

**Interim Phase of the Audits of the Financial
Statements of Major General Government Sector
Entities for the year ending 30 June 2016**

© Commonwealth of Australia 2016

ISSN 1036–7632 (Print)

ISSN 2203–0352 (Online)

ISBN 978-1-76033-172-6(Print)

ISBN 978-1-76033-172-6(Online)

Except for the content in this document supplied by third parties, the Australian National Audit Office logo, the Commonwealth Coat of Arms, and any material protected by a trade mark, this document is licensed by the Australian National Audit Office for use under the terms of a Creative Commons Attribution-NonCommercial-NoDerivatives 3.0 Australia licence.

To view a copy of this licence, visit

<http://creativecommons.org/licenses/by-nc-nd/3.0/au/>.

You are free to copy and communicate the document in its current form for non-commercial purposes, as long as you attribute the document to the Australian National Audit Office and abide by the other licence terms. You may not alter or adapt the work in any way.

Permission to use material for which the copyright is owned by a third party must be sought from the relevant copyright owner. As far as practicable, such material will be clearly labelled.

For terms of use of the Commonwealth Coat of Arms, visit the *It's an Honour* website at

<http://www.itsanhonour.gov.au/>.

Requests and inquiries concerning reproduction and rights should be addressed to:

Senior Executive Director
Corporate Management Branch
Australian National Audit Office
19 National Circuit
BARTON ACT 2600

Or via email:

communication@anao.gov.au.



Canberra ACT
31 August 2016

Dear President and Speaker

The Australian National Audit Office has undertaken the interim audit phase of the 2015–16 financial statements audits of major General Government Sector entities in accordance with the authority contained in the *Auditor-General Act 1997*. The report is titled *Interim Phase of the Audits of the Financial Statements of Major General Government Sector Entities for the year ending 30 June 2016*. I present the report of this audit to the Parliament.

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

Yours sincerely



Grant Hehir
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, financial statement audits and assurance reviews 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.

For further information contact:

Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Phone: (02) 6203 7300
Fax: (02) 6203 7777
Email: ag1@anao.gov.au

ANAO audit reports and information about the ANAO are available on our website:
<http://www.anao.gov.au>

Contents

Executive summary	7
Summary of audit findings and related issues	7
Reporting and auditing frameworks	8
Cost of this report	8
1. Summary of audit findings and related issues	9
Introduction.....	9
Understanding entities and their environments.....	11
Interim audit findings	17
2. Reporting and auditing frameworks	31
Introduction.....	31
Recent changes to the Australian public sector reporting framework.....	32
Future changes to the public sector reporting framework.....	34
Changes to the Australian auditing framework	35
3. Results of the interim audit phase by entity	37
Introduction.....	37
Results of financial statement audits.....	38
3.1 Department of Agriculture and Water Resources	40
3.2 Attorney-General's Department	46
3.3 Department of Communications and the Arts.....	53
3.4 Department of Defence	58
3.5 Department of Veterans' Affairs.....	67
3.6 Department of Education and Training	72
3.7 Department of Employment	78
3.8 Department of the Environment and Energy	81
3.9 Department of Finance	86
3.10 Future Fund Management Agency and the Board of Guardians.....	91
3.11 Department of Foreign Affairs and Trade	94
3.12 Department of Health.....	99
3.13 Department of Immigration and Border Protection	104
3.14 Department of Industry, Innovation and Science.....	112
3.15 Department of Infrastructure and Regional Development	116
3.16 Department of the Prime Minister and Cabinet.....	120
3.17 Department of Social Services	125
3.18 Department of Human Services.....	131
3.19 Department of the Treasury	137
3.20 Australian Office of Financial Management.....	142
3.21 Australian Taxation Office.....	146
3.22 Other reportable matters – Airservices Australia	151
Appendices	155
Appendix 1 Entities covered by this report.....	157
Appendix 2 The financial reporting and auditing standards frameworks for 2015–16.....	158
Appendix 3 The financial reporting and auditing framework for 2015–16 financial statements	159
Appendix 4 Glossary of commonly used accounting terms	164

Executive summary

1. The primary purpose of financial statements is to provide relevant, reliable information to users about a reporting entity's financial position. In the public sector, the users of financial statements include Ministers, Parliament, and the community. The preparation of timely and accurate audited financial statements is also an important indicator of the effectiveness of entity's financial management, which fosters confidence in an entity on the part of users.
2. The Australian National Audit Office (ANAO) publishes two reports annually addressing the outcomes of the financial statement audits of Commonwealth entities, and the Consolidated Financial Statements of the Australian Government, to provide Parliament an independent examination of the financial accounting and reporting of public sector entities.
3. This report focuses on the results of the interim audit phase, including an assessment of entities' key internal controls, of the 2015–16 financial statements audits of 21 departments and other major General Government Sector (GGS) entities. These entities contribute 95 per cent of GGS revenues and expenses. Significant and moderate audit findings are reported to the responsible Minister(s), and all findings are reported to those charged with governance of each entity.
4. The second report, *Audits of Australian Government Entities for the year ending 30 June 2016*, reports on the results of the 2015–16 final audits of the financial statements of all Australian Government controlled entities and the CFS.

Summary of audit findings and related issues

Entity internal controls

5. A central element of the ANAO's financial statement audit methodology and the focus of the interim phase of ANAO audits, is a sound understanding of an entity's environment and internal controls. This understanding informs our audit approach, including the reliance placed on entity systems to produce financial statements that are free from material misstatement. To do this, the ANAO uses the framework contained in the Australian Auditing Standard 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* (ASA 315).
6. Overall, the entities included in this report had established processes and frameworks to support the implementation of effective internal controls for the preparation of financial statements that are free from material misstatement.

Summary of audit findings

7. A total of 79 findings were reported to the entities included in this report as a result of interim audits. These comprised 1 significant, 17 moderate and 61 minor findings. The level of significant and moderate audit findings is consistent with the 2014–15 results. The 2015–16 results relating to minor audit findings represent an improvement compared to the interim results of 2014–15 where 95 minor findings were reported.

8. Seventy-two per cent of significant and moderate findings were in the areas of: compliance and quality assurance frameworks supporting program payments, revenue collection and financial reporting; and management of IT controls, particularly the management of privileged users. These areas warrant further attention by entity management.

9. Entities have an ongoing responsibility 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 annual financial statements.

Reporting and auditing frameworks

Improving the quality and timeliness of financial reporting

10. There are ongoing initiatives by both Australian and international standard setters to reduce the volume and complexity of disclosures in financial statements.

11. The Department of Finance has indicated its intention to enable entities to move to a Reduced Disclosure Regime in future reporting periods that will allow for certain disclosures to be omitted from annual financial statements. The Department of Finance also intends to shorten the timeframes for preparing and auditing financial statements to facilitate timelier annual reporting to Parliament.

12. The ANAO supports initiatives that make financial statements easier to read, and generates timelier annual reporting to the extent that the needs of Parliament are met.

Enhancing performance reporting

13. Each Commonwealth entity is required to produce a corporate plan at least once each reporting period. The corporate plan is intended to be the primary planning document for entities. Entities and companies are also required to present a performance statement in annual reports. These statements will provide an assessment of the extent to which entities have succeeded in achieving their purposes, as outlined in corporate plans.

Auditor's report on the financial statements

14. In December 2015, the Australian Auditing and Assurance Standards Board issued revised standards dealing with auditor reporting. The revisions were made with the aim of increasing the transparency and value of auditor reporting and will apply to financial years ending on or after 15 December 2016. The ANAO is early adopting aspects of the revised auditor reporting standards for 2015–16.

15. The Australian Auditing and Assurance Standards Board also introduced a new auditing standard, ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*. In 2015–16, the ANAO is undertaking a limited pilot of reporting key audit matters for a number of material Commonwealth entities to assess risks and to inform the developments of ANAO methodology in this area. The ANAO expects to amend its auditing standards to include reporting on key audit matters from 2016–17.

Cost of this report

16. The cost to the ANAO of producing this report is approximately \$420 000.

1. Summary of audit findings and related issues

Chapter coverage

This chapter provides:

- an overview of the ANAO's audit approach to financial statements audits;
- a summary of observations regarding the internal controls of those entities included in this report; and
- a summary of audit findings identified at the conclusion of the interim audit.

Conclusion

The 21 entities included in this report had established processes and frameworks to support the implementation of effective internal controls.

A total of 79 findings were reported to the entities included in this report as a result of interim audits. These comprised 1 significant, 17 moderate and 61 minor findings. The level of significant and moderate audit findings is consistent with the 2014–15 results. The 2015–16 results relating to minor audit findings represent an improvement compared to the interim results of 2014–15 where 95 minor findings were reported.

Seventy-two per cent of significant and moderate findings were in the areas of: compliance and quality assurance frameworks supporting program payments, revenue collection and financial reporting; and management of IT controls, particularly the management of privileged users. These areas warrant further attention by entity management.

Entities have an ongoing responsibility 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 annual financial statements.

Introduction

1.1 The ANAO publishes two reports annually addressing the outcomes of the financial statements audits of Commonwealth entities and the Consolidated Financial Statements of the Australian Government (CFS) to provide Parliament an independent examination of the financial accounting and reporting of public sector entities.

1.2 This report focuses on the results of the interim audit phase, including an assessment of entities' key internal controls, of the 2015–16 financial statements audits of departments and other major General Government Sector (GGS) entities that collectively represent 95 per cent of total GGS revenues and expenses. A listing of these entities is provided in Appendix 1.

1.3 This report also includes a discussion of a moderate audit finding identified in 2014–15 relating to the CFS preparation process (refer to paragraph 2.16) and a discussion of a moderate audit finding identified in the 2015–16 interim audit in Airservices Australia (refer to paragraphs 3.22.1 to 3.22.13). These findings are not included in the discussion of issues in this chapter.

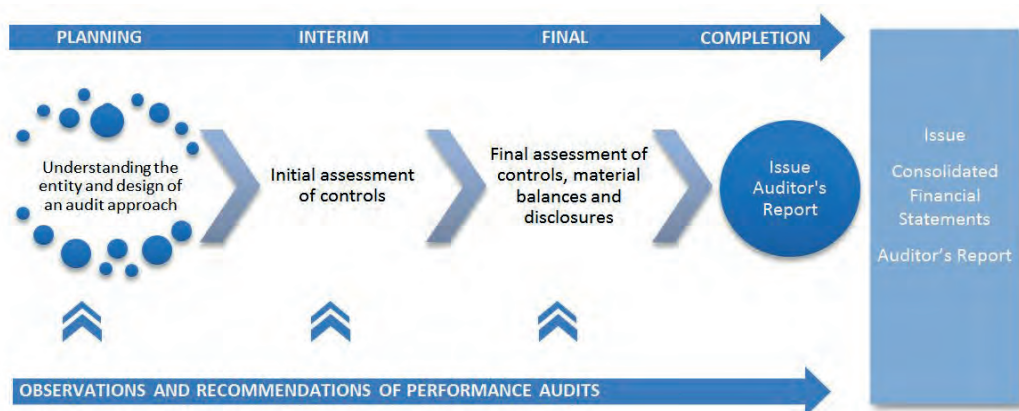
1.4 The CFS are required under section 48 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). The Finance Minister is required to prepare and deliver the CFS to the Auditor-General by 30 November each year. The CFS are prepared in accordance with

AASB 1049 *Whole-of-Government and General Government Sector Financial Reporting* and the Department of Finance has operational responsibility for the preparation of the CFS for the Finance Minister.

1.5 Government accountability and transparency is supported by the preparation and audit of the CFS. The CFS and the associated financial analysis provide information to assist users in assessing the annual financial performance and position of the Australian Government. The CFS present the consolidated whole of government financial results inclusive of all Australian Government controlled entities, as well as the GGS financial statements.

1.6 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 all entities' financial statements. The results of the 2015–16 final audits of the financial statements of all Australian Government controlled entities and the CFS will be included in the ANAO Audit Report *Audits of Australian Government Entities for the year ending 30 June 2016*, which is expected to be tabled in December 2016.

Figure 1.1: ANAO financial statements audit process



1.7 Accountable Authorities of GGS entities subject to the PGPA Act are required to govern their entity in a way that promotes the proper use and management of public resources, the achievement of the purposes of the entity and the entity's financial sustainability. This requires the development and implementation of effective corporate governance arrangements and internal controls designed to meet the individual circumstances of each entity. These processes also assist in the orderly and efficient conduct of the entity's business, and compliance with applicable legislative requirements, including the preparation of annual financial statements that present fairly the entity's financial position, financial performance and cash flows.

1.8 A central element of the ANAO's financial statement audit methodology, and the focus of the interim phase of ANAO audits, is a sound understanding of an entity's environment and internal controls relevant to assessing the risk of material misstatement in the financial statements. This understanding informs our audit approach, including the reliance we may place on entity systems to produce financials statements that are free from material misstatement.

1.9 The auditor's understanding of the entity, its environment and its internal controls, helps the auditor design the work needed and respond to significant risks that bear on financial reporting. The key areas of financial statements risks determined as a result of this planning approach are discussed in Chapter 3 for each entity included in this report.

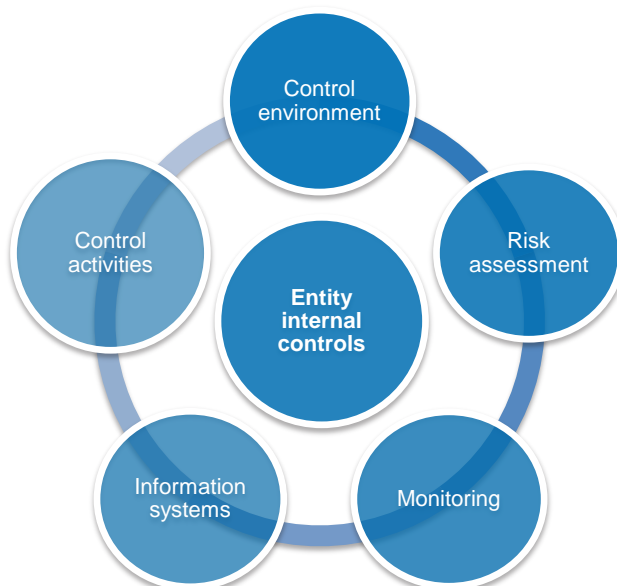
1.10 In accordance with generally accepted auditing practice, the ANAO accepts a low level of risk that the audit procedures will fail to detect that the financial statements are materially misstated. This low level of risk is accepted because it is too costly to perform an audit that is predicated on no level of risk. Specific audit procedures are performed to ensure that the risk accepted is low. These procedures include, 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 significant year end balances with third parties.

1.11 This chapter outlines observations made by the ANAO whilst obtaining this understanding, and the summarised results of detailed testing of entities' underlying control activities.

Understanding entities and their environments

1.12 The ANAO uses the framework in ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* to consider the impact of different elements of an entity's internal controls framework on the design and conduct of an audit. Figure 1.2 outlines these elements.

Figure 1.2: Elements of entity internal controls



Source: ASA 315 *Identifying and assessing the risk of material misstatement through understanding the entity and its environment*, paragraph A58.

1.13 This chapter discusses each of these elements and outlines our observations based on our review of aspects of each entity's internal control, relevant to the risk of material misstatement to the financial statements, including the detailed results of our interim audits.

Control environment

1.14 The ANAO Better Practice Guide, *Public Sector Governance: Strengthening performance through good governance* published in June 2014, detailed fundamental elements of good governance structures. These elements underpin an effective control environment and include:

- developing strong leadership at all levels of the entity, with a focus on ethical behaviour and continuous improvement;
- maintaining governance systems and processes that are fit for purpose;
- optimising performance through planning, engaging with risk, innovation, and performance monitoring, evaluation and review;
- focusing on openness, transparency and integrity, engaging constructively with stakeholders and promoting accountability through clear reporting on performance and operations; and
- where appropriate, participating in collaborative partnerships to more effectively deliver programs and services, including partnerships outside government.

1.15 In assessing an entity's control environment that supports the preparation of financial statements that are free from material misstatement, the ANAO reviews aspects of the governance structures. The ANAO considers whether management has established frameworks and processes that promote positive attitudes, awareness and actions concerning the entity's internal controls and their importance in the entity. The main elements reviewed include; governance structures relevant to the preparation of the financial statements, audit committee and assurance arrangements; and systems of authorisation, recording and procedures.

1.16 All entities included in this report had established executive management structures that met at least monthly, in the form of Executive Committees and sub-committees, supporting financial decision making at the strategic and operational levels.

1.17 All entities had an Audit Committee, with the size and composition of each varying from entity to entity. Membership ranged in number from seven to three, depending on the size and complexity of the entity's operations and all had at least three members who were not staff members of the entity. All Committee's had established a charter which reflected the key elements required by the *Public Governance, Performance and Accountability Rule 2014*.

1.18 Consistent with previous years, consideration of financial performance including accrual information was included on the agendas of all 21 entities' executive and audit committees. The financial information provided to the entities' executives was supplemented by non-financial operational information. Regular reporting of this nature to executive and audit committees places entities in good stead to improve the quality of AASB 1055 *Budgetary Reporting* note disclosures. ANAO Report No.15 2015–16, noted that more than 75 per cent of entities' disclosures required some improvement in the implementation of this standard's requirements. The ANAO will assess all entities' progress in this area during the 2015–16 final audit.

1.19 Clear accountability structures are important in establishing a strong internal control environment for the purposes of preparing the financial statements. The involvement of those charged with governance is an important element of these structures. Just as important is ensuring that staff at all levels understand their own role in the control framework. This can be achieved through the issuance of Accountable Authority Instructions¹, and delegation instruments. All 21 entities reviewed had established Accountable Authority Instructions and delegations reflecting current business arrangements.

1.20 The results of the 2015–16 interim audits identified that the entities included in this Report have appropriate frameworks in place to provide direction, guidance and control over financial management and to support the preparation of the 2015–16 financial statements. The ANAO identified 10 significant and moderate audit findings relating to: weaknesses in compliance and quality assurance frameworks supporting: program payments; revenue collection; and financial reporting. These weaknesses indicate a need for management in these entities to focus attention on:

- maintaining effective governance over third party or joint service delivery; and
- the risk management arrangements that support the effective engagement with risk in the delivery of programs.

1.21 Further detail relating to these issues is provided at paragraphs 1.76 to 1.78.

Risk assessment processes including fraud control

1.22 The PGPA Act sets out an accountable authority's responsibilities in regard to the establishment of appropriate risk oversight and management in their entity.² An understanding of an entity's risk assessment process is essential to an effective and efficient financial statement audit. The ANAO reviews how entities identify risks relating to their financial statements, how these risks are managed and considers the risk of material misstatement of an entity's financial statements.

1.23 All entities reviewed had a risk management process to develop and update risk management plans at the organisational and work area levels. In addition, each had developed processes for the identification and notification of risks relevant to financial statement preparation either as part of the overall risk management plan, or through a targeted risk identification exercise. The monitoring of risks, and the entities' implementation of risk management strategies, was typically assigned to either an executive committee and/or the audit committee.

Fraud control management

1.24 The *Commonwealth Fraud Control Framework* outlines the principles for fraud control within the Australian Government and sets minimum standards to assist entities in carrying out their responsibilities to combat fraud against their programs. As with risk management plans, fraud

1 Section 20A of the *Public Governance, Performance and Accountability Act 2013* authorises accountable authorities to give instructions to officials in their entities on any matter necessary or convenient for carrying out or giving effect to the Act or the rules.

2 Section 16, *Public Governance, Performance and Accountability Act 2013*.

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

1.25 The importance of entities establishing effective fraud control arrangements is recognised in section 10 of the *Public Governance, Performance and Accountability Rule 2014*, which specifies that Accountable Authorities must develop and implement a fraud control plan for their entity. The Framework requires entities to conduct fraud risk assessments regularly and when there is a substantial change in the structure, functions or activities of the entity.

1.26 As part of the ANAO's 2015–16 interim audits, the ANAO identified that all entities included in this report had established a fraud control plan. These plans were monitored, reviewed and updated when required.

1.27 Entities had also assigned responsibility for the oversight and monitoring of fraud control strategies and initiatives to specified fraud and governance roles or dedicated branches and the audit committee.

Monitoring of controls

1.28 Entities undertake many types of activities as part of their monitoring of control processes, including external reviews, self-assessment processes, post-implementation reviews and internal audits. The level of review of these activities by the ANAO is determined through a risk assessment approach that takes into consideration the nature, extent and timing of each activity and the activities application to the preparation of the financial statements. Given the significance of the internal audit function to Australian Government entities, this function is reviewed by the ANAO each year to gain an understanding of its contribution to the overall control environment.³

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

1.30 As part of its financial statement audit coverage, the ANAO reviews the activities of internal audit in accordance with ASA 610 *Using the Work of Internal Auditors*. The ANAO approach takes into account the work completed by internal audit, and, where appropriate, reliance is placed on it to ensure an effective audit approach.

1.31 The ANAO observed that internal audit coverage in the entities included in this report is based on an internal audit plan that is aligned with entities' risk management plans and includes a combination of audits that address assurance, compliance, performance improvements and IT systems reviews. In addition, recommendations from management, audit committees and external influences, such as the ANAO work program, are factors considered in the development of internal audit work plans.

1.32 The extent of ANAO's reliance on internal audit coverage varies between entities, and greater reliance is placed on internal audit where the work is focused on financial controls and

3 ANAO reviews the activities of internal audit in accordance with ASA 610 *Using the Work of Internal Auditors*.

legislative compliance. The ANAO continues to encourage entities to identify opportunities for internal audit coverage of key financial systems and controls as a means of providing increased assurance to Accountable Authorities to support their expressing an opinion on the entity's financial statements.

Information systems

1.33 An entity's information system is used extensively for the processing of financial information that is used to prepare its financial statements. As a consequence, the review of each entity's information system and its related controls forms a significant part of the ANAO audit examination of internal controls. Information system controls include entity-wide general controls that establish an entity's IT infrastructures, policies and procedures, together with specific application controls that validate, authorise, monitor and report financial and human resource transactions.

1.34 Table 1.1 outlines the areas of focus used by the ANAO in assessing entities' information system controls, including common controls tested to determine the effectiveness of those systems in supporting complete and accurate financial statements reporting.

Table 1.1: Information system controls – areas of focus

Area of focus	Control element	Control subject to ANAO assessment
IT General controls	IT security	<ul style="list-style-type: none"> IT security governance General and privileged user access Monitoring and reporting of security events
	IT change management	<ul style="list-style-type: none"> Governance Approvals Testing Implementation Emergency changes
Application controls	Financial management information systems (FMIS) Human resources information systems (HRMIS)	<ul style="list-style-type: none"> Change management Masterfile maintenance Payment processing Privileged user access management General user access management
Business continuity arrangements	Significant systems supporting financial reporting (including FMIS & HRMIS)	<ul style="list-style-type: none"> Backup and recovery Business continuity planning Business continuity testing Disaster recovery planning Disaster recovery testing

Source: ANAO compilation.

1.35 Observations from the ANAO's interim audit phase relating to entities' information system controls are provided under the IT Control environment section included in Control activities below. Refer to paragraphs 1.43 to 1.75.

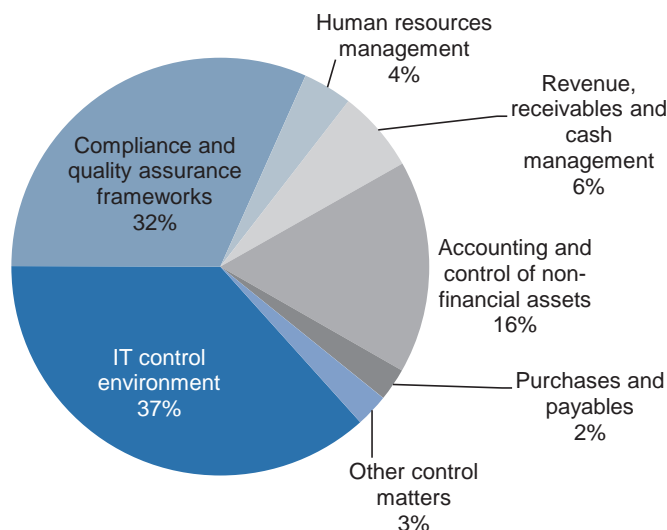
Control activities

1.36 As part of the interim audit phase, the ANAO assesses the effectiveness of key controls identified during the planning stages. This assessment is made at a point in time and provides the Parliament and entities an insight into weaknesses which have the potential to impact the financial statements at year end. The broad categories of control activities assessed by the ANAO include entities’:

- IT control environment;
- compliance and quality assurance frameworks;
- accounting and control of non-financial assets;
- revenue, receivables and cash management processes;
- human resources financial processes;
- purchases and payables management; and
- other control matters relevant to the financial statements.

1.37 Figure 1.3 presents the percentage of total audit findings by category, identified for the 21 entities considered in this report during the 2015–16 interim audits.

Figure 1.3: 2015–16 interim audit findings – by category



Source: ANAO compilation of interim findings.

1.38 The following section provides a summary of interim audit findings identified in these categories across the past four financial years, as well as making observations regarding common weaknesses identified in the 2015–16 interim audits across the different finding categories outlined above.

Interim audit findings

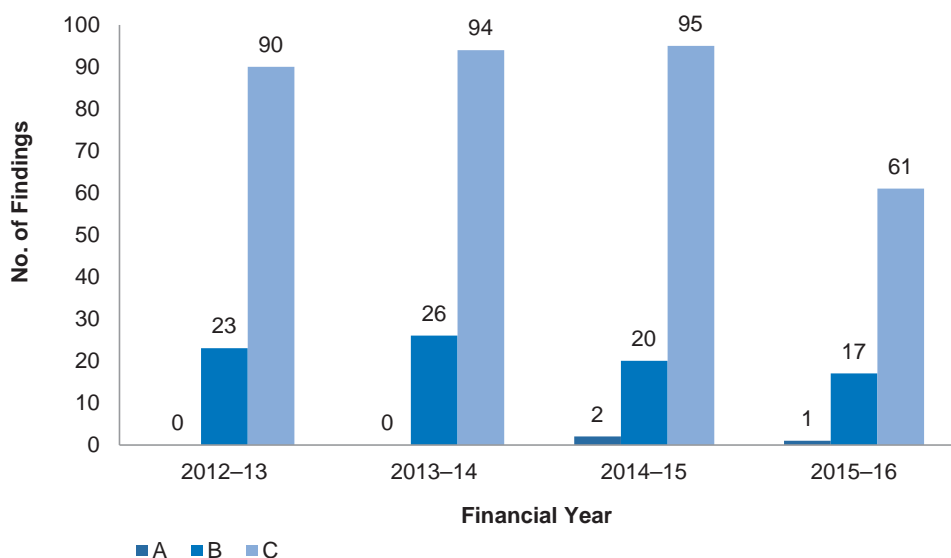
1.39 The ANAO rates audit findings according to the potential business or financial management risk posed to the entity. The rating scale is presented in Table 1.2.

Table 1.2: Findings rating scale

Rating	Description
Significant (A)	Issues that pose a significant business or financial management risk to the entity. These include issues that could result in a material misstatement of the entity's financial statements.
Moderate (B)	Issues that pose a moderate business or financial management risk to the entity. These may include prior year issues that have not been satisfactorily addressed.
Minor (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.

1.40 A summary of all significant, moderate and minor audit findings identified at the conclusion of the interim audit phase across the past four financial years is presented in Figure 1.4 below.

Figure 1.4: Aggregate audit findings



1.41 Over the last four years, there has been an overall reduction in the number of significant, moderate and minor audit findings. As demonstrated in the figure above, there was an improvement in the number of minor findings identified during the 2015-16 interim period, compared to 2014-15, with the number of overall findings decreasing by approximately 35 per cent.

1.42 While the reduction in minor findings reflects positively on the actions of entities in resolving identified weaknesses, the modest reduction in significant and moderate findings indicates there are still specific areas requiring improvement. Table 1.3 summarises the number of significant, moderate and minor findings per category in 2015–16 and common weaknesses noted in each.

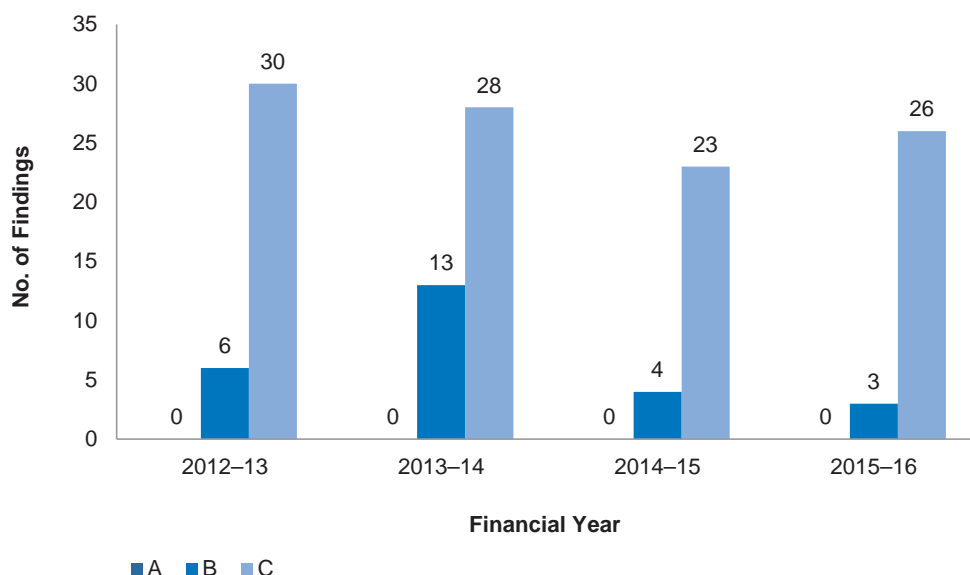
Table 1.3: Significant, moderate and minor audit findings by category

Category	Significant	Moderate	Minor	Main areas of weakness
IT control environment	–	3	26	<ul style="list-style-type: none"> Security management, particularly management of user access and monitoring of privileged users.
Compliance and quality assurance frameworks	1	9	15	<ul style="list-style-type: none"> Compliance frameworks for program payments and revenue collection; and Appropriate quality assurance frameworks supporting financial reporting.
Revenue, receivables and cash management	–	1	4	<ul style="list-style-type: none"> Timeliness and completion of reconciliations.
Accounting and control of non-financial assets	–	3	10	<ul style="list-style-type: none"> Processes supporting the valuation and impairment of assets.
Human resources financial processes	–	1	2	<ul style="list-style-type: none"> Review processes supporting employee commencements and terminations.
Purchases and payables management	–	–	2	<ul style="list-style-type: none"> Foreign currency arrangements and management of purchase cards.
Other control matters	–	–	2	<ul style="list-style-type: none"> Grants management, including acquittals processes; and Compliance with entity policies and procedures relating to specific transactions.
Total	1	17	61	79

Source: ANAO compilation of interim findings.

Information Technology control environment

1.43 As mentioned in paragraph 1.33, the review of information systems and related controls is an integral part of an entity's control environment. Figure 1.5 demonstrates the trends in interim audit findings related to entities' overall IT control environments from 2012–13 to 2015–16.

Figure 1.5: IT control environment audit findings

1.44 Findings related to entities' IT control environments represented 37 per cent of total findings identified during the 2015–16 interim period—the highest proportion of all findings categories. Four moderate findings were reported in 2014–15 and have now been resolved. Three new moderate findings were identified during the 2015–16 interim audit phase in two entities—the Attorney-General's Department (one finding) and the Department of Defence (two findings). Further detail regarding these findings can be found at paragraphs 3.2.22 and 3.4.37 respectively.⁴

1.45 A cross entity performance audit, ANAO Report No. 37 2015–16 *Cyber Resilience*, was tabled by the ANAO in May 2016. This audit reviewed the ICT arrangements of four entities and assessed compliance with the four mandatory ICT security strategies in the *Australian Government Information Security Manual* (ISM).⁵ The observations and recommendations in the *Cyber Resilience* report are consistent with issues identified during the interim audits, particularly in relation to improvements in IT security arrangements and the management and monitoring of privileged user access.⁶

4 Weaknesses across information system control elements may be consolidated into one audit finding for reporting purposes. As a result, the total number of observations reported in paragraphs 1.46 to 1.75 does not align to the number of findings presented in Figure 1.5.

5 The four ICT mandatory security strategies are: application whitelisting; patching applications; patching operating systems; and minimising administrative privileges.

6 Users with administrative privileges, commonly referred to as privileged user access, are able to make significant changes to IT systems configuration and operation, bypass critical security settings and access sensitive information. To reduce the risks associated with this access, the ISM requires that privileged user access be appropriately restricted and when provided, that the access is logged, regularly reviewed and monitored. Source: *Australian Government Information Security Manual*.

1.46 An overview of the weaknesses⁷ identified during the 2015–16 interim audits for the entities included in this report relating to the information system control elements: IT security; IT change management; IT application controls; and business continuity management is provided below.

IT Security

1.47 IT security is concerned with protecting an entity's information assets from internal and external threats. It includes controls to prevent or detect unauthorised access to systems, programs and data.

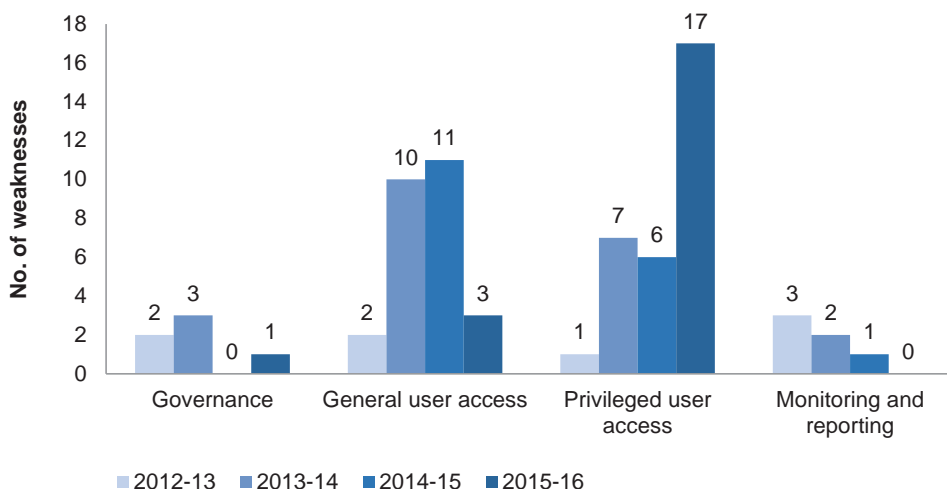
1.48 As discussed at paragraph 1.12, ASA 315 provides guidance on identifying and assessing the risks of material misstatement of financial statements, including risks associated with an entity's IT environment. Many of the risks identified in ASA 315 can be mitigated through effective implementation of IT security controls. The extent of controls implemented in an entity may vary depending on the particular business and operational circumstances.

1.49 The key controls that address risks relating to IT security and that are assessed by the ANAO as part of the interim audit are:

- IT security governance;
- general and privileged user access; and
- monitoring and reporting.

1.50 Figure 1.6 illustrates the trends in matters observed by the ANAO in entities' IT security arrangements between 2012–13 and 2015–16.

Figure 1.6: IT security arrangements 2012–13 to 2015–16



1.51 The ANAO observed that entities continue to effectively manage security governance and processes for monitoring and reporting security events.

⁷ Op. cit. (see footnote 4 on page 13).

1.52 Three weaknesses in general user access controls were identified in 2015–16, representing a decrease in this area compared to the prior two periods. Areas for ongoing improvement include the removal of user access once employment has ended and the performance of regular user access reviews.

1.53 As part of reviewing IT security arrangements, the ANAO examines different groups of privileged users, including:

- application administrators, sometimes referred to as super users;
- database administrators;
- system administrators; and
- network or domain administrators.

1.54 The ANAO identified a significant increase in entities not managing privileged user access⁸ in 2015–16 with 17 weaknesses identified. While issues were not typically identified with the management of application administrators, risks associated with the other groups of privileged users appeared to be less well recognised and controlled. Areas for improvement include:

- minimising the number of users granted privileged access to systems and data;
- regular monitoring and review of privileged user access and activity; and
- prompt removal of privileged access when it is no longer required.

1.55 These issues increase the risk of unauthorised changes being made to systems and data, or unauthorised data leakage. Entities should review their management of this area in light of the requirements of the ISM and the risks to their operational environment.

IT Change Management

1.56 IT change management provides a disciplined approach to making changes to the IT environment. It includes controls to prevent unauthorised changes being introduced, and to ensure that the implementation of authorised changes does not disrupt normal business operations.

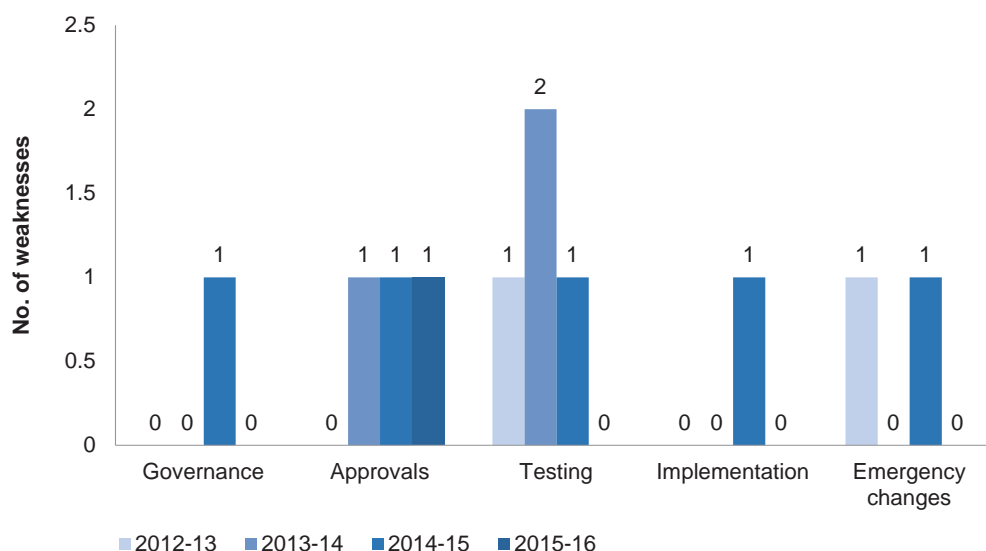
1.57 The ANAO observed that changes to entities' IT environments were managed using a standardised process, usually based on the Information Technology Infrastructure Library⁹. This process was well understood and well managed. Issues were identified in only one entity in relation to the authorisation of changes.

1.58 Figure 1.7 illustrates the trends in issues identified by the ANAO in entities' IT change management controls between 2012–13 and 2015–16.

⁸ Op. cit. (see footnote 6 on page 14)

⁹ The Information Technology Infrastructure Library is a framework for designing, implementing, delivering and managing IT services. It was originally developed in the 1990s with the support of the British government, and has been widely adopted by public and private sector entities world-wide.

Figure 1.7: IT change management arrangements 2012–13 to 2015–16



1.59 The number of weaknesses in relation to IT change management has remained very low over the past four years. This demonstrates the maturity of the IT change management process in most entities. The following factors contribute to this maturity:

- existence of an internationally accepted framework for change management (Information Technology Infrastructure Library), with associated training and a professional qualification; and
- availability of standard software tools with built-in workflow controls, to support the implementation of this framework.

IT Application Controls

1.60 Australian Government entities 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).

1.61 The ANAO assesses entities' key FMIS and HRMIS controls in view of their importance for financial reporting. Areas of focus include:

- changes to the systems or data that are not assessed through the entity's IT change management system. These are changes that only affect the users of the FMIS or the HRMIS and are therefore often out of scope for the main change management process;
- changes to master data, including banking details;
- controls over invoice payment and payroll processing; and
- management of general and privileged user access to the FMIS and HRMIS.

1.62 FMIS and HRMIS applications include standard controls to provide assurance over the completeness, accuracy and authorisation of master data and payments. These controls have

been well-implemented in the entities reviewed. In addition, all entities were found to manage changes at the application level to ensure that only authorised changes are made.

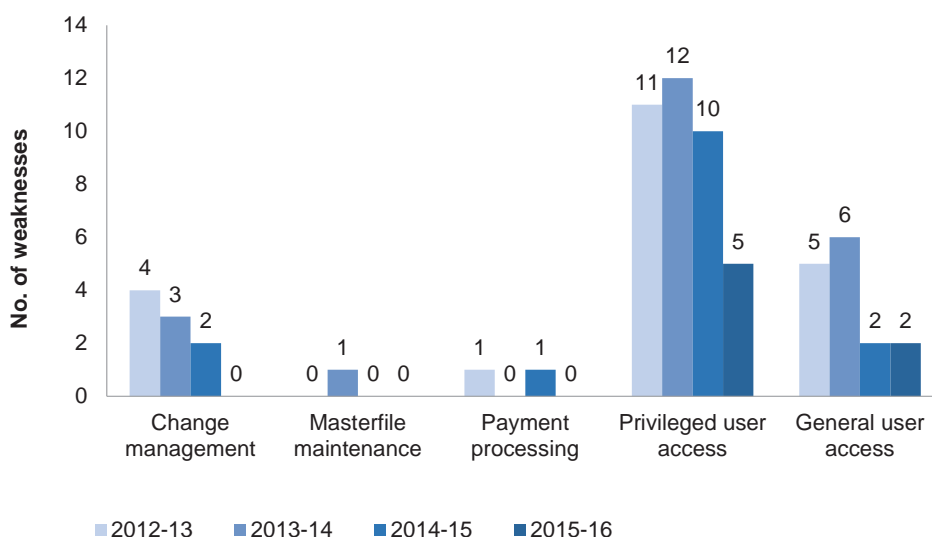
1.63 Privileged user access includes the ability to bypass normal application controls or make changes to system settings. This access is often necessary to fully administer applications, however it should be restricted and monitored to reduce the risk of errors or unauthorised activity. Entities' management of application privileged user access remains an area that requires management attention. Five weaknesses were identified in the 2015–16 interim audits (2014–15: ten weaknesses).

1.64 Weaknesses identified in the 2015–16 interim audits included entities not having adequate logging and/or monitoring of privileged user activity. Only one entity had weaknesses in controls over general user access.

1.65 Application change management, masterfile maintenance and payment processing controls continue to be managed by entities.

1.66 Figure 1.8 illustrates the trend in weaknesses observed by the ANAO in relation to entities' application controls between 2012–13 and 2015–16.

Figure 1.8: Application control arrangements 2012–13 to 2015–16



Business Continuity Management

1.67 Business Continuity is defined as the capability of an entity to continue delivery of products or services at acceptable predefined levels following a disruptive incident.¹⁰ It includes three key elements:

¹⁰ International Organization for Standardization ISO 22301:2012.

- effective back-up and recovery arrangements, to ensure that current versions of key IT systems and data are available to be recovered from;
- business continuity planning, including the development, maintenance and testing of a business continuity plan for each key business area to ensure that the entity can continue operations while waiting for systems and data to be restored; and
- disaster recovery planning, including the development, maintenance and testing of a disaster recovery plan to ensure that IT systems can be recovered in line with defined business requirements.

1.68 The ANAO assesses entities' business continuity arrangements in view of the potential for a disruptive event to impact on financial reporting. In 2012–13 and 2013–14, the review focussed specifically on business continuity arrangements for the FMIS and HRMIS. From 2014–15, the scope of the review was broadened to include all significant financial and information technology systems.

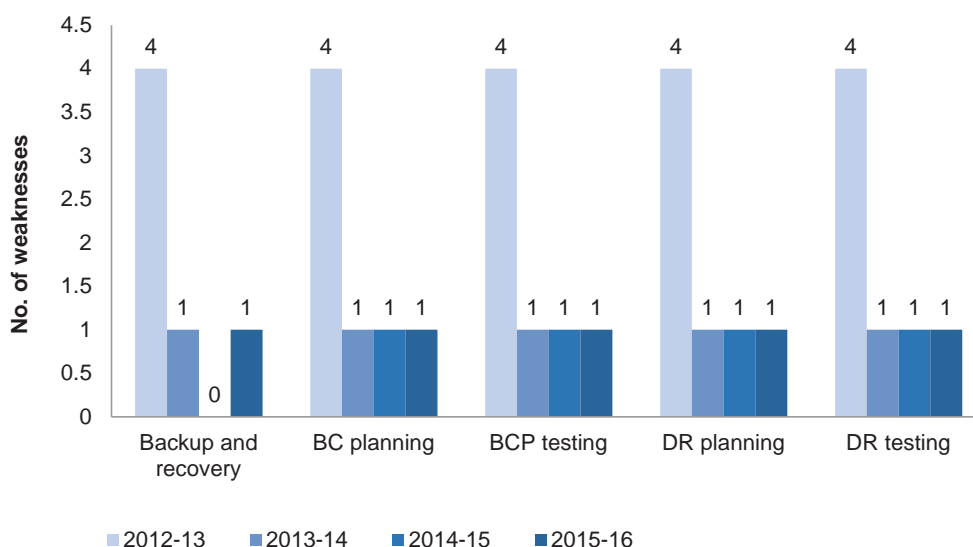
1.69 All but one entity had business continuity and disaster recovery plans and testing arrangements that catered for all of the entity's significant financial and information technology systems, and were appropriate to their business circumstances.

1.70 Consistent with 2014–15, the ANAO observed that an unplanned event had been used by some entities for the testing and review of business continuity and disaster recovery plans rather than a scheduled test event. Such an approach may increase the risk of entities having an inadequate response to such incidents when they occur in the future. Risks of relying on an unplanned event include the potential for a lack of a coordinated approach or a lack of preparation for the type of incident experienced.

1.71 Entities should ensure that they are in a position to test their business continuity plans if an unplanned event was not to occur for some time.

1.72 All but one entity had well established backup and recovery processes. Backup and recovery arrangements underpin an entity's business continuity and disaster recovery plans, and may also be used to support the resumption of business operations. As such, it is important that entities continue to ensure backup and recovery arrangements are in place.

1.73 Figure 1.9 illustrates the trend for issues identified by the ANAO in entities' business continuity arrangements between 2013 and 2016.

Figure 1.9: Business continuity arrangements 2012–13 to 2015–16

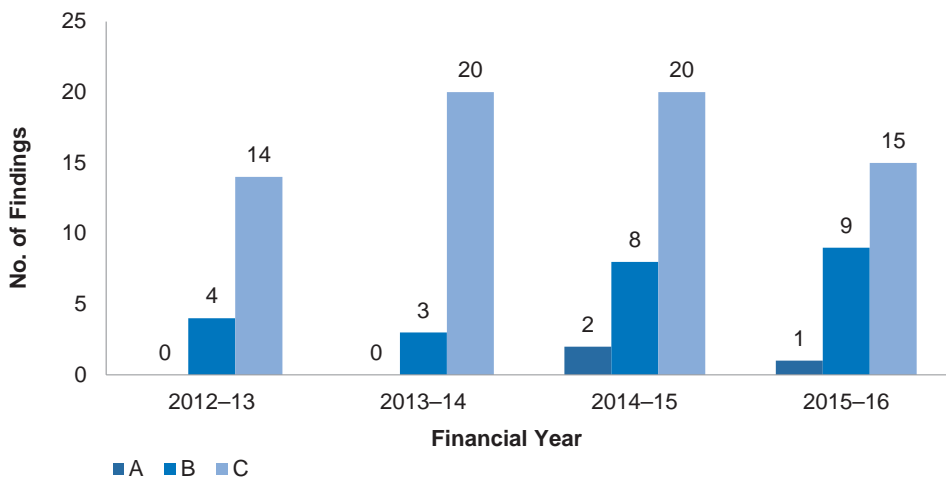
1.74 As noted above, this area was initially assessed only in relation to the FMIS and HRMIS, and was broadened to include other financial and information technology systems. This has not had a noticeable effect on the results observed. Since 2013–14, this area has been consistently addressed by most entities, with only one entity in each year failing to demonstrate adequate measures. This has not been the same entity in each year.

1.75 Overall, the majority of IT controls continued to be effective in most entities included in this Report during 2015–16. Consistent with observations in previous years, the management of user access arrangements, including privileged users, is an area requiring improvement. In light of the risk posed to systems and data by inadequate user access controls, entities and audit committees should focus attention on these matters as soon as possible.

Compliance and quality assurance frameworks

1.76 The business of government requires, in many circumstances, placing reliance on internal and external systems, parties and information in decision making processes. For this reason, the implementation of effective compliance frameworks, and processes that provide assurance regarding the completeness and accuracy of information, are integral to an entity's internal control. Figure 1.10 demonstrates the trends in interim audit findings related to entities' compliance and quality assurance frameworks from 2012–13 to 2015–16.

Figure 1.10: Compliance and quality assurance frameworks audit findings



1.77 The number of significant and moderate audit findings remains consistent with the 2014–15 interim audit results. There has been an improvement in the number of minor audit findings related to entities compliance and quality assurance frameworks between 2014–15 and 2015–16 from 20 findings to 15.

1.78 These findings mainly related to weaknesses in entities processes to obtain assurance over information sourced from third parties in administering payments, compliance frameworks supporting revenue collection, and completeness and accuracy of consolidation of divisional or disparate information supporting financial reporting.¹¹

1.79 As discussed in paragraph 1.20 above, the ANAO identified that the entities included in this report have appropriate frameworks in place to provide direction, guidance and control over financial management and to support the preparation of the 2015–16 financial statements. The findings discussed in paragraph 1.78 indicate a need for management in these entities to focus attention on:

- maintaining effective governance over third party or joint service delivery arrangements; and
- the risk management arrangements that support the effective engagement with risk in the delivery of programs.

Accounting and control of non-financial assets

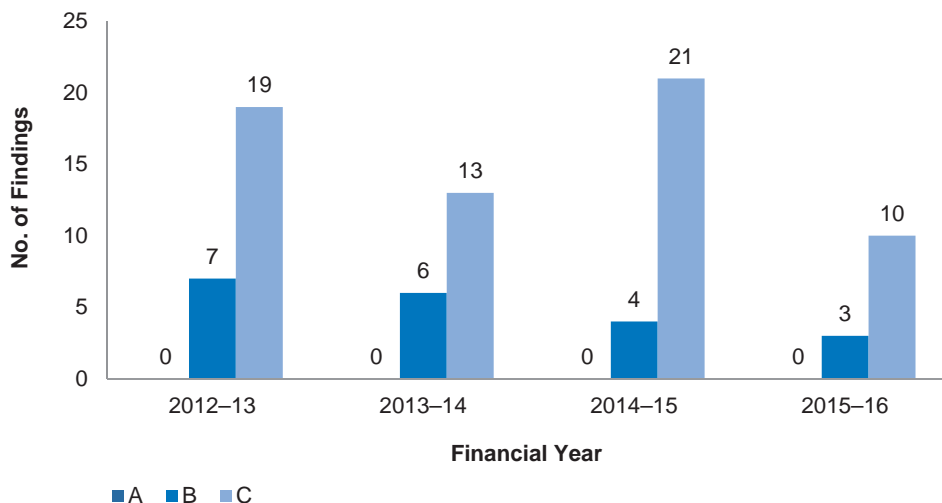
1.80 Entities control a diverse range of non-financial assets on behalf of the Commonwealth, with the main asset classes being land and buildings, specialist military equipment, leasehold

¹¹ For further detail regarding the significant and moderate findings in this category, refer to the following entities' detailed results in Chapter 3: the Attorney-General's Department; the Departments of Defence; Education and Training; Human Services; Immigration and Border Protection; Prime Minister and Cabinet; and the Australian Taxation Office.

improvements, infrastructure, plant and equipment, inventories and internally-developed software.

1.81 The number of audit findings related to entities' controls in this area over the last four years is presented in Figure 1.11 below.

Figure 1.11: Accounting and control of non-financial assets audit findings



1.82 The moderate and minor audit findings reported during the 2015-16 interim period related largely to the Department of Defence. As Defence is responsible for the largest proportion of non-financial assets in the General Government Sector it is positive to see the significant improvement on the previous financial year, where 17 of the 25 reported findings related to Defence. Three moderate findings reported to Defence in 2014-15 remain unresolved. Further detail regarding these findings can be found at paragraphs 3.4.19 to 3.4.26.

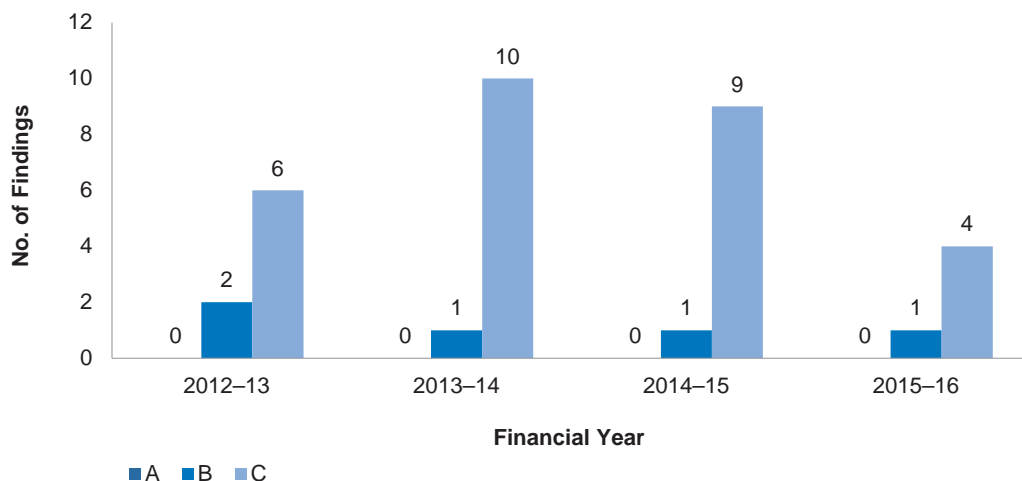
1.83 The remaining findings covered a range of items and entities including: the monitoring of assets under construction; appropriateness of impairment assessments; and weaknesses in stock take procedures.

Revenue, receivables and cash management

1.84 The key financial statement items related to revenue and receivables consist of Parliamentary appropriations, taxation revenue, customs and excise duties and administered levies. Other revenue is also generated by entities from the sale of goods and services and a range of other sources including interest earned from cash funds on deposit. Cash management involves the collection and receipt of public monies and the management of official bank accounts.

1.85 Figure 1.12 outlines trends in findings related to revenue, receivables and cash management identified during interim phases between 2012-13 and 2015-16.

Figure 1.12: Revenue, receivables and cash management audit findings



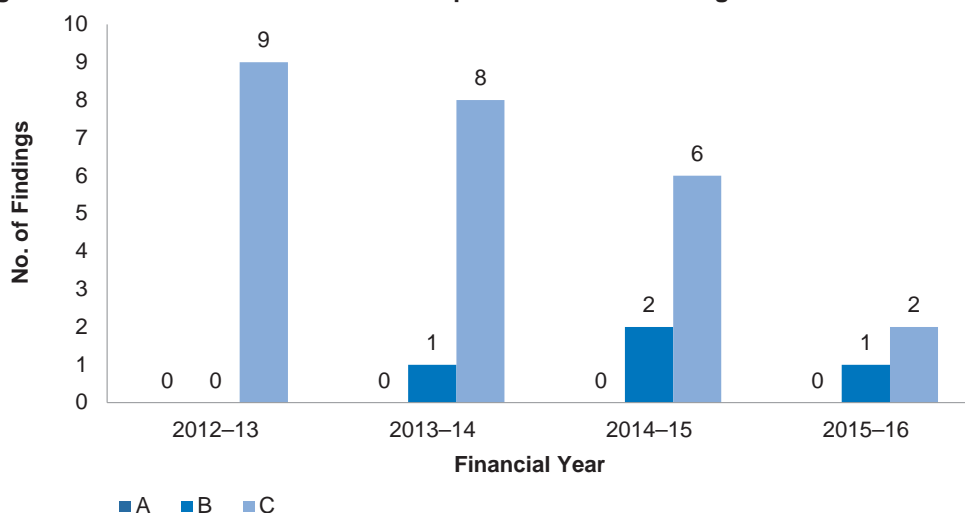
1.86 The small number of findings identified in this category indicates that entities typically place a proper emphasis on establishing strong controls in relation to revenue and cash management processes, and understand the potential for control weaknesses to lead to fraud or misuse of public monies. While at least one moderate audit finding has been reported each year, once identified, entities' resolved the identified weaknesses by the conclusion of the audit. New arrangements and circumstances in each year have given rise to different control weaknesses being identified.

1.87 Further information regarding the 2015-16 moderate audit finding relating to the Department of Defence can be found in Chapter 3, paragraph 3.4.32.

Human resource financial processes

1.88 Human resources encompass the day-to-day management and administration of employee entitlements and payroll functions. Expenditure associated with employee benefits represents the largest departmental expenditure item for most entities and employee entitlement liabilities are typically the largest liability. It is therefore important for entities to establish robust controls in these areas to support complete and accurate payment and recording of transactions.

1.89 Figure 1.13 indicates entities have made a concerted effort to address the identified control weaknesses, and maintaining or strengthening existing controls relating to human resource processes over the past four years.

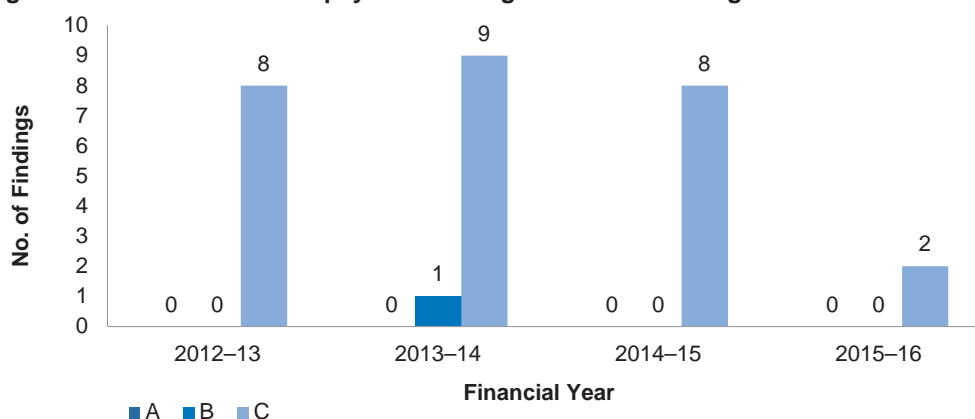
Figure 1.13: Human resources financial processes audit findings

1.90 The one moderate and two minor findings identified in 2015-16 related to identified weaknesses in entities' processes relating to commencement or termination of employees and controls supporting the payment of allowances. These findings were also reported in 2014-15.

1.91 Further detail regarding the unresolved moderate audit finding, related to the Department of Immigration and Border Protection, can be found in Chapter 3, at paragraph 3.13.24.

Purchases and payables management

1.92 The main financial statement components of purchases and payables are payments to, or due to, suppliers including contractor and consultancy expenses, lease payments and general administrative and utility payments. These payments typically comprise the other significant departmental expenditure item of entities. The number of audit findings identified in this category over the past four financial years is presented in Figure 1.14.

Figure 1.14: Purchases and payables management audit findings

1.93 The figure above demonstrates the controls in this area for entities included in this report are typically strong, with one moderate finding and no significant audit findings identified in the past four years. The significant decrease in minor findings from 2014–15 to 2015–16 reflects positively on actions taken by entities to address identified control weaknesses, with only one finding remaining unresolved from 2014–15.

1.94 An aspect of purchases and payables management includes entities' control and use of Commonwealth credit and payment cards. ANAO Audit Report No. 33 2015–16 *Defence's Management of Credit and Other Transaction Cards*, assessed whether Defence is effectively controlling the use of Commonwealth credit cards for official purposes in accordance with legislative and policy requirements. The audit concluded that Defence does not have a complete and effective set of controls to manage the use of credit and other transaction cards.

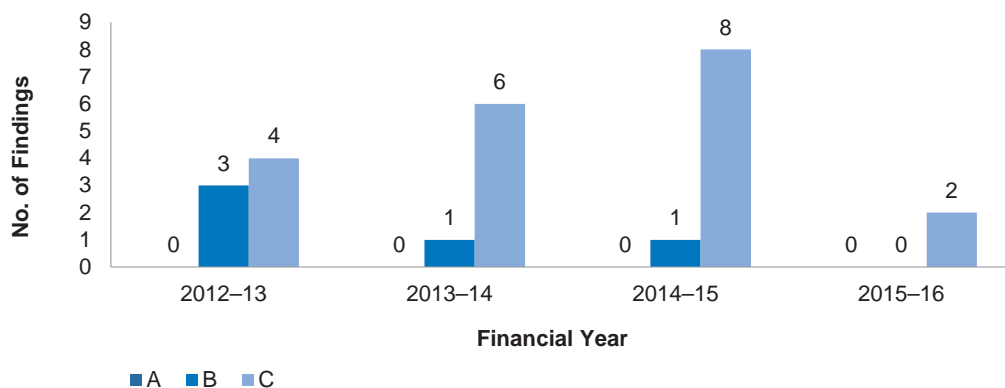
1.95 In light of the results of Audit Report No. 33, and observations made in previous financial statements and performance audits, the ANAO has commenced a cross-entity audit, *Controls Over Credit Card Use*. The audit objective is to assess whether selected Australian Government Entities are effectively controlling the use of credit cards for official purposes in accordance with legislative and entity requirements. The results of this audit will inform the audit approach during planning for the 2016–17 financial statements audits.

Other control matters

1.96 Other control matters typically include items regarding general reconciliation processes, the management and implementation of service level agreements or memoranda of understanding, and matters affecting the administration of government programs, including grants. The number of audit findings identified in this category over the past four financial years is presented in Figure 1.15.

1.97 At the conclusion of the 2015–16 interim audit, one minor audit finding remains unresolved and one new minor finding was reported. The unresolved finding was previously reported as a moderate audit finding to the Department of the Prime Minister and Cabinet, and has been downgraded to a minor finding as a result of work carried out by the entity. Further detail can be found at Chapter 3, paragraph 3.16.15.

Figure 1.15: Other control matters audit findings



2. Reporting and auditing frameworks

Chapter coverage

This chapter outlines recent and future changes to the public sector reporting framework including improving the quality and timeliness of financial reporting and enhancing performance reporting. This chapter also discusses changes to the Australian auditing framework relating to the auditor's report on financial statements.

Summary of developments

Initiatives by Australian standard setters and the Department of Finance are in place to improve the quality of entities' financial reporting.

There are also initiatives underway to improve the timeliness of financial reporting with the Joint Committee of Public Accounts and Audit stating that bringing forward the delivery of the annual reports of Australian Government entities would be both valuable and viable.

Enhancements to performance reporting include Commonwealth entities being required to: publish a corporate plan by 31 August each reporting period; and include a performance statement in entities' annual reports. ANAO audit coverage in this area will be a focus in future performance audit work programs. Under the current legislative framework, Parliament does not receive the same level of assurance on the quality of performance statements as it does for financial statements as audits of performance statements are not mandated.

In December 2015, the Australian Auditing and Assurance Standards Board issued a suite of new and revised standards dealing with auditor reporting. A number of revisions were made to enhance the value of auditors' reports by providing greater transparency about the audit that was performed. The ANAO expects to amend its auditing standards to include reporting on key audit matters from 2016–17.

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). The framework is designed to support decision-making by, and accountability to, the Parliament.

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 primarily for use by private sector and for-profit organisations, the AASB amends the IFRS to reflect significant transactions and events that are particularly prevalent in the public and not-for-profit private sectors. In doing so, it takes into account standards issued by the International Public Sector Accounting Standards Board.

2.3 The Finance Minister prescribes additional reporting requirements for Australian Government entities. These are contained in the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*. This rule is made under the PGPA Act.

2.4 The audits of the financial statements of Australian Government entities are conducted in accordance with the ANAO Auditing Standards, which are made by the Auditor-General under section 24 of the *Auditor-General Act 1997*. The ANAO Auditing Standards incorporate, by

reference, the auditing standards made by the Australian Auditing and Assurance Standards Board (AUASB). The AUASB bases its standards on those made by the International Auditing and Assurance Standards Board (IAASB), an independent standard setting board of the International Federation of Accountants.

2.5 The financial reporting and auditing frameworks that applied in 2015–16 are illustrated in appendices 2 and 3 of this report.

Recent changes to the Australian public sector reporting framework

Transactions with related parties

2.6 AASB 124 Related Party Disclosures requires an entity to disclose transactions with its related parties. The AASB has extended the application of this standard to all not-for-profit public sector entities for reporting periods beginning on or after 1 July 2016.

2.7 From 1 July 2016, all Australian Government controlled entities will be required to identify and disclose related party transactions in the notes to the financial statements. This will include significant transactions between Ministers and their departments and between Cabinet Ministers and all Australian Government entities.

2.8 The Department of Finance is coordinating arrangements for the centralised collection of information relating to Ministers. The Department of Finance will provide this information to entities to assist in preparing the disclosures.

Improving the quality and timeliness of financial reporting

2.9 There are ongoing initiatives by both Australian and international standard setters to reduce the volume and complexity of disclosures in financial statements.

2.10 In 2014, the AASB published a staff paper¹² proposing ways in which entities can remove unnecessary clutter from their financial statements. In July 2015, the AASB amended AASB 101 Presentation of Financial Statements as a result of the IASB's project to improve disclosures. The amendments clarify that entities are only required to disclose information that is relevant to users of their financial statements. The amendments apply to reporting periods beginning on or after 1 January 2016.

2.11 In July 2015, the AASB relieved not-for-profit public sector entities from the requirement to make certain disclosures about the fair value of property plant and equipment. The AASB granted this relief because it considered that the requirement imposed challenges and costs for the public sector that would not impact the private sector to the same extent.

2.12 Australian Accounting Standards include a Reduced Disclosure Regime (RDR) option that allows for certain disclosures to be omitted from annual financial statements. As the RDR is not permitted at the whole-of-government level, the Department of Finance needs to collect information that might not be reported in entity financial statements, but is required for the

12 *To disclose or not to disclose: Materiality is the question.* AASB staff papers are not authoritative pronouncements of the AASB.

whole-of-government statements. Finance has indicated its intention to enable entities to move to RDR in future reporting periods.

2.13 The ANAO supports these initiatives, to the extent that the needs of Parliament are met. Entities need to take advantage of these initiatives, if the full potential for change is to be achieved. Australian Government entities have responded positively to this challenge, but greater efforts in this area are still possible.

2.14 An important attribute of any report is its timeliness. Recently, the Joint Committee of Public Accounts and Audit stated that bringing forward the delivery of the annual reports of Australian Government entities would be both valuable and viable¹³. Achieving this may require, amongst other things, entity financial statements to be prepared and audited earlier than is now the case.

2.15 The Department of Finance intends to shorten the timeframes for preparing and auditing financial statements to facilitate timelier annual reporting to the Parliament. This is likely to require greater efforts by some entities to enhance existing processes for the preparation of financial statements.

2.16 In 2014–15, the ANAO reported a moderate audit finding to the Department of Finance in relation to a number of weaknesses associated with the process to prepare the CFS.¹⁴ These weaknesses related to:

- assets (including specialist military equipment) that are required to be measured at fair value being measured at cost in the CFS (refer to paragraphs 3.4.10 to 3.4.12 for further discussion of this issue);
- adjustments not identified by the Department of Finance's quality assurance process;
- timely consideration of accounting treatments for new or changed circumstances; and
- inconsistent accounting and disclosure treatments by individual entities not being addressed at the CFS level.

2.17 The Department of Finance has commenced remediation of these weaknesses by:

- undertaking an analysis of budget measures for potential accounting issues to support their early resolution; and
- developing data collection arrangements, using a supplementary reporting pack, to gather additional information from entities required for the consolidated financial statements (CFS) in 2015–16.

2.18 These arrangements will also support adoption of the Reduced Disclosure Regime by Australian Government entities in future reporting periods discussed at paragraph 2.12 above. The ANAO will review these processes as part of the 2015–16 final audit.

2.19 Finalisation of the Department of Finance financial reporting rules and guidance by 31 December each year will also support the timely preparation and audit of financial statements.

13 JCPAA, *Report 457 Development of the Commonwealth Performance Framework – Second Report, May 2016*

14 Audit Report No. 15 2015–16 *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2015*: pp 15 and 16.

Enhancing performance reporting

2.20 Financial reporting is only one element of reporting by not-for-profit entities. Such entities are established to deliver services, and users need reports on entities' performance in delivering those services. While there has been a focus on public sector performance measurement and reporting for some years, further improvement in this area is required.

2.21 The PGPA Act now requires each Commonwealth entity to produce a corporate plan at least once each reporting period and provide it to the responsible Minister and the Finance Minister. The corporate plan is intended to be the primary planning document for entities. The first corporate plans were required to be published by 31 August 2015.¹⁵

2.22 Each Commonwealth entity is also required to include a performance statement in its annual report. These statements will provide an assessment of the extent to which entities have succeeded in achieving their purposes, as outlined in their corporate plans. The Department of Finance has issued guidance to entities on the preparation of performance statements. The first performance statements will be included in entity annual reports for 2015–16.

2.23 These changes are intended to be a catalyst for improving the quality of performance information in the public sector.

2.24 The PGPA Act does not require performance statements to be audited. The Act does provide that the responsible Minister or the Finance Minister may request the audit of performance statements by the Auditor-General. The Auditor-General also has the discretion to conduct audits of performance statements under the Auditor-General Act 1997. ANAO audit coverage in this area will be a focus in future performance audit work programs. Under the current legislative framework, Parliament does not receive the same level of assurance on the quality of performance statements as it does for financial statements as audits of performance statements are not mandated.

Future changes to the public sector reporting framework

2.25 New accounting standards have been released that will significantly change accounting for financial instruments¹⁶ and leases¹⁷ in future years. These standards are not specifically written for the public sector, but the public sector will be affected by the changes.

2.26 Further changes to the financial reporting framework are expected over the next few years, as projects by Australian and international accounting standard setters lead to new accounting standards for both the public and private sectors.

2.27 Projects specific to the public sector include new accounting requirements for recognition of revenue and reporting of service performance information.

2.28 The AASB has developed proposals¹⁸ to change the way not-for-profit entities recognise income from non-commercial transactions such as grants and appropriations. Currently, entities

15 ANAO Report No.6 2016–17 *Corporate Planning in the Australian Public Sector*.

16 AASB 9, *Financial Instruments*, effective from 2018–19.

17 AASB 16, *Leases*, effective from 2019–20.

18 *ED 260 Income of Not-for-Profit Entities*, April 2015

recognise income from these transactions when they receive, or are eligible to receive, funds. Under the proposals, entities would recognise income as they fulfil their obligations, if any, to the party providing the funds. This is expected to lead, in some cases, to later recognition of income and closer matching of income with related expenses.

2.29 Under other proposals issued by the AASB¹⁹, not-for-profit entities would be required to report service performance information annually on their efficiency and effectiveness in meeting their service delivery objectives. Entities would be allowed to report this information in the same report as their financial statements, in a separate report or in a variety of different reports. The information could be reported qualitatively, quantitatively, as a narrative discussion, or in a combination of these forms. Where an entity has published information about its planned service performance, it would also report on the variance between its planned and its actual service performance.

2.30 Projects aimed primarily at the private sector, but with public sector implications, include the continuing initiative to improve the quality of disclosures in financial statements.

Changes to the Australian auditing framework

Auditor's report on financial statements

2.31 In December 2015, the Australian Auditing and Assurance Standards Board issued a suite of new and revised standards dealing with auditor reporting.²⁰ A number of revisions were made in the standards with the aim of increasing the transparency and value of auditor reporting. In a key change to the form of the auditor's report, the auditor's opinion on the financial statements will form the first section of the report, directly followed by the basis of the opinion.

2.32 The content of the auditor's report will change to add information about the ability of the entity to continue operating and the auditor's responsibilities, particularly those relating to auditor independence and audit procedures around the entity's annual report. These revisions to the auditing standards will apply to financial years ending on or after 15 December 2016. The ANAO is early adopting these aspects of the revised auditor reporting standards.

2.33 The auditor reporting suite also included a new auditing standard ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report. The purpose of communicating key audit matters is to enhance the value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to users of financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. Key audit matters may relate to, for example, the highest risks of material misstatement, highly uncertain accounting estimates or significant events or transactions during the reporting period. Communicating key audit matters may also assist users to understand the entity and the areas of significant management judgment in the financial statements.

19 ED 270 *Reporting Service Performance Information*, August 2015

20 These included: ASA 700 *Forming an Opinion and Reporting on a Financial Report*; ASA 570 *Going Concern*; and ASA 720 *The Auditor's Responsibilities Relating to Other Information*.

2.34 The standard applies from 15 December 2016 to audits of listed entities' financial statements and also in circumstances where the auditor otherwise decides or is required by law to communicate key audit matters in the auditor's report. The ANAO is considering how it might appropriately apply the principles of ASA 701 to audits of Commonwealth Entities and Commonwealth Companies. In the 2015–16 audit cycle, the ANAO is conducting a limited pilot of key audit matter reporting to assess risks and to inform developments of ANAO methodology in this area. A report on key audit matters will be presented to the accountable authorities, directors, audit committees and senior management of these entities for their information. These reports will be in addition to the published auditor's report on the financial statements. The ANAO expects to amend its auditing standards to include reporting on key audit matters from 2016–17.

3. Results of the interim audit phase by entity

Chapter Coverage

This chapter summarises the results of the interim audits of the 2015–16 financial statements of 21 entities covered by this report. These entities comprise the portfolio departments and other entities that account for 95 per cent of the revenues and expenses of the General Government Sector and are presented in Table 3.1.

The final results of the financial statement audits of all Government entities, including those covered by this report, will be summarised in the Auditor-General's report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*, expected to be tabled in December 2016.

Audit results

The ANAO identified an improvement in entities addressing previously reported findings. Eighteen significant and moderate findings were reported to the entities covered by this report at the completion of the 2015–16 interim phase compared with 22 in 2014–15.

Introduction

3.01 The ANAO's assessment of the overall risk of material misstatement of the financial statements is based on professional judgement relating to the entity's particular circumstances. The financial audit planning process involves joint procedures with performance audit and takes into account each entity's environment and governance arrangements, its system of internal control, and prior year financial and performance audit findings. These planning processes inform the identification of areas of key risk that have the potential to impact on the integrity of the financial statements.

3.02 The ANAO's interim phase of the audit focuses on the steps taken by entities to manage these risks, including their systems of internal control.

3.03 This chapter reflects portfolio arrangements existing at 30 June 2016²¹ and outlines the following information for each of the reported entities:

- the entity's primary role as reflected in its Portfolio Budget Statements;
- 2015–16 appropriation funding and key financial statements items;
- key areas of financial statements risk;
- ANAO's assessment of the overall risk of material misstatement of the financial statements; and
- the status of significant and moderate audit findings at the completion of the interim audit, and the conclusion relating to audit coverage to date.

21 These arrangements were established by the Administrative Arrangements Order of September 2015.

Results of financial statement audits

3.04 Table 3.1 presents a summary of new and unresolved significant and moderate findings²² at the conclusion of our 2015–16 and 2014–15 interim audits.

3.05 Details of the findings summarised below can be found in the relevant entity's 'Audit results' section.

Table 3.1: Significant and moderate findings by entity

Entity	Interim 2015–16		Final 2014–15		Interim 2014–15	
	New findings ^a	Unresolved findings ^b	New findings ^a	Unresolved findings ^b	New findings ^a	Unresolved findings ^b
Department of Agriculture and Water Resources	0	0	0	0	0	0
Attorney-General's Department	1	1	1	1	1	1
Department of Communications and the Arts	0	0	0	0	0	0
Department of Defence	2	7	6	1	1	7
Department of Veteran's Affairs	0	0	0	0	0	2
Department of Education and Training	0	1	0	0	0	1
Department of Employment	0	0	0	0	0	1
Department of the Environment and Energy	0	0	0	0	0	0
Department of Finance	0	0	0	0	0	0
Future Fund Management Agency and the Board of Guardians	0	0	0	0	0	0
Department of Foreign Affairs and Trade	0	0	0	0	0	1

²² The ANAO's rating scale for findings can be found at Table 1.2, on page 11.

Entity	Interim 2015–16		Final 2014–15		Interim 2014–15	
	New findings ^a	Unresolved findings ^b	New findings ^a	Unresolved findings ^b	New findings ^a	Unresolved findings ^b
Department of Health	0	0	0	0	0	0
Department of Immigration and Border Protection	1	2	3	0	0	1
Department of Industry, Innovation and Science	0	0	0	0	0	0
Department of Infrastructure and Regional Development	0	0	0	0	0	0
Department of Prime Minister and Cabinet	0	1	1	1	1	1
Department of Social Services	0	0	1	1	0	1
Department of Human Services	0	1	1	0	0	1
Department of the Treasury	0	0	0	0	1	0
Australian Office of Financial Management	0	0	0	0	0	0
Australian Taxation Office	1	0	0	0	0	1
TOTAL	5	13	13	4	4	18

Note a: Minor findings identified previously but upgraded to a moderate or significant finding are considered new for the purposes of this table.

Note b: Findings transferred to another entity as a result of Machinery of Government changes, which remain unresolved, are treated as repeat findings for the purposes of this table.

Source: 2014–15 and 2015–16 ANAO audit correspondence.

3.1 Department of Agriculture and Water Resources

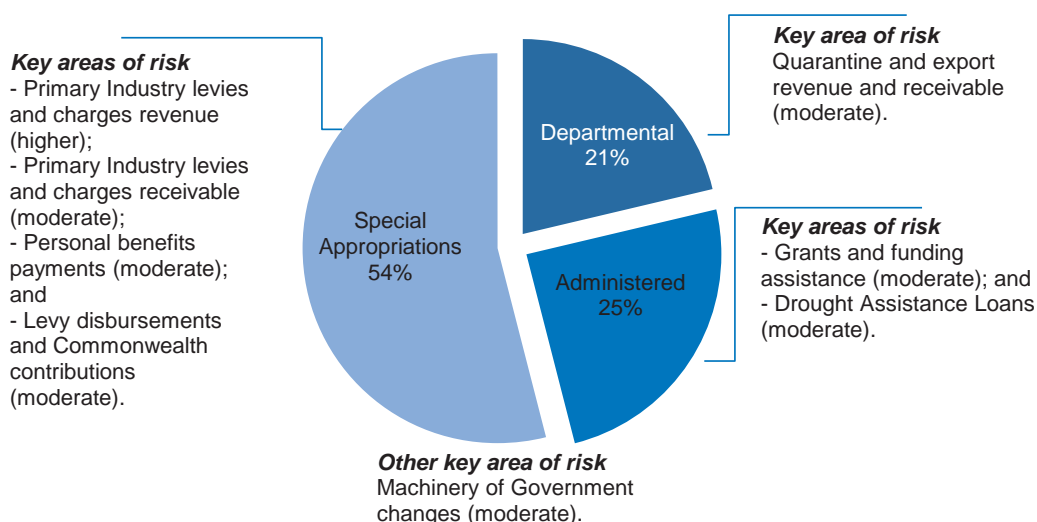
Overview

3.1.1 The Department of Agriculture and Water Resources²³ (Agriculture) is responsible for developing and implementing policies and programs that: advance the prosperity of Australia's agricultural, fisheries, food and forestry industries; safeguard Australia against animal and plant pests and diseases; and improve water use efficiency and the health of rivers, communities, environmental assets and production systems.

3.1.2 Annual appropriation funding of \$337.9 million (departmental) and \$392 million (administered) was provided to Agriculture in 2015–16 to support the achievement of the department's outcomes.²⁴ Agriculture was also budgeted to receive special appropriation funding of \$856.5 million.²⁵ Special appropriation funding is provided to the department largely for payments to primary industry corporations and bodies.

3.1.3 Figure 3.1 shows departmental, administered and special appropriation funding as a percentage of total annual funding, and the key areas of financial statements risk.

Figure 3.1: Appropriation funding and key areas of financial statements risk



23 As part of the Machinery of Government changes of September 2015, the former Department of Agriculture's name changed to the Department of Agriculture and Water Resources.

24 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016.*

25 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.1.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Agriculture's financial statements. The ANAO's risk identification process considers the nature of the financial statements items and an understanding of Agriculture's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.1.5 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items²⁶

3.1.6 Table 3.2 and Table 3.3 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.2: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	755.6	1,327.0
Employee benefits	468.5	-
Suppliers	243.3	44.1
Grants and disbursements	13.7	1,061.0
Personal benefits	-	79.2
Assets transferred to related entities	-	129.6
Other	30.1	13.1
Total own-source income	416.2	608.3
Sale of goods and rendering of services	392.9	-
Levies and taxes	-	514.0
Other	23.3	94.3
Net cost of services	339.4	718.7

26 Figures in Table 3.2 and Table 3.3 have been sourced from the Agriculture and Water Resources Portfolio Budget Statements 2016–17.

Table 3.3: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total Assets	305.3	1 644.5
Trade and other receivables	101.1	619.5
Investments	12.0	339.0
Property, plant and equipment	32.4	508.8
Intangibles	99.2	108.0
Other	60.6	69.2
Total Liabilities	215.3	119.7
Employee provisions	130.3	-
Grants	-	117.9
Other	85.0	1.8
Net assets	90.0	1 524.8

Source: Agriculture's estimated average staffing level for 2015–16 is 4 250.

3.1.7 The results of recent performance audits relevant to the financial management or administration of Agriculture's operations are also considered in identifying key areas of financial statements risk.

3.1.8 Audit Report No.28 2015–16 *Administration of the Concessional Loans Program* was tabled on 28 April 2016 examining the effectiveness of Agriculture's establishment and administration of Farm Finance and Drought concessional loans programs. A recommendation in the report was for Agriculture to obtain appropriate assurance that all relevant funding agreement requirements have been met before related payments are released.²⁷

3.1.9 This recommendation aligns to the key area of financial statements risk related to drought assistance loans set out in Table 3.4 of the following section.

Key areas of financial statements risk

3.1.10 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.4.

27 ANAO Report No.28 2015–16, Recommendation No.2, paragraph 3.29.

Table 3.4: Key areas of financial statements risk

Relevant financial statements line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered levies and taxes revenue	Primary industry levies and charges revenue	Higher	<ul style="list-style-type: none"> • self-assessment nature of collections; and • complexities involved in estimating agricultural production on which revenue is based.
Administered other receivables	Primary industry levies and charges receivable	Moderate	<ul style="list-style-type: none"> • the degree of estimation and judgement required to determine primary industry levies and charges receivable as at the reporting date; and • complexities involved in the forecasting of agricultural production.
Administered grants expenses	Levy disbursements and Commonwealth contributions	Moderate	<ul style="list-style-type: none"> • payments made in accordance with a range of legislation, with some payments required to meet eligibility criteria; • complexities in payment calculations; and • significant dollar value of payments made, both individually and in aggregate.
Departmental sale of goods and rendering of services	Quarantine and export revenue and receivable	Moderate	<ul style="list-style-type: none"> • the large range of revenue streams, collected across the country through multiple systems; • complex cost recovery arrangements; • collection of a significant portion of biosecurity revenues via the Department of Immigration and Border Protection; • estimation involved in the calculation of the provision for doubtful debts; and • complex disclosure requirements for cost recovery arrangements.

Relevant financial statements line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered other revenue (interest revenue) Administered other receivables (repayments of advances and loans)	Drought assistance loans	Moderate	<ul style="list-style-type: none"> variation in loan terms across jurisdictions; potential changes in accounting treatment for loans should they be deemed concessional in nature; the level of estimation involved in any potential impairment of loans, with the likelihood of impairment increasing as the loans age; and management of loans is undertaken by a third party, who is responsible for approval of recipients, ongoing monitoring and maintenance of loans.
Administered personal benefits expense	Personal benefits payments	Moderate	<ul style="list-style-type: none"> susceptibility to fraudulent benefit claims; eligibility for personal benefits paid by the Department of Human Services under the Farm Household Allowance scheme is subject to applicants meeting a number of complex legislative conditions; and an unresolved moderate audit finding reported by the Department of Human Services relating to their role in the Farm Household Allowance scheme. Refer to paragraphs 3.18.17 to 3.18.19 for further detail.
Multiple items	Machinery of Government changes, comprising water resources and associated policy transferred from the Department of the Environment	Moderate	<ul style="list-style-type: none"> risks associated with the transfer of employees and related leave balances to Agriculture's systems; timely and accurate recognition of revenue and expenses from the time of legal transfer; transfer of significant administered assets; and additional financial statements disclosures.
Administered grants expenses	Grants and funding assistance	Moderate	<ul style="list-style-type: none"> the level of subjectivity in assessing eligibility requirements for particular grants; and transferred grants related to the water resources functions, which will be processed via a third party system.

3.1.11 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Agriculture's financial statements.

Audit results

3.1.12 The ANAO has completed its interim audit coverage, including the key areas of financial statements risk relating to revenue arising from primary industry levies and charges, and the subsequent levy disbursement processes, biosecurity revenue and receivables and grants and funding assistance. Interim audit procedures have also been undertaken over key IT general and application controls, including a review of logical security, change and release management, and controls surrounding the FMIS, HRMIS and other supporting systems.

3.1.13 As part of the 2015–16 final audit, work will be undertaken over biosecurity revenue and receivables collected by the Department of Immigration and Border Protection on Agriculture’s behalf, the accounting treatment and collectability of farm finance and drought assistance loans, personal benefits payments, and the transfer of water functions as a result of Machinery of Government changes.

3.1.14 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. There were no significant or moderate audit findings unresolved from the 2014–15 audit.

Conclusion

3.1.15 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Agriculture will be able to 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 2015–16 final audit.

3.2 Attorney-General's Department

Overview

3.2.1 The Attorney-General's Department (AGD) is responsible for providing advice and services on a range of law and justice, national security, emergency management, and disaster recovery assistance to portfolio ministers and to government.

3.2.2 On 1 July 2015, the Australian Government Solicitor (AGS) merged with the department, as a result of the *Judiciary Amendment Act 2015*. This expanded the functions of AGD to include providing legal services to the Commonwealth.

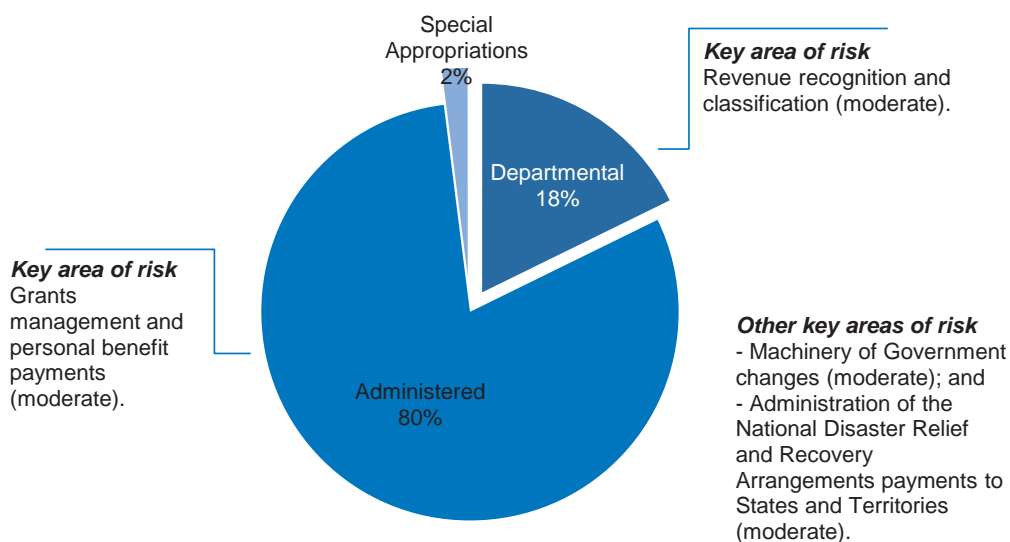
3.2.3 As a result of the Machinery of Government changes of September 2015, AGD transferred responsibility for cultural affairs, classification and copyright functions and associated legislation to the Department of Communications and the Arts.

3.2.4 Annual appropriation funding of \$259.3 million (departmental) and \$1 172.6 million (administered) was provided to AGD in 2015–16 to support the achievement of the department's outcomes.²⁸ The department was also budgeted to receive special appropriation funding of \$29.1 million largely in relation to administering personal benefit payments to individuals in the event of a natural disaster.²⁹

3.2.5 Figure 3.2 shows departmental and administered funding as a percentage of total annual funding, and the key areas of financial statements risk related to each. Paragraph 3.2.10 provides further detail regarding the Administration of National Disaster Relief and Recovery arrangements risk noted in the figure.

28 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16*. These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

29 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

Figure 3.2: Appropriation funding and key areas of financial statements risk

3.2.6 The ANAO's audit approach identifies key areas of risk that have the potential to impact on AGD's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of AGD's environment and governance arrangements, including its financial reporting regime and system of internal control. The results of any recent performance audits relevant to the financial management or administration of AGD's operations are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

3.2.7 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items³⁰

3.2.8 Table 3.5 and Table 3.6 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

³⁰ Figures in Table 3.5 and Table 3.6 have been sourced from the Attorney-General's Portfolio Budget Statements 2016–17.

Table 3.5: Key expenses and own-source income

Expenses and own-source income	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total expenses	410.8	955.9
Employee benefits	247.0	35.4
Suppliers	133.1	120.2
Personal benefits	-	29.8
Grants	-	489.2
Payments to corporate entities	-	265.7
Other	30.7	15.6
Total own-source income	196.7	62.4
Sale of goods and rendering of services	193.8	4.1
Interest	0.2	4.4
Other	2.7	53.9
Net cost of services	214.1	893.5

Table 3.6: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	261.3	451.5
Land and buildings and Property, plant and equipment	81.9	7.4
Other	179.4	444.1
Total liabilities	129.4	32.7
Employee provisions	66.9	7.0
Other	62.5	25.7
Net assets	131.9	418.8

AGD's estimated average staffing level for 2015–16 is 2 034.

Key areas of financial statements risk

3.2.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.7.

Table 3.7: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
All items	Machinery of Government changes, including the integration of the AGS	Moderate	<ul style="list-style-type: none"> • Machinery of Government changes of September 2015 will result in several new disclosures in the financial statements, including accounting for the functions of AGS; and • financial statement information for AGS will be drawn from a separate FMIS that does not have complete internal controls in place.
Departmental own source revenue	Revenue recognition and classification	Moderate	<ul style="list-style-type: none"> • the department accounts for a variety of material revenue streams, including AGS income derived from time recorded on legal matters in a separate FMIS.
Administered grants and personal benefits	Grants management and personal benefit payments	Moderate	<ul style="list-style-type: none"> • a decentralised grants management system is in place which encompasses multiple and varied practices; • a significant component of the grants expense is managed by the Department of Social Services; and • personal benefit payments are managed by the Department of Human Services.

3.2.10 The AGD manages the National Disaster Relief and Recovery Arrangements (NDRRA) on behalf of the Department of the Treasury (the Treasury). The AGD also provides information to the Treasury to facilitate payments for disaster relief and recovery to the States and Territories. These payments and the estimate for the Australian Government liability are reported in the Treasury's financial statements. Table 3.8 summarises audit coverage of this area in 2015–16.

Table 3.8: Key area of risk relating to arrangements managed on behalf of the Treasury

Key area	Audit risk rating	Factors contributing to risk rating
Administration of the NDRRA	Moderate	A range of issues identified in previous audits have been highlighted in relation to the accounting and reporting of the estimate of the NDRRA liability and the subsequent payments.

3.2.11 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of AGD's financial statements.

Audit results

3.2.12 The ANAO has completed its interim audit coverage, including an assessment of controls over administered grants and personal benefits, and departmental revenue. IT general and application controls, and key controls over payroll and appropriation processes, cash administration and special account payments have also been assessed.

3.2.13 As part of the 2015–16 final audit, audit coverage in relation to the valuation of non-financial assets, including administered investments and the integration of AGS information into the department's financial statements will be completed. Testing of the administration of NDRRA will also be completed.

3.2.14 The following table summarises the status of audit findings reported by the ANAO in 2014–15 and 2015–16.

Table 3.9: Status of audit findings raised by the ANAO

Category	Closing position (at the end of the 2014–15 final audit)	Resolved findings (at the time of the 2015–16 interim audit)	New findings (during the 2015–16 interim audit)	Closing position (at the end of the 2015–16 interim audit)
A	0	0	0	0
B	2	1	1	2
Total	2	1	1	2

Resolved audit finding

IT network user access management

3.2.15 During the 2013–14 interim audit, the ANAO identified a number of weaknesses in AGD's management of user access to the department's IT network. The network access rights of a number of employees whose employment had ceased had not been deactivated. In addition, an effective process for logging and monitoring privileged user access to the IT network had not been implemented. These issues increased the risk of unauthorised access and the integrity of the data maintained in the various IT applications supporting the preparation of the financial statements.

3.2.16 During the 2015–16 interim audit, the ANAO confirmed that access rights of terminated employees are deactivated in a timely manner, and an effective process for monitoring system access had been implemented. The ANAO considers this issue to be resolved.

Unresolved audit finding

Administration of the National Disaster Relief and Recovery Arrangements

3.2.17 As discussed at paragraph 3.2.10, the AGD manages the NDRRA on behalf of the Treasury. As at 30 June 2015, the Treasury's financial statements reported a liability of \$1.8 billion relating to NDRRA.³¹

31 While this issue does not directly affect AGD's financial statements, AGD is responsible for managing the NDRRA and providing the required information for inclusion in the Treasury's financial statements.

3.2.18 Previous audit coverage of the NDRRA³² had highlighted a range of weaknesses in relation to the estimate of the NDRRA liability and subsequent payments. The main issues, which represent a key risk to the AGD, were:

- the need to strengthen the validation of information provided by the States used to support estimates of future costs; and
- significant weaknesses in the payment framework, including limited analysis and verification by the department concerning the eligibility of claims.

3.2.19 The department has made progress in addressing these matters by:

- developing improved documentation of State processes for collating and evaluating the NDRRA estimate;
- developing enhanced certification signoffs from the States, to be accompanied by more comprehensive variance analysis; and
- committing to undertake collaborative audits with the States and Territories, designed to strengthen the validation of information used to support NDRRA claims and estimates.

3.2.20 The AGD has advised the ANAO that the collaborative audits will be part of an interim measure, while the department pursues a longer term solution involving moving to an upfront recovery model to succeed the existing NDRRA arrangements.

3.2.21 At the time of the interim audit, many of the initiatives were in the process of being implemented by the department. The ANAO will re-assess the status of this audit finding as part of the 2015–16 final audit.

New audit finding

Monitoring of privileged users in the AGS network

3.2.22 During the interim audit, the ANAO identified that a privileged user account was used to access the AGS network. This access was not monitored and the department was unable to identify the user. In addition, there was no formal process to identify and disable inactive users of the network. These weaknesses increase the risk that unauthorised changes can be made without being detected.

3.2.23 The department agreed with the finding and advised that a process has been implemented to regularly identify inactive users in the AGS network and disable these accounts. The department also advised that the implementation of processes to monitor privileged user accounts is nearing completion.

3.2.24 The ANAO will review the remedial action taken by the department as part of the 2015–16 final audit.

32 ANAO Audit Report No.34 2014–15 *Administration of the Natural Disaster Relief and Recovery Arrangements by Emergency Management Australia*.

Conclusion

3.2.25 Based on our audit coverage to date, and except for the matters referred to above, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the department will be able to prepare financial statements that are free of material misstatement. The effective operation of these internal controls for the full financial year will be assessed in conjunction with additional audit testing during the 2015–16 final audit.

3.3 Department of Communications and the Arts

Overview

3.3.1 The Department of Communications and the Arts' (Communications) responsibilities include: the promotion of an innovative and competitive communications sector through policy development, advice and program delivery, to achieve the full potential of digital technologies and communications services; and supporting participation in, and access to, Australia's arts and culture through developing and supporting cultural expression.

3.3.2 From 1 July 2015, the Department assumed responsibility for the administration of the telecommunications universal service obligation from the former Telecommunications Universal Service Management Agency.

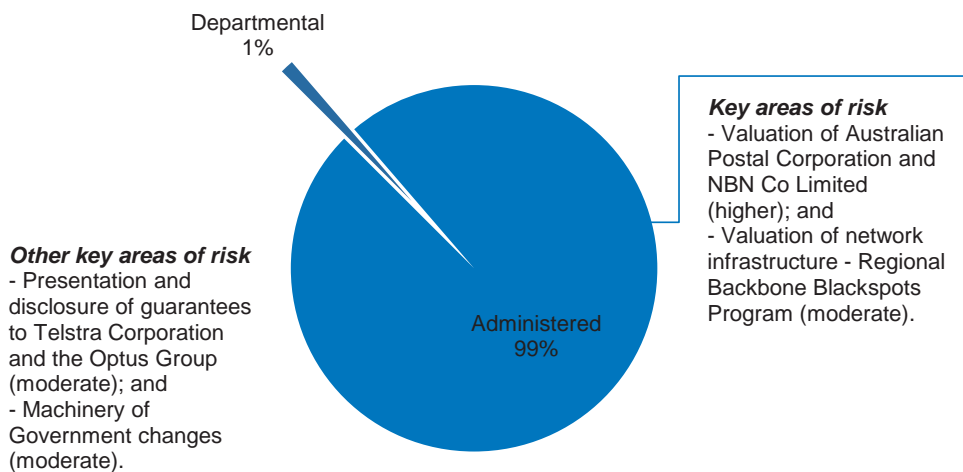
3.3.3 As a result of the Machinery of Government changes of September 2015, Communications assumed responsibility for cultural affairs, classification and copyright functions, and associated legislation from the Attorney-General's Department. In addition, the department's responsibilities for enhancing digital productivity and the data policy function were transferred to the Departments of Industry, Innovation and Science and the Prime Minister and Cabinet respectively.

3.3.4 Annual appropriation funding of \$90.2 million (departmental) and \$8 938.6 million (administered) was provided to Communications in 2015–16 to support the achievement of the department's outcomes.³³ The majority of administered funding relates to equity funding provided to NBN Co Limited to assist in the planning and rollout of the National Broadband Network.

3.3.5 Figure 3.3 shows departmental and administered funding as a percentage of total funding, and the key areas of financial statements risk.

33 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

Figure 3.3: Appropriation funding and key areas of financial statements risk



3.3.6 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Communications' financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of Communications' environment and governance arrangements, including its financial reporting regime and system of internal control. The results of any recent performance audits relevant to the financial management or administration of Communication's operations are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

3.3.7 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items³⁴

3.3.8 Table 3.10 and Table 3.11 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

³⁴ Figures in Table 3.10 and Table 3.11 have been sourced from the Communications and the Arts Portfolio Budget Statements 2016–17.

Table 3.10: Key expenses and own-source income

Expenses and own-source income	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total expenses	107.8	2 033.7
Employee benefits	65.7	-
Suppliers	36.3	331.2
Grants	-	172.3
Depreciation and amortisation	5.8	9.1
Payments to corporate entities	-	1 491.0
Other	-	30.1
Total own-source income	2.1	8.1
Net cost of services	105.7	2 025.6

Table 3.11: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	82.9	24 969.5
Land and buildings	2.3	53.4
Property, plant and equipment	3.7	164.1
Heritage and cultural assets	39.8	-
Other investments	-	24 626.9
Other	37.1	125.1
Total liabilities	38.0	362.4
Employee provisions	20.4	-
Other	17.6	362.4
Net assets	44.9	24 607.1

Communications' estimated average staffing level for 2015–16 is 495.

Key areas of financial statements risk

3.3.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.12.

Table 3.12: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered other investments	Valuation of Australian Postal Corporation and the NBN Co Limited	Higher	<ul style="list-style-type: none"> complexity of the valuation process in light of estimates and judgements required.
Administered property, plant and equipment	Valuation of network infrastructure - Regional Backbone Blackspots Program	Moderate	<ul style="list-style-type: none"> complex infrastructure assets requiring significant judgement and expert assessment.
Administered contingent liabilities and commitments are disclosed separately, including in the notes	Guarantees to Telstra Corporation Limited and the Optus Group under contracts with NBN Co Limited	Moderate	<ul style="list-style-type: none"> guarantees are significant; and are difficult to measure accurately as there are extensive and complex contract and project management arrangements associated with third party delivery of the new broadband network.
All items	Machinery of Government changes, including cultural affairs classification and copyright functions transferred from the Attorney-General's Department	Moderate	<ul style="list-style-type: none"> the functions acquired by the department are diverse both in nature and geographical location; the new functions require the department to implement new systems and processes; and complexity associated with the accurate reporting and disclosure of a number of balances.

3.3.10 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Communications' financial statements.

Audit results

3.3.11 The ANAO has completed its 2015–16 interim audit coverage, including an assessment of the controls relating to administered grants expenses, cash and asset management, payroll processing, supplier expenses, the Machinery of Government changes and IT general controls.

3.3.12 Audit procedures relating to: the valuation of administered investments; the valuation of assets associated with the Regional Backbone Blackspots Program; and the presentation and disclosure of administered contingent liabilities and commitments will be undertaken as part of the planned 2015–16 final audit. The IT application controls in the FMIS and HRMIS will also be assessed as part of the final audit.

3.3.13 To date, our audit coverage of the above areas has not identified any new significant or moderate audit findings. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.3.14 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Communications will be able to 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 2015–16 final audit.

3.4 Department of Defence

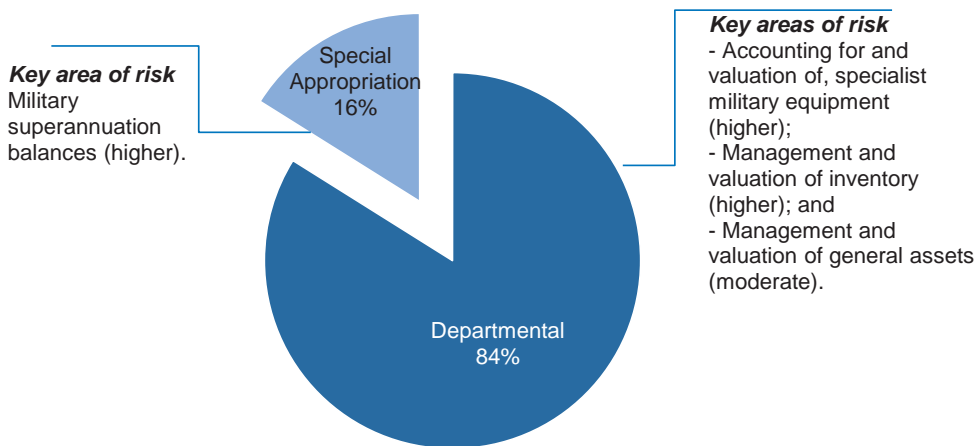
Overview

3.4.1 On 1 July 2015 as a result of the First Principles Review the former Defence Materiel Organisation (DMO) was delisted and its functions merged with the Department of Defence (Defence).

3.4.2 Defence, incorporating the Australian Defence Force, is responsible for protecting and advancing Australia's strategic interests through the provision of appropriately prepared and equipped armed forces. Accordingly, Defence prepares for and conducts military operations and other tasks directed by the Government.

3.4.3 Annual departmental appropriation funding of \$32 105.8 million was provided to Defence in 2015–16 to support the achievement of the department's outcomes.³⁵ Defence was also budgeted to receive administered special appropriation funding of \$6 157.3 million, largely for the administration and funding of military personnel superannuation, retirement and death benefits.³⁶ Figure 3.4 below, shows departmental and special appropriation funding as a percentage of total funding, and the key areas of financial statements risk.

Figure 3.4: Appropriation funding and key areas of financial statements risk



3.4.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Defence's financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of Defence's environment and governance arrangements, including its financial reporting regime and system of internal control.

35 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.*

36 *Part 1: Special Appropriations Table, Agency Resourcing, Budget Paper No.4, 2016-17.*

3.4.5 In light of the key areas of risk and the ANAO's understanding of the operations of Defence, the ANAO has assessed the risk of a material misstatement as **high**.

Key financial statements items³⁷

3.4.6 Table 3.13 and Table 3.14 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.13: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	29 970.2	6 157.3
Employee benefits	11 711.0	-
Suppliers	12 426.2	-
Depreciation and amortisation	4 540.6	-
Write-down of assets and impairment of assets	954.4	-
Military superannuation benefits	-	5 984.2
Other	338.0	173.1
Total own-source income	802.3	1 626.3
Sale of goods and rendering of services	447.8	-
Reversal of previous asset write-downs	292.3	-
Military superannuation contributions	-	1 470.6
Other	62.2	155.7
Net cost of services	29 167.9	4 531.0

Table 3.14: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	83 149.7	3 204.7
Financial assets	647.9	2 994.6
Specialist military equipment	45 720.5	-
General assets:		
Land and buildings	18 011.3	-

37 Figures in Table 3.13 and Table 3.14 have been sourced from the Defence Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Infrastructure, plant and equipment	7 530.1	-
Intangibles	753.6	-
Heritage and cultural	955.9	-
Inventories	6 288.8	-
Prepayments	3 203.9	210.1
Other	37.7	-
Total liabilities	7 640.4	61 520.2
Suppliers	2 339.8	-
Leases	1 422.8	-
Employee provisions	2 526.3	-
Restoration, decontamination and decommissioning	1 006.4	-
Military Superannuation	-	61 514.7
Other	345.1	5.5
Net assets/(liabilities)	75 509.3	(58 315.5)

Defence's estimated average civilian employees staffing level for 2015–16 is 18 501 and Australian Defence Force (ADF) permanent force level is 58 021.

3.4.7 The results of recent performance audits relevant to the financial management or administration of Defence's operations were also considered in identifying key areas of financial statements risk. The following reports were tabled during 2015–16 and are relevant to the financial statements of Defence:

- Audit Report No.9 2015–16 *Test and Evaluation of Major Defence Equipment Acquisitions*;
- Audit Report No.16 2015–16 *2014–15 Major Projects Report*;
- Audit Report No.26 2015–16 *Defence's Management of the Mulwala Propellant Facility*; and
- Audit Report No. 33 2015–16 *Defence's Management of Credit and Other Transaction Cards*.

3.4.8 These reports included observations relevant to each of the key areas of financial statements risk outlined in Table 3.15, in particular Specialist Military Equipment and general assets. The results of Audit Report No. 33 2015–16 will be considered in the development of the 2016–17 financial statements audit approach. The approach will also take into account the results of the ANAO's planned cross-entity performance audit, *Controls Over Credit Card Use*, discussed in paragraph 1.95 of this report.

Key areas of financial statements risk

3.4.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.15.

Table 3.15: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Departmental Specialist Military Equipment Departmental prepayments	The accounting for and valuation of, specialist military equipment (SME) which includes Defence Weapons Platforms (DWP), Military Support Items and Assets Under Construction (AUC) and associated prepayments	Higher	<ul style="list-style-type: none"> complexity in measuring assets at fair value. This is a new requirement for Defence for 2015–16. Refer to paragraphs 3.4.10 to 3.4.12 below for further detail; annual impairment and revision of useful lives are subject to a high degree of judgement and subjectivity; management of AUC is dispersed across numerous projects that have complex multi-year contractual arrangements and project management requirements; and large prepayments are often made in relation to the acquisition and sustainment of certain SME.
Departmental inventory	Management and valuation of inventory	Higher	<ul style="list-style-type: none"> decentralised holdings and management by multiple third parties; and identification of, and accounting for, obsolete stock.
Administered military superannuation liabilities	Military superannuation balances	Higher	<ul style="list-style-type: none"> complexity of the calculation and the nature of the economic and demographic assumptions involved.
Departmental general assets	Management and valuation of general assets	Moderate	<ul style="list-style-type: none"> high volume of capital works and associated purchases managed across numerous locations; completeness and accuracy of the fixed asset register; and accuracy of calculations of depreciation or impairment adjustments.

3.4.10 Under AASB 1049 *Whole of Government and General Government Sector Financial Reporting* the Australian Government's Consolidated Financial Statements (CFS) are required to report non-financial assets, including SME, at their fair value. The *Public Governance, Performance*

and Accountability (Financial Reporting) Rule 2015 (Financial Reporting Rule) allowed Defence to report these assets at depreciated historical cost at 30 June 2015.

3.4.11 The auditor's report on the 2014–15 CFS was qualified because the Australian Government had not completed its work to establish reliable measurements of the fair value of SME in time for the 2014–15 CFS. As a result, the Auditor-General was unable to obtain sufficient appropriate audit evidence whether a material difference existed between the carrying amount and fair value of SME at 30 June 2015. This was a limitation on the scope of the CFS audit.

3.4.12 The Australian Government has advised that it is committed to recognising SME at fair value where this can be done reliably. The Financial Reporting Rule applicable for 2015–16 requires Defence to report these assets at fair value at 30 June 2016.

3.4.13 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls of key systems that support the preparation of Defence's financial statements.

Audit results

3.4.14 The ANAO has substantially completed its planned interim audit coverage which included assessing asset management processes and the analysis of data used to calculate the value of the inventory balance at year end. Interim audit coverage also included assessing: IT general and selected application controls for systems that support the preparation of Defence's financial statements; and assessing the operation of key non-IT controls in areas including appropriation management and supplier expenses. The ANAO has also reviewed progress by Defence in addressing audit findings previously identified.

3.4.15 As discussed above at paragraph 3.4.12, the Financial Reporting Rule applicable for 2015–16 requires Defence to report SME at fair value at 30 June 2016. During the interim audit Defence had commenced work on assessing the assets held to determine the most appropriate valuation method. During the 2015–16 final audit, the ANAO will complete testing of this area.

3.4.16 During the 2015–16 final audit, the ANAO will also complete testing of the internal controls and the work in relation to the 30 June 2016 balances for employee provisions, inventory, general assets, military superannuation provision, appropriations and special accounts.

3.4.17 Our interim audit coverage has identified two new moderate audit findings in relation to IT general controls.

3.4.18 The following table summarises the status of audit findings reported by the ANAO in 2014–15 and 2015–16.

Table 3.16: Status of audit findings raised by the ANAO

Category	Closing position (at the end of the 2014–15 final audit)	Resolved findings (at the time of the 2015–16 interim audit)	New findings (during the 2015–16 interim audit)	Closing position (at the end of the 2015–16 interim audit)
A	0	0	0	0
B	7 ^c	0	2	9
Total	7	0	2	9

Note c: Following the merger of DMO and Defence, the responsibility for addressing four unresolved findings was transferred from DMO to Defence.

Unresolved audit findings

Estimation of Military Support Items (MSI) impairment

3.4.19 During 2014–15, Defence estimated the value of MSI assets which were impaired by testing a statistical sample of these assets. The ANAO reviewed the evidence supporting the sampled items and found:

- the evidence was inadequate; and
- the sampling exercise was conducted very late in the financial statement preparation process, resulting in limited time to rectify issues arising from the analysis of the statistical sample.

3.4.20 Based on the results of the statistical sample an adjustment was made to the MSI impairment balance in Defence's 2014–15 financial statements.

3.4.21 During the 2015–16 interim audit the ANAO noted that Defence has made progress in refining the MSI impairment process, however not all remediation activities have been conducted or finalised and the finding will remain unresolved until the ANAO reviews and assesses the process during the 2015–16 final audit.

Estimation of impairment of Defence Weapons Platforms (DWPs) including Assets Under Construction

3.4.22 Defence is required to assess DWPs for indicators of impairment on an annual basis. As these assets are dispersed across Defence bases, Defence requests Project Offices to respond to an annual impairment questionnaire. The ANAO identified a number of deficiencies in the processes underlying the assessment and the calculation of impairment of these assets including:

- potential impairment indicators identified by the Project Offices were not considered in the impairment calculations;
- inconsistent and/or incomplete responses to the annual impairment questionnaires; and
- insufficient evidence to support management's judgements that some indicators of potential impairment did not lead to an actual impairment.

3.4.23 Defence has advised that plans are in progress to improve this process, particularly the documentation and management review activities that identify indicators of impairment. In addition, Defence has revised its accounting methodology for the impairment of DWPs.

3.4.24 The ANAO will review and assess the progress of these plans during the 2015–16 final audit.

General Stores Inventory (GSI) pricing

3.4.25 Defence undertakes an annual assurance process in consultation with an independent statistician, to calculate an adjustment for in-year pricing errors over GSI. In 2014–15 the ANAO was unable to place reliance on this work because a number of pricing errors were identified that had not been detected by Defence. To obtain sufficient audit evidence, the ANAO undertook additional testing to confirm that the GSI pricing error did not result in a material misstatement in Defence's 2014–15 financial statements.

3.4.26 Defence has refined its methodology which includes evidence requirements for the GSI pricing assurance program. The ANAO will review and assess the results of this process and any adjustments during the 2015–16 final audit.

Unresolved audit findings transferred from DMO³⁸

Accounting for Commitments

3.4.27 The former DMO entered into large, complex contracts to deliver Defence's capability requirements which made up the majority of commitments and often included inventory items.

3.4.28 During 2014–15, the ANAO identified:

- numerous instances where inventory amounts, which are specifically excluded from the definition of commitments in the Financial Reporting Rule, had been included in commitments;
- errors in the ageing of the commitments balance; and
- instances where contingent liabilities such as performance incentives were included as commitments.

3.4.29 Defence has advised that plans are underway to improve the process which includes developing a commitments methodology and assurance process. This will be reviewed and assessed by the ANAO during the 2015–16 final audit.

Effectiveness of assurance processes

3.4.30 During the 2014–15 final audit, the ANAO identified that the former DMO's quality assurance activities over some balances reported in its financial statements process were not effective. This resulted in a number of errors in financial information. Defence has advised that it has revised its assurance processes and the ANAO will review and assess these processes during the 2015–16 final audit.

Valuation and management of overseas project bank accounts

3.4.31 DMO had in place a number of arrangements for the acquisition or sustainment of military equipment requiring the establishment of overseas bank accounts, to facilitate payments. In prior years, these accounts were reported as cash by DMO. In 2014–15, DMO reassessed the nature of each of these arrangements and determined that they would be better classified as prepayments, due to DMO's inability to access the funds in these bank accounts. The ANAO agreed with this reclassification.

38 Refer to Table 3.16 on page 63.

3.4.32 During the 2014–15 final audit, the ANAO reviewed the reclassified balances and identified several anomalies. These included that prepayments had been translated from foreign currency to Australian dollars at the year-end exchange rate rather than being recorded at historical cost. In addition, as part of the reclassification, DMO did not consider the cumulative impact of movements from prior years and the flow on impacts to Defence's financial statements.

3.4.33 A contributing factor to the above issues was that DMO did not have a register in place to track and support the payments from these accounts. In response, Defence has advised that it has developed a register for each relevant bank account and developed an approach in line with established processes for purchases. The ANAO will review the register and assurance processes during the 2015–16 final audit.

Accuracy and completeness of month end System Project Office financial information

3.4.34 During 2014–15 the ANAO identified a number of issues affecting the accuracy and completeness of financial information provided by System Project Offices, in relation to prepayments, the capitalisation of assets and the capture of accruals at year-end.

3.4.35 Defence has advised that it plans to review the process which includes the quality assurance process over year-end balances. The ANAO will review this process during the 2015–16 final audit.

New moderate audit findings

3.4.36 The ANAO has identified two moderate audit findings during the 2015–16 interim audit in relation to unauthorised changes to applications and IT systems and weaknesses in the management of privileged security users in the IT general control environment.

Unauthorised changes to applications and IT systems

3.4.37 Defence has engaged an external organisation to manage and maintain Defence's IT Infrastructure that host business applications. Under a services contract, this organisation is required to maintain a reliable and secure ICT environment; perform authorised changes to IT Infrastructure; and support Defence in meeting its performance, monitoring and compliance requirements under the Protective Security Policy Framework (PSPF) and Australian Government Information Security Manual (ISM). The organisation is also responsible for the management and maintenance of hosting infrastructure that supports the enterprise resource planning systems, including the management information domains of the HRMIS, FMIS and the logistics management system.

3.4.38 The ANAO identified that unauthorised changes were made by the external organisation to applications and IT systems and that Defence was not aware of the proposed changes prior to implementation. It was not clear if these changes related to emergency situations in which retrospective approval may have been appropriate. These weaknesses increase the risk of Defence's business processes being compromised, network performance being impeded and unauthorised access to data.

3.4.39 Defence has advised it will strengthen controls to address the above issues. The ANAO will review and assess this process during the 2015–16 final audit.

Granting and terminating access of privileged users in supporting systems

3.4.40 The ANAO's review of users with privileged access to Defence's supporting systems identified weaknesses in the operation of the controls supporting the granting of access for new users and terminating access procedures within a number of domain servers. The weaknesses related to:

- the absence of approval documentation for granting privileged user access;
- privileged users not being removed when a business need no longer existed;
- inadequate documentation of the review of user access; and
- the failure to monitor privileged user access.

3.4.41 The above control weaknesses increase the risk of unauthorised changes to systems or data and may result in data integrity issues.

3.4.42 Defence has advised it will strengthen controls to address the above issues. The ANAO will review and assess this process during the 2015–16 final audit.

Conclusion

3.4.43 Based on our audit coverage to date, and except for the findings referred to above, the key internal controls that support the preparation of the financial statements were operating effectively. The effective operation of these controls for the full financial year will be assessed in conjunction with additional audit testing during the 2015–16 final audit.

3.5 Department of Veterans' Affairs

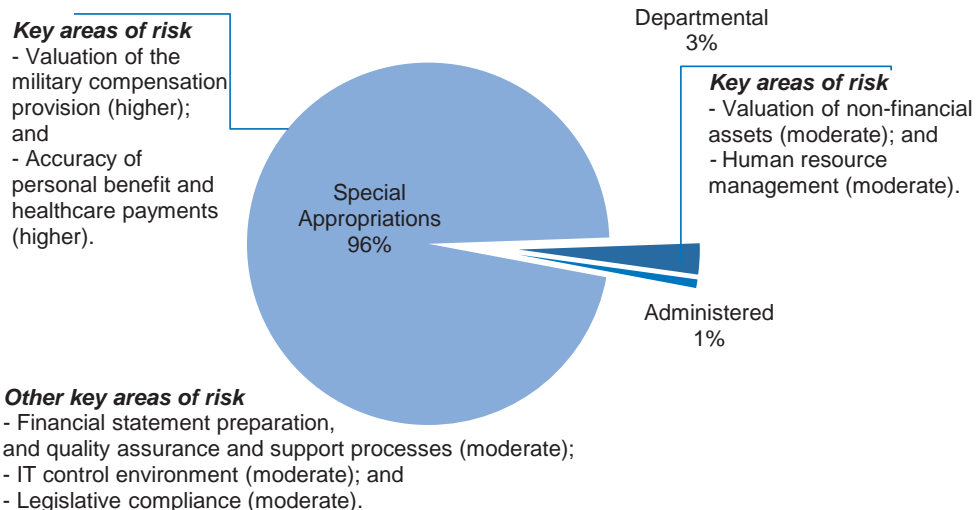
Overview

3.5.1 The Department of Veterans' Affairs (Veterans' Affairs) is the primary service delivery entity responsible for implementing programs to assist veterans and defence force communities.

3.5.2 Annual appropriation funding of \$317.6 million (departmental) and \$140.2 million (administered) was provided to Veterans' Affairs in 2015–16 to support the achievement of the department's outcomes.³⁹ Veterans' Affairs was also budgeted to receive special appropriation funding of \$11.1 billion largely associated with administering veterans' entitlements.⁴⁰

3.5.3 Figure 3.5 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.5: Appropriation funding and key areas of financial statements risk



3.5.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Veterans' Affairs financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of Veterans' Affairs environment and governance arrangements, including its financial reporting regime and system of internal control.

3.5.5 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

39 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.*

40 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4 2016–17*.

Key financial statements items⁴¹

3.5.6 Table 3.17 and Table 3.18 provide a summary of the 2015–16 key departmental and administered estimated financial statements items.

Table 3.17: Key expenses and own-source income

Expenses and revenues	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	359.6	11 497.4
Employee benefits	192.2	-
Suppliers	111.4	-
Personal benefits	-	6 298.6
Healthcare benefits	-	5 139.4
Other	56.0	59.4
Total own-source income	49.4	19.7
Net cost of services	310.2	11 477.7

Table 3.18: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	188.4	1 409.8
Financial assets	87.5	1 404.8
Non-financial assets	100.9	5.0
Total liabilities	126.7	8 254.8
Employee provisions	61.4	-
Personal benefits	-	5 621.2
Healthcare	-	2 597.5
Other	65.3	36.1
Net assets/(liabilities)	61.7	(6 845.0)

Veterans' Affairs estimated average staffing level for 2015–16 is 1 823.

⁴¹ Figures in Table 3.17 and Table 3.18 have been sourced from the Veterans' Affairs Portfolio Budget Statements 2016–17.

3.5.7 The results of recent performance audits relevant to the financial management or administration of Veterans' Affairs operations are also considered in identifying key areas of financial statements risk.

3.5.8 Audit Report No.32 2015–16 *Administration of Rehabilitation Services under the Military Rehabilitation and Compensation Act 2004* was tabled on 5 May 2016 assessing the effectiveness of Veterans' Affairs joint administration with the Department of Defence of rehabilitation services under the *Military Rehabilitation and Compensation Act 2004*. The audit focused on whether there were effective governance and coordination arrangements to support the administration of rehabilitation services, and whether the program is achieving intended outcomes.

3.5.9 There were no recommendations in the audit report which had a direct financial impact on Veterans' Affairs financial statements. The accuracy of payments made under the Act, and valuation of the military compensation provision are key areas of financial statements risk, outlined in Table 3.19 below.

Key areas of financial statements risk

3.5.10 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.19.

Table 3.19: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered personal benefit and healthcare provisions	Valuation of military compensation provision	Higher	<ul style="list-style-type: none"> complexity of assumptions and calculations underpinning the actuarial assessment of the military compensation provision; increasing value of the provision which is expected to be \$5.6b in 2015–16⁴² (2014–15: \$4.5b); and availability, quality and completeness of data used to derive the valuation.
Administered personal benefit and healthcare expenses	Accuracy of personal benefit and healthcare payments	Higher	<ul style="list-style-type: none"> complex legislation applicable to individual claims; ageing IT infrastructure that supports the personal benefit and healthcare payments; dependence on veteran provided information; and reliance on shared service providers.

42 Figure has been sourced from the Veterans' Affairs Portfolio Budget Statements 2016–17.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Departmental non-financial assets	Valuation of departmental non-financial assets	Moderate	<ul style="list-style-type: none"> complexity of the valuation process; and judgements applied to the capitalisation of costs associated with internally developed software.
All expense items	Legislative compliance (including section 83 of the Constitution)	Moderate	<ul style="list-style-type: none"> conditions legislated by Parliament must be met before payments are made; and section 83 breaches were reported in the 2014–15 financial statements.
Departmental employee provisions	Human resource management	Moderate	<ul style="list-style-type: none"> complexity in assumptions and calculations underlying the actuarial assessment of employee provisions.
All items	IT control environment	Moderate	<ul style="list-style-type: none"> large number of ageing IT systems involved in the capturing and processing of financial data required to produce the financial statements.
All items	Financial statement preparation, quality assurance and support processes that underpin the integrity of financial statement balances	Moderate	<ul style="list-style-type: none"> prior period finding relating to weaknesses in financial statement preparation and quality assurance processes.

Audit results

3.5.11 The ANAO's interim audit coverage included an assessment of the department's methodology to estimate the military compensation provision and related quality assurance controls; and an assessment of the controls supporting personal benefit and healthcare payments.

3.5.12 Audit coverage also included an assessment of: IT general controls and application controls in the FMIS and HRMIS; manual controls relating to non-financial assets, supplier expenses and employee benefits; and the department's financial statements preparation plan.

3.5.13 As part of the 2015–16 final audit, additional work will be performed to complete our evaluation of the above mentioned areas. This will include testing to substantiate the year-end balances in respect of the military compensation provision and personal benefit and healthcare payments, and disclosures relating to legislative compliance.

3.5.14 Audit coverage to date has not identified any new significant or moderate audit findings. There were also no significant or moderate audit findings unresolved from the 2014–15 audit.

Conclusion

3.5.15 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Veterans' Affairs will be able to prepare financial statements that are free of material misstatement. The effective operation of these controls for the full financial year will be assessed during the 2015–16 final audit.

3.6 Department of Education and Training

Overview

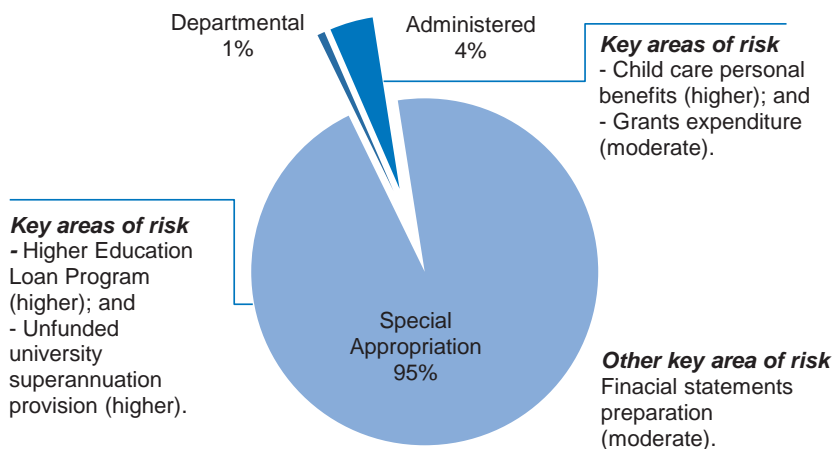
3.6.1 The Department of Education and Training (Education) works with state and territory governments, other government entities and a range of service providers to deliver education and training related policy, advice and service for the benefit of Australians.

3.6.2 Education is responsible for administering a number of programs to assist with the cost of child care. Education is also responsible for managing a number of programs, including the Higher Education Loan Program (HELP), grants to schools, and supplementary funding to assist universities to meet superannuation expenses for eligible current and former university higher education service providers.

3.6.3 Following the Machinery of Government changes of September 2015, responsibility for child care programs was transferred to Education from the Department of Social Services.

3.6.4 Annual appropriation funding of \$295.4 million (departmental) and \$1 704.4 million (administered) was provided to Education in 2015–16 to support the achievement of the department's outcomes.⁴³ Education was also budgeted to receive special appropriation funding of \$39 936.4 million⁴⁴, largely in relation to the administration of the Higher Education Loan Program. Figure 3.6 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.6: Appropriation funding and key areas of financial statements risk



⁴³ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016.*

⁴⁴ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.6.5 The ANAO's audit approach identifies key areas of risk that have the potential to impact Education's financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of Education's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.6.6 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁴⁵

3.6.7 Table 3.20 and Table 3.21 provide a summary of the nature of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.20: Key expenses and own-source income

Expenses and own-source income	Departmental	Administered
	estimated actual (\$m) 2015–16	estimated actual (\$m) 2015–16
Total expenses	364.9	34 951.8
Subsidies	-	371.3
Personal benefits	-	5 637.7
Grants	0.6	25 811.7
Finance costs	-	924.5
Write-down and impairment	-	1 558.8
Suppliers, employees, and other expenses	364.3	647.8
Total own-source income	36.0	2 042.6
Other taxes – Overseas Student Tuition Fund	-	8.6
Interest and HELP loan discount	-	1 088.2
Gains and other own source revenue	36.0	945.8
Net cost of services	328.9	32.909.2

⁴⁵ Figures in Table 3.20 and Table 3.21 have been sourced from the Education and Training Portfolio Budget Statements 2016–17.

Table 3.21: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	222.3	40 460.9
Financial assets	14.0	37 412.1
Other investments	-	2 150.0
Other	208.3	898.9
Total liabilities	123.3	7 533.6
Personal benefits	-	1 349.7
Provision for grants	-	6 075.7
Other	123.3	108.2
Net assets	99.0	32 927.3

Education's estimated average staffing level for 2015–16 is 1 815.

3.6.8 The results of recent performance audits relevant to the financial management or administration of Education's operations are also considered in identifying key areas of financial statements risk.

3.6.9 Audit Report No.31 2015–16 *Administration of Higher Education Loan Program Debt and Repayments* was tabled on 5 May 2016 assessing the effectiveness of the administration of the Higher Education Loan Program (HELP) debts and repayments, including Education's monitoring of HELP debt and repayments to inform program decision-making.

3.6.10 The observations and recommendations made in the report support the ANAO's focus on HELP as a higher key area of financial statements risk as set out in Table 3.22 of the following section.

Key areas of financial statements risk

3.6.11 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.22.

Table 3.22: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered supplier payments and personal benefits	Child care personal benefits – transferred from the Department of Social Services in September 2015	Higher	<ul style="list-style-type: none"> the complex legislation and administration of child care benefits; payments are reliant on information provided by recipients and child care service providers; the IT environment is highly dependent on information systems external to Education, which are administered by the Departments of Human Services and Social Services; and a significant audit finding raised in 2013–14 remains unresolved.
Administered concessional loans; write-down and impairment expense and finance costs	The Higher Education Loan Program (HELP) which assists students with the cost of their tuition under the <i>Higher Education Support Act 2003</i>	Higher	<ul style="list-style-type: none"> the balance is derived from complex actuarial estimates based on judgements relating to discount factors, trends and payment information; and payment information is provided by sources external to Education such as: the Australian Taxation Office; universities; and other third parties.
Administered provision for grants and grants payments	The unfunded superannuation provision is a joint responsibility of the Commonwealth and states to provide for superannuation payments made under the <i>Higher Education Support Act 2003</i>	Higher	<ul style="list-style-type: none"> the valuation of the liability is subject to an actuarial estimation process and sensitive to movements in discount factors and bond rates; and the valuation is complex as it is heavily reliant on accurate source data which is provided by universities and collected through a number of systems.
Administered grants payments	The administration of multiple and diverse grant programs, including those under the <i>Australian Education Act 2013</i> and <i>Higher Education Support Act 2003</i>	Moderate	<ul style="list-style-type: none"> grants programs are decentralised and are managed across a number of different systems that rely on third parties including grants to universities, government and non-government schools; and the payment process is reliant on third parties' assessment of eligibility to receive a nominated grant.
All line items	Financial statements preparation	Moderate	<ul style="list-style-type: none"> the complexities arising from data managed by a number of areas, both internal and external to Education.

3.6.12 Since 2014–15 Education has operated in a shared IT and corporate services control environment following the establishment of the Shared Services Centre with the Department of Employment. As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Education's financial statements, including those managed by the Shared Services Centre.

Audit results

3.6.13 The ANAO has completed its interim audit coverage, including an assessment of Education's IT general controls over security and change management. The remaining areas, including the key areas of financial statements risk, will be completed as part of the final audit. During the 2015–16 interim audit, the ANAO did not identify any new significant or moderate audit findings.

Unresolved significant audit finding

Child Care Compliance – estimated incorrect payments

3.6.14 In 2013–14, Education implemented a change in approach for monitoring the compliance of child care service providers, moving from inspections of providers, to parent confirmation of their child's attendance. This approach was designed so that the results of the confirmation process can be extrapolated to provide a statistically reliable national estimate of the information provided by child care providers, and any level of estimated incorrect payments. The ANAO identified significant weaknesses in the child care compliance program, and a significant amount of estimated incorrect payments being made to childcare services providers—approximately \$300 million.

3.6.15 Education agreed to strengthen compliance activities to address this issue, however responsibility for child care related programs, and the associated significant audit finding, was subsequently transferred to the Department of Social Services (Social Services) in 2014–15.

3.6.16 In addressing the audit finding, Social Services had made progress in implementing measures designed to protect and improve the integrity of the child care fee assistance payments and had drafted legislation to expand the Commonwealth's powers to strengthen its corrective action against non-compliant child care service providers. As such, changes were made to the *Child Care Benefit (Eligibility of Child Care Services for Approval and Continued Approval) Determination 2000* that affects family day care service providers however, as at 30 June 2015, Social Services projected an estimated \$693 million of potential incorrect payments made to child care service providers.

3.6.17 In September 2015, the responsibility for child care policies and programs returned to Education, including the unresolved significant audit finding.

3.6.18 The compliance activities undertaken by Social Services have been continued by Education since the transfer, including resources devoted to serious non-compliance matters and increasing the level of other monitoring activities, such as risk based data interrogation and analysis. In monitoring the effect of the changes to legislation, Education has also noted a reduction in payments made to family day care service providers.

3.6.19 Education has indicated that the statistical estimate of incorrect payments made to child care providers due to non-compliance has reduced due to compliance activities, however it

remains at \$587 million. As such, the ANAO will continue to review Education's progress in continuing to reduce the overall amount of estimated incorrect payments as part of the 2015–16 final audit.

Conclusion

3.6.20 Based on audit coverage to date, and except for the unresolved audit finding outlined above, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Education will be able to prepare financial statements that are free of material misstatement. The effective operation of these controls for the full financial year will be assessed during the 2015–16 final audit.

3.7 Department of Employment

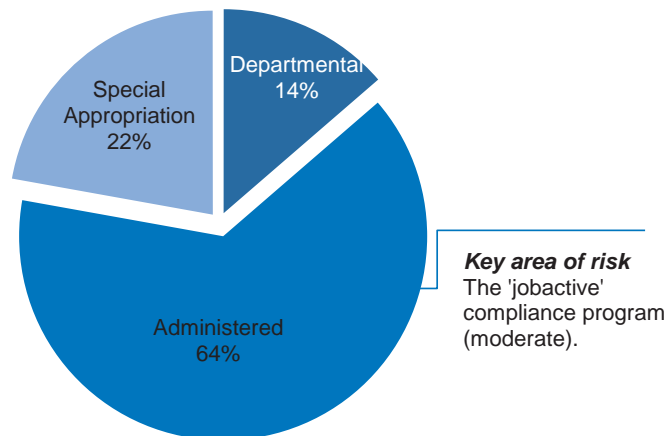
Overview

3.7.1 The Department of Employment's (Employment) role is to provide national policies and programs that help Australians find and keep employment, work in safe, fair and productive workplaces, and improve the employment-related performance of enterprises in Australia.

3.7.2 The employment services program, known as 'jobactive', is delivered through a deed of agreement between Employment and third-party service providers. A new agreement for jobactive commenced on 1 July 2015 with estimated expenditure of \$7.5 billion over five years.

3.7.3 Annual appropriation funding of \$328.4 million (departmental) and \$1 552.4 million (administered) was provided to Employment in 2015–16 to support the achievement of its outcomes.⁴⁶ Employment was also budgeted to receive special appropriation funding of \$533.7 million largely associated with the department's employee assistance and workplace compensation programs.⁴⁷ Figure 3.7 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.7: Appropriation funding and key area of financial statements risk



3.7.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Employment's financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of Employment's environment and governance arrangements, including its financial reporting regime and system of internal control.

⁴⁶ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.*

⁴⁷ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.7.5 The results of any recent performance audits relevant to the financial management or administration of Employment's operations are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

3.7.6 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁴⁸

3.7.7 Table 3.23 and Table 3.24 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.23: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	325.2	1 813.2
Employee benefits	197.9	-
Suppliers and depreciation	127.3	1 125.3
Personal benefits	-	407.1
Grants and subsidies	-	280.8
Total own-source income	20.1	185.0
Other taxes	-	154.6
Other	20.1	30.4
Net cost of services	305.1	1 628.2

Table 3.24: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	260.6	262.3
Investments accounted for using the equity method	-	224.7
Trade and other receivables	120.8	-
Other	139.8	37.6
Total liabilities	120.9	2 870.4

⁴⁸ Figures in Table 3.23 and Table 3.24 have been sourced from the Employment Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Other payables (Comcare)	-	2 786.6
Employee provisions	62.3	-
Other	58.6	83.8
Net assets/(liabilities)	139.7	(2 608.1)

Employment's estimated average staffing level for 2015–16 is 1 770.

Key areas of financial statements risk

3.7.8 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. The key area highlighted for specific audit coverage in 2015–16 is provided in Table 3.25.

Table 3.25: Key area of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered personal benefits, suppliers and subsidies	The 'jobactive' compliance program	Moderate	Payments are reliant on assessments made by third-party service providers.

3.7.9 Since 2014–15 Employment has operated in a shared IT and corporate services control environment following the establishment of the Shared Services Centre with the Department of Education and Training. As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Employment's financial statements, including those managed by the Shared Services Centre.

Audit results

3.7.10 The ANAO interim audit coverage included an assessment of: IT general controls over security and change management; and compliance and assurance activities relating to the 'jobactive' compliance program, and within the Shared Services Centre. The ANAO will complete this audit coverage as part of the 2015–16 final audit.

3.7.11 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.7.12 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Employment will be able to prepare financial statements that are free of material misstatement. The effective operation of these controls for the full financial year will be assessed during the 2015–16 final audit.

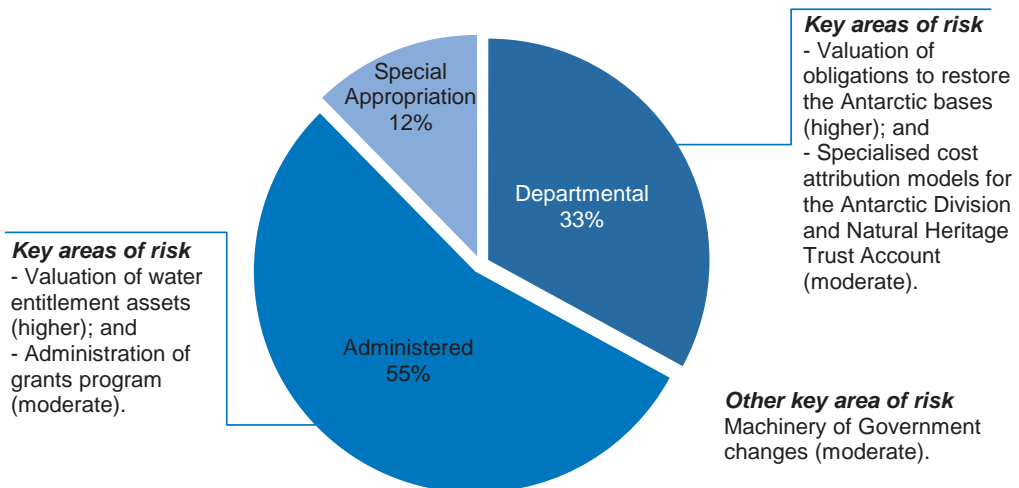
3.8 Department of the Environment and Energy

Overview

3.8.1 The Department of the Environment and Energy⁴⁹ (Environment) is responsible for advising the Government on environmental policy and for the management of a range of programs designed to achieve a healthy environment, as well as regulatory and operational functions. The department is also responsible for managing the conservation, protection and sustainability of Australia's natural resources, biodiversity, ecosystems, environment and heritage requirements, and contributes to the national response to climate change. Other areas of departmental responsibilities include advancing Australia's interest in the Antarctic and managing the environmental water use and resources.

3.8.2 Annual appropriation funding of \$529.3 million (departmental) and \$899 million (administered) was provided to Environment in 2015–16 to support the achievement of the department's outcomes.⁵⁰ Environment was also budgeted to receive special appropriation funding of \$198.1 million.⁵¹ Figure 3.8 below shows departmental, administered and special appropriation funding as a percentage of total funding, and the key areas of financial statements risk.

Figure 3.8: Appropriation funding and key areas of financial statements risk



49 As part of the Machinery of Government changes of 2016, the former Department of Environment's name changed to the Department of Environment and Energy.

50 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, Appropriation Act (No.4) 2015–16*. These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

51 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

3.8.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Environment's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of the department's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.8.4 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁵²

3.8.5 Table 3.26 and Table 3.27 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.26: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	517.0	703.2
Employee benefits	206.7	-
Suppliers	188.1	201.4
Grants	10.8	497.4
Other	111.4	4.4
Total own-source income	41.5	180.2
Sales of goods and rendering of services	40.8	6.5
Fees and fines	-	33.4
Other	0.7	140.3
Net cost of services	475.5	523.1

52 Figures in Table 3.26 and Table 3.27 have been sourced from the Environment Portfolio Budget Statements 2016–17.

Table 3.27: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	449.2	4 254.7
Administered investments	-	1 683.3
Land and buildings and property, plant and equipment	333.6	-
Water assets	-	2 549.1
Other	115.6	22.3
Total liabilities	595.3	23.9
Employee provisions	68.4	-
Antarctic make good provisions	499.7	-
Other	27.2	23.9
Net assets/(liabilities)	(146.1)	4 230.8

Environment's estimated average staffing level for 2015–16 is 1 826.

3.8.6 The results of recent performance audits relevant to the financial management or administration of Environment's operations were also considered in identifying key areas of financial statements risk. The following reports were tabled during 2015–16 and are relevant to the financial statements of Environment:

- Audit Report No.7 2015–16 *Managing Compliance with the Wildlife Trade Provisions of the Environment Protection and Biodiversity Conservation Act 1999*; and
- Audit Report No.22 2015–16 *Supporting the Australian Antarctic Program*.

3.8.7 Both reports included observations relevant to the key areas of financial statements risk outlined in Table 3.28 below, specifically the administration of grant programs (Report No.7) and specialised asset cost attribution models (Report No.22).

Key areas of financial statements risk

3.8.8 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.28.

Table 3.28: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered water assets	Valuation of water entitlement assets	Higher	<ul style="list-style-type: none"> the balance is subject to estimation and judgement, particularly given the trading of water assets is a relatively new and developing market; and information to support the valuation is provided by third parties.
Departmental Antarctic make good provisions	Valuation of obligations to restore the Antarctic bases	Higher	<ul style="list-style-type: none"> the balance is subject to judgement and estimation, particularly relating to discount rates, escalation factors, asset replacement costs and useful lives.
Administered grants expenses and payables	Administration of grant programs	Moderate	<ul style="list-style-type: none"> the department administers a wide variety of grant programs which constitute a significant expense reported in the department's financial statements.
Departmental land and buildings Departmental property, plant and equipment Departmental employee and supplier expenses	Specialised cost attribution models for the Antarctic Division and Natural Heritage Trust Account	Moderate	<ul style="list-style-type: none"> the models are based on a variety of assumptions and cost drivers, which involve varying levels of judgement.
All line items	Machinery of Government changes, including clean energy financing transferred from the Department of the Treasury, and water resources and policy transferred to the Department of Agriculture and Water Resources	Moderate	<ul style="list-style-type: none"> accurate accounting and reporting of the transferred items in the financial statements; and additional disclosure requirements including reporting of full-year revenues and expenses for all functions transferred to and from the department.

3.8.9 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Environment's financial statements.

Audit results

3.8.10 The ANAO has completed its interim audit coverage over administered grant payments, the cost attribution model to capitalise the cost of self-constructed assets for Antarctica, the impact of Machinery of Government changes on the financial statements, and Environment's key

IT general and application controls. The ANAO also examined controls relating to other financial statement balances, including employee entitlements, asset management and supplier expenditure.

3.8.11 Audit coverage of: the valuation of water assets; the assessment of the estimated restoration costs for Antarctic bases; the cost attribution model to allocate program support costs for the National Heritage Trust Special Account; and finalisation of the financial statements impact of the Machinery of Government changes will be completed as part of the 2015–16 final audit.

3.8.12 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.8.13 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the department will be able to 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 2015–16 final audit.

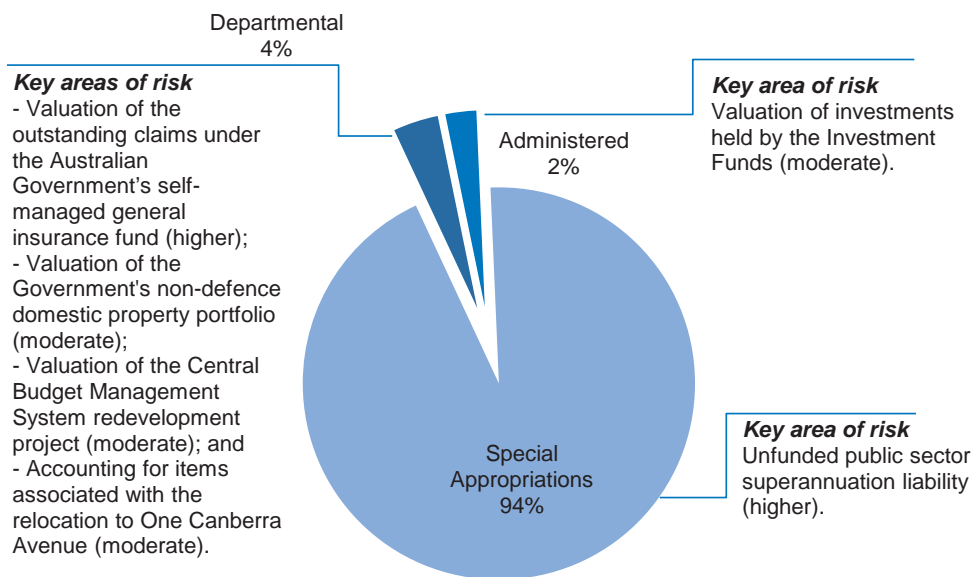
3.9 Department of Finance

Overview

3.9.1 The Department of Finance (Finance) is responsible for supporting the Government's Budget process and oversight of public sector resource management, governance and accountability frameworks. In addition, the department is responsible for the preparation of the annual Consolidated Financial Statements of the Australian Government, which includes the Whole-of-Government, the General Government Sector financial statements and the Australian Government's financial outcome.

3.9.2 Annual appropriation funding of \$428.5 million (departmental) and \$293.7 million (administered) was provided to Finance in 2015–16 to support the achievement of its outcomes.⁵³ Finance was also budgeted to receive special appropriation funding of \$10 822.9 million, largely related to administering the Australian Government's superannuation schemes.⁵⁴ Figure 3.9 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.9: Appropriation funding and key areas of financial statements risk



3.9.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Finance's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of Finance's environment and governance

⁵³ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.*

⁵⁴ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

arrangements, including its financial reporting regime and system of internal control. The results of any recent performance audits relevant to the financial management or administration of Finance's operations are also considered. No performance audits were tabled in 2015–16 which impacted on the financial statements risk assessment process.

3.9.4 In light of the key areas of risk and the ANAO's understanding of the operations of Finance, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁵⁵

3.9.5 Table 3.29 and Table 3.30 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.29: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	631.8	9 473.3
Employee benefits	176.0	241.8
Suppliers	308.0	228.5
Insurance claims	116.2	-
Superannuation payments	-	8 788.8
Other	31.6	214.2
Own-source income	403.6	1 763.1
Rendering of services	180.3	3.7
Insurance premiums	126.7	-
Superannuation contributions	-	1 390.1
Other	96.6	369.3
Net cost of services	228.2	7 710.2

55 Figures in Table 3.29 and Table 3.30 have been sourced from the Finance Portfolio Budget Statements 2016–17.

Table 3.30: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	2 554.1	15 973.1
Land and buildings	933.8	23.0
Investment property	589.8	-
Investments	-	15 667.6
Intangibles	103.2	2.0
Other	927.3	280.5
Total liabilities	597.9	107 884.1
Outstanding insurance provisions	329.0	-
Superannuation liability	-	107 590.5
Other	268.9	293.6
Net assets/(liabilities)	1 956.2	(91 911.0)

Finance's estimated average staffing level for 2015–16 is 1 349.

Key areas of financial statements risk

3.9.6 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.31.

Table 3.31: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered superannuation liability	Calculation of the unfunded public sector superannuation	Higher	<ul style="list-style-type: none"> complex calculation of each superannuation fund's liability and sensitivity of each fund to demographic factors and other movements, such as salary growth and bond rates; and reliance on the Commonwealth Superannuation Corporation for the processing of superannuation benefit payments and the provision of complete and accurate data to Finance's actuary.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Departmental outstanding insurance provision	Valuation of the outstanding claims liability under the Australian Government's self-managed general insurance fund	Higher	<ul style="list-style-type: none"> complex calculation based on assumptions that require significant judgement; and reliance on the control environment of an external service provider for the effective management of the claims process.
Administered investments	Valuation of investments held by the Investment Funds ⁵⁶	Moderate	<ul style="list-style-type: none"> complex assumptions underpinning the valuation of investments.
Departmental investment property	Valuation of the Government's non-defence domestic property portfolio	Moderate	<ul style="list-style-type: none"> significant judgement required on the selection of assumptions within the valuation models across a large portfolio of properties.
Departmental intangibles	Valuation of the Central Budget Management System redevelopment project	Moderate	<ul style="list-style-type: none"> judgements associated with determining impairment relating to internally developed software; and accounting for costs in accordance with accounting standards.
Departmental property, plant and equipment and lease liabilities	Accounting for items associated with the relocation to One Canberra Avenue	Moderate	<ul style="list-style-type: none"> recognition of new lease arrangements, including sub-leases, are subject to specific accounting treatments; it is necessary to unwind current accounting treatments relevant to the previous premises; and a large number of assets are to be disposed of, and new ones acquired, as a result of the relocation.

3.9.7 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Finance's financial statements.

Audit results

3.9.8 The ANAO's interim audit coverage has been completed. Audit coverage has included assessing key controls over employee entitlements, asset management and supplier expenditure.

⁵⁶ The Investment Funds collectively refers to the DisabilityCare Australia Fund, Building Australia Fund, Education Investment Fund and Health and Hospitals Fund.

In addition, the ANAO has substantially completed assessing controls relating to entitlements paid to Parliamentarians and their staff.

3.9.9 Audit coverage relating to the valuations of the unfunded superannuation liability, general insurance liability, investments in the Administered Investment Funds, Finance's property portfolio and departmental intangibles, and accounting for the relocation will be completed as part of the 2015–16 final audit.

3.9.10 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.9.11 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 will be able to 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 2015–16 final audit.

3.10 Future Fund Management Agency and the Board of Guardians

Overview

3.10.1 The Future Fund Board of Guardians (the Board), supported by the Future Fund Management Agency (the FFMA), has responsibility for investment of the assets of the Future Fund under the *Future Fund Act 2006* and other investment funds under the *Nation-building Funds Act 2008*, the *Disability Care Australia Fund Act 2013*, and the *Medical Research Future Fund Act 2015*, for the benefit of future generations of Australians.

3.10.2 The FFMA is responsible for making recommendations to the Board on the most appropriate investment strategy for each fund and for the implementation of these strategies. All administrative and operational functions associated with the management of the funds are undertaken by the FFMA.

3.10.3 Under the *Future Fund Act 2006*, the FFMA and the Board are treated as a single Commonwealth entity for financial reporting purposes and accordingly the financial statements incorporate the transactions of both the Board (incorporating the Future Fund) and the FFMA.

3.10.4 Although the Board is also responsible for investing the assets of the Nation-building Funds, the Medical Research Future Fund and DisabilityCare Australia Fund, these funds are reported in the Department of Finance's financial statements.

3.10.5 The FFMA does not receive any annual appropriation funding. Between May 2006 and June 2008, the Government made cash contributions to the Future Fund totalling \$51.3 billion. The FFMA also received Telstra shares to the value of \$9.2 billion. No further Government contributions have been made since this time. As a result, the operational functions of the FFMA are funded through payments from the administered Future Fund special account. In 2015–16, these payments are estimated to total \$49 million.

3.10.6 The ANAO's audit approach identifies key areas of risk that have the potential to impact on FFMA and the Board's financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and the ANAO's understanding of FFMA and the Board's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.10.7 In light of the key areas of risk and the ANAO's understanding of the operations of the FFMA and the Board, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statement items⁵⁷

3.10.8 Table 3.32 and Table 3.33 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

57 The figures in Table 3.32 and Table 3.33 have been sourced from the Finance Portfolio Budget Statements 2016–17.

Table 3.32: Key expenses and own-source income

Expenses and own-source income	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total expenses	49.8	418.5
Employee benefits	35.2	0.8
Suppliers	13.3	417.7
Depreciation and amortisation	1.3	-
Total own-source income	49.8	3 506.3
Interest	-	399.0
Dividends	-	2 698.5
Other	49.8 ^d	408.8
Net contribution of services	-	3 087.8

Note d: As noted in paragraph 3.10.5, this represents an amount transferred from the Future Fund administered special account to offset the operational expenses incurred by the FFMA in managing the Future Fund.

Table 3.33: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	24.8	121 565.5
Investments	-	119 625.1
Other	24.8	1 940.4
Total liabilities	24.8	1 332.0
Employee provisions	18.3	-
Other	6.5	1 332.0
Net assets	-	120 233.5

FFMA's estimated average staffing level for 2015–16 is 122.

Key areas of financial statements risk

3.10.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.34.

Table 3.34: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Investments	Investment strategy, management and valuation	Higher	<ul style="list-style-type: none"> the inherent subjectivity of valuations and liquidity requirements for certain assets.
Investments	Effectiveness of governance processes, including monitoring external service providers and the custodian	Moderate	<ul style="list-style-type: none"> reliant on information from the custodian (including asset valuation, rights, obligations and existence of assets); and potential for financial loss where custodian or sub-custodian fails to meet their obligations in accordance with the agreed terms.

3.10.10 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of the financial statements of the FFMA and the Board.

Audit results

3.10.11 The audit coverage completed to date has included an assessment of the compliance functions and key controls relating to management of investments and liquidity requirements, including monitoring of its services providers.

3.10.12 The valuation of investments, including the assessment of controls that reside within the outsourced custodian, will be completed as part of the final audit.

3.10.13 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.10.14 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the FFMA and the Board will be able to 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 2015–16 final audit.

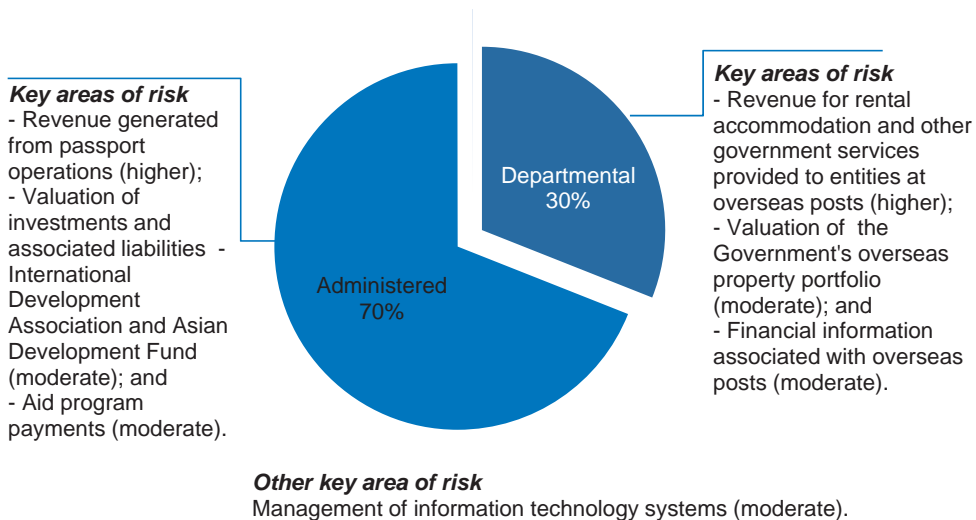
3.11 Department of Foreign Affairs and Trade

Overview

3.11.1 The Department of Foreign Affairs and Trade (DFAT) is responsible for providing foreign, trade and development policy advice and for leading the Australian Government's international efforts to shape the regional and international environment.

3.11.2 Annual appropriation funding of \$1 626.3 million (departmental) and \$3 761 million (administered) was provided to DFAT in 2015–16 to support the achievement of the department's outcomes.⁵⁸ Figure 3.10 below, shows departmental and administered funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.10: Appropriation funding and key areas of financial statements risk



3.11.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on DFAT's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of DFAT's environment and governance arrangements, including its financial reporting regime and system of internal control. The results of recent performance audits relevant to the financial management or administration of DFAT's operations are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

3.11.4 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the overall risk of a material misstatement as **moderate**.

⁵⁸ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16*. DFAT also receive special appropriation funding to make refunds of passport fees in certain circumstances. The *Agency Resourcing Budget Paper No. 4, 2016–17* estimates that this will be \$1.0 million in 2015–16.

Key financial statements items⁵⁹

3.11.5 Table 3.35 and Table 3.36 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.35: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	1 574.9	3 767.4
Employee benefits	758.0	3.0
Suppliers	657.1	1.7
Grants	5.0	482.6
International Development Association	-	3 112.2
Other	154.8	167.9
Total own-source income	108.0	519.7
Sale of goods and rendering of services	99.0	450.0
Other	9.0	69.7
Net cost of services	1 466.9	3 247.7

Table 3.36: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	4 287.7	2 534.9
Investments (International Development Association and Asian Development Fund)	-	1 936.1
Land and buildings	2 996.1	-
Other assets	1 291.6	598.8
Total liabilities	422.7	1 902.5
Suppliers	122.7	-
International Development Association and Asian Development Fund (grants)	-	301.1

⁵⁹ Figures in Table 3.35 and Table 3.36 have been sourced from the Foreign Affairs and Trade Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
International Development Association and Asian Development Fund (concessional)	-	1 028.9
Aid program payable	-	461.0
Employee provisions	214.6	80.8
Other provisions	85.4	30.7
Net assets	3 865.0	632.4

DFAT's estimated average staffing level for 2015–16 is 5 700.

Key areas of financial statements risk

3.11.6 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.37.

Table 3.37: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered sale of goods and rendering of services	Revenue generated from passport operations	Higher	<ul style="list-style-type: none"> a significant proportion of revenue is collected under contractual arrangements by a third party on behalf of the department; and a significant component of the passport inventory balance is held and managed by a third party on behalf of the department.
Departmental sale of goods and rendering of services	Revenue for rental accommodation and other services provided to other government entities at overseas posts	Higher	<ul style="list-style-type: none"> multiple sources of revenue; and revenue is assessed based on attached agencies staffing profiles at post, agreed floor space and other factors.
Departmental land and buildings	Valuation of the Government's overseas property portfolio	Moderate	<ul style="list-style-type: none"> subject to estimation and judgement; and the management of overseas property is undertaken by a third party through contract arrangements.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered assets – Investments (International Development Association and Asian Development Fund) Administered liabilities – International Development Association and Asian Development Fund (concessional)	Valuation of investments and associated liabilities – International Development Association and Asian Development Fund	Moderate	<ul style="list-style-type: none"> • subject to estimation and judgement; and • complex measurement, classification and disclosure requirements.
Administered Expenses – International Development Association Administered liabilities – International Development Association and Asian Development Fund (grants)	Administered aid program payments	Moderate	<ul style="list-style-type: none"> • there is a significant geographical spread of aid program recipients and a diverse range of aid program payments.
Departmental suppliers expense and liabilities Departmental employee benefits expenses	Financial information associated with overseas posts	Moderate	<ul style="list-style-type: none"> • financial information is collected through decentralised operations; and • locally engaged staff payments are subject to various employee conditions and benefits based on local laws and regulations.
Multiple items	Management of Information Technology systems	Moderate	<ul style="list-style-type: none"> • the financial statements information is derived from a number of unique and distinct IT systems.

Audit results

3.11.7 The ANAO's interim audit has been completed. Our coverage has included key areas relating to departmental revenue for rental accommodation and services provided to other entities at overseas posts; administered passport revenue; and the operations of overseas posts.

3.11.8 Interim audit coverage has also been completed over the department's processes relating to cash and asset management, employee and supplier expenditure, IT general controls and application controls in the FMIS and HRMIS.

3.11.9 As part of the 2015–16 final audit, audit procedures will be undertaken over the remaining key areas relating to financial statement balances subject to valuation, and grants.

3.11.10 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. No significant or moderate audit findings were unresolved at the completion of the 2014–15 audit.

Conclusion

3.11.11 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the department will be able to 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 2015–16 final audit.

3.12 Department of Health

Overview

3.12.1 The Department of Health (Health) is responsible for achieving the Australian Government's health priorities through evidence-based policy, program administration, research, regulatory activities and partnerships with other government entities, consumers and stakeholders.

3.12.2 Health operates in a complex environment and has a broad range of stakeholders, including Australian citizens, State and Territory governments, the Department of Human Services, private sector health providers and professionals, and pharmaceutical companies.

3.12.3 As a result of the Machinery of Government changes of September 2015, responsibilities for Aged Care and Medicare Provider Compliance were transferred to Health from the Department of Social Services, and the Department of Human Services respectively.

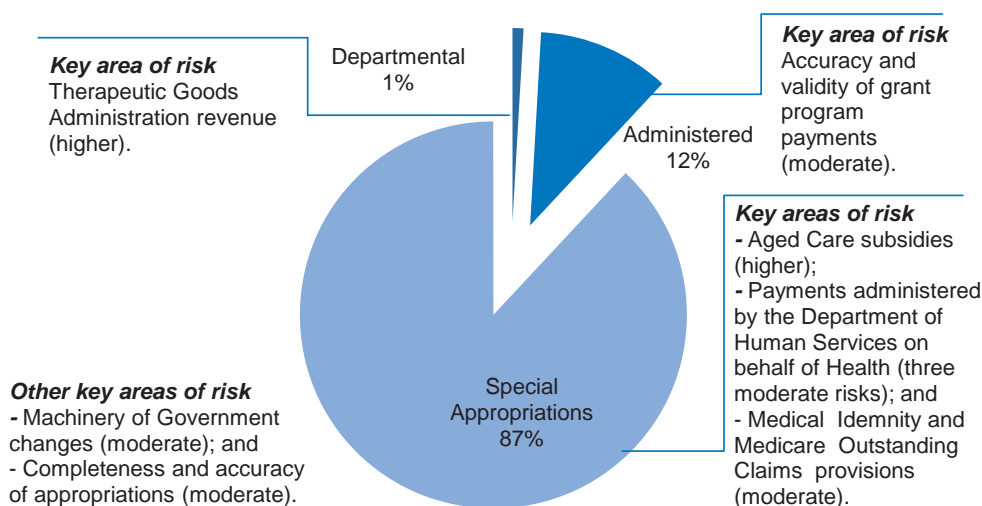
3.12.4 Annual appropriation funding of \$489.6 million (departmental) and \$6.3 billion (administered) was provided to Health in 2015–16 to support the achievement of the department's outcomes.⁶⁰ Health was also budgeted to receive special appropriation funding of \$47.5 billion largely associated with administering Medicare and pharmaceutical benefits, private health insurance rebates and aged care subsidies.⁶¹

3.12.5 Figure 3.11 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

60 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

61 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

Figure 3.11: Appropriation funding and key areas of financial statements risk



3.12.6 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Health's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of Health's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.12.7 In light of the key areas of risk and the ANAO's understanding of the operations of Health, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁶²

3.12.8 Table 3.38 and Table 3.39 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.38: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	784.7	54 921.5
Personal benefits	-	38 582.7
Subsidies	-	9 189.1
Grants	-	6 164.0
Suppliers	238.0	506.5

62 Figures in Table 3.38 and Table 3.39 have been sourced from the Health Portfolio Budget Statements 2016–17.

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Other	546.7	479.2
Total own-source income	173.6	1 694.9
Sale of goods and rendering of services	171.2	-
Other	2.4	1 694.9
Net cost of services	611.1	53 226.6

Table 3.39: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	422.1	2 063.3
Receivables	139.7	1 039.7
Investments	-	512.2
Other	282.4	511.4
Total liabilities	297.6	2 892.7
Personal benefits payables and provisions	-	1 953.6
Subsidies payable and provisions	-	561.3
Grants payable	-	370.7
Other payables and provisions	297.6	7.1
Net assets/(liabilities)	124.5	(829.4)

Health's estimated average staffing level for 2015–16 is 4 000.

3.12.9 In addition, the results of recent performance audits relevant to the financial management or administration of Health's operations were considered in identifying key areas of financial statements risk. The following reports were tabled during 2015–16 and are relevant to the financial statements of Health:

- Audit Report No.12 2015–16 *Administration of the Child Dental Benefits Schedule*; and
- Audit Report No.35 2015–16 *Administration of the Radiation Oncology Health Program Grants Scheme*.

3.12.10 Both reports included observations relevant to the key areas of financial statements risk outlined in Table 3.40 below, specifically the administration of personal benefit payments by the Department of Human Services on behalf of Health (Report No.12) and the accuracy and validity of grant program payments (Report No.35).

Key areas of financial statements risk

3.12.11 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.40.

Table 3.40: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Departmental sale of goods and rendering of services revenue	Therapeutic Goods Administration revenue	Higher	<ul style="list-style-type: none"> cost recovery revenue and related unearned revenue from the Therapeutic Goods Administration involves significant estimation.
Administered subsidy expenses	Aged Care subsidies	Higher	<ul style="list-style-type: none"> payments to nursing home providers are based on self-assessments made by those providers.
Administered personal benefits expenses and payables	Payments administered by the Department of Human Services on behalf of Health:		<ul style="list-style-type: none"> payments are complex and high volume; and processed on Health's behalf by the Department of Human Services on ageing IT systems.
	Medicare	Moderate	
	Pharmaceutical Benefits Scheme	Moderate	
	Private Health Insurance Rebate	Moderate	
Administered personal benefits and subsidies provisions	Medical Indemnity and Medicare Outstanding Claims provisions	Moderate	<ul style="list-style-type: none"> subject to complex valuation methodologies.
Administered and Departmental assets and liabilities	Machinery of Government changes, including Aged Care and Medicare Provider Compliance functions transferred from the Department of Human Services and the Department of Social Services	Moderate	<ul style="list-style-type: none"> valuation methods may differ between Health and the Departments of Human Services and Social Services.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered grants expenses and payables	Accuracy and validity of grant program payments	Moderate	<ul style="list-style-type: none"> • a significant number of grant programs are administered with different eligibility criteria; and • grants may be susceptible to fraud and there are limited recovery options available if payments are made in error.
Appropriation note disclosures	Completeness and accuracy of appropriations	Moderate	<ul style="list-style-type: none"> • a large number of appropriations and special accounts are administered; and • specific accounting rules apply to appropriations and special accounts.

3.12.12 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Health's financial statements.

Audit results

3.12.13 The ANAO's interim audit coverage has been completed. Our coverage included an assessment of the department's controls over: IT security and change management in the FMIS and HRMIS; cash and asset management; accounts payable and receivable; payroll processing; and testing of grant payments. In addition, testing of aged care and health care payments processed by Human Services on behalf of the department was also undertaken.

3.12.14 Audit coverage of compliance processes for Aged Care subsidies and Medicare payments together with the assessment of the valuation methodologies used to estimate the medical indemnity program and Medicare outstanding claims liability provisions will be completed as part of the final audit.

3.12.15 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.12.16 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Health will be able to 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 2015–16 final audit.

3.13 Department of Immigration and Border Protection

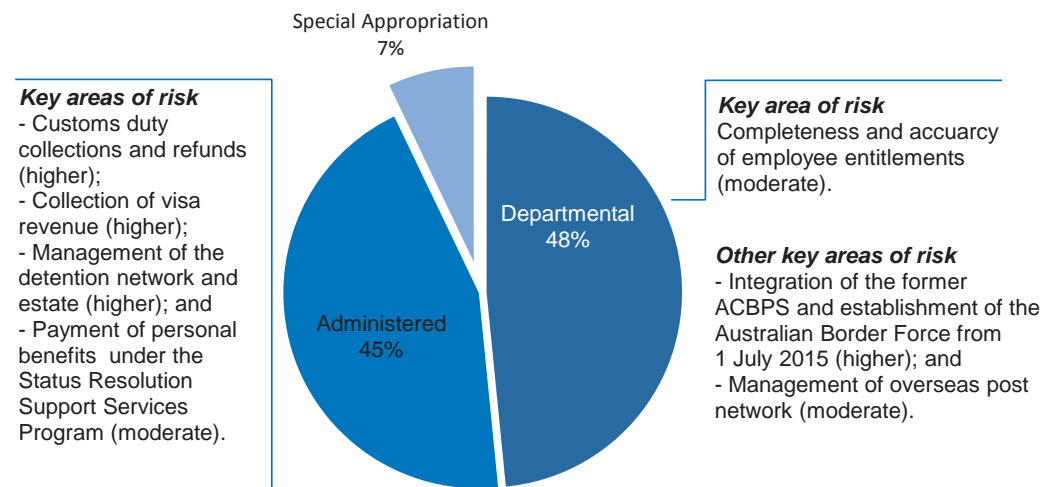
Overview

3.13.1 From 1 July 2015 the Department of Immigration and Border Protection and the Australian Customs and Border Protection Service (the ACBPS) were formally integrated into a single department, the Department of Immigration and Border Protection (Immigration).

3.13.2 Immigration is responsible for managing the stay and departure of non-citizens, implementing visa, citizenship and refugee and humanitarian assistance programs, facilitating international trade and collecting border revenue. The Australian Border Force is the operational arm of the department, and has statutory responsibility to enforce the customs and migration laws and the protection of Australia's border.

3.13.3 Annual appropriation funding of \$2 861.2 million (departmental) and \$2 628.5 million (administered) was provided to Immigration in 2015–16 to support the achievement of the department's outcomes.⁶³ Immigration was also budgeted to receive special appropriation funding of \$420 million.⁶⁴ Figure 3.12 shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.12: Appropriation funding and key areas of financial statements risk



⁶³ *Appropriation Act (No.1) 2015–16, Appropriation Act (No. 2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.*

⁶⁴ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.13.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Immigration's financial statements. The ANAO's risk assessment process considers the nature of the financial statements items and an understanding of Immigration's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.13.5 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁶⁵

3.13.6 Table 3.41 and Table 3.42 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.41: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	2 868.3	2 551.5
Employee benefits	1 455.7	-
Suppliers	1 183.2	2 129.3
Depreciation and amortisation	229.4	129.2
Personal benefits	-	259.8
Other	-	33.2
Total own-source income	165.0	16 152.9
Customs duty	-	12 909.5
Other taxes	-	3 175.7
Fees and fines	-	51.8
Other	165.0	15.9
Net (cost of)/contribution to services	(2 703.3)	13 601.4

⁶⁵ Figures in Table 3.41 and Table 3.42 have been sourced from the Immigration and Border Protection Portfolio Budget Statements 2016–17.

Table 3.42: Key assets and liabilities

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total assets	1 983.5	2 157.6
Land and buildings	220.7	1 661.1
Property, plant and equipment	660.0	165.1
Other	1 102.8	331.4
Total liabilities	747.6	375.8
Employee provisions	462.1	-
Other	285.5	375.8
Net assets	1 235.8	1 781.8

Immigration's estimated average staffing level for 2015–16 is 13 750.

3.13.7 The results of recent performance audits relevant to the financial management or administration of Immigration's operations are also considered in identifying key areas of financial statements risk.

3.13.8 Audit Report No.34 2015–16 *Administration of Tobacco Excise Equivalent Goods* was tabled on 5 May 2016. The report examined the effectiveness of the administration of tobacco excise and excise equivalent goods by Immigration and the Australian Taxation Office.

3.13.9 The recommendations in the report are consistent with findings raised by the ANAO during the current and previous financial statements audits of Immigration, and align to the key area of financial statements risk related to customs duty collections and refunds set out in Table 3.43 of the following section. Paragraphs 3.13.21 to 3.13.23 detail an unresolved moderate audit finding related to Immigration's customs duty compliance program which includes tobacco excise.

Key areas of financial statements risk

3.13.10 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.43.

Table 3.43: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
All items	The integration of the former ACBPS and establishment of the ABF from 1 July 2015	Higher	<ul style="list-style-type: none"> • data migration complexities associated with combining multiple systems into the department's key systems following the integration; • alignment of business and accounting processes; and • combining governance structures and requirements.
Administered customs duty	Duty collections and refunds	Higher	<ul style="list-style-type: none"> • the nature of a self-assessment regime; • complexity of the related IT infrastructure that supports the collection of revenue; and • a moderate audit finding relating to weaknesses in the governance and management oversight of the department's compliance program.
Administered other taxes	Collection of visa revenue	Higher	<ul style="list-style-type: none"> • decentralised collection of revenue including by both domestic and international offices, and by third parties under service level arrangements; and • complexity of the related IT infrastructure that supports the collection of revenue.
Administered land and buildings Administered property, plant and equipment Administered supplier expenses	Management of the detention network and estate	Higher	<ul style="list-style-type: none"> • complex project and contract management associated with third party providers for health services, detention centre management and construction of detention centre assets; and • judgements applied to estimate the value of the detention centre portfolio undertaken by external experts.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered personal benefits	Payment of personal benefits under the Status Resolution Support Services (SRSS) program	Moderate	<ul style="list-style-type: none"> • complex eligibility criteria for the categories of allowable personal benefits; • payments are managed through a memorandum of understanding with the Department of Human Services; and • a moderate audit finding relating to weaknesses in Immigration's management of the arrangements with the Department of Human Services.
Departmental employee benefits and provisions	Completeness and accuracy of employee entitlements	Moderate	<ul style="list-style-type: none"> • selected Immigration staff are entitled to a range of allowances, subject to a number conditions; and • staff are located both in Australia and overseas, including locally engaged staff who may be entitled to varying employment conditions and benefits based on local laws and regulations.
Multiple items	Management of overseas post network	Moderate	<ul style="list-style-type: none"> • decentralised nature of operations and controls; and • managed under third party arrangements through service level agreements with DFAT, and the Australian Trade and Investment Commission.

3.13.11 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Immigration's financial statements.

Audit results

3.13.12 The ANAO's interim audit coverage has been completed. Our coverage has included the audit focus areas relating to: the data migration of the department's FMIS with the former ACBPS; collection of visa revenue; management of the detention network and estate; specific elements of accounting for employee entitlements; and the reporting of overseas transactions.

3.13.13 Audit coverage relating to appropriation management, supplier expenditure, cash management, IT general controls, and application controls in the FMIS and HRMIS has also been completed.

3.13.14 As part of the 2015–16 final audit, audit procedures will be completed relating to the remaining key areas of financial statements risk including the integration of the department's HRMIS with the former ACBPS, customs duty collection and refunds, payment of personal benefits under the SRSS programme and the remaining elements of accounting for employee entitlements.

3.13.15 The following table summarises the status of audit findings reported by the ANAO in 2014–15 and 2015–16.

Table 3.44: Status of audit findings

Category	Closing position (at the end of the 2014–15 final audit)	Resolved findings (at the time of the 2015–16 interim audit)	New findings (during the 2015–16 interim audit)	Closing position (at the end of the 2015–16 interim audit)
A	0	0	0	0
B	3 ^e	1	1 ^f	3
Total	3	1	1	3

Note e: One moderate audit finding was transferred to Immigration from the ACBPS on integration from 1 July 2015.

Note f: One minor audit finding has been raised to moderate as a result of issues identified during the 2015–16 interim audit.

Resolved audit finding

Appropriation revenue adjustments associated with the funding model agreement

3.13.16 During the 2013–14 final audit, the ANAO identified weaknesses in the documentation supporting adjustments to appropriation funding revenue reported in the financial statements. The adjustments are made under the department's funding agreement with the Department of Finance. This was reported to Immigration as a minor audit finding. During 2014–15, the ANAO identified a number of issues associated with Immigration's management of appropriation revenue. As a result, this finding was reclassified to a moderate audit finding.

3.13.17 During 2015–16, Immigration has implemented processes to address the weaknesses identified, including the development of an appropriation tracking model. The ANAO has reviewed Immigration's appropriation management processes and the appropriation tracking model as part of the interim audit. As a result of remediation action taken by Immigration, this finding has been resolved. The ANAO will continue to monitor Immigration's management of appropriations as part of the 2015–16 financial statements audit.

Unresolved audit findings

Personal benefit payments

3.13.18 During 2014–15 Immigration engaged Human Services to make personal benefit payments to eligible recipients under the SRSS program. The payments totalled \$232 million in 2014–15. The ANAO identified that Immigration had not established a compliance program to confirm that only valid and accurate payments were made.

3.13.19 The ANAO also identified, that for a significant portion of the 2014–15 financial year, Immigration had not received detailed performance and financial reporting from Human Services to support the personal benefit payments made.

3.13.20 At the time of the 2015–16 interim audit, Immigration had undertaken a review of personal benefit payments made to eligible recipients under the SRSS program, to obtain data to support the on-going business monitoring and process improvements required to remediate this audit finding. Immigration had also engaged an external consultant to perform an independent

review of the SRSS program, including the development of a compliance framework. The ANAO will assess progress on the resolution of this matter during the 2015–16 final audit.

Customs duty compliance program

3.13.21 During the 2014–15 audit, the ANAO reviewed the former ACBPS' customs duty compliance program and identified weaknesses in the governance and management oversight arrangements. In particular, the ANAO identified a lack of regular oversight and monitoring; inconsistent policies and procedures related to planning, managing and executing compliance activities; no end-to-end risk assessment process, register or plan for compliance activities during 2014-15; and no documented rationale for the sample size and selection methodology that is consistent with the level of assurance that the ACBPS aimed to achieve from the compliance program.

3.13.22 At the time of the 2015–16 interim audit Immigration had commenced remediation action to address the weaknesses identified. This has included:

- establishing the Customs Compliance Branch within the Border Management Division, responsible for the customs compliance workforce and activities;
- developing a compliance risk management framework and risk register in line with the new Customs Compliance Branch structure;
- developing a coordinated approach to compliance reporting to relevant stakeholders; and
- establishing a Compliance Practice Management Review Framework and Section within the Border Management Division responsible for continuous improvement in compliance activities.

3.13.23 As part of the 2015–16 financial year Immigration has advised it will continue to develop the revised policies and procedures in relation to the customs duty compliance program. Additional remediation action in relation to documenting a rationale for the sample size and selection methodology used within the compliance program is scheduled for late 2015–16. The ANAO will continue to review remediation action implemented by Immigration as part of the 2015–16 final audit.

New audit findings

Human resource management

3.13.24 During the 2013–14 final audit, the ANAO raised a moderate audit finding in relation to the employee cessation process. During 2014–15, Immigration implemented processes to address the weaknesses identified. The ANAO reclassified the audit finding to a minor finding based on the remediation action taken.

3.13.25 During the 2015–16 interim audit, the ANAO has identified a reoccurrence of weaknesses in relation to the employee cessation process. The ANAO has also identified weaknesses in relation to the payment of allowances to eligible employees and the commencements process. The weaknesses identified during 2015–16 include inadequate controls relating to:

- procedures associated with ceasing an employee. In addition, the ANAO identified a number of instances where documentation on the employee file had not been retained or completed;
- the management of the payment of allowances to eligible employees, including where eligibility for an allowance changed or ceased; and
- the timely recognition of leave entitlements when an employee transferred to the department from another government entity.

3.13.26 As a result of the weaknesses identified, the ANAO has reclassified this finding to a moderate audit finding.

3.13.27 Immigration has advised that it is implementing processes to address these weaknesses. The ANAO will review the progress against this issue during the 2015–16 final audit.

Conclusion

3.13.28 Based on our audit coverage to date, the ANAO has identified a number of areas where improvements are required. The audit findings outlined above reduce the level of confidence that can be placed on the identified key internal controls that support the preparation of the financial statements. During the 2015–16 final audit the ANAO will undertake further procedures and assess action taken by Immigration to address the weaknesses identified.

3.14 Department of Industry, Innovation and Science

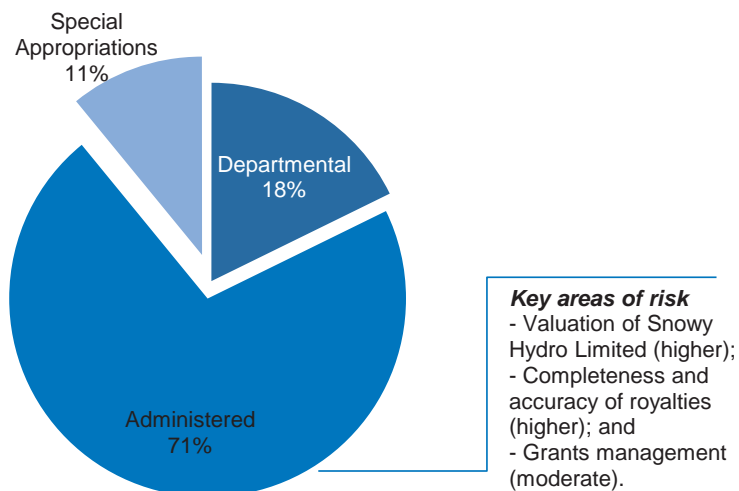
Overview

3.14.1 The Department of Industry, Innovation and Science (Industry) is responsible for supporting science and commercialisation; growing business investment and improving business capability; and streamlining regulation.

3.14.2 The department delivers programs covering a broad spectrum of individual and business grants, subsidies, services and education to businesses, individuals and the broader Australian community. Industry is also responsible for the administration and collection of fees and royalties associated with key offshore and onshore resources, such as petroleum and uranium.

3.14.3 Annual appropriation funding of \$463.5 million (departmental) and \$1 862.4 million (administered) was provided to Industry in 2015–16 to support the achievement of its outcomes.⁶⁶ Industry was also budgeted to receive special appropriation funding of \$285.4 million.⁶⁷ Figure 3.13 below shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.13: Appropriation funding and key areas of financial statements risk



3.14.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact the financial statements. The ANAO's risk identification process considers the nature of the

⁶⁶ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.*

⁶⁷ *Part 1: Special Appropriations Table, Agency Resourcing, Budget Paper No.4, 2016–17.*

financial statement items and an understanding of Industry's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.14.5 In light of these characteristics and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁶⁸

3.14.6 Table 3.45 and Table 3.46 provide a summary the key 2015–16 departmental and administered estimated financial statements items.

Table 3.45: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual 2015–16 (\$m)	Administered estimated actual 2015–16 (\$m)
Total expenses	516.6	1 868.1
Employee benefits	312.5	6.7
Suppliers	160.9	116.0
Grant expenses	-	568.3
Other	43.2	1 177.1 ^g
Total own-source income	73.6	1 148.1
Royalties revenue	-	1 048.6
Other	73.6	99.5
Net cost of services	443.0	720.0

Note g: This amount includes \$947 million of payments made to Corporate Commonwealth entities in the Industry, Innovation and Science portfolio which are determined by legislation.

⁶⁸ Figures in Table 3.45 and Table 3.46 have been sourced from the Industry, Innovation and Science Portfolio Budget Statements 2016–17.

Table 3.46: Key assets and liabilities

Assets and liabilities	Departmental estimated actual	Administered estimated actual
	2015–16 (\$m)	2015–16 (\$m)
Total assets	438.0	4 284.5
Investments	-	3 962.0
Other	438.0	322.5
Total liabilities	189.0	122.6
Employee provisions	82.7	1.1
Grants payable	-	60.8
Other	106.3	60.7
Net assets	249.0	4 161.9

Industry's estimated average staffing level for 2015–16 is 2 580.

3.14.7 In addition, the results of recent performance audits relevant to the financial management or administration of Industry's operations were considered in identifying key areas of financial statements risk. Audit Report No.25 2015–16 *Delivery and Evaluation of Grant Programmes* was a cross-entity audit tabled during 2015–16. The report focused on the selected entities' management of projects awarded grant funding under a particular grant program. While the report did not make specific recommendations regarding Industry's financial management of the grant program, grants management remains a key area of financial statements risk and the factors contributing to this assessment are set out in Table 3.47.

Key areas of financial statements risk

3.14.8 The ANAO undertakes appropriate audit procedures on all material items and focuses audit effort on those areas that are assessed as having a higher risk of material misstatement. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.47.

Table 3.47: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered investments	Valuation of Snowy Hydro Limited	Higher	<ul style="list-style-type: none"> subject to complex estimation and significant judgement relating to forecasts of future performance; and a unique asset that is not readily traded in an open market increasing the risk of determining an accurate value.

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered royalties revenue	Completeness and accuracy of royalties	Higher	<ul style="list-style-type: none"> reliant on external third party information increasing the risk of recording incomplete or inaccurate revenue; and timing of receipts necessitates recording estimates of revenue prior to receipt, increasing the risk of misstatements.
Administered grants expense and payables	Grants management	Moderate	<ul style="list-style-type: none"> a significant number of individual grant programs which operate under separate grant agreements with different eligibility criteria; and grant funding can be susceptible to fraud.

3.14.9 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of the financial statements.

Audit results

3.14.10 The ANAO interim audit has been completed. Audit coverage has included the areas relating to the valuation of the Australian Government's investment in Snowy Hydro Limited and the administration of grants.

3.14.11 Audit coverage of the department's controls relating to employee and supplier expenditure, asset and cash management, and IT general controls, and application controls in the FMIS and HRMIS has also been completed.

3.14.12 As part of the 2015–16 final audit, audit procedures over all key areas will be completed, including the valuation of Snowy Hydro Limited, grants administration and revenue generated by offshore petroleum and uranium royalties.

3.14.13 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. No unresolved significant or moderate audit findings were carried forward from 2014–15.

Conclusion

3.14.14 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that Industry will be able to prepare financial statements that are free of material misstatement. The effective operation of these controls for the full financial year will be assessed during the 2015–16 final audit.

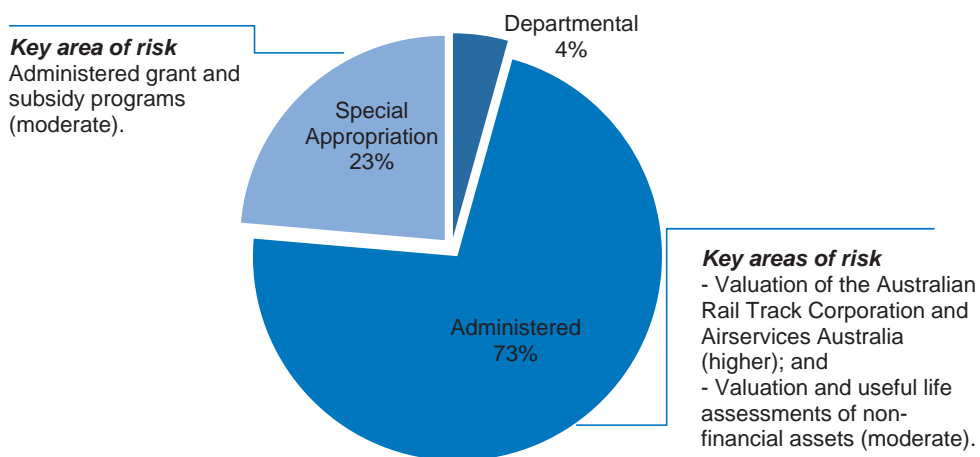
3.15 Department of Infrastructure and Regional Development

Overview

3.15.1 The Department of Infrastructure and Regional Development (Infrastructure) is responsible for: improving infrastructure across Australia, through funding coordination of transport and other infrastructure; providing an efficient, sustainable, competitive, safe and secure transport system for all transport users; strengthening the sustainability, capacity and diversity of regional economies; and supporting governance arrangements in the Australian territories.

3.15.2 Annual appropriation funding of \$266.7 million (departmental) and \$4 549.5 million (administered) was provided to Infrastructure in 2015–16 to support the achievement of the department's outcomes.⁶⁹ Infrastructure was also budgeted to receive special appropriation funding of \$1 454.1 million largely associated with local government financial assistance grants.⁷⁰ Figure 3.14 below, shows departmental, administered and special appropriation funding as a percentage of total funding, and the key areas of financial statements risk.

Figure 3.14: Appropriation funding and key areas of financial statements risk



3.15.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Infrastructure's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of Infrastructure's environment and governance arrangements, including its financial reporting regime and system of internal control.

⁶⁹ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16,*

⁷⁰ *Part 1: Special Appropriations Table, Agency Resourcing, Budget Paper No.4, 2016–17.*

3.15.4 In light of the key areas of risk and the ANAO's understanding of the operations of Infrastructure, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁷¹

3.15.5 Table 3.48 and Table 3.49 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.48: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	280.5	3 358.7
Employee benefits	143.2	17.7
Subsidies	-	224.2
Grants	-	2 823.2
Other	137.3	293.6
Total own-source income	6.2	459.0
Other taxes	-	37.9
Fees and fines	-	208.0
Dividends	-	94.3
Other	6.2	118.8
Net cost of services	274.3	2 899.7

Table 3.49: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	151.2	6 285.0
Trade and other receivables	117.7	1 073.8
Investments	-	4 576.9
Land and buildings	6.8	229.3
Property, plant and equipment	7.1	310.3
Heritage and cultural assets	-	78.0

⁷¹ Figures in Table 3.48 and Table 3.49 have been sourced from the Infrastructure and Regional Development Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Other	19.6	16.7
Total liabilities	79.8	40.9
Suppliers and other payables	23.6	9.1
Grants & Subsidies	-	25.7
Other	56.2	6.1
Net assets	71.4	6 244.1

Infrastructure's estimated average staffing level for 2015–16 is 1 135.

3.15.6 In addition, the results of recent performance audits relevant to the financial management or administration of Infrastructure's operations were considered in identifying key areas of financial statements risk. The following reports were tabled during 2015–16 and are relevant to the financial statements of Infrastructure:

- Audit Report No.17 2015–16 *Design and Implementation of the First Funding Round of the Bridges Renewal Programme*; and
- Audit Report No.25 2015–16 *Delivery and Evaluation of Grant Programmes* (a cross-entity audit).

3.15.7 While these reports did not make recommendations regarding Infrastructure's financial management of the programs subject to audit, grants management remains a key area of financial statements risk and the factors contributing to this assessment are set out in Table 3.50.

Key areas of financial statements risk

3.15.8 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.50.

Table 3.50: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered investments	Valuation of the Australian Rail Track Corporation and Airservices Australia	Higher	<ul style="list-style-type: none"> valuations are subject to complex estimation and require significant judgement in the selection of certain assumptions and inputs.
Administered grants and subsidy expense	Management of grant and subsidy payments	Moderate	<ul style="list-style-type: none"> complex and diverse range of programs that include a number of different arrangements; and reliance on the Department of Human Services to provide accurate and timely information for subsidy payments from complex and ageing IT systems.
Administered land and buildings Administered property, plant and equipment and Administered heritage and cultural assets	Valuation and useful life assessments of administered non-financial assets	Moderate	<ul style="list-style-type: none"> complex judgements and assumptions are applied in assessing the value and useful lives of the assets.

3.15.9 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Infrastructure's financial statements.

Audit results

3.15.10 The ANAO's interim audit coverage has been completed. Audit coverage has included assessing key controls relating to the accounting for grant and subsidy payments, cash, appropriations and special accounts, supplier expenditure and administered revenue and receivables.

3.15.11 In addition, the ANAO's interim audit coverage included key IT general controls and application controls of the FMIS and HRMIS. Audit coverage of the valuations of administered assets and investments will be completed as part of the 2015–16 final audit.

3.15.12 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.15.13 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 will be able to 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 2015–16 final audit.

3.16 Department of the Prime Minister and Cabinet

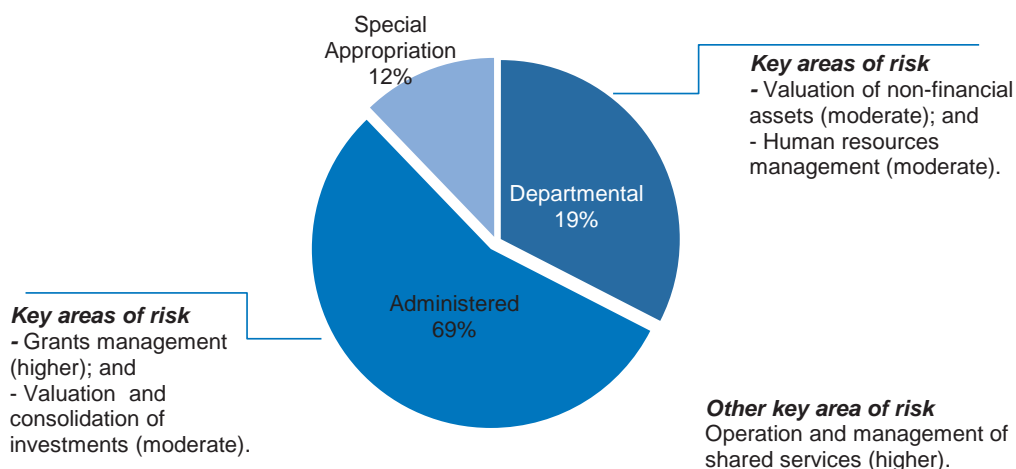
Overview

3.16.1 The Department of the Prime Minister and Cabinet (PM&C) is responsible for coordinating policy development across government in economic, domestic and international affairs, Aboriginal and Torres Strait Islander advancement and public service stewardship.

3.16.2 Annual appropriation funding of \$389.3 million (departmental) and \$1 395.5 million (administered) was provided to PM&C in 2015–16 to support the achievement of the department's outcomes.⁷² The department was also budgeted to receive special appropriation funding of \$247.5 million in relation to royalty payments for the Aboriginals Benefit Account and higher education Indigenous grants.⁷³

3.16.3 Figure 3.15 below shows departmental, administered and special appropriations funding as a percentage of total funding, and the key areas of financial statements risk.

Figure 3.15: Appropriation funding and key areas of financial statements risk



3.16.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on PM&C's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of the department's environment and governance arrangements, including its financial reporting regime and system of internal control. The results of any recent performance audits relevant to the financial management or administration of PM&C's operations are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

⁷² *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16 and Appropriation Act (No.4) 2015–16.*

⁷³ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.16.5 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁷⁴

3.16.6 Table 3.51 and Table 3.52 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.51: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	412.7	1 659.4
Employee benefits	256.4	-
Suppliers	140.9	87.6
Depreciation and amortisation	15.0	-
Grants	-	1 307.6
Other	0.4	264.2
Total own-source income	13.5	74.7
Other	13.5	74.7
Net cost of services	399.2	1 584.7

Table 3.52: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	247.6	4 444.9
Administered investments	-	4 354.0
Financial assets	116.9	82.2
Non-financial assets	130.7	8.7
Total liabilities	115.5	50.8
Employee provisions	74.5	-
Other	41.0	50.8
Net assets	132.1	4 394.1

PM&C's estimated average staffing level for 2015–16 is 2 064.

⁷⁴ Figures in Table 3.51 and Table 3.52 have been sourced from the Prime Minister and Cabinet Portfolio Budget Statements 2016–17.

Key areas of financial statements risk

3.16.7 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.53.

Table 3.53: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Risk assessment
Administered grants expenses	Grants management	Higher	<ul style="list-style-type: none"> the magnitude and diversity of grant programs that are subject to an eligibility and assessment process which is decentralised; and moderate audit findings reported in 2014–15 relating to weaknesses in grants acquittal management and the Community Development Program compliance framework.
All items	Operation and management of shared services	Higher	<ul style="list-style-type: none"> interactions with a service provider can create complexities in the authorisation, recognition and allocation of transactions and balances; changes to shared services arrangements or their implementation may have implications on the IT general control environment and key governance arrangements; and Whole-of-Government financial reporting implications for certain inter-agency shared service arrangements.
Departmental non-financial assets	Valuation of departmental non-financial assets	Moderate	<ul style="list-style-type: none"> subject to judgement and estimation; and the existence and ownership of assets, particularly those in remote locations.
Departmental employee provisions	Human resources management	Moderate	<ul style="list-style-type: none"> the complexity of assumptions and calculations underlying the actuarial assessment of employee provisions.

Relevant financial statement line item	Key area	Audit risk rating	Risk assessment
Administered financial assets	Valuation and consolidation of investments	Moderate	<ul style="list-style-type: none"> underlying assumptions, calculations and valuation techniques may not be reasonable and/or valid; and inaccurate or incomplete consolidation of the Aboriginals Benefit Account and the Aboriginal and Torres Strait Islander Land Account investment balances into the administered financial statements.

3.16.8 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of the department's financial statements.

Audit results

3.16.9 The ANAO has completed its interim audit coverage to assess the effectiveness of internal control in the areas identified as significant to the financial statements. The interim audit included coverage of selected administered grant programs, and IT general and application controls for key systems, including those provided through shared service arrangements with other entities.

3.16.10 Audit coverage of the following areas will be completed as part of the 2015–16 final audit:

- the department's transition into the new Indigenous Advancement Strategy program model, including progress with the implementation of internal control and governance processes;
- the department's management and oversight of shared services arrangements; and
- the valuation of non-financial assets and administered investments.

3.16.11 The following table summarises the status of audit findings reported by the ANAO in 2014–15 and 2015–16.

Table 3.54: Status of audit findings raised by the ANAO

Category	Closing position (at the end of the 2014–15 final audit)	Resolved findings (at the time of the 2015–16 interim audit)	New findings (during the 2015–16 interim audit)	Closing position (at the end of the 2015–16 interim audit)
A	0	0	0	0
B	2	1	0	1
Total	2	1	0	1

Unresolved audit finding

The Community Development Programme compliance processes

3.16.12 The Community Development Programme (CDP – formally the Remote Jobs and Communities Programme) provides jobs, participation and community-development services in 60 remote regions across Australia. The delivery of CDP services is provided through contracted service providers over a five year period, 2013 to 2018, at an estimated total cost of \$1.1 billion.

3.16.13 At the conclusion of the 2014–15 audit, PM&C continued to experience delays in the implementation of a consolidated program compliance framework, including formalising management reporting and oversight responsibilities. The delay in the implementation of a compliance framework increased risks associated with providing financial accountability over program expenditure and assurance for the program’s management.

3.16.14 In response, PM&C has developed a CDP Performance Management Framework that includes a stronger focus on review and monitoring of providers performance and expenditure. The new framework was endorsed by the PM&C executive in 2015. Progress in implementing this framework will be assessed as part of the 2015–16 final audit.

Resolved audit finding

Grant acquittal management processes

3.16.15 During the 2014–15 audit the ANAO identified weaknesses in internal acquittal practices across a significant backlog of un-acquitted grants expenditure.

3.16.16 PM&C subsequently commenced a remediation program to progress and finalise outstanding grant acquittals. This included strengthening of internal policies and procedures. At the conclusion of the 2015–16 interim audit the remediation work was substantially completed, and as a result, this issue was considered resolved.

Conclusion

3.16.17 Based on our audit coverage to date, and except for the finding relating to the Community Development Programme referred to above, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that PM&C will be able to 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 2015–16 final audit.

3.17 Department of Social Services

Overview

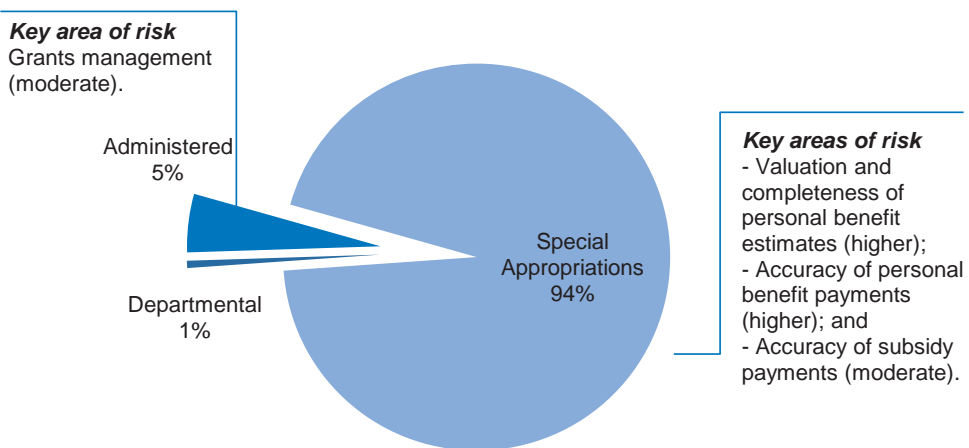
3.17.1 The Department of Social Services (Social Services) has four core areas of responsibility—social security, families and communities, disability and carers, and housing. Social Services works in partnership with other government and non-government organisations, particularly with the Department of Human Services, to develop, manage and deliver a range of policies, programs and services focused on improving the wellbeing of people and families in Australia.

3.17.2 Following the Machinery of Government changes of September 2015, responsibility for child care related programs was transferred to the Department of Education and Training, and responsibility for the aged care program was transferred to the Department of Health.

3.17.3 Annual appropriation funding of \$725.6 million (departmental) and \$5 834.6 million (administered) was provided to Social Services in 2015–16 to support the achievement of the department’s outcomes.⁷⁵ Social Services was also budgeted to receive special appropriation funding of \$113 387.1 million largely associated with administration and delivery of social security and family assistance programs.⁷⁶

3.17.4 Figure 3.16 shows departmental, administered and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.16: Appropriation funding and key areas of financial statements risk



⁷⁵ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016.*

⁷⁶ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.17.5 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Social Services' financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of the department's environment and governance arrangements, including its financial reporting regime and system of internal control.

3.17.6 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁷⁷

3.17.7 Table 3.55 and Table 3.56 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.55: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	618.6	120 289.8
Employee benefits	331.2	-
Suppliers	224.1	1 051.1
Personal benefits	-	113 360.3
Grants	-	2 579.9
Subsidies	-	3 034.0
Other	63.3	264.5
Total own-source income	87.0	41.9
Net cost of services	531.6	120 247.9

Table 3.56: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	342.2	4 199.4
Property, plant and equipment	25.1	-
Intangibles	138.8	-
Receivables	135.6	3 748.3
Other	42.7	451.1

⁷⁷ Figures in Table 3.55 and Table 3.56 have been sourced from the Social Services Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total liabilities	154.1	7 750.0
Employee provisions	95.6	-
Personal benefits provision	-	5 232.6
Other	58.5	2 517.4
Net assets/(liabilities)	188.1	(3 550.6)

Social Services' estimated average staffing level for 2015–16 is 2 379.

3.17.8 The results of recent performance audits relevant to the financial management or administration of Social Services' operations were also considered in identifying key areas of risk. The following reports were tabled during 2015–16 and are relevant to Social Services:

- Audit Report No.18 2015–16 *Qualifying for the Disability Support Pension* (a cross-entity audit); and
- Audit Report No.25 2015–16 *Delivery and Evaluation of Grant Programmes* (a cross-entity audit).

3.17.9 While the reports did not include recommendations regarding Social Services' involvement in the financial administration of these programs, personal benefits payments and grants management remain key areas of financial statements risk and the factors contributing to this assessment are set out in Table 3.57.

Key areas of financial statements risk

3.17.10 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.57.

Table 3.57: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered personal benefit provisions Administered personal benefit receivables	Valuation and completeness of personal benefit estimates	Higher	<ul style="list-style-type: none"> • accuracy and completeness of source data used by the Australian Government Actuary as it is critical in developing the estimation models; and • the significant judgements and assumptions used in the estimation models are dependent on a number of factors including but not limited to the new budget measures affecting the benefit programs, timing of payments, personal circumstances of recipients and the economic environment.
Administered personal benefit expenses	Accuracy of personal benefits payments	Higher	<ul style="list-style-type: none"> • dependence on the correct disclosure of personal circumstances by a large number of recipients across diverse social economic groups; and • the complexity and high volume of various personal benefit payment programs processed by the Department of Human Services on ageing IT systems.
Administered subsidy expenses	Accuracy of subsidy payments	Moderate	<ul style="list-style-type: none"> • payments are made based on the information provided by a large number of aged care providers; and • reliance on complex and ageing IT systems administered by the Department of Human Services and the Department of Health to support subsidy payments.
Administered grants expenses	Grants management	Moderate	<ul style="list-style-type: none"> • the large number and value of grants programs with different legislative and policy requirements; • reliance on different systems in obtaining complete and accurate data for financial reporting purposes; and • information technology challenges for expanding the existing grant management infrastructure to use as a shared service operation for other entities.

3.17.11 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Social Services' financial statements.

Audit results

3.17.12 The ANAO has completed its interim audit coverage including: an assessment of the department's IT general controls over security and change management; and compliance activities and assurance processes relating to personal benefits, disability services and grants.

3.17.13 Audit coverage of the department's processes relating to cash, asset management, payroll processing, suppliers expenses, IT general controls, and application controls in the FMIS and HRMIS has also been completed.

3.17.14 As part of the 2015–16 final audit, our assessment of the valuation of personal benefit related asset and liability balances will be completed. The testing of application controls for the IT systems that process payments related to personal benefits, disability services and grants will also be finalised.

3.17.15 The following table summarises the status of audit findings reported by the ANAO in 2014–15 and 2015–16.

Table 3.58: Status of audit findings raised by the ANAO

Category	Closing position (at the end of the 2014–15 final audit)	Resolved findings (at the time of the 2015–16 interim audit)	New findings (during the 2015–16 interim audit)	Closing position (at the end of the 2015–16 interim audit)
A	1	1 ^h	0	0
B	1	1 ⁱ	0	0
Total	2	2	0	0

Note h: As a result of the Machinery of Government changes of September 2015, one category A finding, related to the child care compliance framework, was transferred from Social Services to the Department of Education and Training.

Note i: The finding relating to the Disability Employment Services Assurance and Compliance Framework has been reclassified as a minor finding.

Resolved audit finding

Disability Employment Services Assurance and Compliance Framework

3.17.16 The management of the Disability Employment Services program is governed by the *Disability Services Act 1986*. The program is delivered by Social Services in collaboration with approved providers. Social Services implemented an Assurance and Compliance Framework (Compliance Framework) to assist in validating the integrity of payments made under the Disability Employment Services program.

3.17.17 In 2014–15, the ANAO identified weaknesses in the governance and management oversight arrangements necessary to achieve the objective of a risk-based compliance program.

3.17.18 The 2015–16 interim audit identified that Social Services has implemented measures to improve the governance arrangements supporting the Disability Employment Services Compliance Framework. These measures included:

- regular reporting to governance committees;

- a review of the risk assessment process to ascertain whether risk profiles across service providers were consistent and appropriate;
- updating and documenting the sampling methodology used to select claims for review; and
- a pilot to establish baseline performance indicators for integrity of payments made to disability employment service providers.

3.17.19 As a result of these measures, the ANAO reclassified the finding to a minor finding.

3.17.20 Social Services continues to improve the governance arrangements supporting the Compliance Framework, and in some cases additional measures are being developed. In light of this, the ANAO will review Social Services' progress in this area as part of the 2015–16 final audit and the 2016–17 audit.

Conclusion

3.17.21 Based on our audit coverage to date the key internal controls that support the preparation of the financial statements were operating effectively to prepare financial statements that are free from material misstatement. The effective operation of these controls for the full financial year and the legislative issue referred to above, will be assessed in conjunction with additional audit testing during the 2015–16 final audit.

3.18 Department of Human Services

Overview

3.18.1 The Department of Human Services (Human Services) is responsible for delivering a range of payments and services to support individuals, families and communities, as well as providers and businesses. These include: income support payments and services; aged care payments; Medicare payments and services; and child support services.

3.18.2 The range of social and health related payments and services delivered by Human Services includes:

- Centrelink payments and services for retirees, the unemployed, families, carers, parents, students, people with disabilities, Indigenous Australians, farmers, people from diverse cultural and linguistic backgrounds, people living overseas, and provision of services at times of major change, including disaster recovery payments;
- services and programs that support the health of Australians such as Medicare, the Pharmaceutical Benefits Scheme, the Private Health Insurance Rebate, and the Australian Childhood Immunisation Register; and
- Aged Care payments to services funded under the *Aged Care Act 1997*, including residential care, home care, and flexible care services.

3.18.3 Human Services also delivers other services and payments, including veterans' entitlements and the Tasmanian Freight and Bass Strait passenger equalisation schemes.

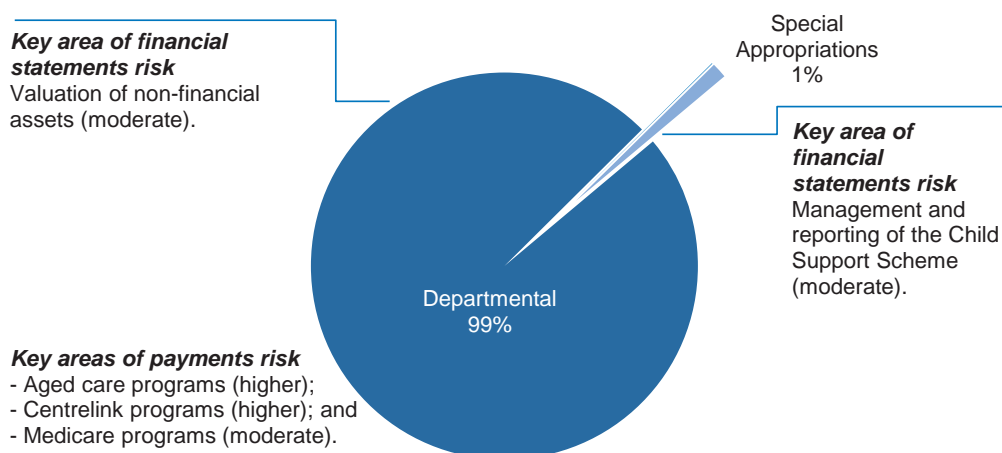
3.18.4 Annual departmental appropriation funding of \$4 531 million was provided to Human Services in 2015–16 to support the achievement of the department's outcomes.⁷⁸ Human Services' was also budgeted to receive special appropriation funding of \$58.4 million largely associated with administering the Child Support program.⁷⁹

3.18.5 Figure 3.17 shows departmental and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

78 Human Services also received \$2.3 million in funding via administered annual appropriations in 2015–16. *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16*. These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

79 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

Figure 3.17: Appropriation funding and key areas of financial statements risk



3.18.6 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Human Services' financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of Human Services' environment and governance arrangements, including its financial reporting regime and system of internal control.

3.18.7 In light of the key areas of risk and the ANAO's understanding of the operations of Human Services, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁸⁰

3.18.8 Table 3.59 and Table 3.60 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.59: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual 2015–16 (\$m)	Administered estimated actual 2015–16 (\$m)
Total expenses	4 602.2	1 549.3
Employee benefits	2 883.6	-
Suppliers	1 476.0	-
Child Support payments to custodial parents	-	1 429.9
Other	242.6	119.4

⁸⁰ Figures in Table 3.59 and Table 3.60 have been sourced from the Social Services Portfolio Budget Statements 2016–17.

Expenses and own-source income	Departmental estimated actual 2015–16 (\$m)	Administered estimated actual 2015–16 (\$m)
Total own-source income	147.7	1 582.4
Child Support revenue from non-custodial parents	-	1 523.0
Other	147.7	59.4
Net (cost of)/contribution to services	(4 454.5)	33.1

Table 3.60: Key assets and liabilities

Assets and liabilities	Departmental estimated actual 2015–16 (\$m)	Administered estimated actual 2015–16 (\$m)
Total assets	2 008.8	865.7
Land and buildings	314.0	-
Property, plant and equipment	168.6	-
Intangibles	437.4	-
Child Support receivables	-	806.1
Other	1 088.8	59.6
Total liabilities	1 332.1	847.4
Employee provisions	880.0	-
Suppliers	361.6	-
Child Support provisions	-	803.8
Other	90.5	43.6
Net assets	676.7	18.3

Human Services' estimated average staffing level for 2015–16 is 30 210.

3.18.9 The results of recent performance audits relevant to the financial management or administration of Human Services' operations are also considered in identifying key areas of risk. The following reports were tabled during 2015–16:

- Audit Report No.12 2015–16 *Administration of the Child Dental Benefits Schedule* (a cross-entity audit); and
- Audit Report No.18 2015–16 *Qualifying for the Disability Support Pension* (a cross-entity audit); and
- Audit Report No.35 2015–16 *Administration of the Radiation Oncology Health Program Grants Scheme* (a cross-entity audit).

3.18.10 While the three reports did not include recommendations regarding Human Services' involvement in the financial administration of these programs, Centrelink and Medicare programs

remain key areas of payments risk and the factors contributing to this assessment are set out in Table 3.62.

Key areas of financial statements risk

3.18.11 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas reported in Human Services' financial statements highlighted for specific audit coverage in 2015–16 are provided in Table 3.61.

Table 3.61: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered revenue, expenses, receivables and provisions	Management and reporting of the Child Support Scheme	Moderate	<ul style="list-style-type: none"> a large volume of child support financial transactions are processed under complex <i>Child Support Act 1988</i> legislation; and the assumptions applied in determining the value of child support receivables at year-end requires involvement of an actuary. This increases the importance of data integrity in the information provided to the actuary and the appropriateness of assumptions used in the assessment process. The data is maintained in spreadsheets and requires manual processing.
Departmental property, plant and equipment, buildings and intangibles	Valuation of non-financial assets	Moderate	<ul style="list-style-type: none"> property, plant and equipment is geographically dispersed; the valuation is subject to judgements and assumptions; and there are complexities in capturing the actual costs involved in the development of various internally-developed software and determining whether costs should be capitalised or expensed in compliance with the accounting standard.

3.18.12 As referred at paragraph 3.18.2 above, Human Services delivers payments on behalf of the Departments of Social Services, Health and a number of other Commonwealth entities. These payments are reported in the respective entities' financial statements and are budgeted to be approximately \$170 billion in 2015–16. The areas highlighted for specific audit coverage in relation to these payments for 2015–16 are provided in Table 3.62.

Table 3.62: Key areas of payments risk

Key area	Audit risk rating	Factors contributing to risk assessment
Aged care programs	Higher	<ul style="list-style-type: none"> aged care payments are processed by a large, complex, tailored and ageing IT system based on complex regulatory requirements; incomplete and/or accurate migration of data from the existing system to the new Aged Care Management and Payment System; data may not be accurately transmitted between the Aged Care Management and Payment System and the general ledger; and an increased risk of overpayments due to duplication of aged care recipients and service providers in the Aged Care Management and Payment System.
Centrelink programs	Higher	<ul style="list-style-type: none"> social welfare payments are calculated by a large, complex and ageing IT system which has been configured to meet legislative requirements; the recovery of overpayments operates under complex legislative provisions processed in a different system; social welfare payments are based on information obtained on a voluntary basis from the personal benefit recipients, and may be significantly impacted by external fraud such as provision of misleading information in order to obtain financial gain; and issues were identified in the Farm Household Allowance program, in which payments were made to recipients who did not meet the eligibility criteria. Payments under this program for parts of the 2014–15 financial year were not calculated on the rates determined by the legislation.
Medicare programs	Moderate	<ul style="list-style-type: none"> payments are made to a large number of health care services and providers based on complex eligibility criteria and different rates. This level of complexity in the context of scale of the program increases the risk of inaccurate payment; health care benefits are delivered and supported by multiple IT systems that are subject to different application processes and internal controls; and payments made under Medicare programs may be significantly impacted by external fraud such as provision of misleading information in order to obtain financial gain.

3.18.13 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of Human Services' financial statements.

Audit results

3.18.14 The ANAO's interim audit has been completed. Our coverage included an assessment of controls in relation to key areas of focus and key IT systems. The remaining areas of audit focus to be completed as part of the 2015–16 final audit include the valuation methodology to determine child support debts at year-end, and the valuation of Human Services' non-financial assets, particularly intangibles.

3.18.15 During the 2015–16 final audit, the ANAO will also assess the controls over social and health related payments made by Human Services on behalf of other Commonwealth entities, including the associated compliance and quality assurance activities.

3.18.16 To date, our audit coverage has not identified any new significant or moderate audit findings. A moderate audit finding reported in 2014–15 relating to Farm Household Allowance payments remains open.

Unresolved audit finding

Farm Household Allowance payments

3.18.17 The Farm Household Allowance (FHA) is an income support payment, with complex legislative conditions, available to farmers and their partners facing financial hardship. Payments of FHA are made by Human Services on behalf of the Department of Agriculture and Water Resources. The *Farm Household Support Act 2014* (the Act) outlines the criteria to become eligible for the allowance to be paid. During 2014–15 the FHA personal benefit payments were processed through a new Social Services Plan payment system.

3.18.18 In 2014–15 the ANAO identified that some payments were being made to recipients that failed eligibility assessment criteria such as the Australian residency test criteria or being a farmer. In addition, the ANAO found occasions where the FHA benefit payment calculations were not indexed in accordance with the Act.

3.18.19 During 2015–16, Human Services strengthened its controls over the assessment of eligibility, application of payment rates, debt monitoring and recovery. This process is ongoing and the ANAO will review the progress made by Human Services to address the audit issue during the 2015–16 final audit.

Conclusion

3.18.20 Based on our audit coverage to date, the ANAO identified that, except for the finding relating to the Farm Household Allowance payments referred to above, key elements of internal control were operating effectively to provide reasonable assurance that Human Services will be able to:

- prepare financial statements that are free of material misstatement; and
- provide financial information that is free of material misstatement to other Commonwealth entities for payments delivered on their behalf.

3.18.21 The effective operation of these internal controls for the full financial year will be assessed during the 2015–16 final audit.

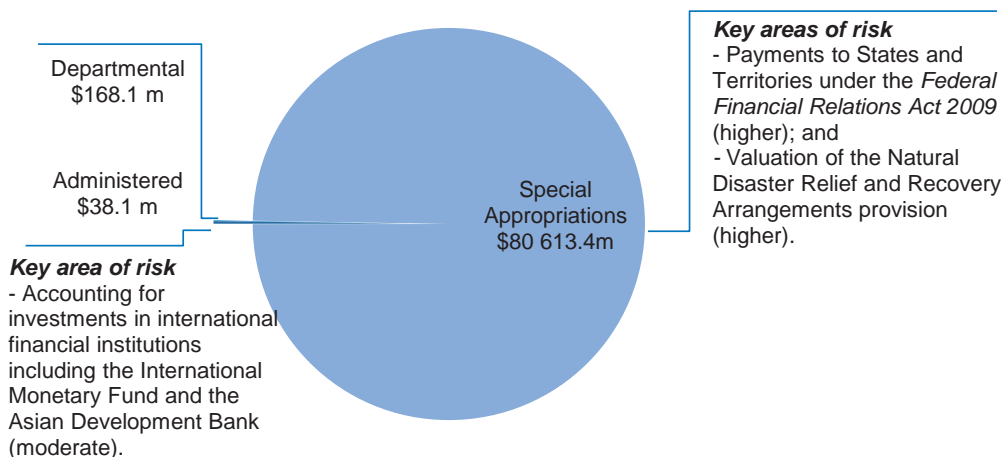
3.19 Department of the Treasury

Overview

3.19.1 The Department of the Treasury (the Treasury) is responsible for the development, delivery and implementation of economic policy and advice. This includes advice on: taxation; the Budget and economy; financial and foreign investment; competition and broader structural policy; small business; and international economic policy.

3.19.2 Annual appropriation funding of \$168.1 million (departmental) and \$38.1 million (administered) was provided to Treasury in 2015–16 to support the achievement of the department's outcomes.⁸¹ Treasury was also budgeted to receive special appropriation funding of \$80 613.4 million largely related to the administration of payments to State and Territory governments under the *Federal Financial Relations Act 2009* and the National Disaster Relief and Recovery Arrangements.⁸² Figure 3.18 below demonstrates the proportion of each appropriation funding type received by the Treasury, and the key areas of financial statements risk.

Figure 3.18: Appropriation funding and key areas of financial statements risk



3.19.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on Treasury's financial statements. The ANAO's risk identification approach considers the nature of the financial statement items and an understanding of the Treasury's environment and governance arrangements, including its financial reporting regime and system of internal control.

81 *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.* These figures do not reflect transfers as a result of Machinery of Government changes. These transfers will be reviewed as part of the final audit and reported in ANAO Audit Report *Audits of the Financial Statements of Australian Government Entities for the year ending 30 June 2016*.

82 Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

3.19.4 In light of the key areas of risk and the ANAO's understanding of the operations of the department, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁸³

3.19.5 Table 3.63 and Table 3.64 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.63: Key expenses and own-source income

Expenses and revenues	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	182.3	90 412.6
Employee benefits	122.9	-
Grants	2.2	90 400.1
Other	57.2	12.5
Total revenue	14.5	4 153.9
Sales of goods and rendering of services	9.3	746.8
Dividends	-	2 806.4
COAG revenue from government entities	-	352.2
Gain on NDRRA provision - revaluation	-	240.8
Other	5.2	7.7
Net cost of services	167.8	86 258.7

Table 3.64: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	92.9	42 806.7
Trade and other receivables	65.8	3 615.0
Investments	-	39 191.7
Other	27.1	-

⁸³ Figures in Table 3.63 and Table 3.64 have been sourced from the Treasury Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total liabilities	58.8	17 317.3
Grants	-	58.3
Unearned income	-	53.1
Loans	-	10 011.2
Provisions for grants	-	1 517.1
Other payables and provisions	58.8	5 677.6 ^j
Net assets	34.1	25 489.4

Note j: This amount is largely attributable to the Australian Government's liability to repay the International Monetary Fund (IMF) the cumulative allocations of Special Drawing Rights provided to Australia since joining the IMF.

The Treasury estimated average staffing level for 2015–16 is 810.

3.19.6 The results of recent performance audits relevant to the financial management or administration of the Treasury's operations are also considered in identifying key areas of financial statements risk.

3.19.7 Audit Report No.14 2015–16 *Approval and Administration of Commonwealth Funding for the East West Link Project* was tabled on 14 December 2015. The report assessed the approval and administration of funding provided to the Victorian government in June 2014 for the East West Link project. The ANAO recommended that the Treasury make a recommendation to the Treasurer that a determination be made requiring the return of this funding to the Commonwealth.⁸⁴

3.19.8 This aligns to the key area of financial statements risk related to payments to States and Territories under the *Federal Financial Relations Act 2009* set out in Table 3.65 of the following section.

Key areas of financial statements risk

3.19.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.65.

⁸⁴ ANAO Report No.14 2015–16, Recommendation No.1, paragraph 4.16.

Table 3.65: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered grant expenses Administered grant payables	Payments to States and Territories under the <i>Federal Financial Relations Act 2009</i>	Higher	<ul style="list-style-type: none"> reliance on a number of government entities which are responsible for administering the programs, assessing eligibility and advising the Treasury of the amount to be paid.
Administered other provisions Administered grant expenses and NDRRA provision	Valuation of the Natural Disaster Relief and Recovery Arrangements provision	Higher	<ul style="list-style-type: none"> complexities in calculating the provision due to the devolved nature and high level of judgement relating to the estimation process and compliance requirements; and reliance on estimates provided by state and territory governments in determining the provision.
Administered investments	Accounting for investments in international financial institutions, including the International Monetary Fund and Asian Development Bank	Moderate	<ul style="list-style-type: none"> complex nature of international investments including their valuation at fair value; and the volatility of the international economy, including the foreign exchange conversion rate and its combined effect on the impairment assessments performed by international financial institutions.

3.19.10 As an integral part of the interim audit, the ANAO also assesses IT general and application controls for key systems that support the preparation of the Treasury's financial statements.

Audit results

3.19.11 The ANAO's interim audit coverage included assessing Treasury's processes in relation to cash and asset management; accounts payable and receivable; and payroll processing. Testing of IT general controls and application controls in the FMIS and HRMIS has also been completed.

3.19.12 The interim audit also reviewed the Treasury's risk assessment and payments processing under the *Federal Financial Relations Act 2009* for National Partnership Agreements. During the final audit the ANAO will complete audit coverage over the assurance processes for all types of payments under the *Federal Financial Relations Act 2009* and compliance with the terms of funding.

3.19.13 Procedures relating to the Australian Government's investments in international financial institutions held by the Treasury, and coverage relating to the valuation, accounting and reporting disclosures associated with the investments will be completed as part of the final audit.

3.19.14 In 2014–15 the Treasury agreed to strengthen the control framework in relation to the National Disaster Relief and Recovery Arrangements liability. This included reviewing the Memorandum of Understanding between the Treasury and the Attorney-General's Department to more clearly define the responsibilities of each party and improve the estimation process over the

liability. The Memorandum of Understanding has not yet been finalised. The ANAO will assess progress in addressing this area as part of the 2015–16 final audit.

3.19.15 No significant or moderate audit issues have been raised by the ANAO as a result of the audit coverage of the areas of audit focus to date. The 2014–15 final audit also did not identify any significant or moderate audit issues.

Conclusion

3.19.16 Based on our audit coverage to date, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the Treasury will be able to 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 2015–16 final audit.

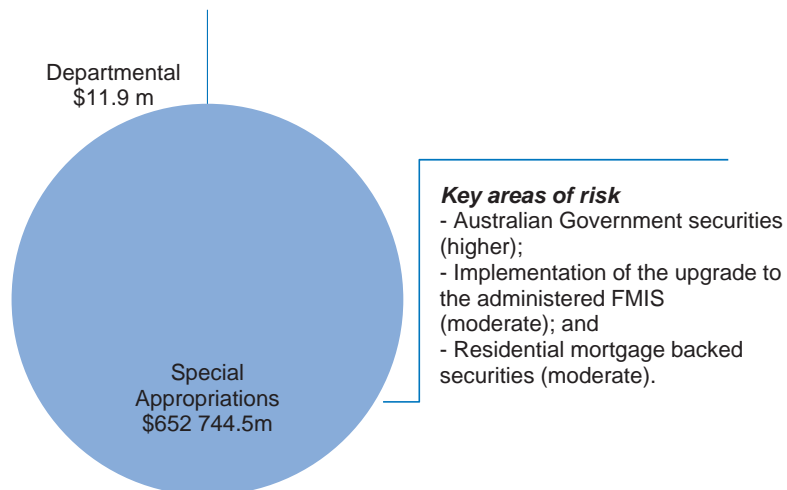
3.20 Australian Office of Financial Management

Overview

3.20.1 The Australian Office of Financial Management (AOFM) is responsible for managing Australian Government debt and financial assets. AOFM is responsible for issuing treasury bonds, treasury indexed bonds and treasury notes, managing the Australian Government's cash balances and investing in financial assets.

3.20.2 In 2015–16 AOFM was budgeted to receive special appropriations funding of \$652 744.5 million to support the: issuance and management of debt; investment in financial assets; payment of interest; and redemption of debt.⁸⁵ The AOFM also received \$11.9 million of departmental annual appropriation funding to support its operations.⁸⁶ Figure 3.19 demonstrates the proportion of each appropriation funding type received by AOFM, and the key areas of financial statements risk.

Figure 3.19: Appropriation funding and key areas of financial statements risk



3.20.3 The ANAO's audit approach identifies key areas of risk that have the potential to impact on AOFM's financial statements. The ANAO's risk identification process considers the financial statement items and an understanding of AOFM's environment and governance arrangements, including its financial reporting regime and system of internal control. The results of any recent performance audits relevant to AOFM are also considered. No performance audits were tabled in 2015–16 which impacted the financial statements risk assessment process.

⁸⁵ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17*.

⁸⁶ *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16*.

3.20.4 In light of the key areas of risk and the ANAO's understanding of the operations of the AOFM, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁸⁷

3.20.5 Table 3.66 and Table 3.67 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.66: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	11.8	15 376.1
Employee benefits	6.3	-
Suppliers	5.0	-
Depreciation and amortisation	0.5	-
Interest costs	-	15 359.7
Other	-	16.4
Total own-source income	1.1	791.7
Sales of goods & services	0.8	-
Resources received free of charge	0.3	-
Interest revenue	-	791.7
Net cost of services	10.7	19 366.4^k

Note k: This amount reflects estimated net re-measurements and gains/losses of \$4 782.0 million.

Table 3.67: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	31.9	39 011.6
Cash & cash equivalents	0.1	0.6
Receivables	29.3	1 958.0
Investments	-	37 052.9
Non-financial assets	2.5	-

⁸⁷ Figures in Table 3.66 and Table 3.67 have been sourced from the Treasury Portfolio Budget Statements 2016–17.

Assets and liabilities	Departmental	Administered
	estimated actual	estimated actual
	(\$m) 2015–16	(\$m) 2015–16
Total liabilities	2.7	476 999.5
Employee provisions	2.4	-
Australian Government securities	-	476 999.4
Other	0.2	0.1
Net assets/(liabilities)	29.2	(437 987.9)

AOFM's estimated average staffing level for 2015–16 is 42.

Key areas of financial statements risk

3.20.6 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.68.

Table 3.68: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
Administered liabilities Administered gains Administered interest expense	Australian Government securities	Higher	<ul style="list-style-type: none"> significant liability class for AOFM and Whole-of-Government; significant increases in volume in prior and current period; fair value movements have a material impact on the financial statements and are impacted by external factors; and significant financial statement disclosure requirements.
All administered items	Implementation of the upgrade to the administered financial management information system	Moderate	<ul style="list-style-type: none"> Administered general ledger records financial information from many significant asset and liability balances.
Administered investments Administered interest revenue Administered gains	Residential mortgage backed securities	Moderate	<ul style="list-style-type: none"> significant asset class; subjectivity and complexity involved in applying valuation methods, using external inputs that are subject to variation; potential large fair value impacts on the financial statements; and significant financial statement disclosure requirements.

3.20.7 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of AOFM's financial statements.

Audit results

3.20.8 The ANAO's interim audit coverage has been completed. Audit coverage included the review of the implementation of the upgrade to the administered FMIS, and controls supporting the issuance of debt instruments. Audit coverage of cash and other financial assets management; accounts payable and receivable; payroll processing; IT general controls, and application controls in the FMIS and HRMIS, has also been completed.

3.20.9 The other key areas of risk, including the assessment of the measurement and disclosure of financial assets and liability securities, will be completed as part of the 2015–16 final audit.

3.20.10 No significant or moderate audit findings have been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit also did not identify any significant or moderate audit findings.

Conclusion

3.20.11 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 will be able to 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 2015–16 final audit.

3.21 Australian Taxation Office

Overview

3.21.1 The Australian Taxation Office (ATO) is the Australian Government's principal revenue collection entity. The ATO's role is to manage and shape tax, excise and superannuation systems that fund services for Australians. The ATO has a single outcome delivered through 24 programs. In addition, the ATO also provides support to the Tax Practitioners Board, the Australian Business Register and the Australian Charities and Not-for-profits Commission.

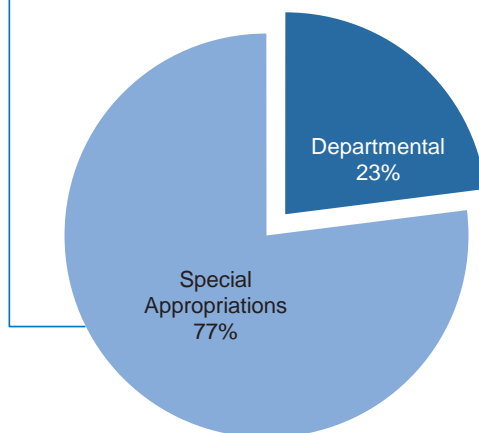
3.21.2 Annual departmental appropriation funding of \$3 447.3 million was provided to the ATO in 2015–16 to support the achievement of the ATO's outcomes.⁸⁸ The ATO was also budgeted to receive special appropriation funding of \$11 547.3 million supporting the administration of the Australian taxation and superannuation systems.⁸⁹

3.21.3 Figure 3.20 shows departmental and special appropriation funding as a percentage of total funding and the key areas of financial statements risk.

Figure 3.20: Appropriation funding and key areas of financial statements risk

Key areas of risk

- ATO compliance risk management (higher);
- Estimation and allocation processes associated with taxation revenue (higher);
- Estimation of allowance for credit amendment and impairment losses associated with taxation receivables (higher);
- Complex manual process for financial data (moderate); and
- IT business systems and associated processing of taxpayer returns and statements (moderate).



3.21.4 The ANAO's audit approach identifies key areas of risk that have the potential to impact on the ATO's financial statements. The ANAO's risk identification process considers the nature of the financial statement items and an understanding of the ATO's environment and governance arrangements, including its financial reporting regime and system of internal control.

⁸⁸ ATO also received \$0.6 million in annual administered appropriation funding in 2015–16. *Appropriation Act (No.1) 2015–16, Appropriation Act (No.2) 2015–16, Appropriation Act (No.3) 2015–16, and Appropriation Act (No.4) 2015–16.*

⁸⁹ Part 1: Special Appropriations Table, *Agency Resourcing, Budget Paper No.4, 2016–17.*

3.21.5 In light of the key areas of risk and the ANAO's understanding of the operations of the ATO, the ANAO has assessed the risk of a material misstatement as **moderate**.

Key financial statements items⁹⁰

3.21.6 Table 3.69 and Table 3.70 provide a summary of the key 2015–16 departmental and administered estimated financial statements items.

Table 3.69: Key expenses and own-source income

Expenses and own-source income	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total expenses	3 482.3	17 239.4
Employee benefits	1 809.3	-
Suppliers	1 482.5	-
Depreciation and amortisation	190.5	-
Subsidies	-	9 651.9
Personal benefits	-	1 179.4
Write-down and impairment of assets	-	5 791.4
Other	-	616.7
Total own-source income	102.4	353 920.9
Income tax	-	269 432.4
Indirect tax	-	82 933.0
Other taxes	-	982.0
Other	102.4	573.5
Net (cost of)/contribution to services	(3 379.9)	336 681.5

90 Figures in Table 3.69 and Table 3.70 have been sourced from the Treasury Portfolio Budget Statements 2016–17.

Table 3.70: Key assets and liabilities

Assets and liabilities	Departmental estimated actual (\$m) 2015–16	Administered estimated actual (\$m) 2015–16
Total assets	1 226.4	32 258.1
Trade and other receivables	279.2	-
Non-Financial assets	901.1	-
Taxation receivables	-	18 516.9
Accrued revenues	-	13 426.3
Other	46.1	314.9
Total liabilities	938.6	9 935.7
Supplier payables	227.1	-
Employee provisions	579.3	-
Taxation refunds provided	-	2 251.9
Other provisions	-	1 076.3
Subsidies payable	-	4 437.5
Personal benefits payable	-	1 288.5
Other	132.2	881.5
Net assets	287.8	22 322.4

The ATO's estimated average staffing level for 2015–16 is 17 781.

3.21.7 In addition, the results of recent performance audits relevant to the financial management or administration of the ATO's operations were considered in identifying key areas of financial statements risk, including where the ATO delivers services on behalf of other government departments. The following reports were tabled during 2015–16 and are relevant to the financial statements of the ATO:

- Audit Report No.27 2015–16 *Strategies and Activities to Address the Cash and Hidden Economy*;
- Audit Report No.31 2015–16 *Administration of Higher Education Loan Program Debt and Repayments* (cross-entity audit); and
- Audit Report No.34 2015–16 *Administration of Tobacco Excise Equivalent Goods* (cross-entity audit).

3.21.8 These reports included observations relevant to each of the key areas of financial statements risk outlined in Table 3.71, in particular ATO's compliance risk management and the estimation and allocation processes associated with taxation revenue.

Key areas of financial statements risk

3.21.9 The ANAO undertakes appropriate audit procedures on all material items and focusses audit effort on those areas that are assessed as having a higher risk of material misstatement of the financial statements. Areas highlighted for specific audit coverage in 2015–16 are provided in Table 3.71.

Table 3.71: Key areas of financial statements risk

Relevant financial statement line item	Key area	Audit risk rating	Factors contributing to risk assessment
All administered items	ATO compliance risk management	Higher	<ul style="list-style-type: none"> self-assessment and voluntary compliance regime; and the risk management approach to compliance activities.
Administered income tax revenue, indirect tax revenue, other tax revenue, write-down and impairment, taxation receivables and accrued revenues	Estimation and allocation processes associated with taxation revenue	Higher	<ul style="list-style-type: none"> complex estimation processes, involving significant judgement and specialist knowledge; completeness, relevance and accuracy of source data; and volatility in economic conditions increases the uncertainty of factors underpinning the estimates.
Administered taxation receivables, taxation refunds provided, other provisions	Estimation of allowance for credit amendment and impairment losses associated with taxation receivables	Higher	<ul style="list-style-type: none"> complex estimation processes, involving significant judgement and specialist knowledge; completeness, relevance and accuracy of source data; and changes to the ATO's impairment estimate methodology in 2015–16.
All administered items	Complex manual process for financial data	Moderate	<ul style="list-style-type: none"> manual calculation of complex information in spreadsheets increases the risk of miscalculation due to data linkages and human error.
All administered items	IT business systems and associated with the processing of taxpayer returns and statements	Moderate	<ul style="list-style-type: none"> large and complex IT environment with several hundred business applications processing a high volume of transactions; many IT systems are tailored or heavily customised to the ATO; and reliance on specialised reports to prepare financial statements balances.

3.21.10 As an integral part of the interim audit, the ANAO also assesses the IT general and application controls for key systems that support the preparation of the ATO's financial statements.

Audit results

3.21.11 The ANAO has completed its interim audit coverage of the ATO's revenue collection and financial administration systems, and its business processes for estimating tax debt collectability. Audit coverage has included an assessment of the ATO's key IT general and application controls, including a review of logical security, change and release management and controls in the ATO's FMIS, HRMIS and other supporting financial systems.

3.21.12 As part of the 2015–16 final audit, audit coverage of the estimate of revenue collected at year-end and its reporting in the financial statements, the year-end taxation receivable balance, and the finalisation of the work on the ATO's external compliance program will be completed.

3.21.13 One moderate audit finding has been raised by the ANAO as a result of the audit coverage to date. The 2014–15 audit did not identify any significant or moderate findings.

New moderate audit finding

Administration of penalties and interest

3.21.14 The ATO applies interest to unpaid taxation liabilities and amended taxation liabilities where the amendment results in an additional amount of taxation payable to the ATO. Penalties may be imposed when a taxpayer has not taken reasonable care in meeting their tax obligations. In addition to the authority to impose interest and penalties, the ATO also has the authority to remit, partially or in full, any of these charges in certain circumstances.

3.21.15 During the 2015-16 interim audit, the ANAO reviewed the imposition and remission of interest and penalties and identified the following weaknesses:

- a number of instances where the officer approving the remission of a charge did not have the appropriate authority; and
- a lack of documentation sufficiently detailing the decision process relating to the remission of charges.

3.21.16 These weaknesses increase the risk that the remission of taxation liability charges is incorrectly administered.

3.21.17 The ATO has advised it will undertake a review of: authorisations and delegations, and the way these are applied; training and guidance provided to ensure decisions are accurately documented; and the quality control framework relating to remission of penalties and interest.

3.21.18 The ANAO will review the ATO's progress in addressing this finding during the 2015–16 final audit.

Conclusion

3.21.19 Based on our audit coverage to date, and except for the finding referred to above, the ANAO identified that key elements of internal control were operating effectively to provide reasonable assurance that the ATO will be able to 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 2015–16 final audit.

3.22 Other reportable matters

Airservices Australia

Overview

3.22.1 On 20 August 2015, Senator Bill Heffernan, Chair of the Senate Rural and Regional Affairs and Transport Legislation Committee, wrote to the Auditor-General referring to a number of matters under examination by the Committee as part of an inquiry into the performance of Airservices Australia (Airservices). These matters included the potential misuse of credit cards and the engagement of consultants and authorisation of expenditure in non-arm's length transactions.

3.22.2 In response to the letter, and following discussions with the Committee on 8 September 2015, the Acting Auditor-General wrote to the Committee Chair on 24 September 2015 advising that the ANAO would undertake a series of audit activities in relation to those matters raised by the Committee, through both the financial statements assurance audit and performance audit programs.

Financial statements assurance audit program

3.22.3 In September 2015, the Auditor-General commenced an examination of matters relating to the administration of corporate credit and travel cards within Airservices as part of the 2015–16 financial statements audit. The scope of the work covered the period 1 July 2014 to 30 September 2015 and was designed to provide reasonable assurance in the context of the auditor's opinion on the 2015–16 financial statements that Airservices had appropriate processes and controls in place over the issuance, appropriate use and monitoring of credit card activity. The scope also included a review of governance arrangements over the investigation and referral of identified misuse through legal channels, with reference to established government and entity specific policies and procedures.

3.22.4 The ANAO undertook sample testing and data analytics procedures to assess the effectiveness of Airservices' controls over corporate and travel cards. The audit procedures included testing of the:

- issuance of corporate credit and travel cards that were appropriately authorised and limits assigned were consistent with Airservices' policies and delegations;
- timely cancellation of corporate credit and travel cards;
- appropriate use of corporate credit and travel cards. This included performing data analytics to identify unusual activity or activity inconsistent with assigned roles. Testing of a sample of transactions was also completed;
- timely and appropriately detailed monthly acquittal, reconciliation and independent approval/review of card activity; and
- establishment and implementation of appropriate systems and processes for the identification, investigation and referral of misuse in accordance with relevant Commonwealth guidelines and Airservices' policies.

3.22.5 As a result of the financial statements audit testing, the ANAO did not identify weaknesses in the Airservices processes relating to the:

- issuing and cancellation of corporate credit and travel cards in accordance with Airservices policies and procedures; or
- acquittal and reconciliation of corporate credit and travel cards on a timely basis.

3.22.6 The ANAO data analytics and sample testing of transactions did not identify transactions that were not supported by appropriate documentation or were not appropriately approved and authorised in accordance with Airservices card usage policies.

3.22.7 The ANAO's testing of arrangements regarding the investigation and referral of identified misuse of credit cards identified that actions taken by Airservices were consistent with the recommendations of investigators. However, the ANAO did observe a number of weaknesses including a lack of:

- documentation of key decisions made in relation to dealing with a fraud incident, particularly with reference to decisions of the use of civil, administrative or disciplinary procedures or to take no further action in relation to a suspected fraud incident;
- documentation to evidence that Airservices had taken all reasonable measures to recover financial losses caused by credit card fraud through appropriate channels such as proceeds of crime, civil recovery processes or administrative remedies; and
- evidence to demonstrate that key decisions were made by the appropriately authorised officer.

3.22.8 These weaknesses increased the risk that the handling of an investigation, or response to a suspected fraud incident, would be inconsistent with established legislation standards or management expectations, and may adversely impact the success of a fraud investigation and the ability of Airservices to recover monies. This issue was reported to Airservices as a moderate audit finding at the completion of the interim audit.

3.22.9 Airservices advised that they have commenced action to address this issue, including the publishing of the Security Investigations Procedure and the establishment of an ethics and fraud working group.

3.22.10 The ANAO's assessment of progress made by Airservices' in addressing this finding will be reported to Parliament as part of the ANAO's report on the results of financial statements of Australian Government Entities for the period ended 30 June 2016, expected to be tabled in December 2016.

Performance audit program

3.22.11 The Auditor-General also committed to undertaking two performance audits as part of this body of work.

3.22.12 The first, which commenced on 23 September 2015, is examining whether Airservices has effective procurement arrangements in place, with a particular emphasis on whether consultancy contracts entered into with the International Centre for Complex Project Management in association with the OneSKY tender process were effectively administered. The audit will include consideration of the management of probity and conflict of interest matters. This report is due to be tabled in Parliament in August 2016.

3.22.13 Following completion of the first audit, ANAO will undertake a second audit involving a comprehensive examination of the OneSKY programme to assess whether it has been effectively administered so as to provide value with public resources. The scope of this second audit will involve the conduct of the OneSKY project from initiation to finalisation of the selection and contracting process for the delivery of the project. This report is intended to be tabled during 2017.



Grant Hehir
Auditor-General

Canberra ACT
31 August 2016

Appendices

Appendix 1 Entities covered by this report

1. The following entities have been considered in this report and represent 95 per cent of General Government Sector total revenues and expenses. The entities are presented in order of portfolio.⁹¹

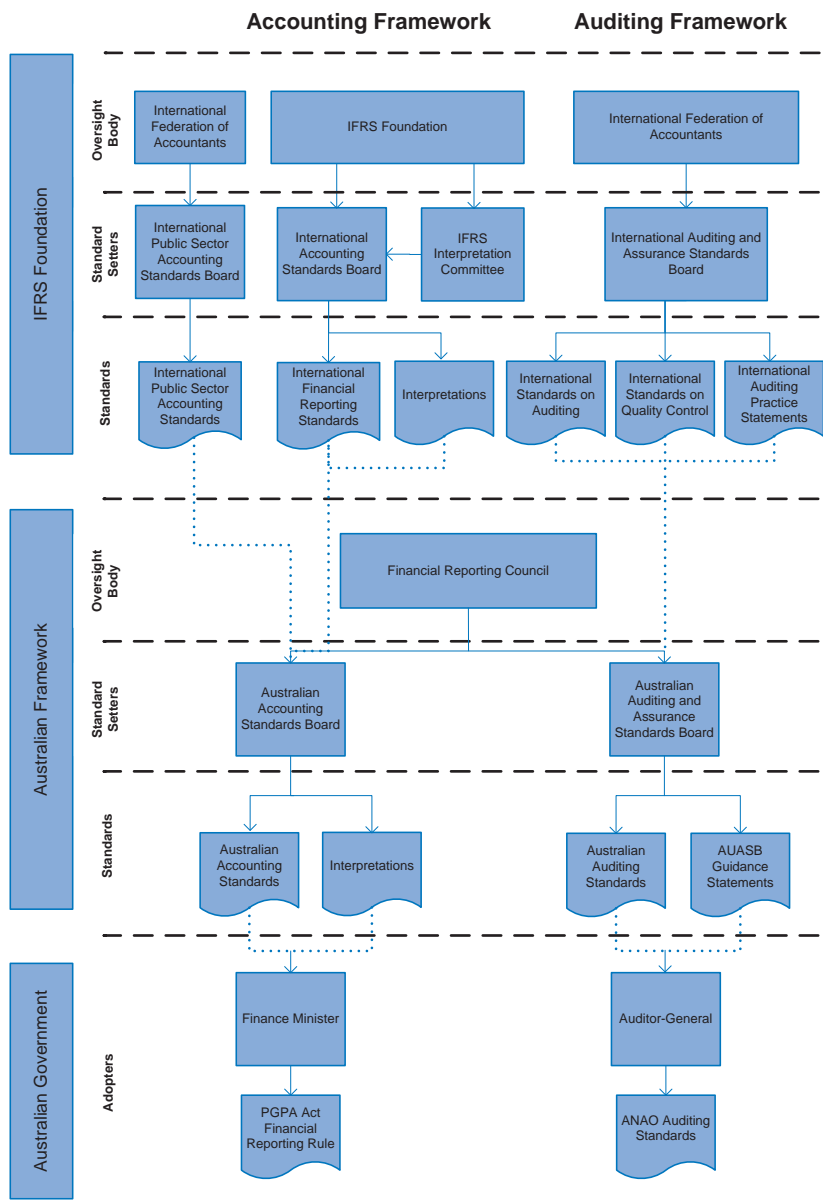
- Department of Agriculture and Water Resources
- Attorney-General's Department
- Department of Communications and the Arts
- Department of Defence
 - Department of Veterans' Affairs
- Department of Education and Training
- Department of Employment
- Department of the Environment
- Department of Finance
 - Future Fund Management Agency
- Department of Foreign Affairs and Trade
- Department of Health
- Department of Immigration and Border Protection
- Department of Industry, Innovation and Science
- Department of Infrastructure and Regional Development
- Department of the Prime Minister and Cabinet
- Department of Social Services
 - Department of Human Services
- Department of the Treasury
 - Australian Office of Financial Management
 - Australian Taxation Office

91 This report also includes a discussion of a moderate audit finding identified in 2014–15 relating to the CFS preparation process (refer to paragraph 2.16) and a discussion of a moderate audit finding identified in the 2015–16 interim audit in Airservices Australia (refer to paragraphs 3.22.1 to 3.22.13). These entities are not included in chapter 3.

Appendix 2 The financial reporting and auditing standards frameworks for 2015–16

1. The figure below depicts the standard setting framework, for financial reporting and auditing, in the Australian Government context.

Figure A.1: Australian Government standard setting framework



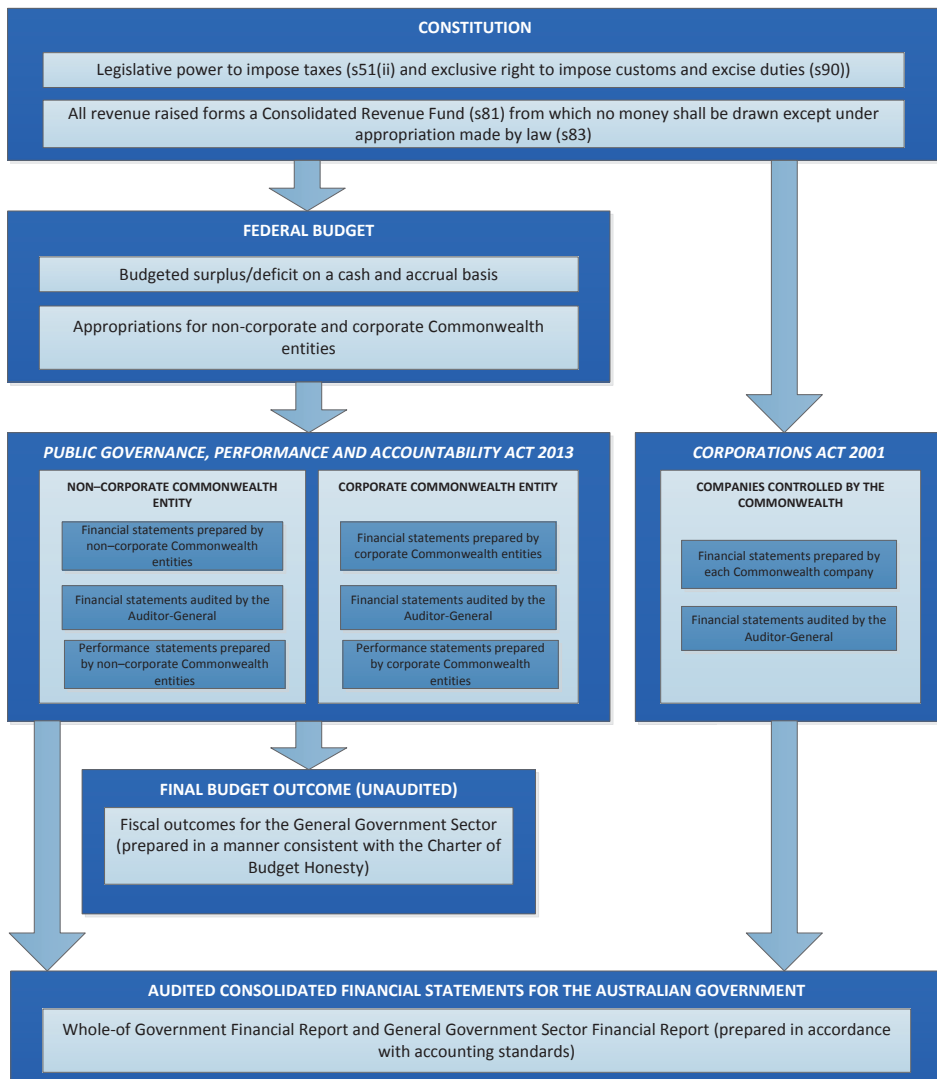
Source: ANAO compilation.

ANAO Report No.7 2016–17
Interim Phase of the Audits of the Financial Statements of Major General Government Sector Entities for the year ending 30 June 2016

Appendix 3 The financial reporting and auditing framework for 2015–16 financial statements

1. 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.2: Australian Government financial reporting framework



Australian Government reporting entities

Commonwealth Government of Australia

1. Section 48 of the PGPA Act requires the Finance Minister to prepare annual consolidated financial statements for the Commonwealth Government of Australia. These financial statements are general purpose financial statements consolidating the financial activities and financial position of Commonwealth entities and other entities controlled by the Commonwealth Government.
2. The PGPA Act prescribes the Australian Accounting Standards (AASs), and any other requirements prescribed by the rules, as the applicable financial reporting framework for the consolidated financial statements.

Commonwealth entities

3. A Commonwealth entity is a department of state, a Parliamentary department, a listed entity or a body corporate established by a law of the Commonwealth. There are two types of Commonwealth entities: a non-corporate Commonwealth entity, which is a Commonwealth entity that is not a body corporate⁹²; and a corporate Commonwealth entity, which is a Commonwealth entity that is a body corporate and legally separate from the Commonwealth.
4. Section 42 of the PGPA Act requires the Accountable Authority of a Commonwealth entity to prepare annual financial statements that comply with the AASs and any other requirements prescribed by the rules.

Non-corporate Commonwealth entities

5. Non-corporate Commonwealth entities, comprising departments of state, Parliamentary departments and listed entities, are subject to the provisions of the PGPA Act.
6. The PGPA Act prescribes the AASs and the Financial Reporting Rules (FRRs) as the applicable financial reporting framework for non-corporate Commonwealth entities.

Corporate Commonwealth entities and subsidiaries

7. Corporate Commonwealth entities are bodies corporate that hold money on their own account and have been created to perform specific functions. Corporate Commonwealth entities operate under their own enabling legislation and also must comply with the relevant provisions of the PGPA Act.
8. The PGPA Act prescribes the AASs and FRR as the applicable financial reporting framework for corporate Commonwealth entities. The financial reporting framework applicable to subsidiaries of corporate Commonwealth entities depends on the nature of the subsidiary.

92 Three entities have a body corporate status but are prescribed as non-corporate Commonwealth entities. These are the Australian Competition and Consumer Commission; the Australian Prudential Regulation Authority; and the Australian Securities and Investments Commission.

Commonwealth companies and subsidiaries

9. Commonwealth companies are companies that are controlled by the Australian Government through majority share holdings or voting rights, or via control over the composition of the company's board. Commonwealth companies operate and prepare financial statements under the Corporations Act.
10. The applicable financial reporting framework for Commonwealth companies is the Corporations Act, including the AASs and the Corporations Regulations.
11. The financial reporting framework applicable to subsidiaries of Commonwealth companies depends on the nature of the subsidiary.

Other bodies

12. The ANAO also audits the financial statements of other bodies under 'by arrangement' provisions in section 20 of the *Auditor-General Act 1997*. These bodies consist primarily of trusts or joint ventures entered into by Commonwealth entities.

Audit of Australian Government entity financial statements

Audit scope

13. The Accountable Authority of a Commonwealth entity is responsible for the preparation and fair presentation of the financial statements and for maintaining records, internal controls, procedures and processes that support the preparation of those statements.
14. The Directors of a Commonwealth company, or a company that is a subsidiary of either a Commonwealth entity or a Commonwealth company, are responsible for the preparation of financial statements that give a true and fair view and for maintaining records, internal controls, procedures and processes that support the preparation of that report.
15. The ANAO's independent audits of financial statements are undertaken to form an opinion whether they are free from material misstatement and present fairly in accordance with applicable accounting standards and legislation. These audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards and provide reasonable assurance.
16. Audit procedures include an 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.
17. The entity's internal control relevant to the entity's preparation and fair presentation of the financial statements or reports 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.

18. 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. The auditor is not responsible for the prevention of fraud and error.

The auditor's report on financial statements

19. The ANAO auditor's report on the financial statements includes a statement of the auditor's opinion as to whether the financial statements present fairly the entity's financial position, the results of its financial operations and its cash flows in accordance with the applicable financial reporting framework.
20. If the auditor is not of that opinion, the auditor's opinion is modified, with the reasons being indicated.
21. The auditor's report on the financial statements may also include an 'emphasis of matter' or 'other matter' paragraph. A report on other legal and regulatory requirements may accompany the auditor's report on the financial statements.

Form of auditor's opinion

22. An auditor's opinion is described as 'unmodified' when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
23. An auditor's opinion may be 'modified' in one of three ways.
- A 'qualified opinion' is expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are material but not pervasive to the financial statements. A 'qualified opinion' is also expressed when the auditor, having been unable to obtain sufficient appropriate audit evidence, concludes that the possible effects on the financial statements of undetected misstatements could be material but not pervasive.
 - A 'disclaimer of opinion' is expressed when the auditor, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.
 - An 'adverse opinion' is expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements individually or in aggregate, are both material and pervasive to the financial statements.

Emphasis of matter

24. An 'emphasis of matter' paragraph is included in the auditor's report when the auditor considers it necessary to draw to users' attention a matter presented in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the users' understanding of the financial statements. The auditor's opinion is not modified in respect of the matter emphasised. The circumstances in which an emphasis of matter is used include:

- when material uncertainty exists relating to an event or condition that may cast significant doubt on an entity's ability to continue as a going concern;
- 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; and
- when financial statements have been prepared in accordance with a special purpose framework, and as a result the financial statements may not be suitable for another purpose.

Other matter

25. The auditor's report on the financial statements may also include a reference to an 'other matter'. This allows the auditor to communicate a matter other than a matter that is presented or disclosed in the financial statements that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Report on other legal and regulatory requirements

26. The auditor's report on the financial statements may also include a report on other legal and regulatory requirements. This report covers matters that the Auditor-General is required by law to report on in conjunction with the financial statements audit that do not affect the truth and fairness of the financial statements.
27. A report on other legal and regulatory requirements may also be used to draw attention to other legislative findings, such as issues relating to the entity's compliance with section 83 of the Constitution.

Appendix 4 Glossary of commonly used accounting terms

Administered:	Those items that an entity does not control but over which it has management responsibility on behalf of the Government and which are subject to prescriptive rules or conditions established by legislation, or Australian Government policy, in order to achieve Australian Government outcomes.
Appropriation:	An authority under any Act or law to draw money from the Consolidated Revenue Fund.
Departmental:	Those items that the entity controls that are applied to the production of the entity's own purposes.
Fair value:	The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Impairment loss:	The amount by which the carrying amount of an asset exceeds its recoverable amount.
Material entity:	<p>Government entities are classified based on the extent to which their financial information has a material impact on the Whole of Government financial statements. The breakdown is determined by aggregating the total income, expenses, assets and liabilities of all entities. Entities whose total income, expenses, assets and liabilities in aggregate are within the top 99 per cent of the aggregate of these balances for all General Government Sector entities are classified as material entities.</p> <p>Departments of state and entities in the Public Financial Corporation and Public Non-Financial Corporation sectors are also considered to be material entities by nature.</p>
Materiality:	Omissions or misstatements of items are material if they could, individually or collectively; influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of an item, or combination of both, could be the determining factor.
Net cost of services:	Calculated as total expenses (excluding income tax expense, where applicable) less total own source income.

Own source income: Consists of all income except:

- (a) annual appropriations;
- (b) special appropriations; and
- (c) amounts appropriated to the relevant portfolio entity for payment to the corporate entity (corporate entity item).

It includes PGPA Act section 74 receipts of amounts by non-corporate Commonwealth entities, and is adjusted for any repayments by the Commonwealth made under PGPA Act section 77.

