

Working with Auditors
Presentation to Defence Senior Leadership Group
Financial Management Course
Australian Defence College, Weston Creek
Speaking Notes - Ian McPhee, Auditor-General,
Thursday 9 October 2008

- Thanks for the invitation – I was pleased to be invited again to the Senior Leadership Group Financial Management course, and to provide my support to Defence’s ongoing emphasis on better governance and financial management;
 - The Australian Defence organisation is large and complex, and on any day of the week there are critical issues to be dealt with
 - : it is often difficult in such circumstances to say one issue is more important than another.
- I found it noteworthy, though, that, at the time of the change of Ministers in recent years, financial management featured heavily in the various comments and editorials as one of the key issues to be ‘dealt with’.
- And I notice 2 of the 6 major Defence priorities for 2007-08 have been:
 - good governance and accountabilities; and
 - strong business systems and effective process.
- The reasons are fairly obvious:
 1. to improve the quality of information for decision making and, in turn;
 2. to improve the efficiency and effectiveness of Defence operations; and
 3. to enhance the Defence organisation’s standing.
- I have observed the time and energy that senior Defence personnel have put into financial management improvement:

- : in launching Defence's Financial Flagship programme back in 2005, Ric Smith stated the initiative was '*a very significant change management programme*';
 - : Nick Warner is committed to continuing the change management programme beyond the Proust review; and flagged in his **Message from the Secretary** of 5 March 2008 that '*the current and future economic and strategic climate compels us to be better risk, financial and resource managers*', and one of his four main priorities is for *Defence to become a first class financial manager*.
 - : General Cosgrove, then CDF, in his direct style said '*There'll be no excuses accepted, to say "I'm very busy on operations". If we don't get the fundamentals fixed, that is, our finances, by taking responsibility and working with our people, then operational success will not be sustained and all the world will see we are half-baked.*'
 - : Angus Houston may not express the point in the same way, but is similarly determined to get on top of these issues.
- I am aware of the time commitment, by being here, that you are contributing, and the leadership role you are taking in having Defence achieve its goal of Defence being *recognised by Government as highly competent, professional and business-like financial managers*.
 - I notice also that the second of your goals was to have your '*accounts accepted by auditors*'.
 - Now, before getting to matters relating to your accounts, there are two things (at least) that you need to know about auditors:
 - 1) they are required to act with 'professional scepticism';
 - 2) until management representations are supported by evidence, they are merely 'management' assertions (ie: '*trust but verify*' - in your parlance).
 - So auditors are required to maintain their objectivity, follow matters through when they are significant, and look for support for positions advanced

- and always act in the public interest, not always in the interest of the client agency's management.
- My office has a broad mandate and wide powers of access and evidence gathering to allow us to undertake our audit programme;
 - my independence is protected under legislation including appointment for a 10 year term;
 - I am not subject to direction by Government in terms of my audit functions;
 - I have wide powers of access to information and records;
 - I am able to table Reports directly in the Parliament;
- These legislative arrangements allow me to report frankly on matters of public administration;
 - I do not have a role in commenting on the merits of Government policy, but can audit advice provided to Government and of course the implementation of Government programmes.
- I am required to audit the financial statements of Australian Government entities; and I may undertake performance audits of aspects of public administration as well.
- For their part, the administration of the Defence Department and DMO is subject to the *FMA Act*, including the requirement to prepare financial statements in accordance with generally accepted accounting standards;
 - and in terms of its general administration, the Department and DMO are expected to operate in an efficient, effective and ethical manner.

In terms of our financial statement audits, we look at issues such as:

- the soundness of internal controls,
- the integrity of financial information produced by Defence/DMO systems, and
- whether the accounting treatment accords with the Accounting Standards.

- The issues we have had in recent years relate around the integrity of
 - inventory balances; and
 - asset recording.
- It was pleasing to see that the qualification of the audit opinion on Defence's financial statements for 2007-08 was removed due to the remediation work undertaken by the department;
 - while there is more work to be done, it shows that success can be achieved by planning, delivery, and a lot of hard work and determination;
 - the key factors which have contributed to your success, from my perspective, have been:
 1. leadership from the top to address the financial reporting challenges;
 2. acceptance by the Services that they were part of the solution;
 3. more openness in discussion issues and business impacts
 4. a clear plan to overcome problems with specific annual targets / not biting off too much in any one year.
- As you are aware, the ANAO also audits several major acquisition projects each year in DMO, covering:
 - governance;
 - project and contract management;
 - performance against plans.
- In most performance audits, the ANAO adopts a fairly standard approach to its work, considering:
 - governance arrangements;
 - how entities manage risks to strong performance;
 - reporting and performance management systems;
 - management responses to performance variations;
 - outputs and outcomes (actual vs budget);
- We work hard to gain an understanding of the programme or project;
 - we seek and value the input of Defence personnel on all issues under review;
 - give recognition to measures taken to address issues;

- provide recommendations in areas where we consider performance can be improved;
- provide Defence with the opportunity to comment on issues papers and final reports.
- I would encourage you to assist the audit teams to understand your approach and perspective;
 - I encourage our teams to do this.
- We are currently working with DMO to develop a pilot report on the 'Top 30 projects'
 - recommended by the Joint Committee of Public Accounts and Audit, and supported by the Government.
- Defence is a large and very complex organisation;
 - it is not a commercial organisation and so, historically, has not had the stimulus of any serious focus on its accounts to encourage strong financial and project management, and financial performance.
- I understand this argument cuts both ways;
 - if we have a Defence organisation that undoubtedly has been successful in its missions, does it matter so much?
 - I think it does.
- Setting aside the debate about whether these issues impact on capability - that is, whether there is any impact on effectiveness - there is a serious economic cost in:
 - not having reliable information for decision-making;
 - building in redundancy to cater for deficiencies in systems and data quality; and
 - in budget extensions for major capital items.
- Under the current fiscal constraints, driving efficiencies in Defence administration is now very important;
 - there is an expectation that Defence will contribute up to \$1 billion annually in efficiencies and savings going forward, for

reinvestment in priority areas of Defence, and I would fully expect, for example, that better inventory management (through better information or inventory) would make a worthwhile contribution to this target;

As we also know, concerns about the standard of financial management can raise doubts in the minds of key stakeholders about the reliability of advice tendered by Defence in other areas, and potentially impact on the standing of Defence;

- the removal of the qualification of the audit opinion can only assist here.
- It is best for organisations to address their issues in their own way;
 - alternative approaches can be too ‘heavy-handed’.
- In the case of Defence, the remediation plans and the training you have put in place has been the best response to these issues:
 - you have had specific plans to address the financial reporting issues, and have in train a broadly based agenda to enhance governance and financial management in the Department;
 - there is considerable training effort being made in relation to both project and financial management.
- There does need to be an acceptance that financial management is part of everyone’s responsibility;
 - it is a simple message, but needs continual reinforcement.
- The extent to which financial management is part of all the different jobs in the Department and in the Services will obviously vary. Just as leaders and managers we are required to take an active role in issues such as communication, staff management, protection of information;
 - we need to also be concerned with financial management;
 - take an interest in it, ask some questions.
- The quality of the strategies employed and decisions made will obviously be critical to success.
 - as always, the plans have to be deliverable and delivered on.

- execution of plans is, or should be, a priority area, so that over time you will build on your successes.
- I am aware that you have a strong commitment at the top of the Department and the Services to overcome current systems and residual financial reporting challenges;
 - it is fair to say that the resolution of these issues has as much to do with people issues as accounting matters.
- The standards you have to meet in relation to financial reporting and financial management are not those set by the ANAO;
 - they are the standards that come with Defence's responsibilities as a Department of State, but,
 - more importantly, they are the standards you should expect as managers entrusted with significant public resources under your control.
- You have to believe you can make a difference:
 - and the people I talk to in the Department have a quiet resolve to get on top of the financial management and project management issues.
- You now have momentum. Keep it up.
- Thank you