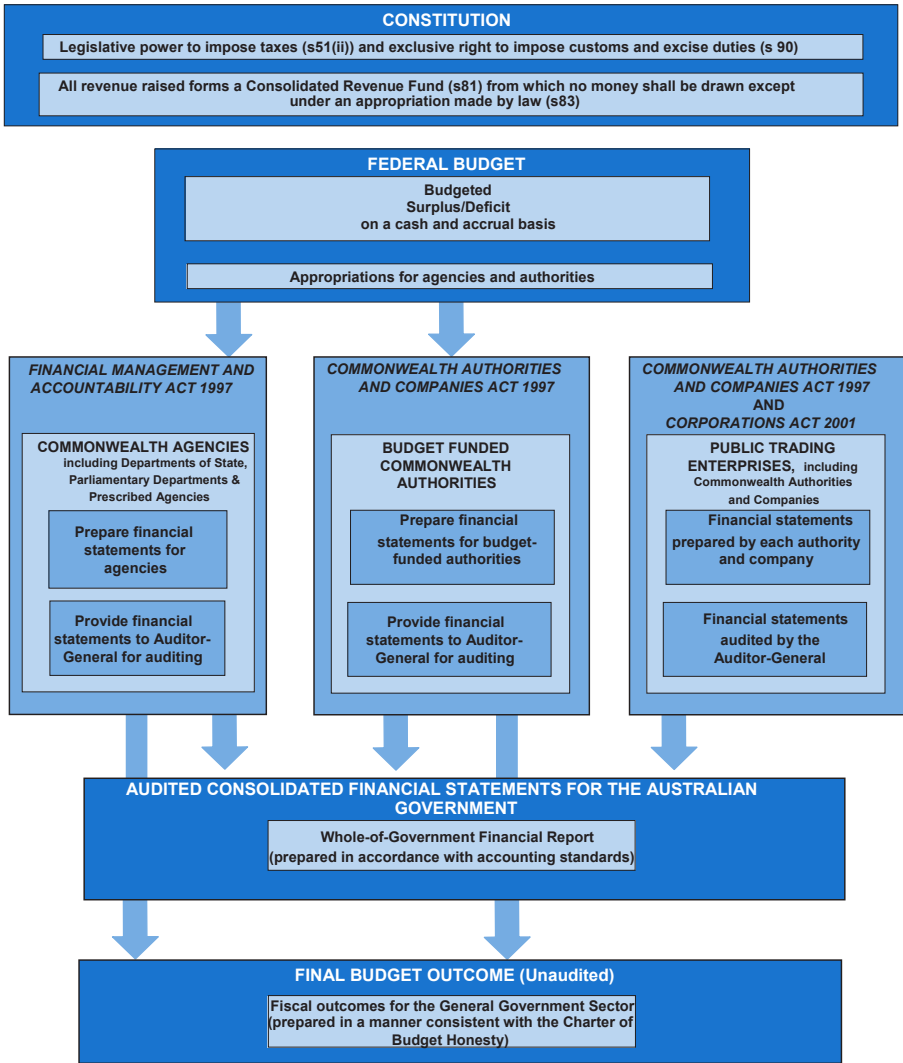
Source: ANAO

# Appendix 3: The Financial Reporting Framework

Key elements of the Australian Government’s financial reporting framework are outlined in the diagram below. An overview of the financial reporting requirements for the various types of Australian Government entities covered by the framework and the audit approach for the financial statements of these entities is also described below.

Figure A 1

## Key Elements of the Financial Reporting Framework



Source: ANAO

## Australian Government Reporting Entities

### Commonwealth Government of Australia

Section 55 of the *Financial Management and Accountability Act 1997* (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, comprising departments of state, parliamentary departments and prescribed agencies, are subject to the provisions of the FMA Act.

The FMA Act requires agency Chief Executives to prepare financial statements for their agencies in accordance with the Finance Ministers Orders (FMOs). The FMOs include a requirement that the financial statements comply with Australian Accounting Standards (AASs) and Interpretations 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 *Commonwealth Authorities and Companies Act 1997* (CAC Act).

The CAC Act requires the directors 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.



The 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 that the Commonwealth controls or over which it has significant influence. These consist primarily of trusts or joint ventures entered into by controlled Commonwealth bodies.

## **Audit of Australian Government financial statements**

### **Audit scope**

The Chief Executives of agencies, and the directors of authorities and companies, are responsible for the preparation and presentation of the financial statements and for maintaining records, internal controls, procedures and processes that support the preparation of those statements. The ANAO's independent audits of financial statements are undertaken to form an opinion whether the financial statements are free from material misstatement.

The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards (ASAs), to provide reasonable assurance as to whether the financial statements are free of material misstatement.

Audit procedures include examination of the entity's records and its internal control, information systems, control procedures and statutory disclosure requirements. Evidence supporting the amounts and other information in the statements is examined on a test basis, and accounting policies and significant accounting estimates are evaluated.

The entity's internal control relevant to the entity's preparation and fair presentation of the financial statements is considered in order to design audit procedures that are appropriate in the circumstances. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include 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 report, taken as a whole, is free from material misstatement, whether due to fraud or error. The fact that an audit is carried out may act as a deterrent. However, the auditor is not responsible for the prevention of fraud and error.

## **The auditor's report on financial statements**

The ANAO 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 the FMOs.

If the auditor is not satisfied that the financial statements are true and fair, the auditor's opinion is modified, with the reasons being indicated. The auditor's opinion may be modified 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 was a conflict between AASs and the requirements of the FMOs.

The various types of auditor's reports that can be issued are explained below.

### ***Unqualified Auditor's Report***

An unqualified auditor's report is provided when the financial statements give a true and fair view of the matters required by the FMOs, so as to present a view which is consistent with the entity's financial position, its financial performance, and its cash flows.

### ***Modified Auditor's Report***

The types of modified auditor's reports and the basis for issuing these reports are as follows:

A 'qualified opinion' is expressed when the auditor concludes that an unqualified opinion cannot be expressed due to a disagreement with management, a conflict between applicable financial reporting frameworks or a scope limitation; however the effect is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. The qualified opinion is expressed as being "except for" the effects of the matter to which the qualification relates.

A 'disclaimer of opinion' is expressed when a limitation on the scope of the auditor's work exists and the possible effect of the limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

An 'adverse opinion' is expressed when the effect of a disagreement with management or a conflict between applicable financial reporting frameworks is so material or pervasive to the financial statements that the auditor concludes that a qualification is not adequate to disclose the misleading or incomplete nature of the financial statements.

An 'emphasis of matter' is expressed in certain circumstances to draw attention to, or emphasise, a matter that is included in a note to the financial statements that is relevant to the users of the auditor's report but is not of such a nature that it affects the auditor's opinion (i.e. the auditor's opinion remains unqualified). The circumstances in which an emphasis of matter is used include:

- when a significant uncertainty exists, the resolution of which depends upon future events and which may materially affect the financial statements;
- when information in a document containing the audited financial statements is materially inconsistent with the financial statements; and
- when financial statements and the auditor's report have been issued and a fact is discovered that leads to revised financial statements and a new auditor's report being prepared.

### *Other Legal and Regulatory Requirements*

The auditor's report on the financial statements may also include a reference to 'other legal and regulatory requirements'. This allows the Auditor-General to draw the attention of the Parliament to significant departures from the financial management framework.

For example, section 57 of the FMA Act requires that, where the Auditor-General is of the opinion that a Chief Executive has contravened section 48<sup>45</sup> of

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<sup>45</sup> Section 48 of the FMA Act requires the Chief Executive of each agency to keep proper accounts and records.

the FMA Act, the Auditor-General must state in the auditor's report, the particulars of the contravention.

The Auditor-General may also refer to contraventions of other statutory requirements that he considers significant.

The Auditor-General is not required to audit the financial statements of overseas subsidiaries of Commonwealth authorities where it is impracticable or unreasonable for him to do so. In these cases, the auditor's report on the authority's consolidated financial statements must make relevant disclosures required by the CAC Act.

### **Other matters**

The auditor's report on the financial statements may also include a reference to 'other matters'. This allows the Auditor-General to communicate a matter other than those that are presented or disclosed in the financial statements that, in the Auditor-General's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, in situations not prohibited by law or regulation.

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