

The Auditor-General

Audit Report No.10 1999–2000

Financial Statement Audit

**Control Structures as  
Part of the Audits of Financial  
Statements of Major Commonwealth  
Agencies for the Period Ended  
30 June 1999**

**Summary of Results**

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Canberra ACT  
9 September 1999

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major Commonwealth agencies as part of the audits of their financial statements in accordance with the authority contained in the *Auditor-General Act 1997*. The results of this audit activity and the outcomes achieved through this work are summarised in this report. I present this report of these audits to the Parliament. The report is titled *Control Structures as Part of the Audits of Financial Statements of Major Commonwealth Agencies for the Period Ended 30 June 1999—Summary of Results*.

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

Yours sincerely



P. J. Barrett  
Auditor-General

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

## **AUDITING FOR AUSTRALIA**

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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# Foreword

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In my Report No.20 1998–99 on the *Audits of Financial Statements of Commonwealth Entities for the Period Ended 30 June 1998*, I foreshadowed tabling a Report this year on financial systems, controls and processes supporting the financial statements of major Commonwealth agencies. This Report outlines the results of this audit work to 30 June 1999. It coincides with the introduction of new governance and financial arrangements by public sector agencies in response to the need for high quality accrual financial information for budgeting, reporting, decision-making and accountability. The ANAO seeks to contribute actively, through its auditing, to the Parliament’s understanding, and agencies’ implementation, of such financial management reforms.

The *Financial Management and Accountability Act 1997* places responsibility on Chief Executive Officers to manage the affairs of their agencies in a way that promotes the efficient, effective and ethical use of resources for which they are responsible—achieved in the main through appropriate governance arrangements, including effective control structures. This Report is concerned with improving the timely reporting and subsequent rectification of internal control weaknesses identified from examinations of control structures as part of the 1998–99 audits of financial statements of major Commonwealth agencies. The final results of these audits will be conveyed to the Parliament in my Report on the *Audits of the Financial Statements of Commonwealth Agencies* in November 1999.

The matters raised in this Report relate primarily to areas of risk, control and compliance. These areas are evaluated as an integral part of the audit of the financial statements, to the extent that it is intended to place reliance on them for the purpose of determining audit procedures leading to the audit opinion on the financial statements. In particular, the issues raised demonstrate the importance of having in place effective control structures that underpin the accrual based outcomes and outputs framework. In this regard, the implementation of financial and human resource management information systems, together with internal control issues dealing with risk management, information technology and communication, asset management and systems reconciliations, continue to be challenging areas for agencies.

While focusing primarily on the larger agencies, the ANAO will continue to assist all agencies with the financial challenges of the Commonwealth reform program. The ANAO's Better Practice Guides are a major source of information for agencies to assist with their initiatives to improve performance. In addition, our knowledge and understanding of public sector management can also help agencies implement their control structures effectively.

I would again like to take this opportunity to acknowledge the professionalism of my staff in undertaking the audit work, which culminated in this Report. Their efforts have enabled the tabling of this Report in a timely fashion. Further, I also record my appreciation for the level of cooperation extended by agencies in the audit process.

P.J. Barrett  
Auditor-General





# Executive Summary



# Executive summary

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1. This Report summarises issues regarding financial systems, controls and processes from examinations of major Commonwealth agencies as part of the audits of their financial statements. It raises significant issues warranting attention to improve the quality of the underlying control structures that support public sector financial performance and accountability. The following represent the major areas impacting on the adequacy of control structures within agencies:

- information technology (IT) controls;
- asset management;
- accounting systems and controls, including financial reconciliations;
- financial management information systems; and
- management reporting and financial monitoring.

2. The most significant common issues emerging from the audits concern inadequate protection over computer systems that record and process information; difficulties in reconciling departmental financial systems to the Department of Finance and Administration (DoFA) systems; and weaknesses in asset management impacting on safeguarding public assets. These areas, if not resolved, may also hinder the success and timeliness of the financial reforms being implemented by agencies. The ANAO has made a series of recommendations aimed at improving the adequacy and performance of agencies' control structures which, ultimately, will contribute markedly to the achievement of program outputs and outcomes.

3. The Report's timing is significant in that it brings important matters to the attention of the Parliament in advance of completion of the audits of financial statements. Traditionally, the ANAO has reported the results of audits of financial statements in December each year, at the conclusion of the final audit. The purpose and timing of this Report recognise the increased responsibility being placed on agencies to maintain effective control structures. The ANAO is committed to the timely reporting of significant matters to assist the Parliament in its oversight of the financial activities of Government. We will report the final results of the audits to the Parliament in November 1999.

4. The changing public sector financial environment has necessitated increased focus on the control structures that facilitate Chief Executive Officers meeting their responsibilities under the *Financial Management*

*and Accountability Act 1997*. As part of this shift, the audit of an agency's financial statements places greater emphasis on identifying significant business risks impacting on the agency and its financial operations, and an evaluation of the design and effectiveness of the control structures in place to mitigate those risks. This work is reported to agencies so that major weaknesses affecting the control structure can be rectified quickly and subsequent improvement in public administration and accountability can result.

5. The majority of the Commonwealth's financial activities are concentrated in certain areas with a relatively small number of Commonwealth agencies managing the vast majority of the Commonwealth's financial activities. These agencies, which operate the more significant and complex financial systems, are the subject of the majority of audit comments made in this Report.

6. Part One of this Report provides a summary of major issues relating to the control structures of Commonwealth agencies covered. While some progress has been made, there remains significant scope for agencies to improve the effectiveness of their control structures to meet the requirements of accrual-based budgeting, reporting and related accountability obligations.

7. Part Two outlines the results of control structure examinations, for each agency covered, as part of the audits of their financial statements.

# Control Structure Issues



# 1. Control structure issues

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## Introduction

**1.1** This Part contains a summary of issues relating to the control structures of major Commonwealth agencies that were detected from examinations of financial systems, controls and processes as part of the financial statements audits to 30 June 1999.

**1.2** The control structure of any agency can be considered in terms of five inter-related components<sup>1</sup>:

- the control environment;
- risk management processes;
- the design and operation of specific control activities;
- monitoring and review processes; and
- the effectiveness of information systems and communication.

**1.3** Agencies develop and maintain various systems, controls and processes to support these components of the control structure. Implementing an effective control structure is an essential responsibility of executive and senior management of an agency. Taken together with their leadership and stewardship roles, these responsibilities represent the three cornerstones of effective corporate governance arrangements concerned with protecting and reinforcing the rights and interests of their various stakeholders.

**1.4** The auditor, while not responsible for an organisation's control structure, aims to place reliance where possible on its effectiveness, as part of gathering evidence to form an opinion on the financial statements. An effective control structure can significantly lower the risk that the financial statements produced by the agency will contain material errors.

**1.5** Where significant control weaknesses are detected, they are reported to the management of the agency. As part of the accountability framework of the Commonwealth, such issues are also reported to the responsible Minister. These issues have been aggregated and are discussed in this part of the Report.

**1.6** The following issues relate mainly to the control environment, control activities, and monitoring and review components of the control structure.

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<sup>1</sup> ANAO's Better Practice Guide to Effective Control "*Controlling Performance and Outcomes*", 1997

## Information Technology controls

**1.7** The Commonwealth invests significantly in IT systems to support program objectives. Accordingly, IT systems can be integral to the validity, completeness and accuracy of financial statements. The audit of IT systems and processes is fundamental to assessing control structures that support financial management and an agency's financial statements.

**1.8** The ANAO's audits of IT systems to 30 June 1999 continue to identify deficiencies which pose risks to agencies achieving their objectives. The following areas continue to be of concern:

- access and logical security controls; and
- program change controls.

### Access and logical security controls

**1.9** Access and logical security controls protect systems and data from unauthorised disclosure or use, and ensure reliability, accessibility and confidentiality of information. The information collected and maintained on Commonwealth computing systems is a critical resource for effective delivery of services. The unregulated provision of access to government information, and the provision of access rights to an unnecessarily large number of users beyond their functional needs, can pose significant risks. Information stored in computer systems is an asset that has to be preserved and safeguarded.

**1.10** Specific matters identified were:

- system access rights found greater than functionally necessary or unauthorised;
- inadequate review and approval of users' access to systems; and
- inadequate segregation of duties and no review or follow-up of control and error logs.

**1.11** Consequently, the risk of compromise of financial information is heightened, requiring close examination of these matters by all agencies as part of their protective security planning.

### Program change controls

**1.12** IT program change controls ensure systems are developed and maintained in an authorised and efficient manner. These controls ensure continuity of business systems and the integrity of data contained within systems. Key aspects include appropriate segregation of duties, formal testing and documentation of change implementation, and an appropriate authorisation framework.



**1.13** Specific matters arising were:

- lack of documented change control procedures; and
- inadequate review, approval and testing of changes to computer programs.

**1.14** Failure to adequately control changes to business critical programs can lead to inefficiencies through rejection, re-specification and re-implementation of changes. More importantly, this can compromise information and, in the worst case, disrupt business continuity and the provision of services to agency clients.

## **Asset management**

**1.15** Effective control over assets is critical to ensure they are safeguarded and their value reflected accurately in the financial statements. Having complete, accurate and reliable asset accounting records is one of the keys to implementing effective asset management.

**1.16** Specific issues identified were:

- acquisitions and disposals not recorded in a timely manner in asset registers; and
- asset registers not regularly reconciled to financial systems.

## **Accounting systems and controls**

**1.17** Controls over accounting systems are fundamental to good management and enhance the reliability of information produced for the financial statements. The following common issues were identified to 30 June 1999.

### **Ledger reconciliations**

**1.18** The timely reconciliation of departmental financial systems to the then DoFA FIRM system is a fundamental control to ensure the reliability of information recorded in those systems. The audits disclosed a high incidence of ledger reconciliations not being completed adequately or in a timely manner. If unresolved at the time of preparation of the financial statements, the reliability of information may be affected, although most agencies expend considerable manual and costly effort at year-end to reconcile their systems.

### **Expenditure**

**1.19** Expenditure controls are necessary to ensure all expenses incurred are correctly paid and recorded. Inadequate control over expenditure can impinge upon the safeguarding of agency funds. Furthermore,

inoperative controls can compromise the validity of expenditure reported in an agency's financial statements. Specific matters identified included:

- the receipt of goods and services not checked prior to payment;
- payments lacking supporting documentation;
- delays in acquitting grants and reviewing financial information provided by grantees; and
- transactions processed by officers without suitable authority.

### **Cash management and debt collection**

**1.20** Management and control of cash are critical to ensuring all cash due is properly collected, banked and recorded. The following matters were noted:

- receipts not banked promptly and cash advance checks not performed;
- bank reconciliations not completed in a timely manner or independently checked;
- invoicing and collection of moneys not timely; and
- inadequate controls to ensure that all revenue due to the Commonwealth is collected and accurately recorded on the financial systems.

**1.21** These weaknesses can affect the completeness and accuracy of revenue reported in financial statements and, ultimately, the timely crediting of moneys to the Commonwealth Public Account.

### **Financial Management Information Systems (FMIS)**

**1.22** In response to accrual based budgeting and reporting, many agencies have implemented new FMISs. These systems are designed to produce timely and accurate financial reporting and, importantly, facilitate the capture of accrual financial information for management and budgetary purposes. Changes to the banking and payment arrangements have also created a need for accrual information to enable agencies to better manage their functions.

**1.23** The Office for Government Online (OGO) supported agencies by providing a list of FMIS solutions established through an extensive evaluation process. A similar process was undertaken for Human Resource Management Systems (HRMS). However, implementation problems have been generally experienced.

**1.24** During the past two years, some 49 agencies have completed, or have in progress, the implementation of new FMISs. The following table

provides the details of the propriety software packages providing FMISs to agencies.

<i>System</i>	<i>Number of Agencies</i>
• Finance 1	15
• Quality Software Products (OLAS)	5
• Oracle Financials	2
• SAP R/3	27

Based on figures provided to OGO, August 1999.

**1.25** As part of the ANAO's financial statements audit coverage, these financial systems and the associated control environments have been reviewed. Generally, the ANAO found that many agencies faced difficulty with the implementation of their FMISs, particularly in regard to the resources and skills required for an effective implementation. As a result, agencies have incurred cost and/or time overruns; the systems do not yet provide the operational functionality anticipated; and management tools to deal with the reporting challenges are currently limited.

**1.26** Agencies tended to underestimate the complexity of their implementations and this, combined with a lack of suitably skilled staff and external providers to support the large number of implementations, were the common difficulties faced. The ANAO noted that a significant number of agencies will encounter difficulties in the preparation of their financial statements as information provided by the financial systems may not be accurate or reliable. The functionality that agencies expect from these systems for the new banking, payment and reporting arrangements for 1999–2000 may also be adversely affected. Other difficulties included:

- inadequate user involvement in systems design and testing;
- inadequate user training;
- lack of staff expertise in systems management and reporting;
- systems reports not meeting management needs;
- problems with interfaces to other systems particularly reconciliations with the then DoFA FIRM system;
- weaknesses in control environments relating to product configuration, privileged user access and application security;
- systems implementations, combined with new processing platforms, increased the complexity of the implementations; and
- lack of computer processing capacity.

**1.27** Agencies have recognised most of these difficulties and, through internal reviews of the final implementations, are working towards resolving many of the problems identified.

## **Management reporting and financial monitoring**

**1.28** Monitoring and review is a key component of an effective control structure to ensure program objectives and control activities are achieved efficiently and effectively. To enable this, management must have functional information systems that provide regular, relevant and accurate financial information for management reporting and monitoring.

**1.29** During 1998–99, as major Commonwealth agencies focused on the implementation of information systems to support the accrual outputs and outcomes framework, the ANAO observed a decline in the quality and timeliness of financial information and related financial monitoring within these agencies. The major causes stem from the lack of appropriately skilled staff and incomplete information systems.

### **Appropriate skills and experience**

**1.30** The ANAO noted that many agencies continue to lack suitably qualified staff with the appropriate skills to support their financial responsibilities. Whilst many agencies have recognised the need to recruit such staff, they are not currently available in the numbers required. As a consequence, many agencies are relying, in part, on external consultants to assist in financial reporting and monitoring.

**1.31** Given these demands will continue for some time, the ANAO supports the continuing commitment by agencies to the training and development of staff to equip them with the necessary skills to be effective. This is matter of some priority given the problems being experienced.

### **Systems implementation and functionality**

**1.32** The majority of Commonwealth agencies have, or are in the process of implementing, revised FMISs and HRMSs to support the new financial management framework. As outlined above, the ANAO found that many agencies underestimated the complexities and faced many difficulties with their systems implementations. These difficulties have been compounded by the lack of functionality of the implemented systems.

**1.33** For example, a number of agencies are manually calculating their year-end employee entitlements as their HRMSs lack appropriate functionality and/or parameters to generate reliable information for financial reporting purposes. Similarly, other FMISs cannot automatically reconcile to the then DoFA FIRM system. This reconciliation is similar to

bank reconciliations in ensuring the reliability of information recorded for management reporting and decision-making. This has led to labour intensive reconciliations being performed that impact on their timeliness and reliability.

## **Summary**

**1.34** The above circumstances have contributed, in varying degrees, to financial information being unreliable or untimely, thereby hindering management reporting and decision making. Agencies have recognised the significance of the situation and are generally taking appropriate remedial action. This will be followed up as part of the financial statements audit process. The more difficult issue for agencies in the longer term will be ensuring that appropriate use is made of this financial information for decision-making and management accountability.

**1.35** Traditionally, Commonwealth agencies have accounted to the Government and the Parliament on cash based appropriations. With the implementation of the accrual based outputs and outcomes framework, agencies are explicitly accountable for the use of all resources for which they are responsible, not just cash. A major challenge facing agencies will be the development of necessary skills in financial management to enable better management in an accrual accounting and budgeting framework.



# Results of the Examinations of Control Structures—by Agency





## 2. Results of the examinations of control structures-by agency

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### Introduction

**2.1** This Part summarises the results of examinations of control structures of major individual Commonwealth agencies as part of the audits of their financial statements. These primarily comprise the portfolio departments that manage the majority of the Commonwealth's financial activities and operate the more significant and complex financial systems. The Australian Customs Service, Department of Veterans' Affairs, Centrelink, Health Insurance Commission and Australian Taxation Office are also included, given their Budget significance.

**2.2** Except for the Health Insurance Commission, Commonwealth authorities and subsidiaries, Commonwealth companies and subsidiaries, and other agencies are not included in this Report. These bodies will be included in the Auditor-General's Report on the *Audits of Financial Statements of Commonwealth Agencies* to be tabled in November 1999.

**2.3** The accounting and auditing framework governing this work is outlined in the appendix.

## Department of Agriculture, Fisheries and Forestry

### **Audit findings**

The results of audit work to 30 June 1999 indicated that the Department's systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. However, weaknesses were noted in the following areas.

#### *IT access and logical security controls*

Weaknesses in IT controls for security monitoring reported in 1997–98 remain outstanding and, consequently, the Department continues to be exposed to possible unauthorised access to systems.

#### *Other matters*

Other control matters impacting on the financial records were:

- use of an incorrect interest rate in the second quarter calculation of interest expense for the Income Equalisation Deposit Scheme, indicating a breakdown in controls over the application and review of interest rates; and
- payments of salaries and related benefits not in accordance with certified agreements for one group within the Department.

#### *Response*

The Department acknowledged the issues raised and indicated that remedial action is being pursued.

## Attorney-General's Department

### Audit findings

The audit indicated that systems and procedures could produce accurate and complete financial information. However, the following continuing weakness was noted.

#### *IT access and logical security controls*

During the 1997–98 audit, the ANAO concluded that the controls in place for access to computer applications were not in accordance with recognised better practice. The ANAO's follow-up in 1998–99 indicated that rectification of the following issues remained outstanding:

- shared passwords were used within the Department;
- there were a number of staff who had excessive access privileges; and
- privileged access to systems needed review.

Inadequate access control can result in unauthorised access to departmental systems raising concern over the protection of data or the integrity of systems.

#### *Response*

The Department advised of action to be taken to address these matters.

## Australian Customs Service

### **Audit findings**

During 1998–99, Customs continued its implementation of an accrual accounting system to support the outputs and outcomes budgeting framework. At the same time, Customs was transferring a number of programs to other agencies as a result of the Administrative Arrangements Orders of October 1998. These changes have had a significant impact on Custom's financial operations, and changes continue to be made to systems and processes to support longer-term financial management requirements. In this context, audit work is on-going with the major areas of coverage to 30 June 1999 being Customs' risk management practices and the control structure supporting information technology systems governing financial operations.

#### *IT control structure*

The ANAO's review of the IT control structure includes follow-up of matters reported previously as well as confirming the reliance that can be placed on the IT environment, and access, logical security, application and program change controls over financial systems.

#### *Risk management*

Previous audit reports have referred to the successful progress made by Customs with the transition to a mature risk managed environment. In particular, the ANAO has commented positively on the comprehensive risk management framework developed by Customs to provide adequate assurance over key financial activities. The ANAO's audit of the financial statements will cover the on-going effectiveness of Custom's risk management framework to assure the completeness and validity of information for its financial statements.

#### *Conclusion*

The results of this work together with any other matters arising will be reported in the final report on the results of the financial statements audit.

## Department of Communications, Information Technology and the Arts

### **Audit findings**

The audit indicated that systems and procedures could produce accurate and complete financial information. The following matters were raised with the Department aimed at enhancing the effectiveness of the overall control structure.

#### *Asset management*

The ANAO noted that, in the maintenance of the asset register, the following deficiencies have the potential to impact adversely on the reliability of asset records for financial statements purposes:

- incorrect coding of assets;
- assets disposed not removed from the asset register; and
- the asset register not reconciled to the general ledger.

#### *Reconciliations*

Reconciliations between the Department's financial systems and the then DoFA FIRM system were not performed and independently reviewed in a timely manner. These reconciliations are similar to bank reconciliations in that they provide assurance over the reliability and integrity of financial information.

#### *Response*

The Department responded positively to the above matters.

## Department of Defence

### Audit findings

The ANAO's risk based audit approach concentrates on those areas most likely to result in material error to the financial statements. The ANAO identified the following key financial statements risks:

- fixed asset revaluations;
- valuation of assets under construction;
- inventory recording and reporting;
- recognition of intangible assets; and
- employee entitlement provisions.

The results of audit work to 30 June 1999 indicated that departmental systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. However, the following issues were noted.

#### *IT access and logical security controls*

Continuing issues from previous audits regarding IT controls supporting inventory systems, were noted as follows:

- access controls over the explosive ordnance inventory system (COMSARM) are less than desirable. The lack of segregation of duties over user access, creation of access and program changes represent the greatest risks to unauthorised access or changes;
- the operating system which supports the Standard Defence Supply System has a relatively large number of users with systems maintenance access. This increases the risk of unauthorised changes to the system. In the event that unauthorised access were to occur, the integrity of system data and programs would be placed at risk; and
- inventory recording systems do not have the functionality to maintain the actual cost of inventory. The Department compensates for this at present with an extensive manual process involving the utilisation of a separate price database that is merged with Defence inventory quantities.

#### *Response*

The Department indicated that it is taking positive action in relation to these matters and will be in a position to meet its financial reporting requirements.

## Department of Veterans' Affairs

### Audit findings

The audit indicated that systems and procedures could produce accurate and complete financial information. However, rectification of the following continuing weaknesses would enhance their potential usefulness.

#### *IT access and logical security controls*

It was noted that monitoring of user access to key functions within the Department's FMIS was not being performed. In addition, a number of weaknesses in access security were noted in various State offices of the Department. As a consequence, potential breaches in security could remain undetected compromising the integrity of financial information and the application programs.

#### *Reconciliations*

It was noted that reconciliations of recreation leave balances following importation of the data from the old to the new HRMS had not been performed adequately raising the potential of inaccurate and incomplete financial information.

In Victoria, it was also noted that reconciliations of the Pension Payment drawing account to the then DoFA FIRM system were not completed on a regular basis throughout the year. Such reconciliations facilitate the reliability of information recorded on departmental systems.

The following weaknesses over the processing of payroll were reported to one State office:

- reconciliations of payroll to DoFA's systems were not completed in a timely manner resulting in payroll errors not being followed up and resolved; and
- reconciliations of leave absences to actual leave processed by the Department's human resource system were not being performed.

#### *Quality assurance checks*

The Department and its State offices undertake quality assurance checks in relation to the payment of Veterans' benefits. The following weaknesses were identified:

- quality assurance checks were not completed in a timely manner, due to an insufficient number of staff;
- the analysis of the results of these checks were not being utilised to identify and target errors identified;

- quality assurance policies in some States had not been finalised;
- fraud control checks were not being performed in accordance with the fraud control checklist; and
- checking of key quality assurance reports was delayed due to insufficient staffing and computer system failures.

#### *Responsibility based processing*

Responsibility based processing is utilised for the payment of Veterans' pensions. The practices and procedures, adopted to support departmental staff with this responsibility, were not maintained in one of the Department's State offices. There is a risk that, in the absence of formalised procedures, the quality and effectiveness of decisions about Veterans' compensation will be adversely affected.

#### *Response*

The Department has taken a positive approach to the issues raised and indicated that substantial progress to rectify them has been made.



## Department of Education, Training and Youth Affairs

### Audit findings

The audit indicated that systems and related procedures could produce accurate and complete financial information. A number of departmental initiatives are evident which have improved the overall control structure. However, continuing weaknesses were noted in the following areas.

#### *IT access and logical security controls*

The Department has a number of user profiles that permit high level access privileges to its FMIS. The ANAO considered that high level access should only be provided on a restricted basis and that an unnecessarily large number of users currently has these privileges. Further, the Department's FMIS had not been properly configured to secure the system generated 'superuser' against unauthorised use.

Ineffective access controls undermine the effectiveness of application security to protect against unauthorised access to the Department's system. In the event that unauthorised access were to occur, the integrity of system data and programs would be placed at risk.

The Department has now taken appropriate action to rectify these weaknesses.

#### *Reconciliations*

Reconciliations of departmental ledgers to the then DoFA FIRM system were not completed on a regular basis throughout the year. These reconciliations ensure that the information recorded in departmental systems is reliable for management and decision making purposes.

The Department advised that the necessary functionality in its new FMIS was still under development for much of the year. However, it had attempted to monitor expenditure levels in the then DoFA FIRM system against its own ledger during the year. A reconciliation program was in place and the Department was finalising the reconciliations as at the end of May and June 1999.

#### *Inaccurate employee data*

Employee leave entitlement balances in the HRMS are not correct and further testing is necessary to ensure the completeness and accuracy of data to be used for the financial statements purposes. The Department is currently testing system enhancements to correct the situation. The Department plans to use an ACCESS database for the calculation of leave balances for financial statements purposes, and has requested its internal audit branch to undertake testing to ensure the accuracy of results.

## Department of Employment, Workplace Relations and Small Business

### Audit findings

During 1998–99, the Department was implementing an accrual accounting system to support the outputs and outcomes budgeting framework. At the same time, the Department was integrating the Employment program transferred from the previous Department of Employment, Education, Training and Youth Affairs in October 1998. These changes have had a significant impact upon the Department's financial operations, and changes continue to be made to the system and processes to support the longer-term financial management requirements of the new Department. In this context, a number of matters requiring attention were advised to the Department. These are outlined in the following paragraphs.

#### *IT access and logical security controls*

Effective control over the use of system access privileges is essential to ensuring the accuracy and reliability of the recording of transactions and maintenance of account balances. Fundamental to this control is:

- minimising the number of staff with these privileges and ensuring adequate monitoring and review of the use of these privileges;
- effective password control and management; and
- the establishment of appropriate segregation of duties.

The ANAO found users with an inappropriate level of access to privileged user functions, inadequate monitoring and review of the use of these functions, ineffective separation of duties and weaknesses in the management of passwords.

#### *Reconciliations*

The Department has encountered a number of problems following the implementation of a new FMIS. Because of ongoing problems with some functions in the FMIS, reconciliations of departmental ledgers to the then DoFA FIRM system were unable to be completed on a regular basis throughout the year. Without such reconciliations, there can be no assurance that the information recorded on the departmental systems and used for management reporting and decision-making purposes throughout the year, is reliable. In the latter half of the year, the Department has expended considerable effort towards completing the reconciliation.

### *Banking of receipts*

It was noted that the Department's receipts of public moneys were not always banked in a timely manner, some being outstanding for between one and eight months. The ANAO advised the importance of banking all receipts promptly to ensure the safe custody of public moneys. The timely banking of receipts also facilitates the reconciliation of bank accounts.

### *Employee transaction processing*

The Department has encountered a number of implementation problems during the introduction of the HRMS. As a result, the system is not at a stage where it can support the preparation of employee entitlement information for financial statements purposes. This is due to functions within the special modifications (the Federal Government Template), including a feature that calculates the employee entitlements, not yet being fully functional. The Department is in a similar position to some other Commonwealth agencies in this regard. The Department has implemented alternative strategies to calculate accurately employee entitlement information for inclusion in its 30 June 1999 financial statements.

### *Response*

The Department has advised that it will address these matters.

## Department of the Environment and Heritage

### Audit findings

The results of the ANAO's review indicated a number of major weaknesses in relation to the preventative and detective controls associated with the implementation of the new FMIS. The weaknesses noted may increase the risk of incorrect payment, potential fraud, data corruption and security breaches. A summary of the more significant matters noted follows:

#### *IT access and logical security controls*

- there was no formal FMIS security policy to guide users. The lack of an approved policy increases the risk of a lack of adherence to approved procedures. As a result, data integrity could be compromised as security breaches may not be detected, prevented and investigated; and
- the password for initial access to super user functions was commonly known. This increases the risk of accidental and unauthorised manipulation and corruption of data.

#### *Reconciliations*

- reconciliations between the FMIS and the then DoFA FIRM system had not been performed at the appropriate times. This could lead to financial reports being incomplete and inaccurate due to missing or unknown transactions remaining undetected.

#### *Expenditure and payroll controls*

- the current FMIS setting did not require goods and services to be receipted into the system and allows payments of 50 per cent over the approved purchase order amounts. Similarly, the option of using mandatory preconditions for purchase orders has not been used and open purchase orders were not reviewed regularly. This increases the risk of payment of invoices for non-existent purchases, the incorrect quantity of goods or for goods not yet received. There is also the risk that overstated invoice amounts will be paid;
- there were duplicate vendor master records held on the FMIS. This increases the risk of duplicate payments and potential fraud;
- there were instances of incompatible functions being performed by staff in the personnel and finance areas. This increases the risk of fraudulent or accidental additions, changes, or deletions to transaction and master file data;

- there were 37 staff members that have access to modify their own salary details and another 80 staff members that have access to employees confidential salary details. This increases the risk of inappropriate amendments to personnel and payroll records;
- there were numerous duplicate employee records in existence in the system. This increases the risk of overpayment or fraudulent payment; and
- the sum of individual employee superannuation contributions generated by the HRMS did not reconcile to the total cheque amount forwarded to the Commonwealth Superannuation Administration (ComSuper). This could result in payment not being made in a timely manner or in the correct accounting period, and/or incorrect payments made to individual accounts.

#### *FMIS and HRMS*

- management reports generated from the FMIS were either not designed correctly or were not utilised for the intended purpose. Without adequate and comprehensive reporting, management may not be able to control effectively the completeness, accuracy and authorisation of transactions and monitor trends. This could lead to management not being able to make informed and effective decisions regarding its business operations;
- accounting periods were not closed off at the end of each month. This allows transactions to be posted to any accounting period in the financial year. This could lead to transactions being posted to the incorrect period and adversely impact on the integrity of management's reporting of financial information;
- there was a lack of adequate planning for the FMIS implementation. In most instances there were no responsibilities assigned to project activities and no revised timeframe developed for delivering these outcomes after the initial implementation date. This led to projects being incomplete and increased the risk of corruption of data on the system resulting in an inability to prepare reliable financial statements information;
- the data conversion strategies have not been followed. This increases the risk of compromising the data completeness, accuracy and validity and in turn may adversely affect the completeness and accuracy of financial information to be included in the financial statements;
- user acceptance testing processes were inadequate. This could lead to an increased risk of accepting a system that does not meet users' requirements; and

- long service leave and recreation leave were not processed by HRMS and employee provisions were unable to be calculated for financial reporting due to a problem with the HRMS software. Accordingly the employee provision would need to be estimated. This would result in accrual information not being reflected in the HRMS and incomplete management reports produced. Moreover, the estimation process may have an adverse impact on the reliability of the amounts for provisions in the financial statements.

*Response*

The Department is addressing these findings and in some cases has implemented a number of initiatives to enhance the control structure to aid the financial statements preparation at year-end. The Department has also accepted the ANAO recommendations aimed at enhancing the control procedures surrounding the new FMIS.

## Department of Family and Community Services

### **Audit findings**

The results of the audit to 30 June 1999 indicate that the Department's systems, controls and processes can be relied upon to produce accurate and complete information for the preparation of the agency components of the financial statements.

In regard to the Department's administered components concerning personal benefit payments and other income support payments, major reliance is placed on Centrelink's systems. Reference is made to the findings on the next page arising from the audit of Centrelink to 30 June 1999. It was concluded that certain aspects of Centrelink's information technology control structure and risk management practices could be improved to increase the level of assurance over the accuracy and validity of benefit payments.

## Centrelink

### Audit findings

Centrelink provides services in relation to the delivery of personal benefit payments and other payments on behalf of other Commonwealth agencies. It relies significantly on the control structure supporting its information systems and the development, implementation and support of systems and procedures for the prevention, identification and deterrence of incorrect payments and fraud.

The ANAO concluded that certain aspects of Centrelink's information technology control structure and risk management practices could be improved to increase the level of assurance over the accuracy and validity of benefit payments. The significant audit findings and recommendations are outlined below.

#### *IT controls*

The ANAO's review of key components of Centrelink's general IT control environment supporting specific business applications highlighted a number of on-going weaknesses, many of which have also been raised by Internal Audit. Recommendations were made in the areas of access control, program change control and operating system management. The more significant areas requiring improvement relate to the risk of unauthorised persons gaining access to systems including inadequate monitoring of access, unapproved changes being made to programs or data and inadequate testing of new or changed programs.

#### *Income support systems*

The income support systems (Pensions, Newstart, Parenting and Families) record customer details, including circumstances such as earnings, assets, children and housing. A significant issue raised with management concerned the lack of reconciliations occurring between Centrelink's debt management system (DMIS) and these income support systems. Consequently, the risk is heightened that not all debts initially generated in the income support systems are transferred to the DMIS where they are tracked and managed.

#### *FMIS*

The review of Centrelink's FMIS focused on systems integrity over financial transactions. A number of weaknesses were identified in the systems administration and general control environment that could adversely impact on the integrity of the system. The ANAO recommended prompt improvements be made in areas such as systems access controls,



systems configuration, program change control, monitoring and assessment to enhance the integrity of the system and its data.

### *Risk management*

The audit identified scope for improvement in the design and application of current preventative control mechanisms to minimise the level of incorrect payments. Procedure and Accuracy Checking, for instance, is defined as a key preventative control mechanism which the ANAO found not to be working as effectively as anticipated. As a consequence, there is increased dependency on detective measures such as program and compliance reviews. However, there is no overall robust evaluation of risk against these measures to determine the acceptability of the residual risk.

The ANAO recommended the development of an overall risk evaluation including the adequacy of existing control mechanisms to provide management with a sound model of assurance to minimise the risk of incorrect payments. The ANAO also recommended that Centrelink undertake an awareness program that highlights the benefits of compliance with established policy.

The ANAO noted that Centrelink has undertaken risk reviews in a number of payment types during 1998–99 and is introducing a series of comprehensive measures aimed at assessing and improving the effectiveness of the control framework in place.

### *Response*

Considerable work has been undertaken by Centrelink over the past four months in an effort to resolve all of the above issues.

## Department of Finance and Administration

### Audit findings

The 1996–97 and 1997–98 audits of the Department’s financial statements focused on substantively verifying financial transactions throughout the periods. This was due to the ANAO’s review of the control structure indicating that it could not be relied upon for financial statements purposes, largely due to the processes adopted in preparing the financial statements in 1996–97 and proposed system implementation in 1997–98. In addition, for 1997–98, the merger of the former department of Administrative Services into the Department impacted on the existing control structure. As a consequence, the ANAO indicated to the Department that improvements to systems and controls, including IT controls, should be pursued.

In 1998–99, the ANAO has again adopted a substantive verification approach, primarily due to the timing of the implementation of the Department’s new FMIS and HRMS. The Department has undertaken a range of initiatives aimed at improving the reliability of systems for on-going management and supporting financial statements preparation at year-end. The following matters were raised with the Department to 30 June 1999.

#### *FMIS*

The ANAO plans to review the Department’s newly implemented FMIS as part of the final stage of the audit. As a result, the ANAO’s interim review concentrated on financial transactions processed on the previous FMIS.

The ANAO identified certain opportunities for enhanced internal control regarding the operation of the previous FMIS and recommended implementation of these controls in conjunction with the new FMIS. The main enhancements suggested were:

- regular completion and independent verification of reconciliations between the FMIS and the then DoFA FIRM system across all business units. Certain program areas had not completed any reconciliations during the nine month period; and
- development and promulgation of appropriate formalised procedures for creating, documenting and processing journals posted directly against key general ledger records.

#### *Other matters*

At the time of the ANAO’s interim review, departmental management were initiating action on a number of matters in readiness for preparing

the Department's financial statements for the year ended 30 June 1999. These matters included:

- establishing a consolidated asset register and valuing property, plant and equipment;
- accounting for the receipt of employer superannuation contributions from all Commonwealth agencies in the Department's financial statements for the first time (previously reported by ComSuper); and
- incorporating certain 'commercial activities' into the Department's financial statements in lieu of separate statements for each activity.

*Response*

The Department advised that it had made substantial progress in finalising each of the above-mentioned initiatives.

## Department of Foreign Affairs and Trade

### Audit findings

The results of the audit indicated that the Department's systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. The following opportunities for improvement in the control structure supporting information technology were raised with the Department.

#### *IT access and logical security controls*

Scope for improvement exists in the mainframe operating environment that supports the passports system. Specific issues relate to:

- access management;
- change control procedures; and
- segregation of duties between system administration and programming functions.

Consequently, there is an increased risk of unauthorised or incorrect changes being made to the system that could adversely impact systems or data integrity.

A review of the FMIS user access privileges identified that the certifying and authorising officer functions were not segregated in accordance with recognised better practice resulting in greater emphasis on detective, rather than preventative, controls to minimise the risk of irregularities.

#### *Response*

The Department has indicated that it will take immediate action to enhance the existing IT control environment and review application controls in conjunction with the establishment of the new FMIS implemented on 1 July 1999.

## Department of Health and Aged Care

### Audit findings

The audit results indicated that a satisfactory control structure exists to provide the Department with reasonable assurance on the accuracy and reliability of financial information. From an IT perspective, the ANAO noted that:

- the Department has good organisational structure within the general IT environment;
- Internal Audit has been active in new system developments, reviews of existing financial systems and monitoring reconciliations of financial systems;
- an IT security group is responsible for monitoring mainframe access; and
- previous audit findings have been, or are in the process of, being actioned.

However, the following matters regarding IT and Aged Care Assessment Teams (ACAT) were raised with the Department.

#### *IT access and logical security controls*

System access privileges are a powerful way of enforcing appropriate segregation of duties. The audit made recommendations in relation to the need for regular reviews of system access privileges and improving controls over the granting of privileges.

The audit indicated an unnecessarily large number of users who had access privileges that allowed them to create and/or approve new suppliers on the system. In addition, there was insufficient control over this process, with no supervisory control nor justification required prior to supplier creation.

The ability to amend or add to the approved list of suppliers on the system should be controlled in such a way as to ensure that only valid, accurate and appropriately authorised changes are made. Inappropriate controls increase the risk of duplicate suppliers being created or, in extreme circumstances, fraudulent transactions occurring.

Audit testing also indicated that improvements were required in controls over segregation of duties in relation to a number of instances of single officer processing of payments within FINEST which were noted at a time when post payment quality assurance checking procedures were not in place. Appropriate segregation of duties is an integral part of a control environment aimed at restricting the possibility of processing

erroneous or invalid transactions. This segregation can involve either two people in transaction processing, or alternatively, post processing quality assurance checks of processing.

#### *ACAT assessments and audits*

The ANAO's review of ACAT assessments indicated that, at times, the documentation provided was incomplete or not received in a timely manner by the Department. This has the potential to delay remittance of payments to the nursing homes and hostels and may cause incorrect payments to be processed. The audit recommended that the Department investigate how the ACAT teams can be made more accountable for the timeliness and completeness of their assessments.

The ANAO also noted that the Residential Classification Scale audits were suspended during the year. As these are an important part of the Department's control over the validity of payments made to nursing homes and hostels, it was recommended that they be recommenced as a matter of priority.

#### *Response*

The Department accepted the recommendations in relation to the above matters and advised of appropriate action to be taken.

## Health Insurance Commission

### Audit findings

The results of the audit indicated that the Commission's systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. Examination of the control systems within the Commission indicated steps have been taken to improve internal control measures. Notwithstanding these improvements, the ANAO identified the following issues requiring attention by the Commission.

#### *Pharmaceutical Benefits Scheme (PBS)*

There are no records held in the PBS system for general (non-concessional) recipients of PBS subsidised medicines. Consequently, for general recipients of PBS subsidised medicines, the system does not hold the information necessary to determine whether medicines have been oversupplied at PBS subsidised rates, that is, whether they have been dispensed more than once within a specified period or whether a claim for general recipients is duplicated.

In addition, for general recipients of PBS subsidised medicines, pharmacists are not required to provide evidence to the Commission that they have dispensed to eligible individuals.

The Commission is trialing alternative processing systems that should address the control issues raised.

#### *Compensation payments*

Under the current compensation arrangements, medicare benefits are not payable where a claimant has received or has a right to receive compensation for injuries sustained. In order to ascertain which medicare services have already been provided that relate to compensable injuries and be deducted from compensation settlement amounts, claimants are required to complete a 'Statement by Claimant of Past Benefits' and sign a Statutory Declaration regarding the supply of the information. This process applies an honesty based policy and can result in individuals 'double dipping'. The Commission is presently drafting a policy to address the issues raised.

#### *Other matters*

Other control weaknesses brought to the Commission's attention included:

- quality control testing within the Medicare Benefits Scheme (MBS) system, is a control which ensures the accuracy and validity of data

input. The lack of random testing leads to staff familiarisation with the quality control process and increases the risk of fraud or complacency when processing claims;

- process indicators, which allow the override of system based assessment procedures used when entering data in the MBS system, are not subject to in depth quality control which leads to the risk of fraud or error in data input;
- review and sample retesting of the PBS quality control testing identified errors in scripts which had been classified as error free;
- asset management within the Commission could be improved with further development and dissemination of approved capitalisation policies and procedures;
- IT access controls could be improved by addressing:
  - large numbers of staff having high level system access;
  - updating the group structures;
  - better password maintenance; and
  - updating procedures in the MBS standing data files;
- services provided to Medibank Private Limited (MPL) are not being managed and billed according to the signed Agreement or the best interests of the Commission. The timeliness and accuracy of billing for services provided to MPL could be improved in accordance with the signed Agreement; and
- there is no requirement for updates to Electronic Funds Transfer (EFT) payment details to be verified by an independent officer and there is a risk that completed EFT payfiles can be amended/replaced just prior to transmission to the RBA.

### *Response*

The Commission responded positively to the above findings and the associated recommendations. In a number of cases, the Commission has reviews already in place to address the deficiencies identified by the ANAO. The ANAO was advised that high priority has been placed on rectification of all matters.



## Department of Immigration and Multicultural Affairs

### Audit findings

As part of planning the 1998–99 audit, a review of the Department’s control environment indicated that it could not be relied upon for financial statements purposes. This was due to significant weaknesses identified in previous years’ audits and the introduction and establishment of a new FMIS, revenue system and information technology. Therefore audit procedures did not include a detailed evaluation of the Department’s financial systems and controls but predominantly focused on assessing management controls and substantively verifying financial transactions throughout the period.

#### *Asset management, receipting and reconciliations*

Significant internal control issues relating to asset management, revenue collection and ledger reconciliations were reported in last year’s audit. At the time of the ANAO’s current audit, the Department was initiating action to enhance the overall resource management and rectification of previously identified control weaknesses. This included the development of:

- asset management policies and a new assets register;
- offshore and onshore revenue policies and procedures;
- systems to capture financial data to facilitate the preparation of the financial statements; and
- regular revenue and system reconciliations.

To date, the ANAO has been satisfied with the level of progress made by the Department. However, rectification remains a high priority to ensure adequate resolution of issues prior to the preparation of the financial statements. Audit work on these matters will be completed during the final audit phase.

#### *Other matters*

The transition to new financial systems has created some difficulties within the Department. The examination of financial transactions throughout the period identified that controls were not operating effectively to ensure that all transactions were approved and processed appropriately. Management controls had not been established to detect irregularities that may have occurred. Banking had been delayed at Regional and

State offices which in turn resulted in difficulties performing bank reconciliations in Central office.

*Response*

The Department has taken immediate remedial action to minimise the risk of irregularities occurring and enhance existing procedures surrounding all financial and banking transactions.

## Department of Industry, Science and Resources

### **Audit findings**

The ANAO's work on the new FMIS has not been concluded. However, testing to 30 June 1999 resulted in the following matters being raised with the Department.

#### *Program change controls*

Unauthorised or invalid changes to system parameters or data can lead to inaccuracies in the payroll and/or invalid payments being processed. This risk would be increased in the event that inappropriate access was granted to the system. The review of system changes to the HRMS found there is no review of changes after the event to ensure only authorised changes are made and taken up correctly in the system.

#### *Accounting systems and controls – journal documentation*

The ANAO's testing revealed instances where large journal adjustments have occurred without any record of authorisation or purpose. If journals are not properly controlled, there is a risk that invalid or incorrect transactions may be processed placing the accuracy of account balances at risk. In an extreme situation, unauthorised or invalid journals could be used to facilitate unauthorised transactions such as the writing off and misappropriation of assets.

#### *Expenditure controls over grants*

The ANAO reviewed processes over performance monitoring of grants to establish their robustness for supporting the acceptance of liabilities on behalf of the Commonwealth and to generate performance information to support assessments against departmental outcomes. Recommendations aimed at enhancing management control over grants were made as a result of this review.

#### *Response*

The Department agreed to the ANAO's comments and accepted the recommendations aimed at strengthening controls and procedures. Appropriate action is being taken to implement the recommendations.

## **Parliamentary Departments**

Department of the Senate

Department of the House of Representatives

Department of the Parliamentary Library

Department of the Parliamentary Reporting Staff

Joint House Department

### **Audit findings**

The results of the individual audits to 30 June 1999 of the above Departments indicated that the systems, controls and procedures used to produce accurate and complete information could be relied for the preparation of the financial statements.

## **Department of the Prime Minister and Cabinet**

### **Audit findings**

The results of the audit to 30 June 1999 indicate that the Department's systems, controls and procedures can be relied upon to produce accurate and complete information for the preparation of the financial statements.

## Department of Transport and Regional Services

### Audit findings

During 1998–99, the Department continued the implementation of an accrual accounting system to support its long-term financial management requirements. Consequently, this system and associated processes will only be used in a supporting role for the 30 June 1999 financial statements. In this context, the following matters were raised with the Department:

#### *Reconciliations*

- reconciliations of departmental ledgers to the then DoFA FIRM system were not completed on a regular basis throughout the year. These reconciliations are analogous to a bank reconciliation and are necessary to ensure that the information recorded on the Departmental systems and used for management reporting and decision making throughout the year, is reliable;
- reconciliations over the completeness and accuracy of departmental revenue collected on Christmas Island were required. These include a reconciliation from the sub-systems to the general ledger used on the Island, and reconciliations over completeness of the revenue by applying a reasonableness test using independent variables; and
- reconciliations of subsidiary records maintained by program areas, including spreadsheets, to the Department's general ledger were required. Failure to carry out reconciliations between these records and the general ledger reduces the level of assurance over the information held in the general ledger and reduces the Department's ability to identify errors and make timely corrective action.

#### *Response*

The Department has advised of appropriate remedial action in relation to these matters.

## Department of the Treasury

### Audit findings

The results of audit work to 30 June 1999 indicated that the Department's systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. The following weaknesses were noted where resolution would result in Treasury's systems and procedures achieving their full potential for financial management purposes.

#### *Reconciliations*

Reconciliations of the general ledger to the then DoFA FIRM system were not completed on a regular basis throughout the year, included unexplained discrepancies and were not subject to review by an independent officer. These reconciliations are analogous to bank reconciliations to ensure information used for management reporting and decision-making is reliable.

It was also noted that reconciliations between the Public Debt Management System (where Commonwealth debt is recorded) and the general ledger were not completed for the first eight months of the year. Such reconciliations are the key control in the timely detection and correction of errors.

The salaries reconciliations between the general ledger and the personnel system were not reviewed by an appropriate official. In addition, the reconciliations did not include reconciling to the then DoFA FIRM system. This breakdown in control could lead to inaccurate or incomplete details for financial reporting purposes.

#### *Asset management*

A considerable number of deficiencies were noted in the management and recording of the Treasury's asset revaluation as at 1 July 1998. As a result, a complete and accurate record of the Treasury's asset holdings does not exist to facilitate asset management and financial reporting. It was also noted that:

- asset reconciliations between the general and subsidiary ledgers had not been performed for the current financial year; and
- asset disposals for the current financial year were not processed in the general ledger.

### *Other matters*

Other significant control weaknesses brought to management's attention included:

- the Treasury's Derivative Credit Risk Policy was an amalgamation of various documents rather than a single policy document which could raise the risk profile. In addition, the policy did not specifically state that Treasury's credit risk management techniques were heavily reliant upon the netting of transactions;
- all calculations of market exposure and potential exposure (for swap transactions) were performed on a net basis within each counterpart. The Treasury should perform potential exposure calculations on the assumption that netting does not apply. This implicitly gives a measure of potential exposure in the event that transactions could not be netted, providing a valuable additional monitoring tool; and
- the Treasury do not recalculate the weighted average yield for allotments of stock to the Reserve Bank of Australia (RBA); rather they rely on the RBA to perform the calculation.

### *Response*

The Treasury's management has responded positively to the above findings and the associated recommendations. The ANAO was advised that high priority is placed on rectification of all matters.



## Australian Taxation Office

### Audit findings

The results of the audit indicated that ATO systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. A number of initiatives were evident which have enhanced the overall control structure. However, the following continuing weaknesses concerning application's access security, systems stability and asset management still require resolution to enhance the control structure's full potential for financial management purposes. In addition, financial statements matters for follow-up at the final stage of the audit are also outlined.

#### *IT access and logical security controls*

The management of access security over various computer systems is a significant component of the overall ATO control structure. Effective management control of access to computer systems ensures that:

- only authorised staff access information, process transactions and change data;
- appropriate separation of duties exist;
- clearly identifiable audit trails are available for quality assurance purposes; and
- risk of fraudulent activities, data corruption, inefficient operations, and breaches of confidentiality and privacy is reduced.

The ANAO has previously raised issues in regard to the management and administration of computer access security. As a result, the 1998–99 audit focused on access security to enable specific feedback to be provided on the implications and importance of the need for management to reassess its standards of access.

Specific issues raised included:

- access authorisations and their review;
- separation of duties for users, developers and system administrators;
- access to privileged functions and data; and
- management of access administrators including key security management functions for branch and workplace administrators.

In addition, the ANAO was unable to determine the current policies prescribing levels of access and how executive management monitored compliance in the absence of predetermined standards.

The ATO recognised the above concerns, stating that contributing factors for the deterioration derived from:

- new systems, organisation(s) and practices;
- lack of a security policy;
- lack of procedural guidance, training and support; and
- a move towards decentralised systems.

### *Systems Stability*

In 1997–98, the ANAO reported a significant increase in the incidence of computer program failures. Since 1997–98, there has been noticeable improvement, for example, the Australian Taxation Office Integrated System program failures are down by 14%; the Automatic Document Dispatch failures are down by 40%; the Electronic Lodgement System are down by 50%; and the National Taxpayer System are down by 27%. However, the Child Support System has had a slight increase of 14%; and the Super Guarantee System has had another large increase of 79% on last year's 197% increase.

Overall, the trend for major computer programs is good but this is offset by increases in failures in other areas that can have adverse implications for efficiency and effectiveness. The process of recovering and restarting failed programs significantly increases the risk of data error resulting from the failure or during the restart/recovery process. Additional ATO resources are required to correct errors and to re-run programs.

### *Asset Management*

As in past years, the ANAO has noted that asset officers are unable to generate reports to monitor asset movements at branch offices. It was also noted that reconciliations were not being conducted for acquisitions and disposals. The current audit review reinforced these findings.

During previous audits, the ANAO commented on the variation and quality of the asset management system given the benefits that can be derived from effective planning, monitoring and costing of assets. The ANAO again recommended that asset management be reviewed and consideration be given to a life cycle costing approach to facilitate evaluations of total costs of owning and maintaining assets as part of the initial acquisition.

It was also noted that the departmental asset system (SOLVE) currently has a number of reporting deficiencies, making the monitoring of asset performance difficult. Consequently, reliance is placed on ATO business lines to ensure the integrity of the system and to acquire and dispose of assets.

*Response*

The ATO has indicated that remedial action is being taken in relation to the above matters.

*Financial statements - risk management*

The ATO acknowledges in its financial statements that its responsibilities are impacted by tax evasion and other breaches of taxation legislation. In effect this means that not all tax which is legally due to the Commonwealth will be collected. To ensure the completeness of taxation revenue for financial statements purposes, the ANAO will examine ATO's risk management practices as part of the overall control structure during the final stage of the audit.

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A handwritten signature in black ink, appearing to read 'P. J. Barrett', written in a cursive style.

Canberra ACT  
9 September 1999

P. J. Barrett  
Auditor-General



# Appendix



## Appendix

### Accounting and auditing framework

This appendix outlines the Commonwealth's financial reporting and auditing framework.

#### The financial reporting framework

The Commonwealth public sector is made up of a number of types of agencies, each of which has distinct financial reporting requirements.

##### Commonwealth of Australia

Section 55 of the *Financial Management and Accountability Act 1997* requires the Finance Minister to prepare annual financial statements for the Commonwealth of Australia. These financial statements are a general purpose financial report consolidating the financial activities of all agencies, authorities, companies and other agencies controlled by the Commonwealth.

The financial statements for the year ended 30 June 1998 were published by the Department of Finance and Administration in March 1999. The results of the audit of those financial statements were reported to Parliament in *The Auditor-General Audit Report No.6 Audit Activity Report: January to June 1999*.

##### Commonwealth agencies

Commonwealth agencies are those agencies that operate on the Commonwealth Public Account under provisions of the *Financial Management and Accountability Act 1997* including Departments of State, Parliamentary Departments and prescribed agencies.

The Act requires the chief executives to prepare financial statements for their agencies and designated business operations in accordance with the Finance Minister's Orders. These Orders require compliance with Australian Accounting Standards and Accounting Guidance Releases issued by the Australian Research Foundation and Consensus Views of the Urgent Issues Group.

##### Commonwealth authorities and subsidiaries

Commonwealth authorities are statutory bodies created by the Parliament to perform specific functions. Authorities operate under their own enabling legislation and generally must comply with provisions of the *Commonwealth Authorities and Companies Act 1997*.

The Act requires directors of authorities to prepare financial statements in accordance with the Finance Minister's Orders. These Orders require

compliance with Australian Accounting Standards and Accounting Guidance Releases issued by the Australian Research Foundation and Consensus Views of the Urgent Issues Group.

Directors of a Commonwealth authority must ensure subsidiaries of the company prepare financial statements in accordance with relevant legislation and *the Commonwealth Authorities and Companies Act 1997*.

### **Commonwealth companies and subsidiaries**

Commonwealth companies are companies in which the Commonwealth has a controlling interest. Commonwealth companies operate and prepare financial statements under the Corporations Law and provisions of the *Commonwealth Authorities and Companies Act 1997*.

Directors of a Commonwealth company must ensure subsidiaries of the company prepare financial statements in accordance with relevant legislation and the *Commonwealth Authorities and Companies Act 1997*.

### **Other agencies**

The ANAO also audits the financial statements of other agencies controlled by the Commonwealth. These consist primarily of trusts or joint ventures entered into by Commonwealth bodies.

## **Financial statement audit scope**

The chief executives of agencies, and the directors of governing bodies of other agencies, are responsible for the records, controls, procedures and organisation that underlie the information in the financial statements and the preparation of these statements. The independent audit of the financial statements, conducted in order to express an opinion on them, involves review of, among other matters, the above factors where their effect on the financial statements could be material.

The audits are conducted in accordance with the ANAO Auditing Standards, which incorporate the Australian Auditing Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement. Audit procedures include examination, on a test basis, of evidence supporting the amounts and other information in the financial statements, and evaluation of accounting policies and significant accounting estimates. These procedures are undertaken to form an opinion whether, in all material respects, the financial statements are presented fairly.

Whilst agency control structures are evaluated as an integral part of the audit process, only those systems and controls on which it is intended to place reliance for the purpose of determining audit procedures leading



to audit opinions on the financial statements are evaluated in detail. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include a detailed evaluation of systems and internal controls.

The audits are not required to search specifically for fraud and therefore they cannot be relied upon to disclose all such matters. However, the audits are planned so that there is a reasonable expectation of detecting material misstatements in the financial statements resulting from irregularities, including fraud.

## The audit report

The audit report on the financial statements is a statement of the auditor's opinion on whether the statements present fairly the agency's financial position, the results of its financial operations and its cash flows in accordance with Australian Accounting Standards, other mandatory professional reporting requirements and statutory requirements.

If the auditor is not satisfied the financial statements are fairly presented, the audit report is modified stating the reasons why.

A qualified audit report is given when the auditor is not satisfied that the financial statements are fairly stated. Audit reports may be qualified due to a disagreement between the auditor and management of the agency on the application of accounting standards or other reporting requirements, or where the scope of the audit work needed to form an opinion has been limited in some way.

An opinion containing an 'emphasis of matter' is used to draw attention to a matter that is relevant to the readers of the financial statements, but is not of such a nature that it affects an unqualified audit report being issued. In the majority of cases, an 'emphasis of matter' relates to inherent uncertainty in an aspect of the financial statements.

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