

The Auditor-General
Audit Report No.52 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 2000**

Australian National Audit Office

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Canberra ACT
30 June 2000

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 statement in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of these audits, and the accompanying brochure, 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 2000*.

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

This Report provides comment on significant risk, control and related management issues identified during the audit work on financial systems, controls and processes that support the financial statements of major Commonwealth agencies for the period ending 30 June 2000. It also consolidates the governance and financial arrangements by public sector agencies in response to the need for accrual financial information for budgeting, reporting, decision-making and accountability. This Report follows from my year-end Report, Audit Report No.21 *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 1999*.

The impact of the financial management and reporting reforms has continued during 1999–2000. The more significant reforms for 1999–2000 include devolved banking, and full accrual monthly and quarterly reporting, together with the changed basis of preparation of the Government's annual budget. The impact of these changes has been considerable for financial managers particularly in putting in place the necessary systems, procedures and training to meet both the Government's operational and reporting requirements.

The matters raised in this Report relate to areas of risk, control and compliance which are evaluated as an integral part of the financial statements audit, 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. This is a fundamental issue as is the linkage between budgeting and financial reporting for management purposes. Agencies' financial systems should be secure and link information streams to produce *decision useful management information*. A primary issue will be the need to address the critical functionality of corporate systems and in particular financial, personnel and resource management computer applications.

These matters have also been emphasised by the Joint Committee of Public Accounts and Audit (JCPAA) in its recent Report 376, "Review of Audit Reports 2 and 10, 1999 – 2000".

In addition, the output pricing regime will take prominence going forward. Integral to this will be how well agencies manage resources in the delivery of outputs to achieve Government outcomes. Proper departmental

resource management will have critical dependencies. Foremost amongst these will be robust resource allocation and risk management frameworks, supported by the maintenance of relevant output costing information.

The Australian National Audit Office (ANAO) will continue to assist agencies, to the extent practicable, with advice and assistance on the implementation of the Commonwealth reform program in the course of our statutory responsibilities. The changes involved will take time to bed down and gain acceptance. In so far as the ANAO is concerned, we will continue with the production of Better Practice Guides. Those guides are a major source of the latest information for agencies to assist with their initiatives to improve performance. In addition, the ANAO's primary audit focus on business risk in conjunction with our knowledge of public sector management will also contribute significantly in helping agencies implement prudent control structures to ensure effective risk management practices. A critical factor will be successful training of all staff, including senior staff and continuation of the current trend to recruit more staff with accounting qualifications. Success in these areas will set the platform for the Commonwealth Public Sector to finalise the accrual based reform program and gain the confidence and acceptance notably of the Parliament.

I would like to acknowledge the professionalism of my staff in undertaking the audit work which culminated in this Report and in reporting back to the individual organisations concerned. Their efforts enabled the tabling of this Report in a timely manner.

P. J. Barrett
Auditor-General

Executive Summary

Executive Summary

1. This report summarises issues relating to financial systems, controls and processes arising from the interim phase of the financial statement audits of major Commonwealth agencies for the year 1999–2000. Examinations of such issues are designed to assess the reliance that can be placed on those systems, controls and processes to produce complete, accurate and valid information for financial reporting purposes.

2. The audits have raised significant matters 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.

3. The ANAO has seen steady improvements in financial reporting to agencies' executive management principally resulting from improvements in the understanding of financial reporting requirements. In addition, the ANAO has noted improvements in the commitment of agencies to financial reporting generally.

4. The most significant common issues requiring attention concern inadequate protection over computer systems that record and process information, inadequate reconciliations of general ledgers to subsidiary ledgers and underlying transaction records, and weaknesses in asset management impacting on safeguarding public assets. These areas, if not resolved, can adversely affect the ability of some agencies in meeting the advanced financial reporting arrangements, and 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 as well as providing assurance to all stakeholders.

5. Many of the issues covered in this Report were also raised in a similar Report last year. As well, the recently issued report by the JCPAA¹ made recommendations consistent with the matters being raised by the ANAO. The recommendations focussed on computer systems access security and improving the use of financial information.

6. 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 recognises the increased responsibility being placed on agencies to maintain effective control structures as part of good corporate governance. The ANAO is committed to the timely reporting of significant matters to assist the Parliament in its oversight of the financial activities of Government. The ANAO expects to report the final results of the audits to the Parliament in November 2000.

7. 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 any major weaknesses affecting the control structure can be rectified quickly and subsequent improvement in performance and accountability can result.

8. The majority of the Commonwealth's financial activities are concentrated in taxation and excise revenue, welfare and benefit payments, other payment programs, defence and property assets and debt financing, 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.

¹ Joint Committee of Public Accounts and Audit, Report 376, *Financial information in management reports and control structures of major Commonwealth agencies*. Review of Audit Reports 2 and 10 1999–2000.

9. 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 still 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. This is not surprising considering the significant cultural, system and management changes required in an environment of major public service reform which, in many ways, is altering the nature and structure of public administration.

10. 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

Introduction

1.1 This part contains a summary of issues relating to the control structures and control environment of major Commonwealth agencies that were detected from examinations of financial and related systems, controls and processes as part of the financial statement audits to 30 June 2000.

What are controls and why they are needed

1.2 The control structure is an essential element of sound corporate governance along with stewardship and leadership. Traditionally, an organisation puts in place a system of internal controls to safeguard the assets of the business as it is these assets that produce the organisations' revenues. A control structure provides a fundamental linkage between strategic objectives and those functions and tasks undertaken to achieve the organisation's objectives². Typically an agency does not have a profit objective, but instead, its key objective is the delivery of agreed program outputs and outcomes.

1.3 A control structure is designed to provide reasonable assurance that risks are managed to ensure the achievement of the agency's objectives. A control structure assists with:

- efficiency and effectiveness of program outcomes;
- reliable financial reporting; and
- compliance with laws and regulations.

1.4 Control is a process that is effected by the governing body of an agency, senior management and other employees. The control environment is critical to the effectiveness of an agency's overall control structure. It reflects management's commitment and attitude to the implementation and maintenance of effective controls. It is management's leadership which dictates the agency's control culture and consciousness. Put simply, the result is dependent on 'the tone at the top'. Key elements of control structures and control environment are an agency's Audit Committee and Internal Audit function.

² ANAO's Better Practice Guide to Effective Control "Controlling Performance Outcomes", 1997.

1.5 The importance of effective control structures is increasing significantly in the public sector. As the use of commercial practices and transactions increase, more activities are outsourced, and more responsibilities are devolved, management and operational risks also increase. Strong effective control is an integral part of effective risk management which is at the core of good corporate governance.

Relationship with the financial statements and the audit thereof

1.6 An effective control structure will significantly lower the risk that an agency's financial statements will contain material errors. 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. 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 discussed in this part of the Report.

Audit results

1.7 Outlined below is a summary of those issues identified during the audits that are common across many agencies.

Information Technology controls

1.8 The delivery of programs and services by the vast majority of agencies is supported significantly by information technology (IT). The Commonwealth has a considerable investment in IT to support program objectives. Accordingly, IT systems are integral to the completeness, accuracy and validity of financial statements. Many agencies are now outsourcing the management of their IT services. In addition, agencies have been implementing new IT financial management and human resource management systems. This has been done to support the ongoing financial management reform process, in particular, the introduction of full accrual accounting and reporting.

1.9 The ANAO's audits of IT continue to identify deficiencies which pose risks to agencies achieving their objectives. The following areas continue to be of concern:

- management of system implementations;
- access and logical security controls; and
- program change controls.

System implementations

1.10 In response to accrual based budgeting and monthly, quarterly and yearly financial reporting, agencies have completed, or are finalising the implementation of new financial management information systems (FMIS). These systems are designed to produce timely and accurate financial reporting and capture accrual financial information for management and budgetary purposes. The cost to the Australian Public Service (APS) of implementing new FMISs is estimated to be approximately \$200 million. In addition, the estimated costs to the APS of implementing new human resource management systems is approximately \$100 million. 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 continue to face difficulties in finalising the implementations of their FMISs. Many systems do not yet have the expected operational functionality. Management tools to deal with reporting challenges are currently limited.

1.11 As functionality improvements are finalised, agencies generally have had to put in place, as an interim measure, alternative processes to ensure their financial reporting responsibilities are met. This has also involved the development of management control processes to ensure the integrity of financial data, which has contributed to time and cost overruns. Other difficulties include:

- 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's needs; and
- inadequate reconciliations with interfaces to other systems.

Access and logical security controls

1.12 Access and logical security controls protect systems and data from unauthorised disclosure or use, and ensure reliability, accessibility and confidentiality of information. The information stored on Commonwealth computing systems is critical to the delivery of agreed outputs and outcomes and, accordingly, is a significant asset that needs to be safeguarded. Specific matters identified were:

- system access rights were found to be greater than functionally necessary;
- inadequate review and approval of users' access to systems; and
- inadequate review and monitoring of access logs³.

Program change controls

1.13 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.

1.14 Specific matters arising were:

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

Financial statement implications

1.15 Appropriately controlled FMISs provide the level of assurance management needs to meet the organisation's financial reporting responsibilities. Well performing systems will facilitate timely and accurate financial reporting. It is very important that the risk of data integrity being compromised be understood and controlled to the assurance levels that management requires. The advancing of the Commonwealth's financial reporting timetable for larger agencies this year to 15 August and 15 September for all other agencies, places a heightened imperative for those agencies to have their FMISs and associated systems fully operational. Well performing, soundly controlled systems allow for timely and accurate financial reporting.

³ A record of activity relating to the security environment around an IT system.

Accounting systems controls

1.16 The implementation of the Accrual Budget and the associated increase in importance of the Commonwealth Financial Statements, to provide for the comparison of financial performance against budget expectations, coupled with monthly and quarterly financial reporting, requires sound financial management controls. This includes controls installed around accounting systems. As part of the ANAO's financial statement audit coverage, key controls including bank reconciliations, ledger reconciliations, authorisations, delegations and segregation of responsibilities are closely examined. As in past years, the ANAO noted that these control areas continue to pose difficulties for agencies. Effective financial controls facilitate the management of the risks of incomplete, inaccurate and invalid financial data. Key areas of concern are:

- bank reconciliations;
- ledger reconciliations; and
- segregation of responsibilities.

Bank reconciliations

1.17 As at 30 June 1999, the general government sector⁴ of the Commonwealth held \$2 billion of cash. Effective from 1 July 1999, responsibility for financial exchange and banking arrangements was devolved to each agency. A key platform to this process was the requirement for agencies to establish and maintain their own bank accounts. Management and control of cash are critical to ensuring all cash due is properly collected, banked and recorded. The ANAO noted that, generally reconciliations of the cash control accounts in ledgers to bank statements were either:

- not being performed;
- were performed on an irregular basis; or
- were not being performed properly.

As a result, there is the risk that agency cash and the bank accounts can be used for unauthorised purposes and the true cash position for financial reporting will not be ascertained.

⁴ Commonwealth Government of Australian Consolidated Financial Statements for the Year Ended 30 June 1999, one of the three sectors together with Public Trading Enterprises and Public Financial Enterprises that encompass Commonwealth financial activity. The General Government Sector's primary function is to provide public services which are mainly non-market in nature, for the collective consumption of the community.

Ledger reconciliations

1.18 Primary accounting records are used to produce financial reports for internal and external purposes. To ensure the integrity of primary accounting records, it is imperative that there is regular reconciliation of ledger control accounts to underlying transaction data, whether that data is maintained manually or in subsidiary systems and/or modules of the ledger system. As with bank reconciliations, the ANAO found a lack of robustness around reconciliation processes more generally. Key areas of concern related to employee expenses, debtors, inventories, property, plant and equipment, and creditors.

Segregation of responsibilities

1.19 Strong control environments include an appropriate level of segregation of responsibilities. Fundamentally, proper demarcation is required between transaction processing and transaction approval, and between processing and review and monitoring activities. This is particularly important in relation to expenditures, revenue collections, cash processing and asset custody. Breakdowns in this control generally occur where required responsibilities are incompatible with the actual duties performed. The ANAO noted instances where transaction processing in respect to expenditures, receipts and bankings were performed without appropriate segregation of the approval and review activities.

Asset control

1.20 Effective control over assets is critical to ensure they are safeguarded and their value reflected as accurately as possible in the financial statements. As at 30 June 1999 the general government sector of the Commonwealth managed \$55 billion of non-financial assets. Having complete, accurate and reliable asset accounting records is one of the keys to implementing effective asset management.

1.21 As in past years, the 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.

1.22 In addition, the ANAO noted instances where asset management policies, including policies for capitalisation thresholds and valuations still needed to be finalised. Of particular significance is the Department of Defence which manages non-financial assets of \$40 billion, representing 72 per cent of the Commonwealth's general government non-financial

asset holdings. Successive financial statement audits have highlighted asset management issues. The key matters of concern relate to:

- inventory obsolescence;
- the valuation of assets under construction, including the Collins Class submarines; and
- depreciation policies and practices.

These unpredictable issues have the potential to impact significantly both the Defence and Commonwealth operating results.

1.23 A key initiative under the Commonwealth's Accrual Budgeting Framework is the introduction of the 12 per cent Capital Use Charge (CUC) as from 1999–2000. Agencies will be required to pay the CUC on their departmental net assets, where operating surpluses are recorded. The outcome/output framework provides for agencies to receive a negotiated price for their outputs. The intention is for the CUC to be funded from the agreed price, creating a direct link between the level of assets held by agencies and the level of funding they receive. The CUC is, therefore, an incentive to manage capital effectively. Accordingly, agencies will need to take steps to improve their asset management practices if they are to deliver the required level of services within their available funding.

Financial management

1.24 The recent financial management and reporting reform process has supported the development of a performance culture in the public sector. In particular, the move to accrual based budgeting and the focus on outputs and outcomes have underlined the importance of sound performance management. The reforms include a focus on capital deployment as well as cash management. Return on capital requirements are receiving greater attention. Essentially, the government is requiring agencies to manage their respective departmental and administered balance sheets, and to manage those balance sheets from an agency business perspective.

1.25 A key requirement is to “manage down” the unpredictability of major balance sheet items. Quite apart from an agency's own financial statements, major variances have the potential to impact both the Budget and the Commonwealth's financial statement. The monthly and quarterly reporting regimes are designed to assist agencies to manage better their financial positions in accordance with their budgets.

Skills and experience

1.26 The ANAO noted that agencies are continuing to develop their financial management teams to ensure they have the skills and capabilities to deliver against performance expectations. Whilst acknowledging the existence of a very tight employment market for experienced and qualified accountants, there is however, still scope for improvement in developing and acquiring the skills and capabilities needed. The ANAO would support the view that strong financial management and reporting is primarily the product of the people charged with the responsibility of delivering that outcome.

Managing 'off balance sheet' exposures

1.27 Financial management relates not only to the operating statement, balance sheet and cash position, but also necessitates an analysis and risk identification of 'off balance sheet' transactions, including foreign exchange and financial instruments exposures. Recent ANAO examinations indicate that there is further room for improvement in this area particularly from a systematic risk management perspective. There are also important policy issues involved. In 1998 there was a net foreign exchange loss position in respect to the general government sector of \$2.6 billion. In 1999 there was a net foreign exchange gain position of \$554 million. During 1998–99 agencies undertook \$8.4 billion of foreign currency transactions with the Reserve Bank of Australia.

1.28 The ANAO's recent examination of the management of foreign exchange risk⁵ has indicated that there is scope for improvement in the management of such exposures by individual agencies. The agencies concerned do not have systems and policies in place to identify their respective exposures, analyse the extent of these exposures and their impact or take steps to cost effectively manage the resultant risks. The report indicates the requirement for professional skills and advice in this complex area.

1.29 These same issues extend to the management of derivatives⁶. Instruments such as currency and interest rate swaps, futures contracts and forward foreign exchange change contracts also have the potential to generate significant losses, where exposures are not identified and

⁵ ANAO Report No. 45 1999–2000 Commonwealth Foreign Exchange Risk Management Practices.

⁶ ANAO Report No. 14 1999–2000 Commonwealth Debt Management.

appropriations structure and the legislative implications underpinning the approval of expenditure process.

1.34 These issues emphasise the need for agencies to pay closer attention to the controls supporting their respective cash and liquidity management processes.

Fraud control

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

1.36 The Commonwealth's Fraud Control Policy, first developed in 1987 and revised in 1994, is supported by the provisions of the FMA Act, whereby Chief Executive Officers are responsible for the implementation of a fraud control plan and for reporting to the Portfolio Minister on fraud control within their agencies.

1.37 Significant changes have occurred in the APS over the past decade, including:

- use of a range of service delivery options, including third party providers; and
- the increasing use of technology and convergent communication links, which, whilst providing many benefits and efficiencies, has increased the potential for fraud unless there are robust controls in place.

1.38 Against this background, the ANAO recently performed a survey of agencies to obtain an overall view of fraud control arrangements across the Australian Public Service (APS). The detailed results of the survey have been reported⁷. In essence, the measurement of the actual level of fraud is difficult. As well, the nature of fraud is changing as the APS adopts new approaches to deliver government services and makes greater use of e-commerce, including the Internet. To allow for a better understanding of the type and scale of response required to control fraud, agencies will need to make greater efforts to define clearly (using the Fraud Control definition wherever possible) and consistently measure fraud.

⁷ ANAO Report No. 47 Survey of Fraud Control Arrangements in APS Agencies.

1.39 In summary, the survey showed that fraud control frameworks varied, particularly in respect to prevention versus detection strategies. Some agencies were still to develop fraud control plans, contrary to the requirements of the FMA Act, and many agencies had not reviewed and revised their plans in light of the changes referred to above. Agencies will need to heighten their awareness to ensure that their future arrangements accord with policy guidelines and, from a risk management perspective, will need to focus on having the 'right' balance of preventative and detection processes and controls.

Corporate governance

1.40 The management of risks, including the establishment of sound control structures and control environments to manage identified risks to tolerable levels, is an essential element of effective corporate governance frameworks. Better practice indicates that such frameworks are characterised by:

- CEOs clearly embracing their responsibilities pursuant to the *FMA Act*;
- effective boards of management;
- professional audit committees with independent membership;
- robust financial management and reporting;
- effective review and monitoring processes; and
- the existence of an agency wide accepted risk management and control culture.

1.41 The results of ANAO audit activity to date indicate that there generally remains opportunities for improvements in corporate governance frameworks. This is highlighted by the number of significant matters identified that need to be addressed, as shown in Appendix 1. Of particular importance is the number of matters that remain outstanding. Audit committees have a key role to play by ensuring matters raised by the various assurance processes, including external audit, are given the appropriate priority for resolution and that management takes effective action.

1.42 In addition, management and audit committees need to identify, through agency respective risk management frameworks, all relevant risks, management tolerances, the assurance deliverables and the residual risks not covered by assurance activity. As part of this process, management needs to establish the balance of preventative and detective controls needed to manage properly the identified risks.

GST readiness

1.43 The Goods and Services Tax (GST) is a key element of the Government's Tax Reform Package. A 10 per cent GST applies on the exchange of most goods and services, including transactions entered into by public sector agencies. The GST takes effect from 1 July 2000 and businesses across both the private and public sectors have been re-engineering processes and systems in readiness for its introduction. The Department of Finance and Administration has established a unit to monitor and assess the GST readiness of general government sector agencies.

1.44 Monitoring by the department is showing that all major Commonwealth agencies are progressing satisfactorily in implementing the GST. On the basis of information provided by agencies as at 15 May 2000, all major agencies are expected to be able to comply with the New Tax System from 1 July 2000.

Summary

1.45 This part of the report has drawn attention to issues relating to the control structures and control environment detected from examinations of financial and related systems, controls and processes as part of the financial statement audits to 30 June 2000. These issues relating to IT controls, accounting systems, asset controls and financial management have contributed, in varying degrees across agencies, to financial information being unreliable or untimely, thereby hindering management reporting and decision making. Whilst some agencies have recognised the significance of the situation and are generally taking appropriate remedial action, other agencies should pay greater attention to their corporate governance frameworks including their risk management and control structure arrangements. This is highlighted by the overall number of significant issues raised and, as indicated above, the number of issues still outstanding from the previous year.

1.46 Remedial action will be followed up as part of the financial statements audit process. The more difficult issue for agencies will be ensuring that financial management and other business critical systems are sufficiently robust to deliver the information required for management decision making and to meet the increasingly demanding external reporting imperatives, at agency, Commonwealth and Budget levels.

1.47 As a result of the issues and reforms highlighted above, a major challenge facing agencies will be obtaining the 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

Introduction

2.1 This part of the report summarises the results of examinations of control structures of major individual Commonwealth agencies as part of the audits of their financial statements. These organisations 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, the Commonwealth Scientific and Industrial Research Organisation, the Repatriation Commission and Department of Veterans Affairs, Centrelink, Health Insurance Commission, Australian Office of Financial Management and Australian Taxation Office are also included, given their Budget significance. In addition, this part includes the results of the audit of the financial report of the Australian National University for the year ended 31 December 1999.

2.2 The ANAO's audits of Commonwealth authorities, companies and subsidiaries are performed on a continuous basis and are structured to meet Board timetables so as to be ready for audit finalisation in September 2000. These bodies will be included in the Auditor-General's Report on the *Audits of Financial Statements of Commonwealth Agencies* expected to be tabled in November 2000.

2.3 The summary of each agency's audit contains:

- introductory commentary regarding business operations;
- selective corporate governance arrangements;
- key business and financial reporting risks; and
- other relevant information.

2.4 In respect to the business and financial reporting risks, these were identified and reported to each agency as part of the planning phase of each audit. They represent the ANAO's assessment of the key factors that give rise to the potential for material misstatement in the financial statements. The ANAO's work during the interim phase of the audit, which gives rise to this Report, focuses on steps taken by agencies to manage and/or control these risks.

2.5 Issues arising from audit activity are rated in accordance with the seriousness of the particular matter. The rating, which is included in ANAO interim reporting to agencies, indicates to the respective agency the priority it needs to give to remedial action. The ratings are defined as follows:

- A:** Those matters which pose significant business or financial risk to the agency and must be addressed as a matter of urgency;
- B:** Control weaknesses which pose moderate business or financial risk to the agency or matters referred to management in the past which have not been addressed satisfactorily;
- C:** Matters which are procedural in nature or minor administrative shortcomings.

Significant issues remaining unresolved at the time of the next audit may, depending on the seriousness of the issue, be given a higher rating.

2.6 This part discusses the more significant matters identified (A and B) in separate sections for each agency. A scorecard table of the more significant matters is also included for each agency, with a consolidated table provided at Appendix 1. The various tables track progress on matters raised from our audits of the 1999 financial statements. "A" rated issues remaining unresolved at the time the ANAO audits the financial statement could result in a qualified Audit Report.

Department of Agriculture, Fisheries and Forestry

Business and operating environment

Agriculture, Fisheries and Forestry—Australia (AFFA) is responsible for assisting Australian agricultural, food, fisheries and forest industries become more competitive, profitable and sustainable. The AFFA portfolio is principally comprised of the department and the Australian Quarantine and Inspection Service (AQIS), as well as a number of statutory, research and development and marketing bodies.

The department provides grants and benefits to producers, collects agricultural levies to fund relevant research and promotion activities and provide policy advice on rural issues. The department has a diverse range of clients including individual producers, co-operatives, community groups and local and state governments.

AQIS provides inspection and quarantine services to importing and exporting agencies to provide both effective and efficient market access between Australia and the global economy and border protection for Australian animal and plant health. AQIS's clients include import and export brokers, producers and industry groups.

The key risk areas include the implementation of an accrual-based FMIS on 1 July 1999, as well as the financial statement preparation process covering, compliance with internal and external reporting requirements.

To assist in managing these risks, AFFA senior management is currently reviewing the roles and membership of its executive committees. In addition, market testing of personnel and other corporate services are currently being undertaken.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	1	1
B	3	3	Nil	Nil
Total	3	3	1	1

IT systems and controls

As from 1 July 1999, AFFA commenced using the QSP financial management system. The implementation was problematic to the extent there was a critical lack of functionality including unreliable reporting

capabilities and difficulties in collecting and recording revenue. The ANAO considered the causes of the difficulties were:

- the re-structuring of the department as a result of the Administrative Arrangement Orders of October 1998;
- the need for AQIS to replace its FMIS; and
- the loss of skilled accounting staff.

To address these problems the Executive Board of Management in October 1999 established a high-level Financial Management Task Force. To date, this Task Force has been effective in managing the difficulties such that the ANAO now considers that the new FMIS has potential to produce reliable financial information within the advanced reporting timetable. Critical to this objective will be a full accrual (close the books) exercise before 30 June, which the ANAO will review and report the results to management.

Response

The department has acknowledged the audit findings and, as indicated above, the Executive Board of Management is actively pursuing resolution of the issues identified.

Attorney-General's Department

Business and operating environment

The Attorney-General's Department is the central policy and co-ordinating element of the portfolio responsible for the maintenance and improvement of Australia's system of law and justice.

The primary functions of the department are to:

- provide an equitable and accessible system of federal law and justice; and
- coordinate security, crime prevention and law enforcement.

The key risk areas include its continued recognition as a provider of high quality legal policy advice and services within the Commonwealth, and managing the funding of various Commonwealth programs.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2
B	2	2	6	6
Total	2	2	8	8

IT systems and controls

The department utilises the accounting system SAP R/3 to produce its financial statements. During the current financial year, the second phase of the implementation, being SAP HR (the human resource management system) will be undertaken. A number of issues are currently being resolved to ensure the correctness of financial data prior to year end.

IT access and change controls

The review of SAP R/3 identified a significant number of users having unlimited access to the system. In addition, the ability to change SAP programs is not effectively controlled.

Systems administration

Administrative controls over the use of the privileged user accounts and user access to powerful profiles need to be strengthened. In addition, reconciliations of payroll data to the various relevant modules in SAP R/3 and the correction of incorrect leave calculations for the Australian Protection Service have not been adequately completed.

Administration of employee entitlements

Administrative controls were not operating effectively. For example, in a number of cases employee entitlements had been processed with inadequate supporting documentation.

Response

The department has agreed with the above-mentioned findings and has advised of appropriate remedial action.

Australian Customs Service

Business and operating environment

The primary objective of the Australian Customs Service (ACS) is to ensure effective border management that, with minimal disruption to legitimate trade and travel, prevents illegal movement across the border, raises revenue and provides trades statistics.

ACS also plays a significant role in achieving the Government's key objectives in the fight against illicit drugs and the implementation of tax reform initiatives, particularly in relation to the import and export of goods. On the latter, ACS revenue responsibility will increase next year by the collection of the Goods and Services Tax (GST) on imported goods and in some circumstances, Wine Equalisation Tax and Luxury Car Tax, and the implementation of the tourist refund scheme for GST on goods purchased by travellers.

The key risk areas include:

- the effective application of complex excise legislation to ensure revenue completeness and that revenue leakage is kept to minimal levels;
- effective facilitation of legitimate movement of goods and passengers across Australian borders;
- the implementation of financial and business systems; and
- the role ACS has in implementing the GST.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	1(a)
B	19	17	1	2
Total	19	17	1	3

Note: (a) Prior year issue re-rated in the current year.

IT systems and controls

ACS outsourced its IT services to EDS Australia from March 1998. During 1999–2000 ACS continued implementation and upgrade of its business systems including its accrual accounting (QSP) and human resources (PeopleSoft) systems. Although IT service levels and performance were variable in the first year of the contract, ACS reported that there were improvements achieved against a background of significant change in both the applications and IT infrastructure.

The ANAO identified a number of areas where enhancements to the preventative and detective controls need to be made in respect to QSP and PeopleSoft, which are discussed below.

Access security

Under the current single sign-on arrangement a user can have access to process privileged transactions using another logon identity. This in turn increases the risk of fraudulent and/or unauthorised transactions being processed. The issue was raised with ACS in 1998–99. ACS has advised that resolution is being actively pursued.

QSP – purchase, payments and payables

There is a need to improve the controls over electronic claims for payment to ensure they reflect the original purchase order and are properly authorised.

General IT issue

There is no tested disaster recovery plan to ensure there is adequate protection over the recovery of significant business systems in light of a disaster.

Response

ACS has advised of remedial action to be taken in respect to the matters raised.

Commonwealth Scientific and Industrial Research Organisation (CSIRO)

Business and operating environment

The CSIRO is the Commonwealth's principal body for scientific research and development. The CSIRO's success in achieving its goals lie in its ability to engage business and community partnerships in the commercialisation of intellectual property and uptake of research results and scientific advice.

Annual operating expenses total about \$750 million with about thirty-three percent of revenue being externally funded. The challenge for the CSIRO is to maintain external research funding in all types of economic environments. This is being achieved by building and maintaining strategic relationships with key customers. In addition, where an industry sector reduces its commitment to research, the CSIRO has taken decisions to redirect its priorities to other sectors.

The key risk areas include the safeguarding of intellectual property having the potential for commercialisation, the geographical disbursement of operations and decentralised administrative structures. To assist in managing these risks, the CSIRO has a strong corporate governance structure supported by the Organisation's Board, its Audit Committee and an effective internal risk assessment and audit function.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

The CSIRO has well established systems, and the results of the audit indicate that management will be able to place reliance on these systems for financial reporting purposes. The ANAO identified issues involving segregation of duties with cheque receipting and controls over the commencement of employees within certain business units.

Response

The CSIRO agreed with the matters raised and has taken action to enhance its control framework.

Department of Communications, Information Technology and the Arts

Business and operating environment

The department provides strategic advice and professional support to the Government on a wide range of rapidly changing issues including telecommunications, information technology, the information economy, broadcasting, including digital broadcasting, the performing and visual arts, intellectual property, Australia’s heritage collections, and the Centenary of Federation. It also administers a number of regulations, grants and incentives to industry and the wider community.

The key risk areas include the valuation and recognition of issues relating to the heritage assets held by the National Archives of Australia, the adequacy and completion of key reconciliations and the financial statement preparation process.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	1	1	Nil	Nil
B	3	3	4	4
Total	4	4	4	4

A number of departmental initiatives are evident which have enhanced the overall control structure including the creation of a chief financial officer position. A number of matters concerning general ledger reconciliations, asset management, employee controls and segregation of duties were raised with the department. The issues raised below, were made in the context of tightening controls in those areas to provide greater assurance over the financial management of the department.

Recognition of heritage assets

As reported previously, the department’s 1998–99 financial statements were qualified because the National Archives of Australia (NAA) collection of heritage assets had not been recognised. This represented a departure from Schedule 2 of the Finance Minister’s Orders and Australian Accounting Standard *AAS 29 Financial Reporting by Government Departments*, which require all assets that meet the recognition criteria to be brought to account. The department is currently developing procedures to identify and value these assets to overcome the qualification. The ANAO is satisfied with progress to date.

Adequate completion of key reconciliations

Reconciliations of departmental ledgers to associated bank accounts were often not being fully completed in some areas of the department. Such reconciliations are vital to the integrity of data contained in the financial management information system for on-going management reporting and decision-making purposes.

Asset management and service purchasing issues

The audit noted scope for improvement in asset management and service purchasing within the department. In particular, opportunities for improvement were identified in the areas of supporting documentation, asset register reconciliations, policies and procedures, delegations and system controls. More effective resource usage would result from reviewing asset and service purchasing procedures relating to the above areas and closer adherence to existing policies.

Employee controls

Controls around the employee records in one area of the department could be improved as documentation did not support figures in the personnel system, and balances were often calculated inaccurately. The implication is that annual leave and long service leave provisions can be distorted. The ANAO recommended a review of current records of full-time and part-time employees, and review of documentation relating to transfers from other departments within the Commonwealth.

Segregation of duties in payments and revenue collection

Segregation of duties over processing revenue and expenditure transactions in some areas of the department need to be reviewed to ensure risks to misappropriation or errors are minimised. Following the ANAO recommendation, a review is to be undertaken to establish the adequacy of existing controls and to enhance segregation of duties as necessary.

Response

The department advised of action being taken to tighten control in the areas discussed above.

Department of Defence

Business and operating environment

The defence environment requires a high level of capital to ensure that the Government's investment in the defence business is adequately maintained. The Department of Defence currently holds non-financial assets of \$39.5 billion, representing 72 per cent of the Commonwealth's general government non-financial assets.

Capability changes impact significantly on the Defence financial position, as decisions to shorten or extend the useful life of assets affect the provision for inventory obsolescence and the valuation of specialist military equipment.

The Department of Defence's operating result is affected by the capability adjustments, the unpredictable impact of asset valuation issues, inventory obsolescence and the depreciation of assets on a component basis. Capability decisions have been a major contributing factor to Defence's \$4.4 billion asset write-down over the last four years.

The defence strategic environment is characterised by changing capability and technology issues supported by major information technology infrastructure support systems. The key risk areas include:

- fixed asset revaluations;
- inventory recording and reporting; and
- employee liability management.

The department does not align adequately the operational elements of Defence with the financial recording and reporting systems. This means that in some cases financial information that relates to capability decisions has not been considered. For example, the economics of a retain/replace decision for a weapons platform should include an automatic assessment of the value of the supporting inventory. This does not happen.

In 1999–2000 Defence has partially implemented new IT systems. These new systems give Defence the opportunity to improve dramatically its business processes, management reporting and financial reporting practices.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	9	Nil	18	27
B	32	12	34	54
Total	41	12	52	81

IT systems and controls

The interim ANAO IT audit has found serious shortcomings in relation to access controls, change controls and general management controls. Some of the processes Defence management needs to assure itself that expenditure, revenue and assets are well controlled, are not in place.

Inventory and asset recording system

The department's main inventory and asset system (SDSS) still requires attention to address significant problems with quantities, prices, classification, obsolescence, general business rules and reporting functionality.

These deficiencies have contributed to the discrepancies in relation to rotatable and repairable item quantities in SDSS.

Accrual accounting knowledge

There are gaps in expertise in areas of the department where strong accounting skills are a key component of positional responsibilities. This can be managed where the position is directly supported by skilled staff. This is commonly not the case in the Department of Defence. The department needs to ensure that key staff have a full understanding of accrual accounting and its implications. Staff in critical positions of financial responsibility should be appropriately qualified.

Defence has advised that their aim is to develop skills in house, with assistance from qualified external staff as required, so that the requisite skills are maintained to record and report financial data in accordance with departmental and external requirements.

Corporate governance

The actual financial position and performance of the department, in financial statement terms, cannot be predicted at this stage. The key means of achieving stability with financial performance is to ensure that an effective corporate governance regime is in place in the department. In this regard, audit committees are seen as one of the hallmarks of good governance and are essential to a rigorous due diligence process and provide an accent on accountability, particularly for financial performance.

The department requires a strong corporate governance framework to align authority, responsibility and accountability. The *Financial Management and Accountability Act 1997* (the Act) places specific responsibility on the Chief Executive (CEO) to ensure the accounts and records are kept as required by, and the Department's financial statements are prepared in accordance with, the Finance Minister's Orders. The only provision in the Act in support of the CEO in respect of corporate

governance is contained in section 46—'Audit Committee'. Pursuant to the Act, the audit committee has a duty to not only identify areas of concern and communicate these to the CEO, but also has a duty to provide advice on action to be taken on matters referred to the CEO as 'areas of concern'. In the Defence context, the Defence Audit and Program Evaluation Committee (DAPEC) is the relevant instrument of the CEO's authority. There has not been full attendance at DAPEC for the last two years and Defence does not publish attendance data in its annual report to Parliament.

In operational terms, there exists a custom and practice convention of DAPEC reviewing internal and external audit findings. Currently, the total of all unresolved audit findings stands at approximately six hundred (600). These findings relate mainly to internal audit issues and are either in progress or are yet to be resolved. There are approximately two hundred and fifty (250) of these findings that relate to moderate or major business risks to Defence. Of these, there are nineteen (19) internal audit issues which constitute major business risks to Defence. This is a management issue that needs to be addressed as a matter of some priority. In these circumstances, management needs to set a time frame for implementation, action and resolution for such issues. As well, DAPEC has not reviewed ANAO performance audit reports to allow identification of areas of concern that need to be raised with the CEO.

The ANAO acknowledges that the department is moving to strengthen its corporate governance disciplines. Of significance here is the recent appointment of an external chairperson of DAPEC. Primary focus will be the resolution of audit issues together with ensuring that the strategic audit coverage aligns with Defence's overall priorities.

Outstanding issues

Full implementation of accrual management in the Commonwealth public sector will take several years to complete. Defence has not moved quickly enough to introduce the necessary accrual systems for effective management. This limitation means that, in accrual terms, Defence has not yet aligned adequately to operational and financial elements of its resource allocation process. Whilst the department's 1999–2000 financial statements may not be qualified, the benefits of accrual accounting are not yet widely accepted or understood throughout the department.

To ensure that resources allocated to Defence are used and accounted for efficiently, the critical issues requiring priority attention are:

- addressing the crucial functionality of Defence corporate systems and in particular the Standard Defence Supply System. The department's

new financial and personnel systems need to be successfully implemented to secure and link information streams to produce *decision useful management information*. For example the department continues to suffer a major reputation risk by holding almost a \$1 billion of obsolete stock against inventory of approximately \$3 billion;

- committing to the accrual reform process. The benefits of accrual management for decision-making needs to be accepted by at least key staff. A critical factor will be successful training and recruitment of staff with appropriate accounting qualifications and skills in key management positions; and
- a focused corporate governance / risk management regime. There is no overall effective system in place to monitor and resolve outstanding management issues including auditing matters.

Response

The department agreed, overall, with the ANAO findings raised above and has commenced appropriate remedial action.

Repatriation Commission and the Department of Veterans' Affairs

Business and operating environment

The Repatriation Commission (the Commission) is responsible, under the *Veterans' Entitlements Act 1986*, for:

- granting pensions, allowances and other benefits;
- providing treatment and other services through its hospitals and institutions, or community facilities to veterans; and
- providing advice to the Minister.

The Department of Veterans' Affairs provides administrative support to the Repatriation Commission in discharging its responsibilities to veterans and other entitled persons. It also administers the *Defence Service Homes Act 1918*, under which subsidised loans for housing and housing related benefits are provided to defence force personnel and veterans.

The key risk areas include:

- the effective management of service level arrangements for the payment of benefits with the Health Insurance Commission and the Department of Family and Community Services;
- decentralised and devolved operations to State offices, which are managed through quality assurance and monitoring processes; and
- the administration of the Military Compensation Rehabilitation Scheme, which was transferred from the Department of Defence on 3 December 1999.

The department operates in a significant IT environment. There a number of operational systems used to process payments that range from payments of benefits to veterans to processing salaries for departmental employees.

In 1997, the department's IT hardware and infrastructure were outsourced to IBM GSA. The department introduced its new financial management information system (FMIS) and human resource system during the 1998–99 financial year. At present, the department has not configured its FMIS fully to produce a complete automated set of financial statements. The department is currently addressing this issue, and is phasing in an integrated benefits payments system.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	18	5	17	30
Total	18	5	17	30

The ANAO's examination identified matters requiring specific attention relating to the operational system controls, quality assurance (QA) processes and reconciliations of the general ledger to the cash ledger and bank accounts. A number of the issues, discussed below, were raised with the department as a result of the 1998–99 financial statement audit and remedial action is still outstanding.

Reconciliation of the Pension Payment System and the Integrated Payment System to the financial management information system (DOLARS) General Ledger

The review of the NSW State Office, which processes a significant portion of pension payments, indicated that reconciliations of payments between the general ledger and subsidiary ledgers were not properly performed.

DOLARS—Financial Management Information System

The department has put in place a QA framework over departmental expenses. Strong management commitment to the conduct and follow up of QA processes is a necessary prerequisite to the effective operation of this key control.

The review of the QA process revealed significant backlogs, delays in analysis of QA reports, and a high rate of errors identified. The ANAO recommended that, in regard to identified business and operational risks, management needs to assess the priority and adequacy of resources devoted to critical QA processes. This assessment should focus on ensuring the timeliness of both monitoring and remedial action can be undertaken in a timely manner.

Benefit processing

Apart from QA processes with respect to departmental expenses, the department has also implemented QA processes over benefit payments. The timeliness of the QA processes and effective analysis and immediate preventive action resulting from such processes are significant management controls over the accuracy of data processed through computerised accounting systems. It is acknowledged that the Income Support QA program is in the process of being fully re-engineered to bring uniformity across all States. However, the ANAO found delays in

consolidation of Income Support Pension QA reports, inconsistencies in the evaluation of QA errors, and a lack of quantification and action taken on critical errors.

In addition, the following system deficiencies were noted in the NSW State Office:

- reports are not produced to identify clients with duplicate registrations on the Pension Payments Systems;
- inadequate processing controls such as, providing confirmations that the IT environment is operating as approved; and
- an inadequate system access request process.

The ANAO recommended that action needed to be taken to improve controls over these processes.

PAHRIS—Human Resource System

PAHRIS produces the financially material employee entitlement balances. The ANAO found there is no review of the data entry to the program for leave entitlement calculations and no regular management review of reports to detect any inaccuracy. In addition, there is no application control within PAHRIS to prevent any exceptions or data entry error. In light of the reduced financial reporting timetable, the ANAO considers it even more appropriate to maintain accurate and timely accrual accounting systems. As a consequence, the ANAO recommended that management implements operational controls and review processes to ensure accurate data on leave entitlements.

It was noted that reconciliations between the records in the PAHRIS and the DOLARS general ledger system also had not been performed. Failure to carry out reconciliations between the general ledger and the personnel system reduces the level of assurance over the accuracy of information held in the general ledger.

Agency banking

An effective cash management process encompasses regular and timely reconciliations of bank accounts (bank statements) with the general ledger and/or cash book. The ANAO noted that a number of bank reconciliations have not been completed. This includes reconciliation of the cash balance in the general ledger with the cash balance in the department's Head Accounts.

In addition, the department is now responsible for its own cash management function as part of the devolved banking reform process. Last financial year, the ANAO raised concerns about significant direct

invoice processing. Direct invoices are processed without raising purchase orders. This does not accord with industry best practice purchasing control over quantity and price. The direct invoice processing can lead to inaccurate cash forecasting and inappropriate cash management. The ANAO recommended that, in accordance with the risk management strategy of the department, consideration should be given to amending the above process along the lines of identified best practice.

IT systems and controls

Controls in respect to the local area network, windows environment, and particularly in respect to the regular review of access logs require improvement.

The department is currently undergoing a process to document policies and procedures in relation to a validation audit process.

Response

The department acknowledged the issues raised and is giving priority to establishing policies and procedures to minimise the risk of irregularities occurring and enhancing its control framework.

Department of the Environment and Heritage

Business and operating environment

The Department of the Environment and Heritage comprises the three autonomous divisions of Environment Australia, the Bureau of Meteorology and the Australian Antarctic Division which, through their activities, aim to advise on and implement policies relating to environmental matters.

Environment Australia delivers the Commonwealth's core environmental programs being the protection and conservation of the environment, while ensuring its use is ecologically sustainable. A key business activity of Environment Australia is the implementation of the *Environment Protection and Biodiversity Conservation Act 1999* (the Act). This new legislation, which repeals existing environment protection enactments, sets a framework for the protection of matters of National Environment Significance.

The Bureau of Meteorology is responsible for the provision of meteorological and related hydrological and oceanographic services to the Australian community, operating under the authority of the *Meteorology Act 1955*.

The objectives of the Australian Antarctic Division are to:

- enhance Australia's role as an influential nation in the Antarctic Treaty System;
- build a systematic knowledge of the Antarctic by conducting and supporting strategic scientific research;
- protect the Antarctic environment; and
- administer the Australian Antarctic Territory and the Territory of Heard Island and the McDonald Islands.

The key risk areas include the successful implementation of the new environment protection legislation mentioned above, finalisation of the FMIS platform, and the valuation and recording of assets, particularly in respect to the Bureau and the Antarctic Division.

Over the past 18 months, the department has been implementing SAP R/3 as its primary financial management information system. The IT assets of Environment Australia are to be outsourced to IPEX during June 2000.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	6	6	3	3
B	14	13	9	10
Total	20	19	12	13

Environment Australia

Asset management

The development of an Asset Management Guide for the department has not been finalised. The guide will ensure consistent accounting treatment of assets held by the Antarctic Division, Bureau of Meteorology, and Environment Australia.

Cash management

The following weaknesses were noted:

- the reconciliation of bank accounts, being a key control over all cash transactions, is not performed in a timely manner. As a consequence, management's ability to manage and monitor cash is diminished;
- payment files can be modified before they are transmitted for payment. This increases the risk that an unauthorised payment can be made;
- access to the computer application Reserve link, which controls the department's bank accounts, does not provide adequate segregation of duties. There is a real risk that unauthorised payments can be made by a single user; and
- segregation of duties over cash management and procurement activity requires improvement. Some of the department's critical banking and cash management functions are completed by one officer. This increases the risk of unauthorised transactions in respect to the department's cash.

Security of the financial management information system (FMIS)

The ANAO identified the following weaknesses over control of user access to SAP R/3:

- some users have access to processes outside their level of authority and responsibility. As a consequence, there is a real risk that these users can breach their present set of duties and create or amend financial information without appropriate authority;

- SAP R/3 user access and processing logs are not being monitored. In the absence of such monitoring, the risk of detecting unauthorised transactions is not available; and
- SAP R/3 uses a database management system to store and retrieve financial information. Presently a single operator has unrestricted access to this system and the financial information contained within it.

Australian Antarctic Division

Asset management

Matters with asset accounting and the ability of asset recording systems to record revaluations have been raised and agreed with management.

Other Matters

Other matters referred included cash management issues involving reconciliation of bank and debtors accounts.

Bureau of Meteorology

Revenues, Receipts and Receivables

Controls surrounding the management of debtors were considered to be inadequate. The debtors balance was not updated on a timely basis, nor appropriately monitored. The present set of procedures was not sufficient for the financial information of the Bureau's debtors to be regarded as reliable.

Response

The department acknowledges the matters raised by the ANAO and through its Financial Statement Accounting Policy Group, is actively managing appropriate remedial action. All matters directly relating to the financial statements will be resolved by 30 June 2000.

Department of Family and Community Services

Business and operating environment

The audit of the Department of Family and Community Services (FaCS) includes CRS Australia and the Child Support Agency, representing significant operations impacting on the financial management of FaCS. FaCS also partners with Centrelink for the delivery of government policies and programs, including processing the majority of FaCS' benefit payments. Centrelink, under the *Financial Management and Accountability Act 1997*, prepares and reports on its own financial operations. The benefit payments Centrelink process, on behalf of FaCS, are reported in FaCS' financial statements. Accordingly, as part of the financial statement audit, a review of Centrelink financial systems was undertaken to determine whether reliance could be placed upon them to produce accurate and complete information for FaCS' financial statements.

Key risks include the fundamental control over benefit payment entitlements. Integral to this is a robust risk management process.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2
B	Nil	Nil	4	4
Total	Nil	Nil	6	6

The ANAO's interim audit coverage focused mainly on the adequacy of assurance mechanisms over personal benefit payments which, for 1998–99, totalled about \$42 billion. Because these payments are delivered by Centrelink, our audit considered the business and operating environment in that agency. The ANAO concluded that Centrelink's risk management framework should be strengthened to include an overarching assessment of the adequacy of existing mechanisms to maintain the risk of incorrect benefit payments at an acceptable level. The ANAO recognised that the outcomes arising from any such assessment should be considered in the context of Centrelink's overall business activities and the impact on the achievement of strategic goals and objectives. The ANAO considered that certain aspects of Centrelink's information technology control structure and compliance activities could be improved to increase the level of assurance over the accuracy and validity of benefit payments. Detailed commentary arising from the audit of Centrelink is provided in this report under that agency's heading.

A similar position applies to FaCS, in that no overall mapping and evaluation of the risks which FaCS face both as an individual agency, and as a purchaser of services from other government agencies, exist from a financial perspective. A high level risk assessment against existing controls, including those provided by other service entities, needs to be undertaken to determine the adequacy and effectiveness of existing assurance mechanisms, as well as to provide a model upon which FaCS can rely, monitor and review.

It is acknowledged that FaCS is undertaking a number of initiatives to address the issue of risk and assurance within the agency including the on-going review of the Business Partnership Agreement with Centrelink which incorporates partnership assurance principles. The ANAO considers that a consolidated assessment of risk and the adequacy of existing assurance mechanisms would contribute to the establishment of an effective risk management regime. FaCS has responded positively to the issues raised and is currently developing a risk and control assessment strategy for endorsement by its board of management.

Other internal control matters

A number of internal control matters significant to sound financial management were raised with FaCS concerning general ledger and service provider reconciliations, asset control and valuation, and the Student Financial Supplement Scheme. It is recognised that significant work has been undertaken by FaCS over the last year to resolve the issues raised. The ANAO is working with FaCS to ensure successful resolution as they impact on both effective financial management and financial statement preparation.

Response

The department accepted the matters raised and advised of appropriate action being taken. As noted above, the department is progressing the development of a high level risk management model addressing the adequacy of existing assurance mechanisms.

Centrelink

Business and operating environment

Centrelink provides services in relation to the delivery of personal benefit payments and other payments on behalf of Commonwealth agencies. In the preparation of the annual financial statements, Centrelink and its client agencies place reliance on the control framework and specific controls supporting its information technology systems, including the development, implementation and support of systems and procedures for managing payments made to benefit recipients. From a financial perspective, those areas present the greatest risk of a material error occurring in the preparation of the financial statements and are the primary focus of audit attention.

The ANAO concluded that Centrelink's risk management framework should be strengthened to include an overarching assessment of the adequacy of existing mechanisms to maintain the risk of incorrect benefit payments at an acceptable level. The ANAO recognises that the outcomes arising from any such assessment should be considered in the context of Centrelink's overall business activities and the impact on the achievement of strategic goals and objectives.

Audit findings

Ratings	Issues Outstanding at September 1999	Issues Resolved Prior to March 2000	New Issues to March 2000	Closing Position at March 2000
A	Nil	Nil	Nil	Nil
B	Nil	Nil	1	1
Total	Nil	Nil	1	1

A number of audit issues have been raised with Centrelink relating to risk management generally, which if addressed, will increase the level of assurance over the correctness of benefit payments. These issues are summarised in the commentary below.

Risk management

The *Social Security Act 1991* imposes an obligation on customers to disclose information affecting entitlement to payment. It is not cost effective, or efficient for benefit payments service delivery, for Centrelink to check all information provided by the customer at the time it is provided. However, once a claim has been lodged Centrelink has in place a series of preventative, detective and deterrence measures aimed at minimising the risk of unauthorised, inaccurate and invalid payments arising from the processing of the customers benefit.

An assessment of Centrelink's risk management practices was undertaken in order to determine the strength of the systems and procedures through which its business is managed, transactions processed and financial statements prepared. This work covered both information technology systems for transaction processing and compliance activities that prevent, detect and deter against invalid or incorrect payments.

Centrelink has a number of key risk management strategies in place that focus on the critical elements of its business and is at the next stage of development in incorporating these elements into an integrated whole of organisation risk management framework. Centrelink has also undertaken considerable work in prioritising and resolving internal and external audit findings to ensure that all business critical risks are addressed. A financial statement sign-off by all Centrelink National Managers provides assurance on matters affecting the financial statements.

The ANAO considers that priority should be given to developing a high-level risk management strategy focussing on the critical components of Centrelink's business. A strategy of this nature would provide a valuable insight into those areas where assurance processes require attention and identify any residual risks not controlled adequately or controlled excessively. At the same time, the strategy should address the matters raised by the ANAO to establish, in the wider business context, whether they diminish the overall effectiveness of the control structure supporting benefit payments.

IT systems and controls

Information technology is critical to Centrelink in terms of business performance, transaction processing and information storage. To minimise unauthorised or accidental security breaches, a fundamental component of the control environment focus is ensuring accessible but secure IT systems. The matters raised by the ANAO identified a need for senior management to establish the level of IT security risk it is prepared to accept.

The audit issues raised highlight the importance of a more strategic approach to IT systems security and its integration into the overall risk management practices of Centrelink. IT security risk assessments are central to this strategic management focus and play an important role in identifying areas of significant risk and the acceptability of existing controls. As systems change, continuous monitoring and review is required to establish the continued effectiveness of controls and the emergence of any new risks.

Where constant change in business and systems environments is a key feature, Centrelink acknowledges that a control and risk management framework be used for security and access control evaluations. In this regard Centrelink initiated a major review of IT Security architecture in February 2000 that will address many of the audit issues raised.

IT general control environment

A number of issues were highlighted by the ANAO's review of key components of Centrelink's general IT control environment, which supports specific business applications. Many of the issues had been raised by Internal Audit. Recommendations had been made in the areas of access control and monitoring, program change configuration, data and program changes and the testing of changed programs.

The ANAO notes that because of the dynamic nature and size of Centrelink's business and IT environment many of the issues raised are constantly being identified and actioned.

Income support systems

The income support systems (Pensions, Newstart, Parenting and Families) record customer details, including circumstances such as earnings, assets, children and housing. The nature of income support payment processing has led to the presence of a number of duplicate records within the system. Duplicate records do not, generally, mean there is the possibility of a duplicate payment. Many of the duplicate records contain redundant personal data with no benefit information. Centrelink is actively working to ensure that duplicate payments do not occur and the controls in place are operating effectively.

Financial management and human resource management information systems

The review of Centrelink's Financial Management and Human Resource Management Information Systems focused on systems integrity over financial transactions. A number of issues were identified in the systems administration and general control environment that could adversely impact on the integrity of the systems. The ANAO recommended improvements in areas such as systems access controls, systems configuration, program change control and monitoring and assessment.

The Financial Management and Human Resources management systems have only recently been implemented into Centrelink and are still being integrated into the IT environment. Many of those issues will be addressed as these systems are refined or upgraded.

Compliance activity

Centrelink's compliance activity aims to minimise the potential for incorrect payments, focusing on prevention, detection and deterrence. Such activity includes proof of identity checks, procedural accuracy checking, accelerated claimant matching, data matching, program risk assessments and compliance reviews. Centrelink is introducing a series of comprehensive measures aimed at assessing and improving the effectiveness of the control framework in place, including the utilisation of the results from the random review process. The review process is funded and monitored by the Department of Family and Community Services.

The audit identified scope for improvement in design and application of some of these control mechanisms, particularly preventative mechanisms, to minimise the level of incorrect payments. The current level of documentation (electronic or paper) supporting Centrelink's review processes increases the risk that Centrelink will not be able to independently satisfy itself as to the correctness of customer entitlements. As a consequence, there is a need to undertake a risk assessment to provide assurance upon which Centrelink can rely, monitor and review.

Response

Centrelink agreed with the above findings, and considerable work is being undertaken to ensure that all business critical risks are addressed and appropriately controlled.

Department of Finance and Administration

Business and operating environment

The Department of Finance and Administration's role encompasses:

- sustainable Government finances incorporating whole of government budgetary advice and reports, budget management, the accrual outputs and outcomes framework and ownership advice to the Government;
- improved and more efficient Government operations which incorporates providing advice in relation to financial legislation and regulation, Public Sector superannuation, competitive tendering and contracting, service charter, management of discretionary payments, property management, contract management and access to government information; and
- an efficiently functioning Parliament through accommodation, VIP transport services, entitlements, services to parliamentarians and their staff.

The department is multi-faceted in a business sense. For example, it manages a large domestic and overseas property portfolio and has a comprehensive role in Budget preparation and Commonwealth financial reporting, including the administration of Comcover, ComSuper and parliamentary services.

The department has taken a leading role in outsourcing and has extensive outsourcing arrangements in respect to Human Resource Management, the IT platform, VIP Car facilities and other travel, Financial Reporting, GST Implementation, Internal Audit, Office services, Comcover's Member Services management, and numerous other such arrangements. In addition, the department is in the process of establishing a strategic alliance with the private sector to manage the non defence property portfolio.

The key risk areas cover contract management including the Strategic Alliance Project with the domestic and overseas properties together with the performance of the property divestment program and the protection of the Commonwealth's insurable risk profile.

The department has a number of outsourcing arrangements in place for the provision of IT services over a number of financial applications including IBM Global Services Australia Limited (IT Infrastructure, Network Support etc), QSP (QSPF) and Knight Frank Price Waterhouse (Aurion).

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	2	2	3	3
Total	2	2	3	3

The department's operations are predominantly automated. As QSPF and Open Aurion are used for financial reporting and to produce the financial statements, these two systems and their respective IT control environments have formed the major focus of the IT interim audit.

The key matters raised include the monitoring of access to business systems.

With IT security monitoring it is normal for a small group of staff to have access to high level functions or 'superuser' status within IT systems. This is a necessary part of maintaining and supporting these systems. Normal practice is for these accesses to be logged and the log files regularly reviewed.

As many of the financial functions have been outsourced to various organisations including QSP, it is important to note that the responsibility for security of this data remains with the department. It is recognised that monthly reporting mechanisms are in place for provision of information from the outsourcer to the department. However, in relation to security, no formal monitoring was performed.

With the year end financial statements audit, the ANAO will concentrate on the verification of asset and liabilities together with validation of the department's operating position. As part of that process, the ANAO will also consider property valuations, foreign exchange accounting and the property divestment program.

Response

The department has rectified the IT security matters raised, with formal review and monitoring processes now in place.

Department of Foreign Affairs and Trade

Business and operating environment

The Department of Foreign Affairs and Trade supports Ministers in the conduct of Australian's foreign relations and trade policy, helps Australian's win export business and generate inward and outward investment. The department also provides consular and passport services to Australian's and aims to improve domestic and international understanding of Australia's foreign relations, trade and aid policies.

Key financial risks include ensuring sound financial management across the department including proper revenue and asset control, and the risks associated with the implementation of a new financial management system are properly managed.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	5	5	Nil	Nil
Total	5	5	Nil	Nil

The results of the audit to date indicate that the department's systems can be relied upon to produce accurate and complete information for financial reporting purposes. A number of departmental initiatives are evident which have enhanced the overall control structure and should aid in financial statement preparation at year end. The most significant is the roll out of the department's new financial management system at overseas posts. As part of the audit process, any opportunities for improvement, or matters that may impact on the department's current risk strategies are raised with management. In this regard, issues concerning information technology security and change control procedures were raised with the department. Recommendations were made in the context of improving controls in those areas to provide greater assurance over the financial management of the department.

Response

The department responded positively to the issues raised and appropriate action has been taken.

Department of Health and Aged Care

Business and operating environment

The department's role is to lead the development and implementation of health and aged care services policy and to promote the development of quality health and aged care services for all Australians.

Major issues facing the department relate to coordination of aged care services and providing access to health services in rural and remote communities, implementation of major structural reforms in aged care services and managing the program payments.

From a financial perspective, the key risks include:

- the ability to meet this year's advanced reporting timetable;
- the need to maintain the highest level of accountability over the administration of program payments and ensuring that these payments are made in a timely and efficient manner; and
- the need for the department to have sound contract management to ensure the accountability and performance of the arrangements for the outsourcing of the information technology (IT) infrastructure.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	6	4	5	7
Total	6	4	5	7

The financial reporting deadline for the current year is particularly challenging for the department due to its size and complexity of operations. The department is running a significant risk of not meeting the 15 August deadline but is taking action to do so. In particular, the department has been experiencing problems with providing quality and timely monthly reporting over the last 10 months. In addition, there are limited resources/experienced staff to handle the collection of information for financial statements preparation.

System access—approval of expenditure

Appropriate segregation of duties, system access and expenditure approval are an integral part of a control environment aimed at restricting the possibility of processing erroneous or invalid transactions. The audit

found that improvements were required in controls over segregation of duties including:

- single officer processing of payments within FINEST;
- staff who have access to amend and create suppliers; and
- expenditure approved by a delegate where the amount exceeded the delegation limit.

Regular reviews of access and proper segregation of duties are required in order to minimise the risk of fraudulent payments.

Grant administration – Office of Aboriginal and Torres Strait Islander Health (OATSIH)

The department's requirements for the accountability of funded aboriginal organisations involve submission of various returns. The ANAO found, in visits to OATSIH State Offices, that a large percentage of acquittals are not assessed on a timely basis. Grant payments will still be processed to organisations even though they have not met the funding obligations. If acquittals are not assessed in a timely manner, the risk of funds being used for purposes other than the intended purpose of the project is increased.

In addition to rectifying the above specific matters, the ANAO has made recommendations concerning the skills of individual project officers and, associated with this, the identification of appropriate training to obtain or enhance skills.

Aged care payments

The ANAO's review of payments to nursing homes indicated two areas of concern:

- the questionable validity of Payroll Tax Supplement payments. The ANAO could not find any evidence of the department checking the validity of payroll costs claimed by the provider; and
- the inadequate management of the recovery of overpayments to nursing homes.

Bank reconciliations

Although payments and some individual receipts are being reconciled from the general ledger to the bank statements, the department does not reconcile the actual cashbook account in the general ledger to the balance in the bank statements. This is a fundamental component of the reconciliation process.

The reconciliation of bank accounts to the general ledger is a vital control to ensure the accuracy and completeness of the monthly receipts and expenditure. These reconciliations are necessary to ensure that the information recorded on the department's systems and used for management reporting and decision making throughout the year is reliable. In addition, the Financial Management Information System is not fully capable of capturing the required financial information. The department cannot effectively reconcile and consolidate the data in order to provide cost information for key activities/outputs.

Response

The department agreed with the above-mentioned findings, advising of appropriate remedial action. Bank account reconciliations have been initiated.

Health Insurance Commission

Business and operating environment

The Health Insurance Commission (the Commission) is a Commonwealth Statutory Authority established by the *Health Insurance Commission Act 1973*.

The Commission's main activities are the administration of Medicare, the Pharmaceutical Benefits Scheme (PBS) and the 30 per cent Rebate Scheme. The Commission also administers:

- the Australian Childhood Immunisation Register;
- the Commonwealth Childcare Rebate Scheme;
- the Practice Incentive Program;
- the General Practice Immunisation Incentives Program;
- aspects of the Private Health Insurance Incentives Scheme;
- Simplified Billing arrangements;
- other Health Program Grants; and
- arrangements for Medicare and nursing home benefits involving compensable injuries.

In addition, the Commission also processes benefit payments for the Department of Veterans' Affairs Treatment Accounts and the Office of Hearing Services. All Commission activities are conducted within the government program policy framework set by the Department of Health and Aged Care, Department of Veterans' Affairs, Department of Family and Community Services and relevant legislative requirements. The Commission focuses on the operational service delivery of the programs within the broad policy and legislative framework.

The key risk areas include the identification and management of fraud and inappropriate practices, administering the 30 per cent rebate scheme, management of service level arrangements with other agencies, compensation case management, and the management of its IT control environment and associated operating systems.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	4(a)	4
B	17	2	20	32
Total	17	2	24	36

Note: (a) Includes 3 "B" rated issues at September 1999 re-rated to "A" at March 2000.

FINNET (SAP R/3) review

A comprehensive review of the Commission's Financial Management System, FINNET (SAP R/3), was conducted. Specific attention was given to FINNET security, financial accounting and IT infrastructure. The following control weaknesses were identified:

- SAP R/3 Basis Security – there is excessive access to the system, and inadequate maintenance of account master data and sensitive transaction codes. There is also inadequate systems maintenance and inadequate review of system maintenance and changes;
- Financial Accounting – excessive access is allowed in relation to journal processing and the amendment of accounting master data. There is no utilisation of SAP R/3 reporting functionality and controls, and no review of data maintenance and changes; and
- IT Infrastructure – specific attention needs to be given to the approval of modification processes and system access.

The Commission has undertaken to strengthen controls over FINNET and has implemented a number of the recommendations made by the ANAO.

30 per cent rebate scheme

From 1 January 1999, The Private Health Insurance Incentives Scheme was superseded by the Government's 30 per cent Rebate on private health insurance. Everyone who pays private health insurance premiums to a registered health fund is eligible for the rebate.

Controls surrounding payments made under the 30 per cent Rebate Scheme are not sufficient to ensure the accuracy and validity of the payments made to the Health Funds. A review by the Commission's Audit Branch, carried out in November 1999, has also highlighted similar concerns.

In the past, the Commission had limited legislative power to obtain the necessary information substantiating claims made by the Health Funds. Recognising the risks associated with these payments the Commission, under the power of the original legislation, has performed some review and confirmation of data at Health Funds.

Revised legislation was enacted recently allowing the Commission to request:

- sufficient detail with each claim to ensure accuracy and validity of payments made;
- independent audit certificates from the Health Funds on the amount claimed from the Commission; and
- data/documents supporting the claims for periodic review by the Commission.

The Commission is aware of the need to establish an effective control structure and address the issues in respect to the accuracy and validity of payments made in 1999–00. It has agreed to take immediate action in order to substantiate validity of payments made this financial year and to establish ongoing control over the payment process.

Medicare and pharmaceutical benefits scheme (PBS)

During the audit of the 1998–99 financial statements, the ANAO highlighted a number of weaknesses in controls surrounding the processing of Medicare and Pharmaceutical Benefit payments. The significant weaknesses related to:

- quality control;
- updates to standing data;
- validity of Pharmaceutical Benefits Scheme payments to non-concessional individuals; and
- the process for changing EFT bank account details.

The Commission advised that forthcoming changes to legislation and redevelopment of the benefit payments systems would rectify the above issues.

Other matters

A number of other control matters have been brought to the Commission's attention relating to:

- management, recording and distribution of moneys relating to compensation cases;

- resolving discrepancies in the reconciliation of the Branch Office Clearing Accounts;
- services provided to Medibank Private Limited (MPL) were not being managed and billed according to the signed Agreement or in the best interests of the Commission;
- asset management within the Commission could be improved with further development and dissemination of approved capitalisation policies and procedures; and
- a number of aspects of the IT control environment, specifically relating to security over logical and physical access to the Commission's IT environment and associated applications.

Response

The Commission has advised that policies and procedures are currently being put in place to address the outstanding matters at this stage. The ANAO acknowledges the substantial efforts made by the Commission in rectifying these matters.

Department of Immigration and Multicultural Affairs

Business and operating environment

The Immigration and Multicultural Affairs portfolio is responsible for the management of the entry of people to Australia, the successful settlement of migrants and refugees, enabling them to participate equitably in society, and the promotion of the benefits of citizenship and cultural diversity.

The key risk areas include maintenance of proper controls over departmental activities covering fundamental areas with assets, revenue and IT operations.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	2	2	Nil	Nil
B	1	1	5	5
Total	3	3	5	5

Significant internal control issues concerning revenue collection, asset management and ledger reconciliations have been reported in previous years. The department has responded positively to these issues, initiating action to enhance the quality and effectiveness of the overall control structure including the implementation of its new financial management information system. Asset management and ledger reconciliations are two areas where action is on-going to address fully the issues raised and, on this basis, the ANAO is satisfied with progress to date.

Recent audit coverage of selected overseas posts also indicated sound progress with the implementation of reforms to strengthen revenue collection and accounting. The recently developed departmental Administrative Circular on Revenue and compliance therewith has provided the department with greater assurance over revenue collection. The ANAO's overseas audit coverage identified the opportunity at one location to improve adherence with the Circular. The department has since taken appropriate remedial action.

Response

The department responded positively noting its continuing efforts to create a sound control structure supporting its financial management, including rectification of matters raised as part of the audit process.

Department of Industry, Science and Resources

Business and operating environment

The department plays a key role in improving Australia's business environment through initiatives such as fostering a stronger venture capital market and increasing investment and export industries. In addition, the department's activities are directed towards enhancing international competitiveness of Australian industry, and encouraging scientific research activities.

The key risk area relates to the department's ability to target and harness industry to improve Australia's business environment and competitiveness. From a financial perspective, the key risks include financial management and reporting, including the finalisation of the implementation of its financial management systems, the outsourcing of the department's information technology platform and business systems, and cash management. In addition, the department is focusing on the controls over the administration of its grants schemes.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2(a)	2
B	5	3	8	8
Total	5	3	10	10

Note: (a) Two prior year issues rated as B have been rated as A in the current year.

The ANAO's work focused on two main areas namely, the management and administration of the financial aspects of various grants schemes and the department's financial management processes. The ANAO concluded that the financial management and human resources systems are not fully reliable and the infrastructure supporting them is yet to be fully implemented. The key systems are Finance One and Open Aurion, covering assets, payroll processing, purchasing, accounts payable (including grants), accounts receivable, and general ledger.

Control weaknesses were noted in payments and journal processing including:

- inadequate separation of duties;
- a failure to complete essential reconciliations;
- weaknesses in essential input/output controls; and
- a high level of transaction and ledger posting errors.

The department has commenced a number of initiatives to address these issues.

Financial management and reporting

At the commencement of this financial year the department had not put in place an effective organisational structure or established procedures or systems to support its financial management and reporting responsibilities. Specifically, the department had not dealt effectively with the new responsibilities of devolved banking and overall cash management through the operation of effective systems and reconciliation regimes as well as additional responsibilities resulting from the devolved framework.

The ANAO acknowledges the department is now in the process of addressing the issues raised. However, the situation remains that, as a result of errors in financial data and failure to reconcile its cash situation, a large part of the financial year has passed without the benefit of effective cash management systems. As a consequence, the department has operated without full knowledge of its complete financial position during this time.

Further, the department has had to commit significant resources to establish an effective control environment. This has been further complicated by the need to correct its current year financial situation caused by posting errors to the general ledger and the need to undertake and finalise required reconciliations. There is also a risk, at this late stage, that the department may have difficulty in producing the information required to support the preparation of its financial statements and meet external reporting obligations. It is also important that the department moves to implement ongoing solutions to ensure that the same issues do not continue into the next financial year.

IT systems and controls

The following opportunities for improvement in the control structure supporting information technology were raised with the department.

Control over Finance One processing

A number of key control weaknesses relating to inadequate reconciliations and validation and processing controls, were noted resulting in errors in general ledger balances. The ANAO acknowledges that the department has implemented procedures to address the data integrity issues, however, it remains unclear whether the underlying weaknesses still prevail. A further review by the ANAO of application controls prior to the completion of the audit will be undertaken to assess progress.

External network connections

It is normal practice to establish significant controls over connections to outside agencies networks to an organisation's internal network to ensure the integrity of its processing and data and to prevent unauthorised access to its business systems. Usually this control is in the form of 'a firewall' certified by an external agency.

The ANAO found that the current firewall provided by the department does not offer the department adequate assurance that controls exist over inappropriate access to facilities, applications and data. The ANAO acknowledges that the department has initiated action for a certified firewall to be established in the near future.

IT security policy

The current departmental IT Security policy covers only security issues for desktop and notebook users, not for the overall infrastructure. For an organisation to be able to implement adequate and appropriate IT security controls, it needs to have an approved IT security policy. This policy would normally be developed following a risk analysis of threats to the department's IT environment and addressing the IT security needs of the organisation, including the impact of outsourcing.

Review of privilege access

It is normal for a small group of staff to have access to high level functions or 'superuser' status within IT systems. This is a necessary part of maintaining and supporting these systems. Normal practice is for access to be logged and the log files regularly reviewed. The ANAO found that, in some cases, logs do not exist, and no monitoring was taking place.

Responsibility for IT controls (IT outsourcing)

The department has outsourced the delivery of its IT processing including server administration and management. The outsourcing arrangement provides for the outsourcer to manage the configuration and operation of the servers including, as required, change management, security configuration, control and privilege access, and the business resumption plan. Although the department has outsourced the service delivery of its IT infrastructure, it retains the responsibility for ensuring that effective controls are in operation. The department has not established any formal processes to provide assurance over the control structure established and maintained by the outsourcer.

Other matters

The following other matters were referred to the department.

- *Asset accounting*

At the time of the audit, the department had not completed the implementation of its new asset register nor provided for complete and effective asset accounting supported by effective reconciliations.

- *Payroll management*

Deficiencies exist in some areas of the department's payroll administration that prevent management from achieving confidence in salary processing.

- *Journal processing*

Control over journal processing found there to be a large number of adjusting journals and that the controls over the process were inadequate.

Response

The department acknowledged the above-mentioned findings and is making a significant investment to address these matters. To date, the deficiencies relating to financial management and reporting have been resolved, and significant progress has been made in respect to the other matters raised.

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

From a financial perspective, the audits of the departments are not considered high risk.

Audit findings

In respect to all five Parliamentary Departments, the ANAO found that the control environments around and supporting the respective financial statement preparation processes were sound. Apart from the Department of the House of Representatives, there were no matters raised with management.

Department of the House of Representatives

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

Bank reconciliations

The reconciliations of the general ledger to the Reserve Bank of Australia bank statements were not performed correctly. These reconciliations 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.

Asset reconciliations

Reconciliations between the general ledger and the departmental asset register have not been performed on a regular basis throughout the year. As a result, there is not a complete and accurate record of the department's asset holdings available for management and control purposes.

Response

The Department of the House of Representatives has implemented remedial action in relation to the matters raised.

Department of the Prime Minister and Cabinet

Business and operating environment

The Prime Minister and Cabinet portfolio comprises agencies responsible for the output of products aimed at achieving a well coordinated, efficient and accountable public administration, supported by a values based Australian Public Service. This is provided by the department which is responsible for the provision of economic, social and international policy advice to the Prime Minister and other Ministers on major domestic and international issues and a coordination role with other departments. There are seven specialist agencies within the portfolio which provide specialist advice to the Government.

From a financial perspective the audit of the department is not considered high risk.

Audit findings

The results of the audit to date indicate that the department's systems can be relied upon to produce accurate and complete information for financial reporting purposes. As part of the audit process, any opportunities for improvement, or matters that may impact on the department's current risk strategies are raised with management. In this regard, a number of matters concerning information technology security, monitoring of data back-ups and change control procedures were raised with the department. Recommendations were made in the context of tightening the IT control structure to provide greater assurance over the integrity of computer programs and information.

Response

The department advised of remedial action being taken to address the recommendations.

Aboriginal and Torres Strait Islander Commission

Business and operating environment

The Aboriginal and Torres Strait Islander Commission (ATSIC) is the principal Commonwealth agency operating in the field of Aboriginal and Torres Strait Islander affairs. It is the main policy-making body and is responsible for administering a diverse range of Commonwealth programs for Indigenous Australians.

The key risks for the Commission relate to its reputation and differing public perceptions in managing Indigenous affairs. This is impacted by the considerable number of entities involved and the breadth and geographical dispersal of operations. From a financial perspective, the key risks relate to the administration of grants and loans. The Commission manages these risks through its corporate governance framework which includes a fundamental focus on controls and compliance.

The Commission utilises SAP R/3 in the production of its financial statements. During 1999–2000 there have been no major changes to the IT environment with applications within SAP R/3 being used as the FMIS system and PERSPECT being used for the HRMIS system.

ATSIC have entered into a contract with IpeX Information Technology Group Pty Ltd to provide IT services. The terms of the contract include selling and leasing back computer hardware and selected software.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	2	1	1	2
Total	2	1	1	2

Systems access controls

SAP R/3 uses access profiles to control access to many activities within the system. Users are provided with user accounts, which are defined to one or more of these access profiles.

The ANAO identified a significant number of users having unlimited access to the system, and an even greater number having unnecessary access to change SAP R/3 program code. It is considered that this high number of “super users” could significantly increase the risk in respect to the reliability of the system’s data.

Employee reconciliations

The ANAO reported in 1998–99 that no reconciliations were performed between the data recorded in the general ledger, human resources system and the service provider system. The Commission has partly addressed this matter by commencing the reconciliation of data in the human resources system and service provider system. However, there are still no reconciliations performed between the human resource system and the general ledger.

Response

The Commission responded positively to the above-mentioned findings, advising of appropriate remedial action.

Department of the Treasury

Business and operating environment

The Department of the Treasury (the Treasury) is the Commonwealth's advisory body on economic and fiscal policies and associated developments and reforms. The activities undertaken by the Treasury are aimed at achieving strong sustainable economic growth. The Treasury provides advice aimed at promoting a sound macroeconomic environment, effective government spending, effective taxation arrangements and well functioning markets.

The Treasury has previously had responsibility for the Commonwealth's debt management. From 1 July 1999 the Australian Office of Financial Management, a 'prescribed agency' under the *Financial Management and Accountability Act 1997*, became responsible for this function.

The key risks include maintaining the department's reputation as a key economic policy adviser. The department administers approximately \$17 billion of grants under a range of schemes. From a financial perspective, the key risks relate to finalisation of the implementation of the department's management and reporting system. Difficulties in finalising controls and assurance processes over data integrity have the potential to impact the department's ability to meet the advanced reporting timetable.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	4	4	1	1
B	2	Nil	3	5
Total	6	4	4	6

IT systems and controls

The ANAO's review identified matters requiring specific attention relating to the general and application IT environments, reconciliations of the cash ledger to bank accounts, salaries reconciliations and asset management. A number of these issues were raised with the Treasury as a result of the 1998–99 financial statement audit. As these issues are now being addressed, the ANAO will review actions taken later in the financial year.

IT controls reliance

The Treasury has experienced difficulties with its FMIS, SAP R/3, since its implementation in July 1998. The FMIS has been required to operate in a dynamic environment over the past two years and this has made the operation of the system problematic. The ANAO acknowledges the significant effort directed towards improving the system.

An internal audit review was also conducted of the controls within SAP R/3 during the 1998–99 financial year. However, a review of the IT general and application controls by the ANAO indicated that the IT environment was not sufficiently robust.

The following weaknesses were identified:

Access control

Consultants contracted to perform development/maintenance work on SAP R/3, in early 1999–00, were granted super-user access privileges in the production system. The ANAO has been advised that the necessary actions have been taken to rectify this situation.

System management

There was no dedicated departmental systems manager/owner of SAP R/3 for the early part of the 1999–00 financial year. This increases the risk of unauthorised users receiving access to sensitive system data, and delays in addressing system errors or correcting erroneous data.

Inaccurate data and staff training

The 1998–99 audit identified a significant number of journals (corrections). This was indicative of a general lack of training or knowledge in the use of the SAP R/3 general ledger. The ANAO has been advised that a user manual and training, have been commissioned to address this issue.

Other matters

The following other control weaknesses were brought to management's attention:

- *Cash reconciliations*

Cash reconciliations of the general ledger to the bank account were only formally completed from January of this year. These reconciliations are analogous to a bank reconciliation. They are necessary to ensure that reliable information is recorded on the departmental systems and used for management reporting and decision making throughout the year.

- *Salaries reconciliations*

Salaries reconciliations were not reviewed by an appropriate official, nor was there a sufficient audit trail ensuring validity of the reconciliations. The reconciliations did not involve a follow up of discrepancies relating to amounts to be paid as reported by the personnel system and amounts actually paid by the service provider (CITEC).

- *Asset management*

The Treasury does not have a designated Asset Manager. This impacts the control and management over the Treasury's assets, and can lead to the asset register not being an accurate reflection of the Treasury's asset holdings.

Reconciliations between the general ledger and asset ledgers had not been performed for the current financial year. The lack of reconciliation can lead to inaccurate or incomplete details for financial reporting purposes.

The fixed asset policy of the Treasury is not specific with regard to capitalisation dates. Consequently, inconsistent capitalisation of assets has occurred resulting in inaccuracies in depreciation expense.

Response

The department has advised that policies and procedures are currently being put in place to rectify the above-mentioned matters.

Australian Office of Financial Management

Business and operating environment

The Office was established on 1 July 1999 as a 'prescribed agency' under the *Financial Management and Accountability Act 1997*. At that time it assumed responsibility for the Commonwealth's debt management, previously undertaken by the Department of the Treasury.

The Office's main activities include:

- the issue and redemption of the Commonwealth's domestic and international debt, including the payment of interest on that debt;
- the day to day management of the public debt, including the management of the swap derivative portfolio; and
- the administration of repayments by the states and territories of previous Commonwealth advances and the payment of grants to the states and territories as part of the *Financial Agreements Act 1994*.

The Office's aim is to enhance significantly the Commonwealth's capacity to manage its net debt portfolio, offering the prospect of savings in debt servicing costs and an improvement in the balance sheet net worth of the Commonwealth over time. It will do so by ensuring that Government debt is managed at the lowest possible cost, consistent with an acceptable degree of risk.

The key risk areas include the achievement of a cost effective Commonwealth debt position against defined risk targets. This encompasses the use of a range of swap derivatives to hedge the debt portfolio. From a financial perspective, the other key risk relates to IT control. The Department of the Treasury provides a bureau service to the Office in relation to personnel/HR, FMIS and other IT. The IT matters discussed above in respect to the Treasury have a consequential impact on the Office.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	1	1	Nil	Nil
B	3	3	2	2
Total	4	4	2	2

The ANAO's review identified matters requiring specific attention relating to the reporting capabilities of the Commonwealth Debt Register and the general and application IT control environment.

Commonwealth debt reporting capabilities

Following the decommissioning of the Public Debt Management System from the Department of Finance and Administration's mainframe computer in November 1999, the existing AOFM Access database developed by the Union Bank of Switzerland for portfolio modelling (the 'Access System') is being utilised as the official record of public debt. The Access System currently has limited financial statement related reporting capabilities, and consequently it is not, at this stage, possible to obtain from the system, a complete listing of public debt currently outstanding. To compensate for this, the Office is maintaining spreadsheets that are regularly reconciled to the Reserve Bank of Australia's record of public debt. The inability of the Access System to produce summary reports impacts the Office's ability to manage effectively the debt portfolio. A reporting mechanism is currently under development, which will support the preparation of the year end financial statements and other necessary information.

IT controls reliance

The Department of the Treasury provides a bureau service to the Office in relation to the FMIS and IT generally. As a consequence, the issues raised in this report in respect to control over the reliability of, and access to, the Treasury's financial management system can affect the integrity of the Office's financial statements.

Response

The AOFM has advised that policies and procedures are currently being put in place to rectify the above-mentioned matters.

Australian Taxation Office

Business and operating environment

The Australian Taxation Office's (ATO) main function is to administer legislation imposing taxes. The main areas of legislation are:

- income tax;
- company tax;
- fringe benefits tax;
- sales tax;
- higher education collections (HECS);
- Medicare levy;
- superannuation guarantee;
- small superannuation accounts;
- superannuation contribution tax;
- excise duty; and
- diesel fuel.

The ATO has the primary responsibility of implementing a range of Tax Reform initiatives including the goods and services tax (GST). Among other things, the ATO has formed the Goods and Services Tax business line and the Reform Program Office as a result of these responsibilities. The ATO will also be responsible for implementation of other tax reforms, including business taxation.

The key risk areas include the:

- ATO's continued recognition as a provider of high quality budget funded services in respect to the collection of taxation;
- ability of the ATO to implement and provide advice on government taxation policy;
- tax reform implementation implications;
- self assessment regime and revenue recognition;
- complex and devolved systems supporting the identification and collection of taxation and excise revenue; and
- complex and changing taxation environment.

The ATO has a complex network of information technology (IT) systems, processes and databases that are subject to continual change, particularly in relation to the new tax system. A number of agency initiatives are evident which have enhanced the overall control structure and should aid in financial statement preparation at year-end. However, continuing weaknesses noted in a number of areas require resolution.

In addition, the ATO is currently undergoing comprehensive changes in the way business systems will operate as a result of Tax Reforms. The focussing of available resources on Tax Reform deliverables has impacted on existing systems, demonstrated by:

- a minimal number of non tax reform related changes being made to existing applications;
- the implementation of “work arounds” instead of correcting control weaknesses identified;
- not effectively addressing matters previously raised by the ANAO and others, in regard to the operation of the control environment; and
- a lack of current security policies reflecting the requirements of emerging business practices.

Audit findings

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2(a)
B	3	Nil	2	5
Total	3	Nil	4	7

Note: (a) prior year issue re-rated in the current year.

Firecall access

For a number of years, the ANAO has raised the issue of the use of Firecall, which is a special access facility created to enable IT personnel to perform quick fixes and gain temporary access to production data. Of primary concern to the ANAO has been the continued excessive use of Firecall without adequate review. Since the outsourcing of the IT function, this practice has been adopted by the ATO’s contractor.

Outsourcer access

The ANAO also noted issues related to the use of DB2 system privileges by the contractor staff. DB2 is the main database management system in use at the ATO and provides data storage for all client data. A number of the contractor’s staff have privileged access to DB2 that provides

unlimited access to all taxpayer data and accounting records. The use of this access is not logged and therefore cannot be reviewed.

Mainframe environment

A number of common issues with program and datafile security involving the management of access to privilege functions and production programs and data were identified. The major issues being the large number of staff with this access, which, combined with inadequate monitoring and review of the use of that access, significantly increases the risk of inadvertent or fraudulent change to production data. Central to effective and efficient security management is the need for clear guidance in the form of an overall IT security policy for the ATO.

Additionally, the ANAO followed up issues reported as a result of the 1997–98 and 1998–99 financial statement audits. A significant number of the matters identified are still outstanding, including the high incidence of failure of scheduled production programs attributed to problems with change control, production control failures and issues relating to access, including the above mentioned firecall access.

Applications security

A significant component of the overall ATO control environment is the management of access security to the various computer systems. Within the ATO responsibility for the management of computer applications access is still fragmented. In the past the ANAO has identified, and reported to management, a number of deficiencies in the management and administration of computer access security. Specific unresolved issues remain with the management of access including:

- access authorisation 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.

IT change management

The ANAO found that the management of IT changes to the ATO's critical business systems and the release of these changes into production were generally well controlled. However the ANAO noted that each application area has tended to establish their own practices for emergency changes and, with the contractor now responsible for the promotion of a number of these changes into the production environment, there are inconsistent approaches to the application of controls.

In the absence of a consistent approach, there have been instances, for both the ATO and the contractor, where authorisation has not been obtained for changes to testing and migration processes. The lack of an ATO-wide change control policy reduces the assurance that all changes are appropriately recorded, approved, tested and migrated to production.

TaxLAN

During 1998–99 the ANAO examined the ATO’s local area network, TaxLAN. A number of issues were raised particularly in the use of privileged access functions and the monitoring of activity logs. A recent review conducted by the ATO Internal Assurance Section identified similar concerns across the TaxLAN.

Quality assurance

The purpose of Certificates of Evidence is to provide management with assurance that controls and accounting procedures are operating consistently over refunds issued. While the ANAO noted some improvements in regard to Certificates of Evidence, the current audit of quality assurance processes identified the following concerns:

- Statements of Support and Certificates of Evidence are not being prepared in a timely manner; and
- where Certificates of Evidence are being completed in a timely manner, discussions with staff concluded there is little or no understanding of what is being signed.

Where Certificates of Evidence are being signed without appropriate assurance that the controls are operating, management is not being provided with the necessary assurance over data provided by ATO systems.

Response

The ATO has advised that it is actively pursuing solutions to IT access issues and is currently undertaking remedial action in relation to the other matters raised.

The Australian National University and ANUTECH Pty Limited

This section deals with the full financial audit of the Australian National University (ANU) and its controlled entity, ANUTECH Pty Limited, including the audit of the respective financial reports as at 31 December 1999.

Business and operating environment

The ANU's mission is to be one of the world's great research institutions, distinguished by outstanding teaching, guiding students to the frontiers of knowledge and the best standards of scholarship. The ANU's research and teaching activities are funded from three principal sources: Commonwealth Government grants; income generated competitively from public and private sources for research and teaching; and from full-fee paying students.

ANU

The key risk areas relate to the maintenance of revenue streams in a highly competitive domestic and international student market. In addition, and against a background of reductions in budget funding, there is varying market capacity to increase non-government sources of revenue.

During 1998, the ANU commenced a major redevelopment of its management information systems with the decision to implement an enterprise solution system architecture, including new financial systems, within the next five years. PeopleSoft was chosen as the main technology provider and the accounts payable and purchasing modules of the new system were implemented in August 1999. The ANAO examined the IT aspects of the new system to provide assurance on the operation of controls relevant to the ANU's accounts payable and purchasing function.

ANUTECH Pty Limited (ANUTECH) is the fully controlled entity of the ANU. The company was established in 1979 to commercialise the research expertise and inventions of the ANU.

Financial statement audit reports

The ANU signed its financial statements for the year ended 31 December 1999 on 7 April 2000. A qualified audit report was issued on the same date. ANUTECH also signed its financial statements for the year ended 31 December 1999 on 7 April 2000 and an unqualified audit report was issued on the same date. Due to going concern issues in respect of ANUTECH, the ANAO relied upon the ANU providing a letter

of financial support for the operations of ANUTECH to ensure that the Company will continue to be a going concern and will be able to meet its debts as and when they fall due, at least in the short term, until April 2001.

ANU Qualification

As in prior years, the audit report on the financial statements of the ANU contained a qualification in respect of land, which has not been valued and brought to account. This represents a departure from the provisions of Australian Accounting Standard AAS4—*Depreciation* and Schedule 2 of the Finance Minister’s Orders issued under the CAC Act. The ANAO considers that the land in question can be reliably measured and should therefore be recognised in the ANU’s statement of assets and liabilities.

Internal control matters

Australian National University

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

Segregation of incompatible duties

The audit noted an excessive number of users whose profiles allowed incompatible duties to be performed in respect of accounts payable processing, and no compensating controls such as an independent check of transactions processed.

Monitoring and approval of changes to vendor details

The audit also revealed scope for improvement over vendor management within the system. In particular, controls over changes to vendor records and periodic review of vendor master files could be improved.

ANUTECH Pty Limited

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	4(a)	4
Total	Nil	Nil	4	4

Note: (a) Prior year issues re-rated in the current year.

Project management and accounting systems

For the year ended 31 December 1998, project management systems were noted as inadequate with regard to project closure and the identification of construction contract projects. The results of this year's audit indicated that project management systems in place at year-end were still inadequate.

Inventory and debtor reconciliation procedures

The ANAO found that, as was the case in prior years, the accounting arrangements relating to monthly reconciliations of inventory, debtors and creditors between the general and subsidiary ledgers require improvement. The existing separation of ledgers, coupled with poor reconciliation and control procedures, resulted in reconciliation errors for both inventory and debtors at year-end.

Debtor collection processes

ANUTECH is currently experiencing problems with its cash flows. These problems are due in part to historically poor debtors' management and inadequate debtor collection processes.

Corporate governance arrangements

As in the previous year, the ANAO has again recommended that the ANUTECH audit committee should consider implementing an internal audit function having a risk based focus across business activity.

Response

ANU

ANU management has advised of appropriate action taken, or proposed, to address the audit findings.

ANUTECH

ANUTECH management has agreed with the ANAO audit findings and has indicated that appropriate action will be taken. An accounting firm has been engaged and is presently working with ANUTECH management to address the major system issues.



Canberra A.C.T.
30 June 2000

P. J. Barrett
Auditor-General

Appendices

Appendix 1

Consolidated table of the number of significant audit findings by audit rating

Agriculture, Fisheries and Forestry

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	1	1
B	3	3	Nil	Nil
Total	3	3	1	1

Attorney-General's

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2
B	2	2	6	6
Total	2	2	8	8

Australian Customs Service

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	1(a)
B	19	17	1	2
Total	19	17	1	3

CSIRO

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

Communications, Information Technology and the Arts

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	1	1	Nil	Nil
B	3	3	4	4
Total	Nil	Nil	Nil	Nil

Defence

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	9	Nil	18	27
B	32	12	34	54
Total	41	12	52	81

Repatriation Commission and Veterans' Affairs

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	18	5	17	30
Total	18	5	17	30

Environment and Heritage

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	6	6	3	3
B	14	13	9	10
Total	20	19	12	13

Family and Community Services

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2
B	Nil	Nil	4	4
Total	Nil	Nil	6	6

Centrelink

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	1	1
Total	Nil	Nil	1	1

Finance and Administration

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	2	2	3	3
Total	2	2	3	3

Foreign Affairs and Trade

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	5	5	Nil	Nil
Total	5	5	Nil	Nil

Health and Aged Care

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	6	4	5	7
Total	6	4	5	7

Health Insurance Commission

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	4(a)	4
B	17	2	20	32
Total	17	2	24	36

Immigration and Multicultural Affairs

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	2	2	Nil	Nil
B	1	1	5	5
Total	3	3	5	5

Industry, Science and Resources

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2(a)	2
B	5	3	8	8
Total	5	3	10	10

House of Representatives

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

Prime Minister and Cabinet

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	Nil	Nil
Total	Nil	Nil	Nil	Nil

ATSIC

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	2	1	1	2
Total	2	1	1	2

Treasury

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	4	4	1	1
B	2	Nil	3	5
Total	6	4	4	6

Australian Office of Financial Management

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	1	1	Nil	Nil
B	3	3	2	2
Total	4	4	2	2

Australian Taxation Office

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	2	2(a)
B	3	Nil	2	5
Total	3	Nil	4	7

Australian National University

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	2	2
Total	Nil	Nil	2	2

ANUTECH Pty Limited

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	Nil	Nil	Nil	Nil
B	Nil	Nil	4(a)	4
Total	Nil	Nil	4	4

Total

<i>Ratings</i>	<i>Issues Outstanding at September 1999</i>	<i>Issues Resolved Prior to March 2000</i>	<i>New Issues to March 2000</i>	<i>Closing Position at March 2000</i>
A	23	14	35	45
B	137	76	135	190
Total	160	90	170	235

Notes: (a) re-rated issues from prior year.

- A Those matters which pose significant business or financial risk to the agency and must be addressed as a matter of urgency.
- B Control weaknesses which pose moderate business or financial risk to the agency or matters referred to management in the past which have not been addressed satisfactorily.

Appendix 2

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 five types of agencies, each of which has distinct 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 and other agencies controlled by the Commonwealth.

The financial statements for the year ended 30 June 1999 were published by the Department of Finance and Administration in December 1999. The results of the audit of those financial statements were reported to Parliament in *The Auditor-General Audit Report No.21 Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 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 Accounting 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 Accounting 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 with the reasons being indicated.

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 about an aspect of the financial statements where the outcome is contingent upon future events and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

Series Titles

Titles published during the financial year 1999–2000

Audit Report No.48 Performance Audit
*Follow-up audit of the Department of Education, Training and Youth Affairs
International Service*
Department of Education, Training and Youth Affairs

Audit Report No.47 Performance Audit
Survey of Fraud Control Arrangements in APS Agencies

Audit Report No.46 Performance Audit
High Wealth Individuals Taskforce
Australian Taxation Office

Audit Report No.45 Performance Audit
Commonwealth Foreign Exchange Risk Management Practices

Audit Report No.44 Performance Audit
Management of Job Network Contracts
Department of Employment, Workplace Relations and Small Business

Audit Report No.43 Performance Audit
Planning and Monitoring for Cost Effective Service Delivery
Centrelink

Audit Report No.42 Performance Audit
*Magnetic Resonance Imaging Services
—effectiveness and probity of the policy development processes and
implementations*

Audit Report No.41 Performance Audit
Commonwealth Emergency Management Arrangements

Audit Report No.40 Performance Audit
Tactical Fighter Operations
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