

Performance audit of internal budgeting and forecasting processes and practices

Australian National Audit Office

Report by the Independent Auditor

September 2020

© Commonwealth of Australia 2020

ISBN 978-1-76033-587-8 (Print)

ISBN 978-1-76033-588-5 (Online)

This document is licensed under the 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/>.



Tower 3
300 Barangaroo Avenue
Sydney NSW 2000
Australia

24 September 2020

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Mr President
Dear Mr Speaker

As Independent Auditor, I have conducted a performance audit of the Australian National Audit Office, in accordance with the authority contained in section 45 of the *Auditor-General Act 1997* (the Act).

The performance audit considered the Australian National Audit Office's internal budgeting and forecasting processes and practices, and was conducted in accordance with the Australian National Audit Office Auditing Standards 2018.

I present the report of this audit to the Parliament. The report is titled *Performance Audit of Internal Budgeting and Forecasting Processes and Practices — Australian National Audit Office*.

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

A handwritten signature in black ink, reading 'Eileen Hoggett'.

Eileen Hoggett
Independent Auditor
Appointed under Clause 1, Schedule 2 of the Auditor-General Act 1997

Contents

Audit overview	3
Executive Summary	4
1. Background.....	7
Internal Budget and Forecasting.....	7
The Australian Government Budget process.....	7
Funding within in the Commonwealth Public Sector.....	8
The Budget process relative to the Australian National Audit Office	8
2. Detailed Findings	11
Budget Process	11
Overview.....	11
The ANAO’s purpose and outcomes.....	11
The ANAO’s Internal Budgeting Process.....	12
Assessment against Criteria.....	13
Budget alignment to overall purpose and outcomes: Entity level	13
Budget alignment to overall purpose and outcomes: Audit level.....	14
Consideration of future investment, capability needs, and external factors and pressures	14
Governance Arrangements	22
Assessment against Criteria.....	22
Governance structures supporting the overall budgeting process	22
Governance Processes within AASG and PASG relating to Audit Level budgets	22
Formalisation of Framework and its Operational Effectiveness	24
Assessment against Criteria.....	24
The ANAO’s Budget Framework and Supporting Documents	24
Operational effectiveness of budget approvals and monitoring at the Audit Level	25
Post budget review and approach to continual improvement	26
Appendix A: Entity Response	27

Audit overview



OBJECTIVE

The objective of this audit was to assess the effectiveness of the Australian National Audit Office's (ANAO) internal budgeting and forecasting processes and practices, in supporting the 2019/2020 and 2020/2021 financial years.



CRITERIA

- ✓ The budgeting process links to organisational *planning*, supports the achievement of the identified purpose and outcomes and future capability needs, and considers external factors and pressures;
- ✓ There are appropriate governance arrangements to review, approve and oversee internal budgeting and forecasting; and
- ✓ The internal budgeting framework is appropriately formalised, and operating effectively.



KEY FINDINGS AND OBSERVATIONS

1. The ANAO is managing its budgets within a challenging environment, with a number of internal and external pressures impacting on its budget position.
2. Overall, the ANAO was found to have mature and robust internal budgeting and forecasting processes, which align with the organisation's purpose and priorities.
3. Appropriate governance arrangements are in place to oversee key internal budget processes.
4. There is an opportunity to take a longer term view to internal budgeting, and create a stronger alignment between internal strategies and the internal budgeting process.
5. There is an opportunity to enhance and formalise aspects of the internal budgeting process.



ANAO SNAPSHOT

The following statistics highlight key aspects of the ANAO, based on 2019-20 key performance indicators, data and information.

330

Approximate staff numbers over the 2019-20 period

\$45.32M

Employee expenses

\$25.88M

Supplier expenses

Estimated Expenditure

\$5.70M

Depreciation expense

Key Audit Activity Targets for 2019-20

Performance audit target

48 reports to Parliament

Assurance audits planned

199 contract-out audits

89 in-house audits

340

\$69,302M

Estimated revenue from Government

Executive Summary



Background

- 1 An effective process to support the development and ongoing management of internal budgets is a critical component of any organisation's financial management framework. Internal budgets provide a means to align the use of available resources to organisational priorities and strategic objectives, and a basis for key business decisions relating to business performance and investment.
- 2 Once established, the ongoing and proactive management of internal budgets is a crucial mechanism to enable organisations to identify risks, challenges and opportunities within their operating environment, and respond accordingly.
- 3 Commonwealth entities are provided with funding through the Australian Government's Budget process. This is a centrally managed process that provides entities with resources to deliver their purpose and objectives.
- 4 Within this overall funding framework, there are a number of internal and external pressures a Commonwealth entity must manage, in order to operate within its budget. Having appropriate internal budgeting and forecasting practices is therefore a key element to the ongoing responsible fiscal management of Commonwealth entities.



Objective

- 5 The objective of this audit was to assess the effectiveness of the ANAO's internal budgeting and forecasting processes and practices.
- 6 The review considered processes and practices used for entity-level and audit-level (i.e. financial statement audit and performance audit groups) budgeting and forecasting.



Audit criteria and scope

- 7 The audit criteria considered whether:
 - the budgeting process links to organisation planning, supports the achievement of identified purpose and outcomes and future capability needs, and considers external factors and pressures.
 - there are appropriate governance arrangements to review, approve and oversee internal budgeting and forecasting at the group-level and audit-level.
 - the internal budgeting framework is appropriately formalised, and operating effectively at entity and audit levels.
- 8 The scope of the audit was limited to:
 - considerations of the 2019-20 and 2020-21 budgeting processes; and
 - assessment of audit-level budgets within the Assurance Audit Services Group (AASG) and the Performance Audit Services Group (PASG).



Conclusion

9 Overall, the ANAO was found to have effective internal budgeting and forecasting processes and practices.

10 The review noted that there is opportunity to enhance and further mature these practices through:

- commencing forward-year internal budgeting and forecasting;
- evidencing a clearer alignment of the budget process to key internal strategies and priorities; and
- incorporating a post budget review process, to encourage continual improvement within the annual budget setting process, while also further formalising and enhancing other key internal budget documentation.



Supporting Findings and Observations

11 The ANAO is facing a number of internal and external challenges, and has demonstrated an understanding of these in how it is managing its internal budget processes. The ANAO has advised that these pressures have impacted on the number of performance audits it is able to deliver each financial year.

12 The ANAO has robust and mature annual budgeting and forecasting processes in place to manage its budget within the current operating environment.

13 At the entity and group levels, there is a clear alignment between budget setting and the ANAO's purpose, outcomes and outputs.

14 There are appropriate governance mechanisms in place to support the development and ongoing monitoring of internal budgets within the ANAO.

15 There are opportunities to enhance existing processes by taking a forward-year view on budgets, and to assist in creating a clearer alignment between organisational strategies and the internal budgeting process.

16 There are also opportunities to formalise the framework and enhance aspects of documentation in some areas to better support and enhance the annual and forward year budget setting and monitoring processes.



Recommendations

The audit identified the following recommendations:

Recommendation No 1: Setting the Internal Budget for Forward Years

The ANAO should consider extending its internal budgeting to forward years, to provide greater alignment to key corporate strategies and priorities, and to enable a more strategic forward outlook to assist in managing future risks and operational pressures.

ANAO Comment

Agreed

<i>Recommendation No 2: Incorporate and evidence key operational plans and strategies into the budget setting process</i>	As part of the annual budget setting process, the ANAO should: <ul style="list-style-type: none"> • identify key internal plans and strategies which impact the internal budget; and • strengthen and evidence the alignment of key internal plans and strategies to the internal budgeting and decision making processes.
<i>ANAO Comment</i>	<i>Agreed</i>
<i>Recommendation No 3: Review budget variation processes within PASG</i>	PASG should review its internal processes relating to budget overruns to ensure there is appropriate monitoring and approval of variations to original baseline budgets. Consideration should also be given to providing additional training or education to audit teams in relation to expected requirements.
<i>ANAO Comment</i>	<i>Agreed</i>
<i>Recommendation No 4: Implement post budget review process</i>	The ANAO should implement a post budget review as part of its annual internal budget process. This should consider the efficiency and effectiveness of processes undertaken, to encourage continual improvement in future budget processes.
<i>ANAO Comment</i>	<i>Agreed</i>



Entity Response

17 The ANAO welcomes the performance audit report and its conclusion that the ANAO has effective internal budgeting and forecasting processes and practices. The ANAO agrees that implementation of the recommendations made will further improve the ANAO's budgeting and forecasting processes and practices. The ANAO accepts the insights and observations made in the report and will consider these in its future budgeting and forecasting activities.

1. Background

Internal Budget and Forecasting

Methods and approaches to establishing internal budgets

1.1. Organisations can adopt a number of approaches in developing their internal budgets and monitoring processes. Better practice approaches ensure this process is tailored to the needs of the organisation. The typical considerations in developing a budget include:

- Whether the budget is determined through one of the following approaches.



A 'top-down' direction, whereby decisions and allocations of relevant resources are made at the organisational level and provided to areas of the business.



A 'bottom-up' approach, where business areas develop their required resource needs.



A 'hybrid approach', where aspects of both 'top-down' and 'bottom-up' are applied to develop the overall budget. Through this approach, goals and constraints are provided to relevant areas of the business, who are then responsible for the allocation of resources within these goals and constraints.

- How detailed budget costings will be built, which can follow various methods, such as:



Whereby the previous year's results, either budget or actual, form a baseline for the current year budget build. This base line is adjusted for known impacts and changes.



Through this approach, the current year budget is built from a zero cost base, where all costs are justified.



Other approaches includes methods such as such as cost inputs and outputs, where budgeting is based upon outputs or activities of an organisation.

1.2. Within the Commonwealth Public Sector, there are no internal requirements which instruct entities to develop and monitor their ongoing budget through a particular approach. However, general principles of appropriate financial management should be applied, in line with requirements of the PGPA Act for Accountable Authorities.

The Australian Government Budget process

1.3. The Australian Government has an established Budget process which is utilised to allocate public resources to relevant Commonwealth entities. It is through this process that Commonwealth entities may obtain access to relevant funding to enable delivery against their individual purpose and

objectives. This process occurs multiple times within any given financial year, and is underpinned by the principles and requirements outlined within:

- the *Charter of Budget Honesty Act 1998*, which establishes the relevant principles and requirements that guide the Government's management of fiscal policy; and
- the Budget Process Operating Rules (BPORs), which outline the major operational arrangements for managing the Australian Government Budget process.

1.4. The primary annual mechanism for having the Budget process approved commences with the Portfolio Budget Statements (PBS), which typically occurs in May each year, and additional Budget rounds can occur, where required, through additional budget review processes, such as the Mid-Year Economic Fiscal Outlook (MYEFO) and the Portfolio Additional Estimates Statements (PAES).

1.5. In addition to providing a means to have relevant funding approved for use, the Budget process also outlines the anticipated forward year estimates for Commonwealth entities, to support and enable relevant and appropriate planning processes.

1.6. These amounts, including forward estimates, may be subject to specific savings measures at any given time. One of the key measures which has been in place for a number of years, is the Efficiency Dividend, which is a savings measure applied to all Commonwealth entities (unless specific exemptions have been obtained) to find efficiency improvements within the public service through an annual percentage reduction applied to funding amounts.

1.7. Once the Budget process is finalised through the passing of relevant legislation, Commonwealth entities have a basis from which they can establish their internal budgets. The internal budget setting process can also be used to inform the external budget process.

Funding within in the Commonwealth Public Sector

1.8. Commonwealth entities receive funding through a number of sources. Whether they are permitted to retain this funding for their own internal use is dependent upon the nature of amounts received, as set out in the relevant sections of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

1.9. The most common types of funding include:

- annual ordinary appropriation funding, which is used to fund some or all of the day-to-day operations of Commonwealth entities;
- special appropriation funding, which is based upon specific other legislation and relates to a specific purpose;
- other relevant receipts, which are retainable under Section 74 of the PGPA Act; and

Administered revenue, such as taxes, may also be collected, however must be returned to the Commonwealth and cannot be retained for entity use.

The Budget process relative to the Australian National Audit Office

Responsibilities for the ANAO and its financial management

1.10. The Auditor-General is an independent officer of the Australian Parliament, whose mandate and functions are set out in the *Auditor-General Act 1997* (the AG Act). The Auditor-General is assisted by the ANAO in delivering against this mandate, and in this capacity, the Auditor-General is the Accountable Authority of the ANAO, as established within the PGPA Act for heads of relevant Commonwealth entities. The ANAO is located within the Prime Minister and Cabinet portfolio for budgeting purposes.

1.11. As the Accountable Authority for the ANAO, the Auditor-General is responsible for the financial management of the entity, per section 15 of the PGPA Act. These responsibilities include the requirement to govern the entity, manage the operations and make decisions in a way that promotes the:

- proper use and management of public resources;
- achievement of ANAO's purpose; and
- financial sustainability of the entity.

1.12. The internal budgeting process is a key component of how an Accountable Authority oversees and delivers on these responsibilities.

Powers and mandate of the Auditor-General

1.13. The powers which are given to the Auditor-General under the AG Act underpin the activities of the ANAO, and form the basis for the funding it receives through the Government's Budget process. The AG Act provides the legislative authority for core activities undertaken, which primarily relate to the delivery of financial statements audits and the delivery of performance audits. Of particular note:

- the delivery of financial statements audits is mandated, and as such, the ANAO must deliver in line with these requirements within the funding model provided to it.
- the delivery of audits of the performance of Commonwealth entities is not mandated, and while the legislation provides the mechanism to undertake these engagements, there is not a legislative obligation to do so. Accordingly, resourcing priority is given towards delivery of financial statements audits, however, in order to meet its desired outcomes and program objectives, these activities are given high importance within the ANAO.

1.14. Furthermore, the Section 50 of the AG Act sets out some additional provisions which enable the ANAO to retain accumulated prior year funding. Without this section, the ANAO would be required to return unspent funds after a period of time, in line with the majority of other Commonwealth entities.

1.15. The Joint Committee of Public Accounts and Audit (JCPAA) also plays a role in the ANAO's budgeting process, through considering and making recommendations to the Parliament on the annual draft budget estimates of the ANAO. The ANAO provides the JCPAA with a series of briefings on the ANAO's expected requirements each year, and the Committee is required under its legislation (*Public Accounts and Audit Committee Act 1951*) to consider the draft estimates of the ANAO and to make recommendations to both Houses of the Parliament and to the Prime Minister on the ANAO's draft estimates.

Funding received by the ANAO

1.16. The ANAO, as a non-corporate Commonwealth entity, as defined within the PGPA Act, receives the significant portion of its funding through annual appropriations. Specific funding received by the ANAO is included in the table below:

Source	Description
<i>Departmental Annual Appropriations</i>	Funding for day-to-day operations. This amount also includes a capital budget for specific capital expenditure.
<i>Special Appropriations</i>	Funding provided in relation to the Auditor-General's salary and entitlements, as determined under the <i>Remuneration Tribunal Act 1973</i> .
<i>Received Revenue</i>	Retained revenues for the ANAO include:

	<ul style="list-style-type: none"> • audit fees for audits undertaken by arrangement under section 20 of the <i>Auditor-General Act 1997</i>; • revenue receiving for specific projects from other Government agencies; and • Other ad-hoc and recoverable revenue.
--	--

1.17. The ANAO also receives administered revenues for conducting audit activities for corporate Commonwealth entities. This revenue is returned to the Commonwealth and is not able to be retained or spent by the ANAO.

The ANAO's Annual Expenditure

1.18. The ANAO has a relatively simple operating model, with its purpose and outcomes largely delivered through internal staffing, or contracted-out arrangements. Accordingly, its annual expenditure is primarily made up of employee and supplier expenses.

1.19. Accordingly, within the ANAO's operating model, only a small proportion of annual expenditure would be considered discretionary. The following chart outlines the average proportion of the ANAO's internal budget by key category over the period 2017-18 to 2018-19.

Average Expenditure - 2016-17 to 2018-19

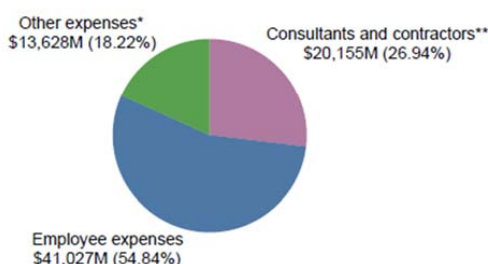


Chart 1: Average expenditure between 2017-18 and 2018-19.

*Other expenses include items such as travel costs, ICT costs and investments.

** Consultant and contractor expenditure is primarily directed to audit activity.

2. Detailed Findings

Budget Process

Criteria 1: *The Budgeting process links to organisation planning, supports the achievement of identified purpose and outcomes and future capability needs, and considers external factors and pressures.*

Overview

The ANAO's purpose and outcomes

2.1 The ANAO's purpose, as documented in the annual PBS statements and the ANAO Corporate Plan 2020-21, is:

To support accountability and transparency in the Australian Government sector through independent reporting to the Parliament, and thereby contribute to improved public sector performance.

2.2 To support overall performance measures, all Commonwealth entities are required to define relevant outcomes associated with their purpose, as well as the programs which are put in place to achieve these outcomes.

2.3 The ANAO has one outcome associated with this purpose, being:

To improve public sector performance and accountability through independent reporting on Australian Government administration to Parliament, the Executive and the public.

2.4 The ANAO has put in place two programs to deliver on this outcome, being:

Program 1.1 – Assurance Audit Services:

2.5 This program contributes to the outcome through:

- providing assurance on the fair presentation of financial statements of the Australian Government and its controlled entities by providing independent audit opinions for the Parliament, the Executive and the public;
- presenting two reports annually addressing the outcomes of the financial statement audits of Australian Government entities and the consolidated financial statements of the Australian Government, to provide the Parliament with an independent examination of the financial accounting and reporting of public sector entities; and
- contributing to improvements in the financial administration of Australian Government entities.

Program 1.2 – Performance Audit Services

2.6 This program contributes to the outcome through:

- audits of the performance of Australian Government programs and entities, including identifying opportunities for improvement and lessons for the sector; and
- other assurance reviews and information reports to Parliament.

2.7 Through these programs, the ANAO provides support to the Parliament on its audit work through submissions, appearances and briefings to committees and to individual Ministers.

2.8 The ANAO's Corporate Plan outlines its performance measures and targets, which have been developed to measure overall performance against these program objectives. These KPIs provide a range of benchmarks through which internal budgets can be established.

The ANAO's Internal Budgeting Process

The ANAO's Budget Framework

2.9 Overall, the budget process adopted by the ANAO was found to be mature and robust. The process is supported by a documented framework, which is underpinned by the following key documents:

- Financial and Budget Strategy;
- 2019-20 Internal Budget Process document; and
- Internal Budgeting Guiding Principles.

2.10 Providing further support to these documents are a number of other guidance and instructional materials, including the Auditor-General's Instructions and the Financial Management Procedures.

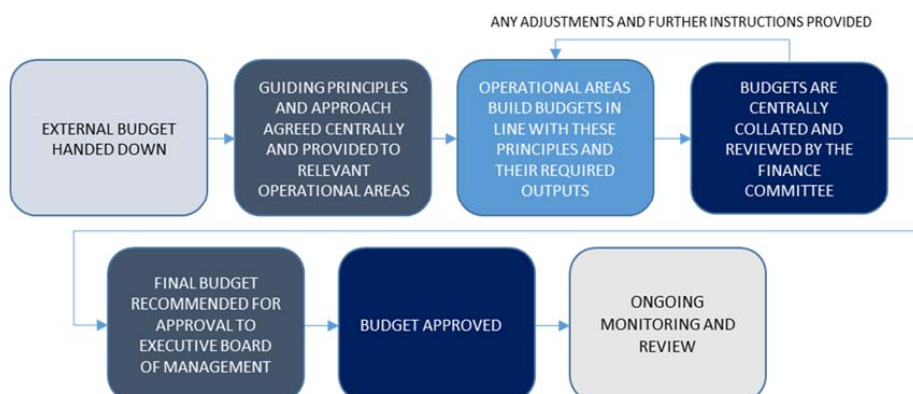
2.11 An integrated software tool, TM1, is used to conduct the end-to-end budgeting process. The use of a budgeting tool supports the consistency and integrity of the overall process, through a number of in-built system controls, reporting and workflows.

2.12 Further analysis of the ANAO's Budget Framework is included in the *Formalisation of Framework and its Operational Effectiveness* section of this report.

The budget approach adopted: Entity level

2.13 As detailed in the *Background* section of this report, the ANAO is provided with the majority of its funding through the Government's annual Budget Process. This process provides the ANAO with a baseline from which internal budgeting can be established.

2.14 In developing operational-area budgets, there is a clear alignment to the required outputs of the organisation, and budgets are built on this basis before being aggregated and assessed at the overall entity level. The following diagram outlines the key steps undertaken in this process:



2.15 The *Governance Arrangements* section of this report provides further detail relating to the governance and oversight mechanisms put in place to support the internal budgeting process.

The budget approach adopted: Audit level

2.16 Within AASG, there is an established annual process which is undertaken to review 'baseline' budgets for each financial statement audit engagement. Through this process, engagement executives must have any changes to audit level budgets approved. This process also balances the external supplier budget requirements for contacted-out engagements, through which a competitive market tender process is undertaken to determine individual and forward year budgets for these engagements.

2.17 Within the ANAO, there is an annual process to develop the Annual Audit Work Program, including the identification of potential performance audit topics for the upcoming financial year. Through this planning process, a preliminary budget setting process is overseen and approved by senior members of PASG and is built and phased in TM1. Decisions surrounding individual budgets are made at the time of scoping, with approvals sought over the audit work plan at the Senior Executive level and subsequently by the Auditor-General. Quarterly meetings are also held with the Auditor-General to provide a program update, covering discussion items such as scheduling, budgets, scopes and teams. This is also overseen and approved by senior members of PASG as well as the Auditor-General.

Assessment against Criteria

Budget alignment to overall purpose and outcomes: Entity level

2.18 In developing its annual internal budget, the ANAO was found to have a clear alignment between its overall budget process and its corporate planning, purpose and outcomes.

2.19 The ANAO adopts a hybrid approach to budget development, with a combination of top-down and bottom-up methodologies applied in formulating the overall budget. Through this approach, broad goals, parameters, guidance and instructions are provided to each of the relevant groups within the ANAO, which build their budgets accordingly.

2.20 It is through this approach that there is a clearly demonstrated linkage between purpose and outcomes and the budgeting process. Through this approach, it was also observed that appropriate stakeholders in the organisation are involved through the budgeting process.

2.21 The review observed that the internal allocation of resources aligned to the ANAO's priorities and required outputs for a given financial year, with a clear focus on the mandated requirements under the AG Act. Furthermore, the Auditor-General, through the corporate planning process, has established a number of performance measures and targets that are considered when prioritising resources and developing internal budgets between the various groups.

2.22 It was however noted that the ANAO's internal budget is not multi-year focused. A better practice approach to internal budgeting looks beyond the current financial year and into forward periods, to enable detailed planning in parallel with key organisational strategies, such as workforce planning and investment strategies.

2.23 Discussions with the ANAO outlined that there is an intention to move to this approach in the future, and to align future budgets to the ANAO's PBS, which provides a four-year forecast.



Recommendation 1 – Setting the Internal Budget for Forward Years

The ANAO should extend its internal budgeting to forward years, to provide greater alignment to key corporate strategies and priorities, and to enable a more strategic forward outlook to assist in managing future risks and operational pressures.

ANAO Comment: Agreed

Budget alignment to overall purpose and outcomes: Audit level

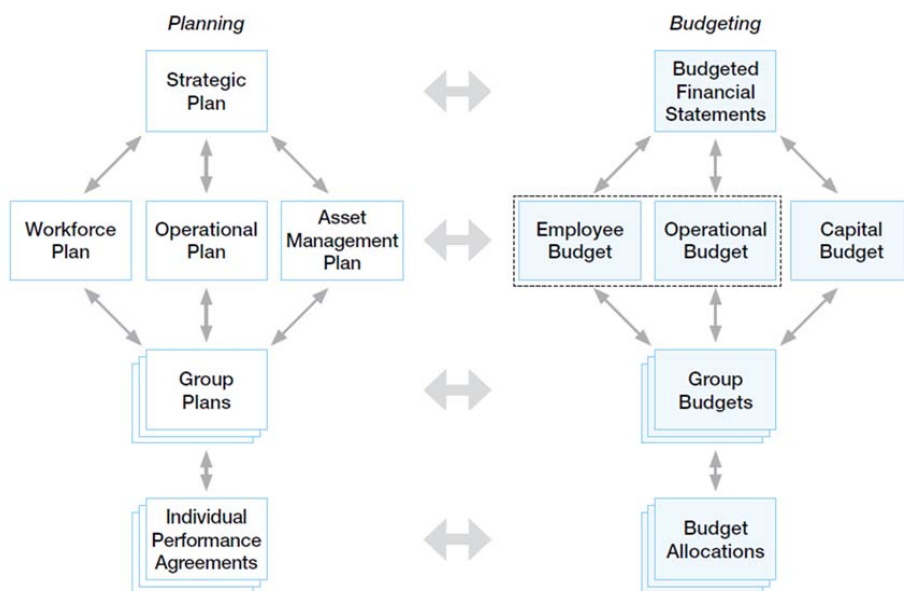
2.24 The Assurance Audit Services Group (AASG) and the Performance Audit Services Group (PASG), which are responsible for the delivery of audits, were able to demonstrate a clear link between their organisational objectives and requirements and the establishment of their group level budgets, which then flows down to setting their individual audit level budgets.

2.25 It was also noted that decisions around budget setting within both AASG and PASG are made giving consideration to the ANAO's broader KPIs, as established by the Auditor-General, which establish relevant benchmarks relating to areas such as the overall number of engagements and average costs per engagement. As detailed above, decisions relating to the number of these engagements directly relate to the ANAO's mandated requirements under the AG Act.

Consideration of future investment, capability needs, and external factors and pressures

[Link to the ANAO's operational model and strategies](#)

2.26 As outlined in *Section 1: Introduction*, there is an important linkage between an organisation's internal budget setting process, and organisational planning. The following diagram illustrates the synergies and relationship between the two processes:



Source: ANAO Better Practice Guide: Developing and Managing Internal Budgets p10

2.27 In assessing the ANAO's organisational planning, there are a number of key strategies which inform future operational direction. These include the Capital Management Plan, Workforce Plan and other Operational Plans at the entity and group level.

2.28 Overall, the review noted the alignment between how internal budget decisions are made and the direction of the various strategies within the ANAO. However, in review of relevant documentation supporting the budget process, it was noted that there is an opportunity to enhance how these are built into the budget setting process, and evidenced in decisions made.

Capital management plan

2.29 The ANAO is provided funding for capital purposes through its annual appropriation, which includes a departmental capital budget component. This funding is also supplemented, when required, through the ANAO's accumulated reserves, which are made up of prior years' unspent funding. The ANAO has an internal policy in place which determines how accumulated reserves can be used

2.30 While the ANAO does not have a high proportion of capital expenditure, it has recently undertaken significant capital investment, primarily in relation to the office relocation and refurbishment. Other key capital considerations include its IT and other technology related holdings.

2.31 In undertaking this review, the capital management plan used for 2019-20 and earlier financial years could not be located, and there was not a clearly demonstrated linkage in how this was utilised to align capital planning with the internal budget process. Whilst noting this, evidence of planning and executive monitoring was provided in relation to major expenditures for the 2019-20 period, including some consideration through the Financial and Budget Strategy.

2.32 The ANAO is currently developing its three-year forward Capital Management Plan, and there may be an opportunity to better integrate capital planning and capital budgeting processes into future budget periods.

Internal investment

2.33 The ANAO's Corporate Plan outlines a number of capability investments that will be required to support the achievement of the ANAO's purpose in the current environment. The key areas outlined include:

- data analytics uplift, which is supported by a Data Analytics (DA) Strategy;
- growing and maintaining a skilled and professional workforce;
- supporting contemporary communication, particularly with the Parliament; and
- ensuring quality in its audit work.

2.34 Discussions with key stakeholders within the ANAO in the budgeting process have highlighted that the savings benefits from these investments are currently being realised through offsetting increased costs from the external pressures facing the organisation. Refer to *consideration and understanding of external factors and pressures* in the section below for further detail relating to these pressures.

2.35 In reviewing the internal budgeting process for current and prior years, while there are links to the above areas of investment, there is an opportunity to better integrate these existing and planned investments into the budgeting process and more specifically, forward year estimates. Intended benefits from these investments should be more readily quantified and factored into the budgeting process to support decision making for current and forward years.

Workforce planning

2.36 The ANAO has workforce planning strategies, with key stakeholders involved in developing such strategies involved in the budgeting process. It is therefore acknowledged that aspects of workforce planning are considered in setting the internal budgets. There is however an opportunity to more clearly demonstrate integration and consideration of workforce planning in the budgeting process. For example, the linkage between capability and development needs to key components of the budget.



Recommendation 2 – *Incorporate and evidence key operational plans and strategies into the budget setting process.*

As part of the annual budget setting process, the ANAO should:

- identify key internal plans and strategies which impact the internal budget; and
- strengthen and evidence the alignment of key internal plans and strategies to the internal budgeting and decision making processes.

ANAO Comment: Agreed

Consideration and understanding of external factors and pressures

2.37 From review of documentation and interviews with senior stakeholders within the ANAO, there is clear evidence that both internal and external environmental pressures are both known and understood throughout the organisation.

2.38 The key internal and external factors and pressures which have been noted through the internal budget process include the following:

External Factor or Pressure	Detail
Ongoing audit quality requirements	<p>The ANAO's core business is providing audit reports to the Parliament. Audits are delivered under the ANAO Auditing Standards. These standards establish a baseline by which auditing services must be delivered, and there is a necessary and ongoing focus on quality when delivering services under these standards.</p> <p>Given these requirements, efficiency gains in delivery of these services are limited, as there are minimum expected requirements in how these standards must be adhered to. In addition, these expectations and requirements to enhance audit quality have been increasing substantively over the last five years, and will continue to in the foreseeable future. There are a range of quality standards which must be maintained, and requirements to have both internal and external quality programs, which assess relevant compliance with these frameworks and standards. The ANAO is subject to both an internal quality assurance program, as well as externally through reviews of financial statements audits by the Australian Securities and Investment Commission (ASIC), and for performance audits, peer review by the Office of the Auditor General, New Zealand.</p> <p>Furthermore, audits of financial statements require conclusions to be made against a number of other standards and frameworks in the public sector, primarily being the Australian Accounting Standards (AAS) and the PGPA (Financial Reporting) Rule 2015 (FRR).</p> <p>These standards are also subject to changes periodically, and when this occurs, there are additional cost associated with the adoption of these changes. Two recent examples of this include the introduction of <i>AASB 16 – Leases</i>, and <i>AASB 15 – Revenue from Contracts with Customers</i>. Both of these standards have</p>

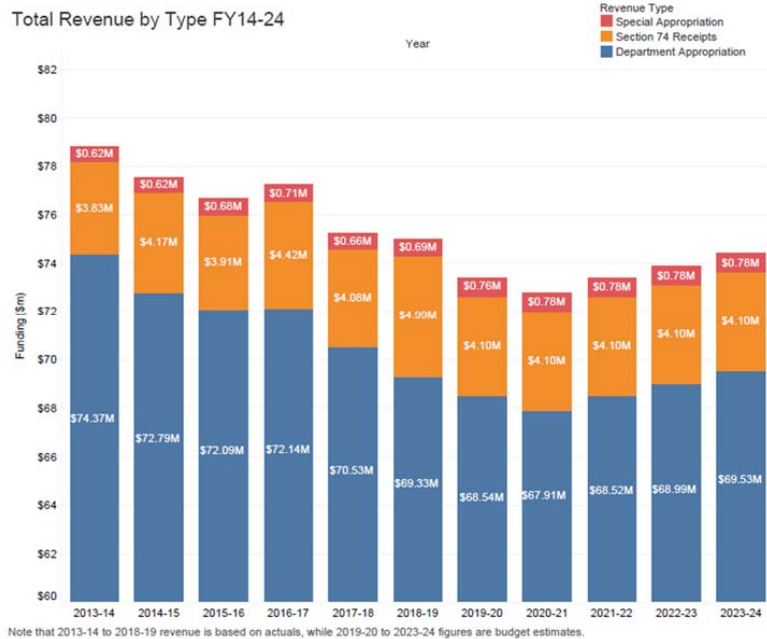
	<p>been adopted by Commonwealth entities during the 2019-20 financial year, and there is a necessary increase in the audit effort required to be applied.</p> <p>It is also acknowledged that, whilst the ANAO looks to invest in data analytics and other technology capabilities, the ongoing cost of investment and the skillsets needed limit efficiencies obtained, however these initiatives contribute to a higher quality audit overall.</p>
Staffing salary increases and CPI increases in the market	<p>The ability to attract and retain high quality audit staff is an issue for the auditing profession both in Australia and globally. The ANAO, like other auditing professional firms, is facing challenges relating to increasing salary costs, as well as general market increases, such as CPI.</p> <p>Staff at the ANAO, through their enterprise agreement negotiations, have received salary increases averaging 2 per cent over recent years, which has a significant impact on the ANAO given the high proportion of annual employee costs compared to total expenditure¹.</p> <p>Furthermore, while supplier costs are not as high as employee costs proportionally, the ANAO is exposed to any market increases through general supplier costs, including the cost of out-sourcing the delivery of financial statements audits to the private sector. For the 2020-21 budget it is estimated that approximately 42 per cent of audit fees relate to out-sourced arrangements.</p> <p>As highlighted overleaf, these increases are being experienced in a period where the ANAO's funding is declining.</p>

¹ The ANAO, in accordance with the directions made within the Australian Public Service, did not pay the scheduled pay rise in April 2020.

Efficiency dividends and staffing level caps

As highlighted in *Section 1: Background*, the ANAO, along with other Commonwealth entities, is subject to an efficiency dividend, which is in place as a Government saving measure to encourage efficiencies in the operations of Commonwealth entities. For the 2020-21 financial year, this efficiency dividend is set at one percent.

With this savings measure being in place for a number of years, the ANAO has seen a consistent reduction in funding available to deliver its services, with an overall reduction in appropriation revenue since the 2013-14 financial year².



This reduced funding creates a number of challenges which must be managed by the ANAO, given its delivery requirements and overall purpose.

The external pressures within the ANAO's market, combined with the reducing funding model available to it, creates a number of risks and challenges to its forward position and over recent years, the ANAO has experienced a number of operating losses.

It is noted that this has also been impacted by recent capital investment undertaken by the ANAO. As highlighted in *Link to the ANAO's operational plan and strategies* above, the ANAO has put in place a budget policy which enables it to draw upon reserves to fund capital investment and other initiatives.

Per broader government requirements, the ANAO is also subject to an average staffing level (ASL) cap, which determines the total number of full time staff they can be funded across a financial year. This limits the ANAO's ability to bring additional audits in-house in place of contract-out arrangements.

The impact of audit issues identified and

Other costs and requirements associated with the ANAO

As with any organisation, the ANAO is also subject to unplanned disruptions relating to its core operations. In relation to audit activities, this is often

² This analysis only includes departmental revenues.

<p>Government changes</p>	<p>encountered through the identification of audit issues on specific engagements. Identification of issues, and particular audits, may also result in additional efforts relating to Parliamentary enquiries and other Government briefings.</p> <p>Within its existing model, these impacts are not planned for within the internal budget, and there are limited means by which the ANAO may recover any of this additional effort through additional funding.</p> <p><u><i>Impact of changes to Commonwealth entities</i></u></p> <p>The Government may make decisions relating to the creation, abolishment or merging of specific Commonwealth entities in order to deliver on its broader policies.</p> <p>Under the AG Act, the ANAO is required to undertake financial statements audits of Commonwealth entities. Accordingly, any changes to this listing of entities in any given year can have a flow on impact to the number of audits required to be delivered by AASG.</p> <p>Under the ANAO's funding model, it does not receive any additional funding to deliver on these changes, and similarly, does not have budget removed should an entity be abolished.</p> <p>In recent years, the ANAO has seen a net increase in entities and costs associated with changes in machinery of government. In instances where Government entities are merged, these can also create additional short and longer term increases in costs, depending on complexities within these agencies.</p> <p>Specifically, audits of new agencies, whether achieved through outsourced arrangements or through in-house resources, must be absorbed within the current budget.</p> <p>Between 2017-18 and 2019-20, the number of new and ceased entities (excluding non-mandated audits) was 28 and 15 respectively, seeing an increase entities requiring audit activities increasing by 13 over this time.</p>
----------------------------------	---

The ANAO's overall funding model and ability to manage external pressures

2.39 The ANAO's funding model is relatively set, in that it is appropriated monies to deliver on its outputs, and has limited means through which additional funding can be obtained to deal with various circumstances as they arise.

2.40 While in other private sector practices, additional fees could be charged or obtained from relevant clients, this is not an option for the ANAO, as additional monies received would typically be required to be returned to the Commonwealth under provisions of the PGPA Act.

2.41 The primary means by which Commonwealth entities are able to obtain additional funding is through New Policy Proposals (NPPs), however there are a number of criteria that must be met in order to obtain such funding, in line with the Government's forward fiscal policies. This includes that any NPPs must be offset by other savings within the portfolio.

2.42 The impact of pressures identified above can differ across the ANAO, depending on where they are experienced:

- within PASG, additional time and effort spent does not result in additional costs to the organisation, however impacts the timelines and timeframes available to deliver on the desired performance audit outputs;

- within AASG, given the nature of the significant body of its work in financial statements to be delivered within Commonwealth reporting deadlines, there are varied impacts. Delays and overruns in relation to AASG can have the following impacts:
 - for in-house engagements, additional hours required to be worked by ANAO staff.
 - the need to bring in additional contract resources to supplement audit activity due to reporting deadlines.
 - The need to utilise resources from PASG, which can impact on performance audit outcomes.
 - for out-sourced audits, contractual obligations may enable external providers to request additional funding from the ANAO in instances where there is a reasonable change in scope. These costs, when approved, must be absorbed by the ANAO within its existing budget.

2.43 The section below outlines the various activities undertaken by the ANAO in response to these pressures.

The ANAO's response to Internal and External Budget Pressures

2.44 ANAO's prioritisation of internal resources within these constraints and in response to the aforementioned pressures is embedded in the budgeting process.

2.45 As highlighted within *Section 1: Introduction*, under its enabling legislation, there are specific mandated requirements which the ANAO must fulfil relating to financial statements audits.

2.46 This prioritisation is evidenced through the annual budgeting process, and consideration is given to where and how resources are allocated to meet overall objectives, based on particular priorities. These priorities consider:

- areas of discretionary spending, which are limited given the ANAO's operating model; and
- outputs which are a mandated requirement, which prioritises the delivery of the ANAO's financial statements audit functions over other activities, such as performance audits.

2.47 As highlighted in Chart 2 below, the ANAO has responded to budget pressures in recent years through a reduction in performance audit activity. Specifically, the number of performance audits has declined from 59 to 44 between 2016-17 and 2019-20³. The ANAO has predicted that this number may fall to 38 by 2023-24.

³ Source: PASG annual tabling schedule reports

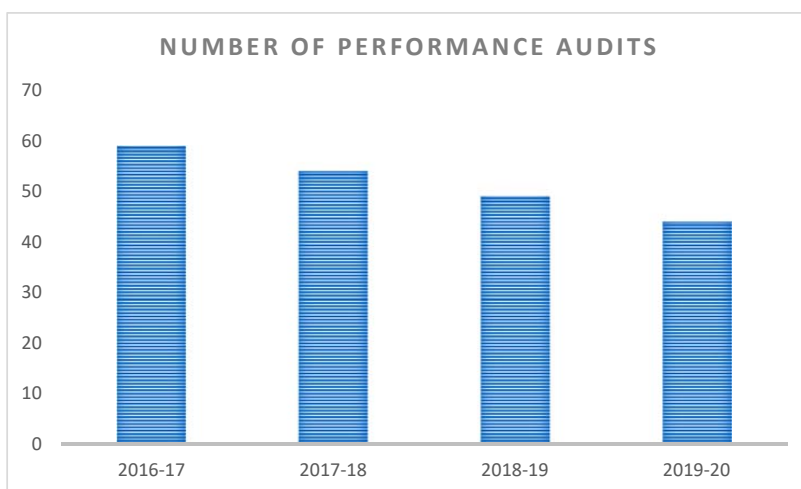


Chart 2: Performance audit volumes per ANAO's Annual Tabling Schedule Reports

2.48 While the scope of this review has not considered the efficiency and effectiveness in the individual delivery of audits, other internal approaches observed through this review to demonstrate the actions the ANAO has undertaken to identify budget related efficiencies. These include:

- an efficiency review undertaken within AASG to review relevant risk and materiality levels of its audits, to identify areas where savings could be made;
- ongoing benchmarking activities undertaken by the ANAO over costs of assurance audit activities;
- implementation of varying types of performance audits, included some limited scope reviews, and reviews with a smaller scope;
- for outsourced financial statements audits, tendering processes which test market prices amongst other considerations. This also includes consideration of whether audits should be delivered in-house or contracted out; and
- ongoing investment in areas of audit efficiency, such as data analytics capabilities.

Governance Arrangements

Criteria 2: *There are appropriate governance arrangements to review, approve and oversee internal budgeting and forecasting at the group-level and audit-level*

Assessment against Criteria

Governance structures supporting the overall budgeting process

2.49 The ANAO has put in place a number of key governance and oversight mechanisms, each with clearly defined roles and responsibilities throughout the budgeting process. Furthermore, there are clearly defined roles and responsibilities for key personnel within the ANAO who play a part in the development of the budget.

2.50 The key governance and oversight bodies with budget responsibilities include:

- the **Executive Board of Management (EBOM)**: EBOM has overall responsibility for budget related decisions and final approval of the internal budget.
- the **Finance Committee**: The Finance Committee supports EBOM, by making recommendations on annual and mid-year budgets and through coordinating with key areas of ANAO's business to provide constructive review and challenge at key points in the process.
- the **People and Change Committee**: The People and Change Committee supports EBOM by managing the ANAO's Learning and Development strategy and training budget, which forms part of the budget setting process as a key area of both internal investment, and discretionary spending within the ANAO's annual budget.

2.51 The roles and responsibilities for each of these committees is documented within their respective Terms of Reference.

2.52 Budgeting roles and responsibilities of key stakeholders within the organisation, including those in service groups, are documented through the 2019-20 Internal Budget Process document, and these were found to be well understood throughout the organisation. These roles and responsibilities outline the various decision makers within the overall process, and the roles of the key governance bodies, as outlined above. The review also found that decision makers within the organisation were at an appropriate level.

2.53 Further supporting the strength of the overall governance processes is the use of TM1 in setting the overall process. As outlined in Section 2.1 of this report, this provides confidence in the information and approvals underpinning this process.

2.54 Overall, the ANAO was able to demonstrate a clear process over how these governance arrangements support the delivery on its responsibilities and through key decision making and approvals. The broader process, which is led by the CFO, was found to be clear, and provide an appropriate structure and framework to develop and deliver the annual internal budget.

Governance Processes within AASG and PASG relating to Audit Level budgets

2.55 Each of AASG and PASG were found to have established internal processes relating to the review, oversight and approval of audit level budgets. As highlighted in the *Overall Budget Processes* section of this report, this process gives consideration to organisational priorities and objectives, as well as KPIs for the ANAO.

Assurance Audit Services Group

2.56 Within AASG, there is an established annual process which is undertaken to set 'baseline' budgets for each financial statement audit engagement. Through this process, any changes to the prior year budgets must be reviewed and approved by the relevant executive as well as the Senior Executive Director and Group Executive Director.

2.57 In addition to this, other periodic exercises to review the overall baseline to find potential efficiencies were observed, with this process overseen and approved by the relevant group head.

2.58 On an individual audit basis, there are established governance and approval processes in place to monitor ongoing audit progress, forecast any budget related issues and to approve changes in budget scope and overruns.

2.59 No observations have been made in relation to the governance arrangements in place to approve and monitor individual audits within AASG.

Performance Audit Services Group

2.60 Within PASG, a preliminary budget setting process is overseen and approved by senior members of PASG, and quarterly meetings are then held to provide program level updates to the Auditor-General. The budget setting process for individual audits is overseen and approved by senior members of PASG as well as the Auditor-General.

2.61 On an individual audit basis, there are established governance and approval processes in place to monitor ongoing audit progress, forecast any budget related issues and to approve changes in budget scope and overruns.

2.62 Further analysis and discussion on the operational effectiveness of approvals and monitoring is included in the *Formalisation of Framework and its Operational Effectiveness* section of this report.

Formalisation of Framework and its Operational Effectiveness

Criteria 3: *The internal budgeting framework is appropriately formalised, and operating effectively at entity and audit levels*

Assessment against Criteria

The ANAO's Budget Framework and Supporting Documents

2.63 The ANAO's budget framework is set out through a number documents. The key documents which outline the budget process are the Financial and Budget Strategy, the 2019-20 Internal Budget Process document and the Internal Budgeting Guiding Principles document.

2.64 Providing further support to these documents are a number of other guidance and instructional materials, including the Auditor-General's Instructions and the Financial Management Procedures.

2.65 As outlined within *Section 2.2: Governance Arrangements*, roles and responsibilities within the ANAO were found to be clearly defined for stakeholders within the budget process. Key governance and oversight bodies, such as EBOM and the Finance Committee, have terms of reference which clearly outline responsibilities in relation to ANAO financial and budgeting matters.

2.66 Key assumptions and priorities are understood across the organisation with key decisions to prioritise mandated requirements made by the Finance Committee. Budget assumptions and priorities are communicated to groups by the CFO during the commencing stages of the internal budget process via email.

2.67 The review found that there was an appropriately formalised framework to support the overall budget process, but also that documentation could be improved and made more readily available to key stakeholders within the ANAO. It was identified that:

- some aspects of the framework were not reviewed on an annual basis, and the documents themselves do not define requirements for periodic review and refresh;
- key documentation was not readily accessible to key stakeholders, such as staff involved in the development of group level budgets, with these documents found only within the Executive Board of Management meeting papers; and
- some key elements relating to key assumptions and priorities within the organisation to support groups in the development and ongoing management were not included within the documents underpinning the framework. Instead, agreed assumptions and priorities are currently communicated to groups via email as part of a broader set of instructions.

There would be benefit in including additional guidance materials to key groups within the ANAO to outline expectations around monthly variance reporting. This is discussed further below.



Improvement Opportunity – Review, update and formalise framework documentation

To support more timely, accessible and relevant supporting documentation, the ANAO should consider reviewing its key budget documentation. This review could include consideration of the following areas to enhance and formalise the existing framework:

required timeframes for document review; and

where all approved assumptions, priorities and principles should be documented and evidenced.

Consideration should also be given to making key documentation available to all stakeholders involved in the budgeting process.

Operational Effectiveness of Budget Approvals and Monitoring and the Entity Level

2.68 The review was able to confirm the operational effectiveness of internal approvals and oversight relating to the approval of internal budgets for the 2019-20 and 2020-21 financial years, noting complexities in the provision of funding for the 2020-21 financial year due to delays in the Government's budget processes due to the global pandemic.

2.69 Ongoing monthly monitoring and periodic reviews of the overall budget were also consistently undertaken and reported to the ANAO's relevant governance bodies.

2.70 No issues were noted at the Group or ANAO level regarding oversight, quality assurance and approvals for group and entity level budgets. It was noted that the use of TM1 supported the quality and consistency of this process.

2.71 Sample testing undertaken confirmed that commentary is provided by all groups to explain budget versus actual figures. Instances were also noted where follow up activity was requested by EBOM, and appropriate follow-up activity was undertaken through the Finance Committee and by relevant stakeholders.

2.72 While testing undertaken confirmed the consistency of reporting in line with internal requirements, detailed sampling of monthly budget monitoring and forecasting noted that commentary provided in relation to budget to actuals was not always comprehensive.

2.73 There is an opportunity to develop and provide further formal guidance which outlines expectations for monthly reporting to support the quality and consistency of agency-wide analysis.



Improvement Opportunity –*Formalise expectations, guidance and requirements for monthly budget reporting and variance analysis.*

To support stakeholders within the organisation, the ANAO could consider developing formal guidance materials which outline relevant requirements, including examples, to assist in enhancing the quality and consistency of monthly analysis.

This could include:

- relevant thresholds for reporting;
- detail of analysis and supporting information provided; and
- expectations for follow up activity.

Operational effectiveness of budget approvals and monitoring at the Audit Level

2.74 At the group level, both AASG and PASG were found to have established processes to develop and approve individual audit budgets, as well as monitor and forecast expenditure.

2.75 To assess the effectiveness of budget approvals and monitoring at the audit level, a sample of five audits was selected from both AASG and PASG to assess:

- approval of the initial budget, including assumptions applied in development for in-house audits;
- approval of budget revisions (where applicable);
- regular monitoring of budgets; and

- regular forecasting.

Assurance Audit Services Group

2.76 Within AASG, the annual process is also driven through key performance indicators as established by the Auditor-General. These indicators set a baseline for setting budgets relating to the delivery of financial statements and other assurance audits within AASG.

2.77 There are established processes in place to approve any changes to prior year budgets, and evidence was found to be maintained for these changes.

2.78 From sample testing undertaken, no observations were noted from the five samples reviewed and evidence reviewed was in accordance with the *AASG Flashsheet – Baseline and Project Budgets*.

Performance Audit Services Group

2.79 From sample testing undertaken, the following observations were noted from the five samples reviewed:

- Necessary budget variation requests were not approved in relation to overruns on three audits, relating to overruns of 55%, 13% overrun and 4% respectively for the samples reviewed.
- It should be noted that PASG's internal process requires approval of variations, with the required approver determined by the extent of the overrun.

2.80 It is acknowledged that at the time of the review, PASG were in the process of enhancing its monitoring and variance approval processes.



Recommendation 3 – Review budget variation processes within PASG

PASG should review its internal processes relating to budget overruns to ensure there is appropriate monitoring and approval of variations to original baseline budgets.

Consideration should also be given to providing additional training or education to audit teams in relation to expected requirements.

ANAO Comment: Agreed

Post budget review and approach to continual improvement

2.81 As part of ongoing monitoring and effectiveness of the overall budget process, a better practice approach should information an element of continual improvement and review.

2.82 In reviewing the ANAO's annual processes, it was found that there is an opportunity to enhance the continuous improvement culture with respect to benchmarking, reflection and lessons learnt following the internal budgeting process.

2.83 It is understood that plans are in place to progress this, which would include seeking and acting upon feedback from stakeholders.



Recommendation 4 – Implement post budget review process

The ANAO should implement a post budget review as part of its annual internal budget process. This should consider the efficiency and effectiveness of processes undertaken, to encourage continual improvement in future budget processes.

ANAO Comment: Agreed

Appendix A: Entity Response



Auditor-General for Australia



18 September 2020

Ms Eileen Hoggett
Independent Auditor

Dear Ms Hoggett

Thank you for your correspondence of 7 September 2020 providing the ANAO with a proposed report on your performance audit of ANAO internal budgeting and forecasting processes and practices.

I note your overall conclusion that the ANAO was found to have effective internal budgeting and forecasting processes and practices. You have made four recommendations which I agree will further strengthen the ANAO's processes. Your further insight and observations will assist us in continuing to build robust and reliable processes into the future.

Thank you for the opportunity to review the report.

Yours sincerely

Grant Hehir

GPO Box 707, Canberra ACT 2601
38 Sydney Avenue, Forrest ACT 2603
Phone: +61 2 6203 7500
Email: grant.hehir@anao.gov.au

Comments on recommendations

Short response (for page 7)

The ANAO welcomes the performance audit report and its conclusion that the ANAO has effective internal budgeting and forecasting processes and practices. The ANAO agrees that implementation of the recommendations made will further improve the ANAO's budgeting and forecasting processes and practices. The ANAO accepts the insights and observations made in the report and will consider these in its future budgeting and forecasting activities.

Recommendation 1

The ANAO should extend its internal budgeting to forward years, to provide greater alignment to key corporate strategies and priorities, and to enable a more strategic forward outlook to assist in managing future risks and operational pressures.

ANAO comment: agreed.

Recommendation 2

As part of the annual budget setting process, the ANAO should:

- identify key internal plans and strategies which impact the internal budget; and
- strengthen and evidence the alignment of key plans and strategies to the internal budgeting and decision making processes.

ANAO comment: agreed

Recommendation 3

PASG should review its internal processes relating to budget overruns to ensure there is appropriate monitoring and approval of variations to original baseline budgets.

Consideration should also be given to providing additional training or education to audit teams in relation to expected requirements.

ANAO comment: agreed

Recommendation 4

The ANAO should implement a post budget review as part of its annual internal budget process. This should consider the efficiency and effectiveness of processes undertaken, to encourage continual improvement in future budget processes.

ANAO comment: agreed