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Payment of Accounts

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Australian National
Audit Office

Canberra ACT
18 June 2001

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken an across-agency Assurance and Contol Assessment audit with the authority contained in the *Auditor-General Act 1997*. I present this report, and the accompanying brochure to the Parliament. The report is titled *Payment of Accounts*.

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

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For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone (02) 6203 7505
Fax (02) 6203 7519
Email webmaster@anao.gov.au

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Audit Team

Sharon Winks

Edward Hay

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Glossary

ANAO	Australian National Audit Office
APS	Australian Public Sector
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CSA	Control self assessment
EFT	Electronic funds transfer
FMIS	Financial management information system
GST	Goods and Services Tax
OPA	Official Public Account

Summary and Recommendations

1. Summary and Recommendations

Introduction

1.1 Payments for goods and services and assets by Commonwealth organisations are estimated to amount to $30.4 billion[1] annually. In this light, the payment of accounts is a significant business support process in the Australian Public Sector (APS) which requires effective management, a sound control framework and streamlined operations to achieve the best outcomes.

Audit objectives

1.2 The main objectives of the audit were to determine whether organisations had implemented appropriate risk management strategies for the processing of accounts and whether payment for goods and services had been properly authorised. The audit also reviewed progress since the payment of accounts audit (Report No.16, 1996-97) undertaken in 1996.[2]

1.3 The audit was undertaken in eight Commonwealth organisations including organisations subject to both the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Companies and Authorities Act 1997* (CAC Act).

Audit conclusion

1.4 The ANAO concluded that the payment of accounts function was being administered satisfactorily. However, better practices could be achieved through the following two main avenues:

- improvements in the organisations' internal control framework, including the implementation of formal process risk assessments, the development of appropriate performance measures and increased use of appropriate monitoring and review mechanisms; and
- greater use of advanced cost-effective information technology.

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1 Consolidated Financial Statements for the Year ended 30 June 2000.

2 Audit Report No.16, 1996–97, *Financial Control and Administration Audit, Payment of Accounts.*

1.5 The 1996 audit of the payment of accounts function also came to a similar conclusion. At that time, the ANAO also suggested that:

- organisations should be assessing the benefits and costs of the opportunities offered by the adoption of new financial management information systems (FMIS) and the new financial management and accountability legislation or be planning to do so in the near future; and
- the then Department of Finance should undertake a cost/benefit study comparing the then current centralised payment processing system and alternative methods, including individual organisations' processing payments.

1.6 Since 1996, the Department of Finance and Administration has ceased to provide a centralised payment processing system and public sector organisations are now responsible for the payment of their own accounts. In conjunction with this reform, organisations have also become responsible for their own banking arrangements. Many have implemented, or are in the process of implementing, new FMISs.

1.7 Notwithstanding the above reforms, the results of the current audit indicate that the findings of the 1996 audit and the opportunities identified in 1996 continue to be largely the same.

Information technology

1.8 The ability of organisations to effectively manage payment of accounts processes is an important part of the building blocks necessary to achieve an organisation's outputs and outcomes efficiently and effectively.

1.9 The strategic importance of paying accounts and managing supplier relationships, as well as the volume of such activity in many organisations, underlines the role of the payment of accounts function as a key business support function. Whatever the relative size of the payment of accounts function within organisations, recent developments in technology provide organisations with valuable opportunities to improve their performance in such areas. This includes opportunities to reduce costs; increase efficiency; improve effectiveness; and better align with, and support, individual organisation's strategic objectives.

1.10 Commonwealth organisations operate in an environment of increasing complexity. The risks and opportunities presented by government financial reform and technological advances currently present organisations with significant challenges to improve their performance.

1.11 Since 1996, changes in government policy and statutory frameworks have led to decreased central administration and a corresponding assumption, by each organisation, of individual accountability, responsibility and control. Recent financial management reform means that organisations now manage individual budgets and reporting requirements on an accrual basis within an outputs and outcomes framework. In 1999, central control over appropriations ceased. Organisations are now entirely responsible for managing appropriations as well as individual banking arrangements. As well, organisations have had to adapt to the need to maintain and report on transactions subject to the Goods and Services Tax (GST).

1.12 The opportunities presented by technological advances, together with the Government's reform in this area, mean that organisations are increasingly required to adopt electronic commerce, using mechanisms such as on-line communication and payment. In addition, organisations are now required to market test corporate services functions as well as to agree, and report on, formal service standards. Organisations that do not know the cost and quality of their existing functions and fully understand the associated risks will be unable to implement effective market testing arrangements.

1.13 Developments in both public and private sector operating environments provide organisations with a wide range of knowledge sources related to the management of risks, performance measurement and better practices through initiatives such as forming productive alliances, adapting organisational structures, effective use of technology, and changing payment mechanisms.

1.14 In 1996, the ANAO suggested that organisations should assess the cost-effectiveness of the earliest possible adoption of electronic commerce capabilities. In the meantime, organisations were urged to take advantage of current technologies available for payment of accounts on their current or proposed FMISs. While some progress has occurred since 1996, the performance of organisations would be enhanced if they went further in these directions, particularly in the light of the Government's initiatives in respect of the Government Online Strategy. This strategy proposed:

- to pay all suppliers to government electronically by the end of 2000; and
- to conduct 90 per cent of purchase related transactions with suppliers through electronic means by the end of 2001.

1.15 The ANAO concluded that most organisations did not achieve the objective of paying all suppliers electronically by the end of 2000. One reason for this appears to be the lack of available system functionality, including difficulties in developing a means of providing standard remittance advice with electronic payments. As a result, significant work continues to be necessary to achieve the goal of conducting 90 per cent of purchase related transactions electronically by the end of 2001.

Summary of audit findings

1.16 The major findings of the audit were as follows:

- **Risk Assessment—**organisations can improve their understanding and management of risk through the use of formal process level risk assessment and the implementation of an appropriate cost/benefit approach to the implementation of controls. By implementing these measures, responsible managers will be provided with the tools to identify, manage and mitigate risks relating to payment of accounts.
- **Control Environment—**organisations can improve efficiency and control effectiveness through the greater use of technology; by aligning centralised payment of accounts functions with procurement functions that encourage economies of scale and enhance beneficial supplier relationships; by formalising and ensuring the completeness, and adequate communication of, related policy and procedures; and, by formalising training programs.
- **Control Activities**—organisations have significant opportunities to improve efficiency and effectiveness through the rigorous implementation of management controls that are appropriately designed to monitor specific control activity. The effective design of controls can be facilitated by the use of technology to process payments as well as facilitating authorisation and timeliness requirements. Organisations can also design controls to reduce the volume of transactions, for example, through the elimination of the use of petty cash and restructuring of processes to reimburse employee travel expenses through the use of credit cards. The above measures can lead to decreased costs. Organisations also need to ensure computer security controls are effectively designed and enforced as intended to ensure effective segregation of duties and appropriate computer system access. This will help ensure a secure framework for the integrity of payments through computer systems.
- **Information and Communication**—while organisations have in place periodic operational reporting related to the payment of suppliers and cost allocations, performance measurement and reporting are not used to focus on payment of accounts functional performance. In general, organisations do not consider the benefits of performance measurement, in this case, are worth the cost.

- **Monitoring and Review—**organisations rely on periodic reviews as the principal method of encouraging continuous improvement. There are opportunities to enhance this approach through utilisation and understanding of process level risk assessment and performance measurement data, as well as building-in control self assessment mechanisms. Such mechanisms are not currently used.

1.17 Chapter 4 of this report provides further detail on these findings. The ANAO provided a report on the results of the audit to each organisation reviewed as part of the audit that included a number of detailed, specific recommendations relevant to those organisations.

1.18 While the organisations selected for audit were not necessarily representative of all organisation's payment of accounts functions, the following recommendations are considered to have relevance to all Commonwealth organisations that are considering market testing, or re-engineering, their payment of accounts function.

Recommendations

The following recommendations are made in response to the findings of the audit and reflect the ANAO's research into better practice in payment of accounts processing generally. The audit findings and the issues that lead to these recommendations are discussed in detail in the following relevant sections of Chapter 4, as shown below:

Risk Assessment

Recommendation No.1

It is recommended that organisations review and strengthen their risk management frameworks to directly and formally address the process level risks associated with the payment of accounts function for improved effectiveness and accountability. As well, all assessments of risk and related controls should be undertaken in the context of an informed analysis such as by appropriate cost benefit analysis.

Control Environment

Recommendation No.2

It is recommended that organisations ensure training programs for payment of accounts employees are comprehensive in their coverage and integral to the organisation's overall training program as an effective means of making key personnel aware of their responsibilities and accountability for the control framework.

Recommendation No.3

It is recommended that organisations ensure the control framework is supported by appropriate policies and procedures that includes Chief Executive Instructions, statement of policies and procedures, workplace instructions and implementation plans. Processes to update these documents need to be formalised and consistently enforced.

Recommendation No.4

It is recommended that organisations take a more active approach to evaluating the applicability of information systems functionality to improve payment of accounts processing.

This approach should consider taking appropriate action in the following two key areas:

- reviewing the potential to increase specific control activity through the use of systems functionality to resolve current control weaknesses; and
- achieving cost savings related to increased efficiency, for example, through increasing the volume of electronic payment, and by increasing the level of internal and external electronic communication.

Recommendation No.5

It is recommended that organisations evaluate the structure of payment of accounts functions in relation to their overall management strategy and specifically to the procurement function. The use of the FMIS should be aligned with, and support, management's objectives in properly structuring the payment of accounts function.

Control Activities

Recommendation No.6

It is recommended that organisations review the design of their control activities in the context of available proven technology.

Consideration should also be given to the design of the controls in each of the following areas—management, organisational, operational and authorisation controls. Increased use of technology will often enable manual processes and controls to be replaced by more efficient system controls. Well considered risk assessment and performance measurement are recommended as useful tools in this process.

Recommendation No.7

It is recommended that organisations:

- examine supplier relationships and related levels of procurement in the context of continuous improvement, including mechanisms such as on-line ordering, electronic billing and bulk billing;
- increase the use of credit cards, with appropriate training and guidance, as mechanisms to assist in removing the need for cash;
- eliminate processes to pay employees through the payment of accounts function. This includes removing off-cycle salary related payments and reimbursements of employee expenses. Processing through the payroll system by EFT can also increase efficiency; and
- educate managers and personnel on the significance of information system security in providing a secure control environment for payment of accounts processing. This should include informing employees of requirements related to protection of logical system access, supplier master file data, and access to EFT and on-line banking systems.

Information and Communication

Recommendation No.8

It is recommended that organisations:

- review the quality of operational reporting produced on a periodic basis. Organisations need to ensure the relevance of the information to the target audience; the presentation of information in user-friendly formats; and the use of technology as a communication tool; and
- implement periodic performance measurement to enhance understanding and the effectiveness of the payment of accounts function. Implementation should involve the identification and definition of performance measures, periodic reporting of these performance measures, and appropriate review.

Monitoring and Review

Recommendation No.9

It is recommended that organisations:

- increase their monitoring activity of the payment of accounts function as part of effective control and improved performance;
- initiate appropriate action to ensure the quality, rigour and relevance of Internal Audit activities as a periodic monitoring and review tool; and
- include appropriate monitoring and review of performance measurement activity as a tool to improve the payment of accounts function. Clearly specified procedures should be developed for implementing appropriate action based on the performance monitoring information and related reports.

Organisations' response

1.19 Organisations generally agreed with the recommendations with a number indicating corrective action had been undertaken recently. Organisations complimented the ANAO on the positive nature of the audit and indicated that it was a useful mechanism for improving their systems and processes.

Sound and better practice

1.20 The audit identified examples of both sound business practices and better practice currently used by the organisations reviewed. While many of the sound business practices would be expected to exist in all organisations reviewed, this was not the case. Therefore, to provide organisations with some in-sight into approaches being taken in various organisations in the Australian Public Sector (APS), details of these approaches have been included in the Report. These are summarised in Table 1.1.

Table 1.1

Examples of better practices in payment of accounts

Control framework component	*Sound and better practice*
Risk Assessment	• A risk based cost benefit approach to the processing of employee telephone reimbursements and payments had been developed. • Additional controls were in place for payments over a defined dollar amount because of the enhanced impact of error.
Control Environment	• Effective use of training that included induction and one-off programs, the latter to communicate new and emerging issues. • Codes of Conduct and Ethics were used to encourage an ethical culture that values internal control. • Communication of policy and procedure documents was via Intranet facilities. • E-business strategies included the payment of suppliers. • Readily available system functionality was used to send EFT payment details to suppliers automatically upon payment. • On-line authorisation and matching functionality to approve purchases and payments was in place. • Internet functionality was used to provide management with the ability to approve credit card expenses on-line. • The Intranet was used to provide sections of the organisation with on-line reporting that provided management with the ability to drill down to detailed information. • A service level agreement and service standards between the finance function and the sections it served had been established.
Control Activities	• 'Exception only basis' reporting was used to review variances. • Reviews of changes to supplier master files were undertaken weekly using exception reports. • Credit cards were used in a variety of ways for operational expenses, travel and cash advances. • On-line authorisation of credit card and telephone accounts through the FMIS or e-mail enabled this process to be efficient and provided access for travelling managers. • Data was checked on a sample basis to ensure completeness and accuracy of operations. • Perform daily on-line bank reconciliations on a regular, complete and timely basis. • Periodic reviews of logical access to payment of accounts system modules. • Implementation of effective controls surrounding all dealings with the on-line banking facility, including dual signatories, minimum alphanumeric password length and locked and coded safe storage of banking system access card.

Control framework component	*Sound and better practice*
Information and Communication	• The Intranet was used to distribute reporting. • Performance data review was part of a service level agreement and related service standard reporting. • Error rates were recorded of different processing centres for use in process improvement.
Monitoring and Review	• A plan to use Comcover specific risk management software to assist in the delegation of management of risks within the function had been developed.

2. Introduction

This section defines the payment of accounts process and describes the organisations included in the audit. It also considers previous audit coverage, the scope and objectives of the current audit and the audit criteria used.

The payment of accounts process

2.1 Payment of accounts is one of the more significant activities conducted within the finance function. It accounts for a median 13.6 per cent of the total finance budget and is the third most significant activity after payroll and budgeting.[3] It is an area where available developments in technology and better practice experience offer significant opportunities for more efficient and cost-effective processing.

2.2 The payment of accounts process is the set of activities that result in organisations paying their suppliers. For most organisations, payment of accounts is a linear process that begins with receiving an invoice and ends with issuing payment to the supplier. The process is graphically represented at Figure 2.1. Organisations pay invoices on a daily, weekly, or bi-monthly basis. In addition to paying invoices, the payment of accounts function typically includes responsibility for managing accounting policies that affect supplier relationships and sound cash management.

2.3 In addition to paying invoices, the payment of accounts function completes all tasks related to payables. For example, it responds to inquiries from suppliers and others within the organisation; resolves payment issues and disputes; categorises expenses to the appropriate general ledger accounts; and keeps the organisation's master file of suppliers up-to-date.

2.4 The quality of the design of the payment of accounts process and how well the organisation executes the process has an impact on two areas important to the organisation; that is supplier relationships and sound cash management. An organisation that knows what its key suppliers expect in terms of payment, and meets those expectations, furthers the productive relationships it has with its suppliers. And an organisation that coordinates its payment schedules with its cash needs makes a positive contribution to cash flow.

2.5 The quality of the design of controls also has a direct relationship to the cost of the function. Properly designed controls will ensure risks are mitigated by an acceptable level of control, which is cost-effective.

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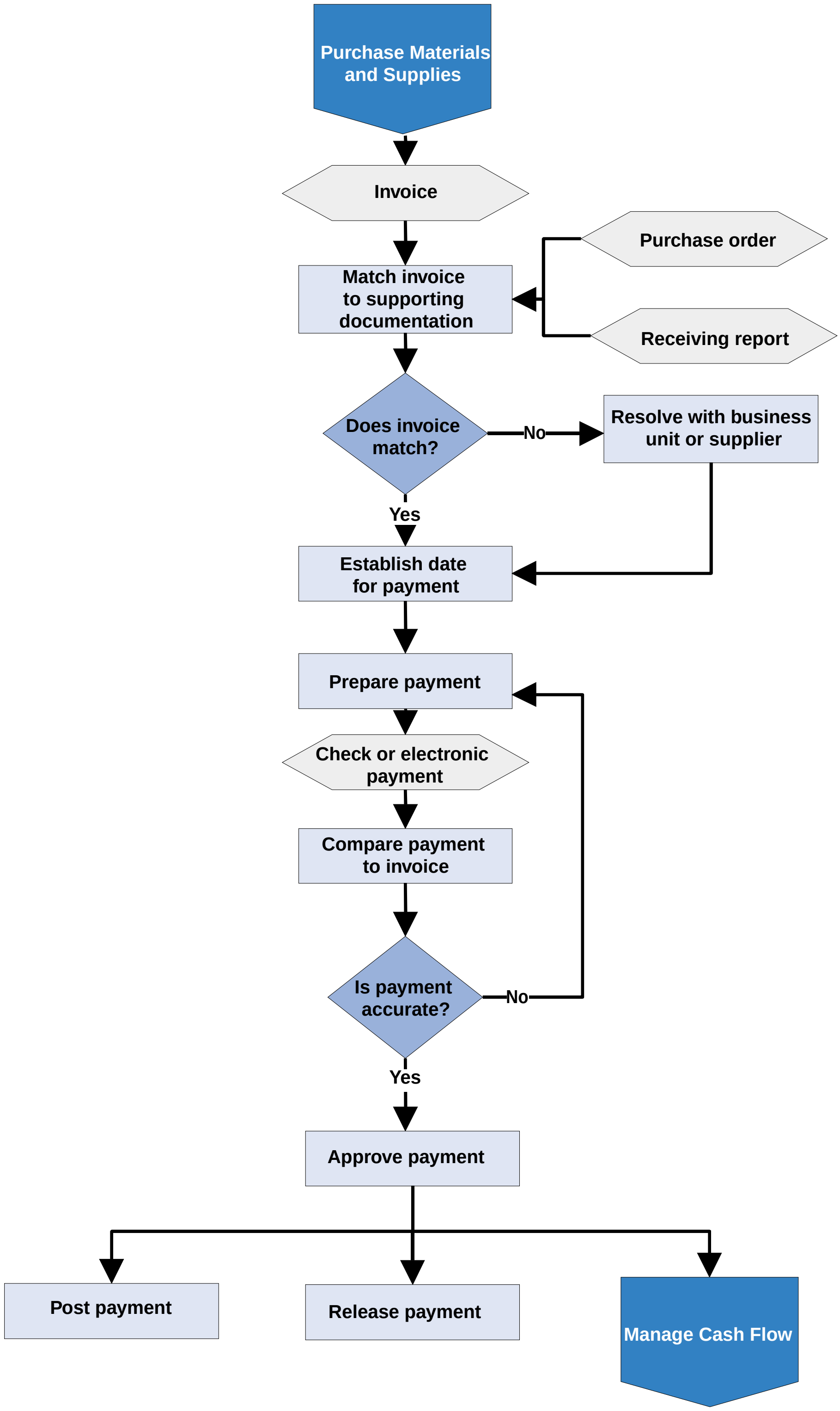
3 Audit Report No.25, 2000–2001, *Benchmarking the Finance Function.*

Figure 2.1
Payment of Accounts process map



Previous audit coverage

2.6 In 1996, the ANAO undertook a financial control and administration audit of the payment of accounts function across a number of Commonwealth organisations.[4] The main objectives of the audit were to assess the management and administration of the payment of accounts function in the Commonwealth and to identify, develop and report better practice to promote overall improvements in public administration.

2.7 The ANAO concluded that the payment of accounts function was being administered satisfactorily within the context of the then current financial legislative and management framework.

2.8 The audit identified the following two main avenues for the achievement of better practices:

- changes in management and organisational framework, including management reporting and performance measurement, the use of risk management and increased flexibility in terms of payment; and
- greater use of information technology.

2.9 Further detail of the findings of this audit is provided at Appendix 2.

This audit

2.10 Eight Commonwealth organisations were included in the audit. Organisations selected were not necessarily representative of all organisations' payment of accounts functions but do provide an informative cross-section of experience.

2.11 Aspects of the diversity of the payment of accounts functions at the organisations audited are illustrated by the following comparisons:

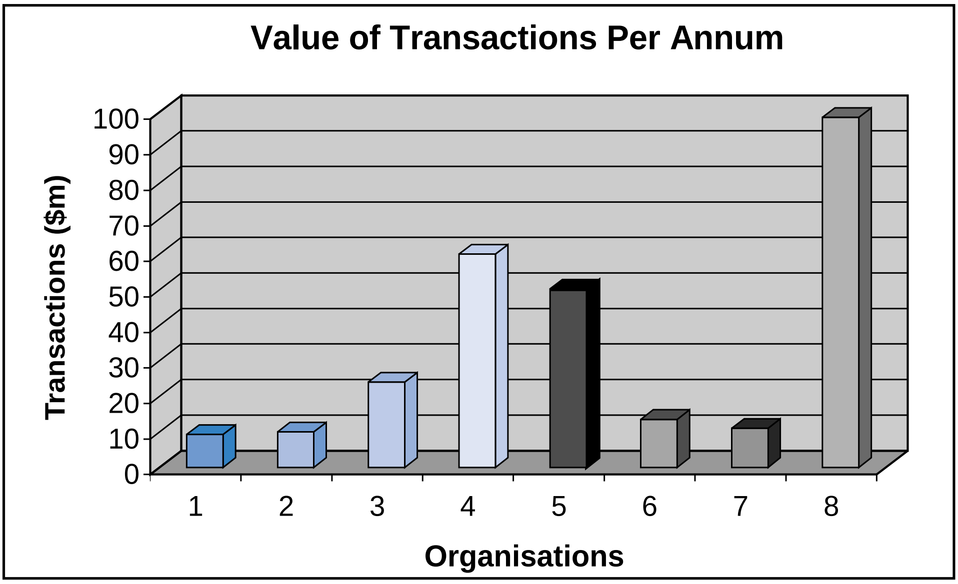
- the *Commonwealth Authorities and Companies Act 1997* provides the statutory framework for five of the organisations. The remaining three derive their framework of responsibility from the *Financial Management and Accountability Act 1997*;
- five of the organisations are located in Canberra, while three operate their central financial and administrative functions from Sydney. Four of the organisations have activities that incorporate branch and regional activity around Australia. One of the agencies has significant activity overseas;

4 op. cit., Audit Report No.16, 1996–67, page ix.

- none of the organisations operates a wholly centralised purchasing function. While the purchase of goods and services was beyond the scope of this audit, the relationship between procurement and payment of accounts is relevant and was considered in terms of its impact on control activities, particularly in relation to authorisation and efficiency issues;
- each of the organisation's operations is supported by a different FMIS. The design and functionality of the system bear a direct relationship to the control framework, particularly in relation to opportunities to align processing with technological advances and more specific control activities; and
- the value of transactions of the different organisations varied significantly—between less than $10 million and $100 million per annum. Approximate dollar values of transactions are displayed graphically in Figure 2.2.

Figure 2.2

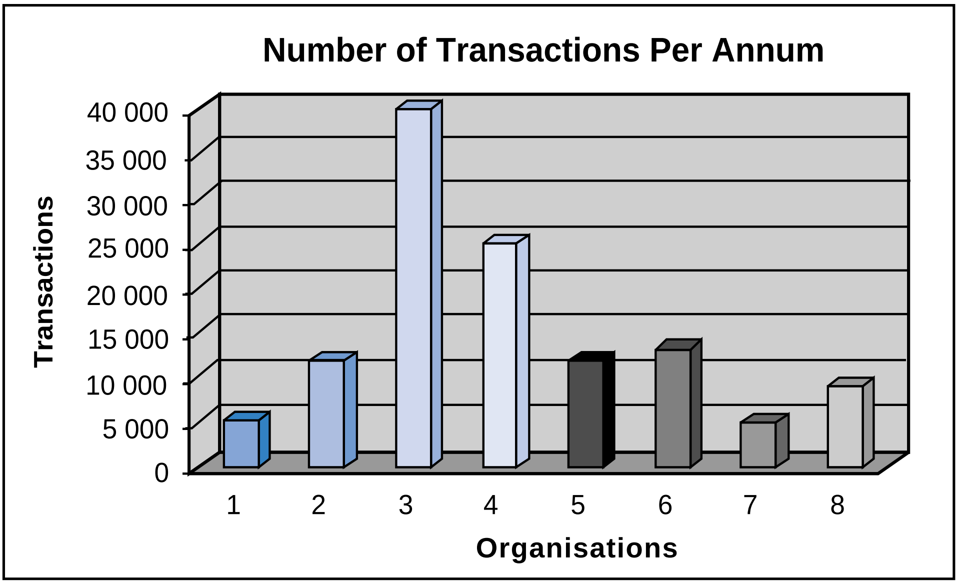
Value of transactions—dollar value



2.12 The volume of items processed also varied greatly—between 5 000 and 40 000 per annum. The figures described in Figure 2.3 relate to individual payments made.

Figure 2.3

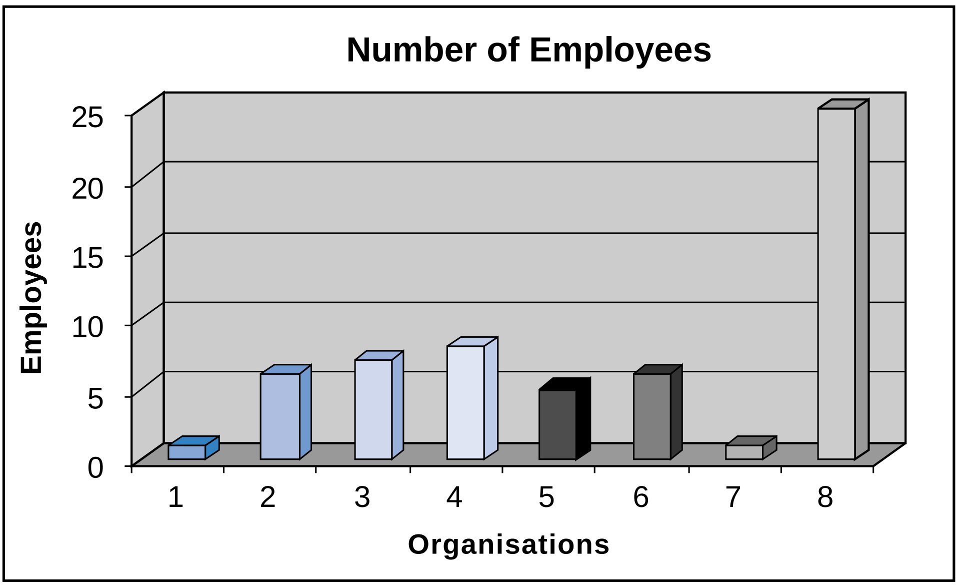
Volume of transactions—number of payments made



2.13 The number of employees participating in the payment of accounts function varied significantly across the organisation. The level of employees detailed in Figure 2.4 represents the total number of employees involved in the process.

Figure 2.4

Number of employees that participate directly in payment of accounts processes



Audit objectives

2.14 In conducting the current audit, the main objectives were to determine whether:

- organisations had implemented risk management strategies for the processing of accounts;
- payment for goods/services had been properly authorised by management and provided by the supplier in accordance with agreed terms and conditions; and
- reasonable progress had been made since the audit undertaken in 1996.

Audit evaluation criteria

2.15 The audit findings and recommendations are organised in accordance with the framework detailed in the ANAO's *Better Practice Guide to Effective Control, Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes*[5]. Summary detail is provided in Appendix 1, Table 1.

2.16 Audit criteria were developed against each component of the internal control framework to assess the effectiveness of payment of accounts. Management is responsible for establishing a robust internal control framework with cohesive policies, processes and procedures that collectively ensure risks are well managed and business objectives are met in an effective, efficient and ethical manner.

2.17 The criteria have been adapted and expanded to take account of the diverse risks and operations of a payment of accounts function. Development of the criteria also considered better practice in both the business and government sectors' payment of accounts functions.

Structure of the remainder of the audit report

2.18 Chapter 3 addresses the background to the audit observations, findings and identification of better practices. It considers the current context within which the organisations operate and their statutory framework, as well as global changes in areas ranging from technological advances to better practice approaches to risk management.

2.19 Chapter 4 considers the detailed findings of the audit. These have been summarised in five sections that deal separately with each of the following audit criteria: risk assessment, control environment, control activities, information and communication, and monitoring and review.

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5 Controlling Performance and Outcomes, Better Practice Guide to Effective Control, ANAO, 1997.

2.20 The Appendices provide supporting information, including a summary of the audit objectives, how the audit was conducted, information relating to the findings of the 1996 audit, details of a payment of accounts risk model, and payment of accounts performance measures.

3. Current Developments and Challenges

Introduction

3.1 The current operating environment of Commonwealth organisations is increasingly complex. This chapter describes the context of the audit through reference to the risks and opportunities within organisations in terms of both risks presented by the changing APS environment and by opportunities available through technology and commercial sector practice.

3.2 The risks and opportunities currently presented to Commonwealth organisations pose significant challenges to organisation's managers. The developments discussed in this chapter of the report can be summarised as follows, according to the context, risks which impact the organisation, and, more specific threats and opportunities directly related to payment of accounts functions.

Context	*Events which may add to organisational risks*	*Threats and Opportunities related to payment of accounts*
APS Environment and Direction	• Decreased central oversight, organisation and control. • Increased responsibility and accountability of organisations.	• CEOs, CFOs and managers increasingly responsible and accountable for the payment of accounts control framework.
Financial Management and Reform	• Accrual based management and budgeting. • Individual responsibility for banking arrangements. • Individual responsibility for cash management. • Use of outputs and outcomes budget framework. • Recording and reporting Goods and Services Tax (GST).	• Accurate and timely recording of payments and liabilities. • Responsibility for cost-effectiveness of banking arrangements. • Management of cash outflows related to timing of payments. • Recording and reporting of GST in payment transactions.
Government Online Initiatives	• Communication with suppliers online. • Electronic payment of suppliers.	• Increased use of electronic funds transfer (EFT). • Implementing e-procurements, including receiving invoices and sending remittance advice electronically.
Procurement Guidelines	• Adoption of electronic commerce.	• Redesign of payment processes to use technology effectively.

APS environment and direction

3.3 An effective corporate governance framework assists organisations to identify and manage risks in a more systematic and effective manner, particularly in a period of significant change. Further, the considerable devolution of central organisational controls and direction has also reinforced the need for good corporate governance in individual organisations to provide the necessary management and other stakeholder assurance of adequate controls (conformance) as well as of required results (performance).

3.4 The current financial management and accountability legislation requires the Chief Executive Officer to '*manage the affairs of the agency in a way that promotes proper use of the Commonwealth resources for which the Chief Executive is responsible*'. Organisations are now clearly responsible for their own operations and need to develop and implement appropriate accountability and performance structures to assist them measure and/ or assess their achievement against strategic objectives.

Financial management reform

3.5 A key element of the Government's reforms has been the Commonwealth's financial reform program which has involved the establishment of a revised financial management framework, including accountability and supporting infrastructures necessary to support optimal performance within the new APS environment.

Accrual budgeting

3.6 The 1999–2000 financial year saw key elements of this reform program introduced within the Commonwealth. The most significant of these was the adoption of an accrual budgeting framework. The basis of this framework is:

- accrual accounting, budgeting, management and reporting at an organisation level;
- budgeting, reporting and measurement against outputs (the goods and services produced by organisations) and outcomes (the results the government wants to achieve) rather than just against inputs; and
- parliamentary appropriations separately identified for the delivery of outputs.

3.7 While organisations had been reporting on an accrual basis for a number of years, the 1999–2000 financial year was the first time that they were required to budget and manage on that basis. At the same time, the new framework resulted in additional financial management responsibilities being removed from central agency control and devolved to individual organisations.

Banking arrangements

3.8 New banking arrangements were introduced throughout the Commonwealth from 1 July 1999 that required organisations to open and manage bank accounts in relation to their operations. As a consequence, each organisation is now fully responsible for its cash management. Similarly, centralised control over management of appropriations was also removed from 1 July 1999. Organisations are now responsible for monitoring the level of payments against individual appropriations and preventing payments occurring in excess of appropriation levels approved by the Parliament.

Outputs and outcomes

3.9 In line with these changes, the focus of organisational accountability has moved away from the management of cash inputs to the achievement of fully costed outputs and outcomes. This change has posed particular challenges for the APS in developing the necessary financial information to enable organisations to measure their performance.

Goods and Services Tax (GST)

3.10 In addition to implementing accrual budgeting requirements, during 1999–2000 organisations were required to manage the impact of a number of other financial initiatives, including the GST. In preparing for the introduction of the GST, public sector organisations were required to examine and re-engineer relevant financial processes and systems.

Government Online Initiatives

3.11 The Government has committed to a series of e-business initiatives under the Office of Government Online umbrella.[6]

3.12 In conjunction with the *Government Online* strategy, the Commonwealth Electronic Procurement Implementation Strategy (the Implementation Strategy) was released in early 2000 and consists of an overarching framework and a series of related projects to assist Commonwealth organisations and their suppliers implement online procurement.

3.13 This strategy sets the following major goals for Commonwealth electronic purchasing and payments:

- to pay all suppliers to government electronically by the end of 2000,

6 Strategic Priority 5—Government Online: The Commonwealth Government's Strategy April 2000.

with this facilitated by the issue of electronic remittance advice to all suppliers;

- to deal electronically with all those simple procurement suppliers who wish to do so by the end of 2001; and
- to conduct 90 per cent of purchase-related transactions with suppliers to government through electronic means by the end of 2001.

3.14 With the introduction of the Government's Shared Systems Suite Initiative and the availability of financial management information systems, most organisations now have, and some routinely use, the capacity to transact all elements of payments to suppliers electronically. Furthermore, the banking system has long had the capability to directly credit supplier bank accounts when instructed.

3.15 Under this strategy, the change process will be pursued by:

- developing a means of providing standard remittance advice with electronic payments—the key enabler for electronic payment; and
- encouraging suppliers to accept direct credit and provide the necessary bank account details, by using this process as a mechanism to ensure accounts are paid on the due-date or on a common due-date.

3.16 These Government e-business strategies, in particular, provide the context for Section 4.2 of this report, dealing with technology as a cornerstone in the control environment.

Procurement guidelines

3.17 Alongside these e-business initiatives, Commonwealth organisations are guided by the Commonwealth Procurement Guidelines[7] (the Guidelines) that provide a framework for government purchasing. This framework notes several key matters that relate to the payment of accounts function. Managers are specifically accountable for:

- adopting electronic commerce in organisation procurement in accordance with government policies;
- ensuring that all persons undertaking procurement functions, including those officers overseeing and/or approving procurement activities, meet appropriate Commonwealth Procurement Competency Standards; and
- ensuring that adequate systems for the recording of decisions and the reasons for making them are maintained.

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[7] Commonwealth Procurement Guidelines:core Policies and Principles, March 1998.

3.18 Organisations have a further responsibility to Gazette[8] their purchases. The financial threshold for notifications is defined as $2000 or more.

3.19 The Guidelines also note that it is Commonwealth policy to pay accounts on the date specified in the agreement for payment with the supplier. This is normally 30 days from the date of acceptance of goods or services and the receipt of a correctly rendered invoice.

3.20 The matters described above are relevant in understanding an organisation's control environment (Section 4.2) and in understanding control activities related to authorisation and timeliness (Section 4.3).

Benchmarking the Finance Function

3.21 A recent ANAO benchmarking study—Benchmarking the Finance Function[9]—provides more detailed information on benchmarks for the cost, efficiency, quality and better practice of the individual activities of the finance function. Benchmarking was undertaken against the experience of Commonwealth organisations and against that of a 'global group' of international organisations. The report concluded that, while the finance function of organisations covered performed well in many areas in comparison to the 'global group', in general, the cost of the finance function overall was greater than that of the 'global group'.

3.22 With reference to payment of accounts, the report concluded that, at the median level, the Commonwealth Group generally reported lower performance across the range of cost and efficiency benchmarks of the accounts payable process. Increases in the number of payments processed per accounts payable full time equivalent (FTE) and the average size of payments and a reduction in the number of vendors could result in a reduction in expenditure. However, it should be noted that the Commonwealth Group achieved substantially fewer errors, highlighting the trade-off between cost and quality.

3.23 In the reformed APS environment, financial management can no longer be the sole responsibility of a corporate support area; it must be pervasive in all decision-making levels and processes. This latter culture will become increasingly important as the Commonwealth maintains the

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8 *Gazette*' means the *Purchasing and Disposals Gazette,* published weekly on Telstra Transigo™ (*http://www.transigo.net.au*). Hard copies can be obtained by contacting the Transigo Customer Assistance Centre on 1800 812 990. The *Gazette* contains notifications submitted to the *Business Opportunities* service, and *Procurement Notifications* service (Contracts Arranged and Standing Offers).

9 ANAO Benchmarking the Finance Function 2000–2001.

financial reform program with its continuing focus on the contestability and cost-effectiveness of service delivery. This includes the use of ‘purchaser/provider’ model, with the Government ‘purchasing’ outputs from provider organisations at benchmarked market prices. In order to succeed in this environment, organisations need to understand and manage the cost structures of all outputs to ensure that they are delivered in a contestable and cost-effective manner. Without robust financial and management systems and a depth of financial management skills throughout the organisation, organisations will have difficulty meeting these challenges.

4. Audit Findings—Internal Control Framework

4.1 Introduction

4.1.1 This chapter discusses the findings and recommendations of the audit against each component of the internal control framework. Central to this framework is the understanding that control is a process, effected by the governing body of an organisation, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the organisation's objectives.[10]

4.1.2 This framework relies on the five key control elements specified in the ANAO better practice guide Controlling Performance and Outcomes. These are detailed below:

- Risk Assessment—Section 4.1;
- Control Environment—Section 4.2;
- Control Activities—Section 4.3;
- Information and Communication—Section 4.4; and
- Monitoring and Review—Section 4.5.

4.1.3 The framework has been adapted and organised to reflect key operational and risk aspects of organisations' payment of accounts function.

Explanation of categorisation of observation

4.1.4 The ANAO's observations are presented in two distinct categories: Audit Findings and Better Practices.

4.1.5 A*udit findings* detail control weaknesses contributing to a breakdown in both efficiency and effectiveness of the control structure. *Sound* and *Better Practice* observations relate to business practices which, if adopted, would strengthen the control structure and lead to improved effectiveness and efficiency.

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[10] Based on COSO Internal Control—Integrated Framework as amended by NSW Treasury, Statement of Best Practice, Internal Control and Internal Audit, June 1995.

4.2 Risk Assessment

Introduction

4.2.1 Risk assessment is the starting point for evaluating the payment of accounts control framework, because, through a formal process, it provides the necessary information to properly design controls which are both complete and cost-effective. A sound risk assessment also provides the basis for ensuring responsibility for managing risks is properly distributed to managers who understand the risks and can be held accountable for their management through the operation of the control framework. Managers need to ensure complete and effective payment of accounts control frameworks are put in place to properly support the organisation's objectives.

4.2.2 However, the assessment and management of risks in payment of accounts processes should aim to balance the cost of control against the likely benefits. As noted in the then MAB / MIAC publication[11]:

> *In managing risk you need to strike a balance between the cost of managing the risk and the benefits to be gained. Recognising that a risk-free environment is impossible (if not uneconomic) to achieve, you need to decide what level of risk is acceptable.*

4.2.3 Generally, payment of accounts in the Commonwealth is construed as a simple low risk process. This is reasonable at one level—as the payment of accounts is a routine process and assumed to be well-understood by most people. However, payment of accounts has business risks warranting consideration, including reputation, efficiency and information risks and these are not commonly considered in designing payment of accounts control frameworks.

Business benefits

4.2.4 Formal risk assessments identify organisational risks. They are the basis for evaluating the costs and benefits of controls and assist an organisation to apply consistent and defensible approaches to the management of risks, including payment of accounts. Process level assessments are the basis for subsequent design of all aspects of the control environment, specific control activities, information and communication processes, and monitoring and review procedures. The process level risk assessment can enhance control structures, detect control weaknesses, prevent control breakdown, increase operational efficiency, and improve internal (employee) and external (supplier) satisfaction levels.

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11 *Guidelines for Managing Risk in the Australian Public Service*, Management Advisory Board/ Management Improvement Advisory Committee (MAB/MIAC), Report No.22 October 1996.

Audit findings and comment

4.2.5 The following table summarises the audit findings.

Risk assessment

Table 4.1

Principle	Implementation of an effective risk assessment framework is a central element of a payment of accounts control framework.
Audit evaluation criteria	Management is aware of, assesses, analyses and mitigates/ takes advantage of risks that impact upon an organisation's goals and objectives. Management considers risk assessments at both the organisational level (outputs, program) and process level (function, task).
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • All organisations have implemented some form of organisational level risk assessment. • Organisations do not conduct a formal process level risk assessment related to the payment of accounts function. • Managers demonstrated a lack of knowledge of process level risk assessments; this included a lack of understanding as to what the benefits might be and of the tools and skills needed to produce the desired outcome.
Sound and better practices noted	The audit noted the following: • A risk based cost benefit approach to the processing of employee telephone reimbursements and payments had been developed. • Additional controls were in place for payments over a defined dollar amount because of the enhanced impact of error.

4.2.6 The audit examined risk assessment activities related to the payment of accounts function: at both *organisational* and *functional* or *process* risk assessment levels to assess whether organisations had properly applied the outputs of this process to the design of the control framework and related activity.

4.2.7 The audit observed that risk management activities generally commence with an *organisational* risk assessment. This means that the organisation formally identifies its risks within the context of the breadth of its organisational activity. These risks would then be evaluated and sourced to activities or functions.

4.2.8 The audit found many organisations had adopted a pro-active approach to risk assessment activities that focus on providing a formally documented framework that identified, analysed and assessed the key risks to the organisation. These frameworks provide useful tools for effective *organisational risk* management.

4.2.9 However, organisations did not undertake *process level risk* assessments related to the payment of accounts function. In general, this was because organisations did not consider that the payment of accounts function presented significant risk to the organisation in the context of its operating environment. In part, this perception was based on a lack of knowledge of a process level risk assessment and the benefits it can provide.

4.2.10 A process level risk assessment and the development of controls to manage the identified risks, provides the basis for an effective and efficient payment of accounts function. A process level risk assessment can enhance control structures, detect control weaknesses, prevent control breakdown, increase operational efficiency, and improve performance. Importantly, it may also confirm organisational perceptions that the payment of accounts function is low risk and operating effectively and efficiently. While all organisations demonstrated concern related to the efficiency and effectiveness of the payment of accounts control framework, the ANAO found few circumstances where the design of controls had been adapted to take account of process level risks. As a result, opportunities to identify gaps in the control framework or possible efficiencies in processes had not been identified.

4.2.11 The audit found that inadequate process level risk assessment had led to control weaknesses in the design of organisations' payment of accounts control framework. Risks, including efficiency risk and lack of sufficient information for decision-making, had not been adequately mitigated. While the organisational risk assessment provides management with the necessary knowledge and understanding to manage risk, further development of risk assessment activity related specifically to the payment of accounts process is required to fully understand control requirements. A more complete understanding of risk leads to, and encourages, a more complete understanding of control issues.

4.2.12 In general, if organisations had completed a structured process risk assessment and evaluated the related controls, many of the control weaknesses described in this Report could have been detected, sourced and resolved. For example, if one of the organisations had assessed and then controlled their efficiency risk, it would have become evident that changes to the structural framework and use of relevant technology were required to adequately mitigate the impacts of this risk. The knowledge gained from formal process risk assessment could have provided the platform for action.

Risk assessment—recommendation

Recommendation No.1

4.2.13 It is recommended that organisations review and strengthen their risk management frameworks to directly and formally address the process level risks associated with the payment of accounts function for improved effectiveness and accountability. As well, all assessments of risk and related controls should be undertaken in the context of an informed analysis such as by appropriate cost benefit analysis.

Implementing the recommendation

4.2.14 The significance of payment of accounts activity and the increasing complexity of business and operational risks faced by organisations indicate that there are risks associated with the activity which need to be formally identified and managed.

4.2.15 Clearly, the extent of risk assessments and the resources committed to risk management should reflect the costs and strategic importance of payment of accounts activity to the organisation. Further, the payment of accounts risk framework needs to be determined from an overall organisation perspective. However, the ANAO encourages management not to *underestimate* the inherent risks of the function or *overestimate* the cost of undertaking process level risk assessment. The implementation of formal and structured evaluation should ensure a clear understanding of these approaches.

4.2.16 P*rocess* level risk assessments aim to provide organisations with a formal framework to assess risks inherent to functions. Process level risks relate to the operation of the specific function but may also have related impacts on the organisation's operations as a whole.

4.2.17 To be effective, managers should address a complete set of risks. While organisations commonly consider the key risks in payment of accounts as being, for example, the risk of fraud or unauthorised payment, the importance of considering a wider range of risks should not be underestimated. The following examples of risk definitions indicate risks that are not commonly considered in designing payment of accounts control frameworks:

- Reputation risk: the risk to an organisation's reputation should mispayment or incorrect payment occur;
- Efficiency risk: the risk that inadequate use of information systems in processing requires an unbalanced proportion of alternative scarce resources; and
- Information for decision-making risk: the risk that management lacks adequate information on the performance of the payment of accounts

function to make decisions about its future application in the organisation's governance arrangements.

4.2.18 A payment of accounts 'risk model' is provided at Appendix 3. The model provides examples of payment of accounts process level risks. Moreover, it can be used as a tool to conduct the first stages of a process level risk assessment.

4.3 Control Environment

Introduction

4.3.1 A critical component of an effective control environment is management's attitude and commitment to the implementation and maintenance of an effective internal control structure. The level of positive support by management strongly influences the design and operation of control policies and procedures.

> *Through their words and actions, management sets the tone of the organisation's workplace, its integrity, values and ethics.*[12]

4.3.2 Without an effective control environment, managers will be unable to ensure the adequacy of the payment of accounts control framework. Organisations should establish a control environment that clearly sets out payment of accounts management responsibilities and promotes sound principles of pro-active management, including continuous improvement. Comprehensive and up-to-date policies and procedures are fundamental to achieving such an environment.

4.3.3 Commonwealth organisations use many and various mechanisms to implement an appropriate control environment. In this audit, the environment was examined by reference to key issues in the areas of *people*, *process*, *technology* and *structure* as follows:

- People—Organisations employ high quality and experienced personnel and use tools such as Codes of Conduct and fraud control plans to establish the culture of the organisation. Organisations generally ensure key personnel are aware of their governance responsibilities through training and regular communication;
- Process—Organisations establish appropriate documentation for policies and procedures that provide the base on which payment of accounts specific control activities are built. As well, it is necessary to maintain the effectiveness and efficiency of these policies and procedures by ensuring their completeness, including provision of up-to-date documentation;

[12] op. cit., ANAO Controlling Performance and Outcomes.

- Technology—Organisations use technology to support payment of accounts activities in a way that contributes to the organisation's strategic objectives as well as ensuring cost-effective and efficient processing; and
- Structure—Organisations structure their payment of accounts functions to allow for clear responsibilities, accountabilities and transparency, including the centralisation of processing where cost-effective to do so.

Business benefits

4.3.4 An effective control environment will ensure payment of accounts policies, procedures and practices are aligned with overall corporate strategy and objectives. Such an environment establishes a control consciousness within which specific operational controls are applied. It provides the framework which supports management's ability to rely on the integrity of processing as well as contributing to cost-effective processing. It is therefore of *fundamental* importance to get the control environment 'right'. Balanced alignment of people, process, technology and structure is required. Too much of one, or not enough of another, could have adverse consequences on either, or both, efficiency or effectiveness of the payment of accounts function.

Audit findings and comment

4.3.5 The audit findings in this section are summarised under the following headings:

- People;
- Process;
- Technology; and
- Structure.

People

Table 4.2

Principle	Key personnel demonstrate an understanding of their role in the organisation's control structure and how this impacts payment of accounts activity.
Audit evaluation criteria	Senior management takes a pro-active approach to risk and control which ensures key personnel are aware of governance responsibilities, through training and communication.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Most organisations could improve their payment of accounts training programs through their formalisation and structuring consistent programs that are directly aligned to operational needs.

Sound and better practices noted	The audit noted the following: • Effective use of training that included induction and one-off programs, the latter to communicate new and emerging issues. • Codes of Conduct and Ethics were used to encourage an ethical culture that values internal control.

4.3.6 The audit observed gaps in training programs and instances where employees were unaware of policy and procedure, indicating the need for improved training and enhanced communication of policy and procedures.

4.3.7 All organisations had implemented formal and informal on-the-job training programs that varied in substance and areas covered. Organisations often make effective use of training for induction, and one-off programs to communicate new and emerging issues. Recently, the latter has included training to communicate the impact of GST on accounts processing. At many of the organisations, training programs could be improved through their formalisation and structuring consistent programs that are directly aligned to operational needs.

4.3.8 Organisations use a variety of mechanisms to encourage an ethical culture that values internal control and to communicate these messages to their people. These tools include fraud awareness and prevention programs and the use of formal Codes of Conduct and Ethics.

Process

Table 4.3

Principle	Effective policies and procedures ensure all personnel have access to a documented framework.
Audit evaluation criteria	There are effective and efficient policies and procedures that reflect the organisation's governance responsibilities.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Policy and procedure documentation is not always complete or up-to-date. • Instances of non-compliance with policy and procedure occurred in many organisations. • Organisations do not always ensure adequate communication of policy and procedure matters.
Sound and better practice noted	The audit noted the following: • Communication of policy and procedure documents was by means of Intranet facilities.

4.3.9 Organisations use various mechanisms to document and communicate policies and procedures. All recognise the importance of this framework in establishing a sound basis for processing. The existence of policies and procedures is a key element for preventing possible control breakdown, should, for example, the organisation experience high turnover in personnel. These mechanisms include the use of policy statements, Chief Executive Instructions and procedures, as well as workplace instructions.

4.3.10 While some organisations have appropriate policies and procedures in place, others do not always have complete documentation in place and/or up-to-date.

4.3.11 The audit noted that authorisation limits and delegation levels were consistently complete and regularly updated. However, the audit found instances of non-compliance with policies and procedures in most organisations. In some cases, management advised this was due to undocumented changes in management policy. Non-compliance with policies and procedures included:

- lack of use of purchase orders. Many organisations stated the use of purchase orders did not fit within their business objectives;
- non-performance of bank reconciliations;
- lack of monitoring of credit notes and maintenance of credit note registers;
- the absence of appropriate policy in regard to making payments through EFT rather than by cheque; and
- inadequate tracking and reporting on GST transactions.

4.3.12 Organisations do not always have workplace instructions, that is, procedural documentation which guides processors through the 'how-tos' of their tasks. The wider introduction of this type of instruction would encourage practical implementation of key control activities and should not be limited to simpler processing activity.

4.3.13 Many organisations increasingly use Intranet functionality to communicate policies and procedures. However, not all organisations ensured adequate communication of changes in these respects.

Technology

Table 4.4

Principle	Information systems processing provides a stable control framework and assists in the achievement of an organisation's strategic objectives.
Audit evaluation criteria	Information systems are used as a strategic resource.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Many organisations could improve their use of the FMIS to automate further aspects of the payment of accounts process and thus encourage efficiency. • Organisations have not met or achieved the Government Electronic Procurement Strategy goal to *'pay all suppliers electronically by the end of 2000'*. • One organisation used two separate FMISs to process payments of accounts thus adding unnecessary complexity and scope for errors.
Sound and better practice noted	The audit also noted the following: • E-business strategies included the payment of suppliers. • Readily available system functionality was used to send EFT payment details to suppliers automatically upon payment. • On-line authorisation and matching functionality to approve purchases and payments was in place. • Internet functionality was used to provide management with the ability to approve credit card expenses on-line. • An Intranet was used to provide sections of the organisation with on-line reporting that allows management the ability to drill down to detailed supporting information.

4.3.14 There are significant opportunities to improve the way an organisation uses its FMIS as a *strategic* resource:

- developing electronic relationships with suppliers by;
- making payments through EFT; and
- ensuring the design of control activity includes inherent system controls.

4.3.15 Organisations use a variety of FMIS to support the payment of accounts function and the communication of related information. All organisations have an FMIS that integrates the payment of accounts function with the General Ledger. Some use associated and integrated project management applications. However, many organisations do not use their FMIS in a manner that effectively provides an efficient and stable control framework and supports the achievement of the organisations' strategic objectives.

4.3.16 While a number of organisations use automated and inherent system controls to increase the effectiveness of the control environment, for example, on-line authorisation, and matching and tracking of payment dates, many do not use available system functionality to enhance internal control in an effective manner. The latter includes automation of purchase orders, and of approval and payment processes. Instead, organisations use manual controls that are less complete and more expensive. In addition, different parts of organisations process transactions in different ways. Tracking of payments is undertaken outside the FMIS with systems functionality being 'turned off'.

4.3.17 Another organisation used two separate FMISs to process payment of accounts. At this organisation, there was no interface between the FMISs, or with a project management application that it used widely in its operational activity. There were significant opportunities to improve efficiency and cost-effectiveness of processing at this organisation. In particular, the FMIS was unable to efficiently process payments by EFT.

4.3.18 Organisations have planned to increase the volume of electronic payments to suppliers. However, they have not met the Government Electronic Procurement Strategy goal to *'pay all suppliers electronically by the end of 2000'*. One reason for this appears to be the lack of available system functionality. In general, the organisations examined ranged from having no payments by EFT to 70 per cent paying by this method at the time of the audit.

4.3.19 While the use of technology was generally limited, the audit noted examples where organisations were beginning to make advances with the use of technology. One organisation had improved efficiency through arranging with Telstra to receive bulk billing on-line and another, similarly with credit card service provider. One agency was in the process of exploring e-procurement and billing opportunities. However, these latter examples were more the exception than the rule.

Structure

Table 4.5

Principle	The structure of the function should make sense in terms of the organisation's needs, and through allowing for clear responsibilities and accountabilities and supporting its strategic direction. The structure should support cost-effective processing.
Audit evaluation criteria	The function is structured in a way that efficiently meets the needs of the organisation, allowing for clear responsibilities and accountabilities.

Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Two organisations had not centralised their payment of accounts functions. The current structures lead to increased costs. • Most organisations did not think strategically about the structure and relationship between the purchasing and payment of accounts functions and how it impacts on their relationship with suppliers.
Sound and better practice noted	The audit also noted the following: • A service level agreement and service standards between the finance function and the other organisational sections it served had been established.

4.3.20 The audit found there were opportunities to improve the structure of payment of accounts functions and to better align them with the strategic aims of the organisation in order to obtain economies of scale and efficiencies through reducing the flow of paper and the duplication of people-based controls.

4.3.21 Most organisations have implemented a centralised payment of accounts function that operates within a Corporate Services or Finance and Administration section. However, two organisations had not centralised the function. One operated two separate processing centres; one for larger payment of accounts function and another for smaller functions to serve a division with a different operating environment. This meant the organisation had invested in two separate FMISs and employed and housed additional payment of accounts personnel. At the time of the audit, the organisation was planning to use the advent of a change in FMIS to restructure the function.

4.3.22 Three organisations had payment of accounts structures which were efficient in meeting the needs of the organisation and provided a clear framework for processing. One of these had implemented a service level agreement and established service standards between the finance function and the sections it served. This structural arrangement was being used to monitor and improve performance through clear communication that included regular monthly reporting and review of quantitative standards achieved.

4.3.23 Beyond these examples, more generally, organisations do not consider structuring their payment of accounts function in a manner which is able to support the strategic aims of the organisation and, in particular, leverage the relationship between procurement and payment. None of the organisations used a centralised purchasing function that was able to consistently develop supplier relationships that encourage cost-effectiveness through straight forward mechanisms such as bulk purchasing agreements and bulk invoicing.

4.3.24 Other impacts resulting from the absence of a clear centralised relationship between payment of accounts and purchasing are felt in the following two aspects of the control environment:

- supplier master file records—the integrity of data was negatively impacted because divisions enter duplicate master file records when contracting separately with the same suppliers; and
- general lack of clarity about the nature of procurement—this impacted on authorisation efficiency and completeness. Many organisations considered there was no need to issue purchase orders. However, in such circumstances, the first time an organisation recorded the commitment to pay was when an invoice was received. As a result, the integrity of accrual and other operational information for decision-making was incomplete, as commitments to pay suppliers were not evident.

Overall conclusion

4.3.25 The audit concluded that significant opportunities exist for organisations to improve the payment of accounts control environment. Organisations have not taken advantage of the opportunities available through the acquisition of new FMIS, to introduce automated control features. Nor have organisations met the requirements of the Electronic Procurement Strategy to pay all suppliers electronically by the end of 2000.

4.3.26 Policy and procedural documentation in most organisations is neither complete or up-to-date. As well a number of organisations continue to operate decentralised payment of accounts processing which may not be cost-effective.

Control environment—recommendations

Recommendation No.2

4.3.27 It is recommended that organisations ensure training programs for payment of accounts employees are comprehensive in their coverage and integral to the organisation's overall training program as an effective means of making key personnel aware of their responsibilities and accountability for the control framework.

Recommendation No.3

4.3.28 It is recommended that organisations ensure the control framework is supported by appropriate policies and procedures that includes Chief Executive Instructions, statement of policies and procedures, workplace instructions and implementation plans. Processes to update these documents need to be formalised and consistently enforced.

Recommendation No.4

4.3.29 It is recommended that organisations take a more active approach to evaluating the applicability of information systems functionality to improve payment of accounts processing.

4.3.30 This approach should consider taking appropriate action in the following two key areas:

- reviewing the potential to increase specific control activity through the use of systems functionality to resolve current control weaknesses; and
- achieving cost savings related to increased efficiency, for example, through increasing the volume of electronic payment, and by increasing the level of internal and external electronic communication.

Recommendation No.5

4.3.31 It is recommended that organisations evaluate the structure of payment of accounts functions in relation to their overall management strategy and specifically to the procurement function. The use of the FMIS should be aligned with, and support, management's objectives in properly structuring the payment of accounts function.

Implementing the recommendations

4.3.32 A critical component of an effective control environment is management's commitment and attitude to the implementation and maintenance of an effective internal control structure. The level of positive and pro-active support by management strongly influences the design and operation of controls.

4.3.33 The nature of management's approach in this area clearly has an impact beyond the payment of accounts function. Their adopted words and actions can establish the culture for the implementation and maintenance of an effective control structure across financial management and operational activity—in effect enhancing the organisation's corporate governance and especially its approach to risk management. Key issues within this category include the following, as noted earlier:

- people—the need for senior management to establish a control environment that clearly defines key personnel responsibilities and accountability, as well as promoting these through effective training and communication programs;
- process—the organisation's policies and procedures should be complete and effectively communicated in order to reflect the organisation's governance responsibilities;

- technology—management need to ensure that information systems efficiently support the process activity in a way that reflects the organisation's strategic objectives; and
- structure—the structure of the function should make sense in terms of the organisation's needs, and allow for efficient and clear responsibilities and accountabilities.

4.4 Control Activities

Introduction

4.4.1 Control activities refer to that group of specific internal controls that, within an effective control structure, combine to mitigate unacceptable risks to assist the achievement of business objectives. They operate as the organisation's front line of defence in ensuring basic controls exist such as segregation of duties, authorisation, completeness, accuracy, timeliness and system security. Without the proper design of control activities, managers cannot ensure payments are properly authorised and recorded.

Business benefits

4.4.2 An effective framework includes both preventative and detective controls that minimise the impact of risks and contributes to the efficient and effective delivery of quality program outcomes. Control activities ensure integrity, accuracy and completeness. Importantly, they also ensure system access, upon which the integrity of the payment of accounts function relies. Properly designed control activities provide an important key to efficiency in processing.

4.4.3 It is only at this level of the overall control framework that specific internal controls operate. The latter's effectiveness is greatly enhanced by the surrounding pervasive controls, the control environment, and monitoring and reporting activities. However, their failure can create wide ranging risks, including exposure to fraud. For this reason, emphasis should be more on preventative rather than detective controls.

Audit findings and comment

4.4.4 The audit findings in this section are summarised under the following headings:

- Management controls;
- Organisational controls;
- Authorisation controls;
- Operational controls; and
- Computer controls.

Management controls

Table 4.6

Principle	Management reviews the operation of control activities.
Audit evaluation criteria	High level supervision and review. These controls include management's monitoring of other specific control measures.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Many organisations could improve the design and operation of basic management controls. • Organisations need to improve monitoring of the integrity of supplier master files.
Sound and better practices noted	The audit also noted the following: • 'Exception only basis' was used to review variance reporting. • Reviews of changes to supplier master files were undertaken weekly, using exception report.

4.4.5 The audit found that there are opportunities to make significant improvements to control frameworks at low cost, through management's regular monitoring in a few key areas. Seven organisations did not use one or more of the following basic management controls:

- timely and complete review of bank reconciliations and control account reconciliations; and
- reviews of cheque sequences, cheque registers and credit notes.

4.4.6 While there are some organisations where technological advance has changed the nature of these monitoring controls, most still require these traditional controls to ensure a robust control framework. For example, some organisations use daily downloads of data from their bank to reconcile bank details on a daily basis. The resolving of unmatched items on a daily basis has turned the traditional month end reconciliation process into *'just another day's activity'*. At the other end of the spectrum, one organisation, unable to conduct on-line reconciliations, used a monthly process that involved the completion of lengthy handwritten reconciliations. Whatever the reconciliation process, review of reconciliations was not always evidenced at the organisations reviewed. Without rigorous review, the control is prone to lapse in integrity and lack of resolution of issues.

4.4.7 The audit also found that the review of cheque sequence, registers and credit notes were being increasingly replaced by the use of inherent system controls to provide a framework that ensures full resolution and integrity. However, while some organisations continue to pay suppliers by manually prepared cheques; issue credit notes outside of the system; and allocate cheque run numbers manually; they still need to ensure these basic management controls are in operation.

4.4.8 Importantly, organisations need to improve their monitoring of the integrity of supplier master files. Many did not have formal processes to review changes to supplier master file data or currency of supplier master file data, which would also include a periodic culling of inactive data.

4.4.9 The absence of this control in two organisations was evident with over 90 per cent of supplier master file records in these organisations being inactive. Consequently the risk of inadvertent error was significantly increased in these organisations. Integrity of supplier master file records is central to the integrity of payment of accounts processing. Without sound control mechanisms, it is difficult to mitigate the risk of fraud and to rely on the integrity of payments.

Organisational controls

Table 4.7

Principle	The organisation of payment of accounts supports segregation of duties; uses efficient payment mechanisms; and provides adequate physical security.
Audit evaluation criteria	These include: • Well-defined responsibilities and segregation of functions for payment of accounts personnel; • The structure of payment functionality and associated mechanisms, including the use of bank accounts, credit cards, bulk invoicing and petty cash; and • Physical controls over related assets and documentation.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Many organisations used petty cash extensively contributing to administrative workload and cost, or loss of interest income potential. • There were opportunities to increase efficiency by using credit cards for minor purchases, travel reimbursements and cash withdrawals. • The volume of payments processed by EFT was low. • Some organisations regularly paid employees though the payment of accounts function. This process is less efficient and less controlled than paying them through EFT. • Organisations do not generally use technology to store and archive data.
Sound and better practice noted	The audit also noted the following: • Credit cards were used in a variety of ways for operational expenses, travel and cash advances.

4.4.10 The audit considered organisational controls under two main headings: *payment functionality*—relating to the organisation of payment methods; and *physical controls*.

Payment functionality

4.4.11 Most organisations had decentralised purchasing functions. While this approach is appropriate where devolution of authority has been adopted, it is important that organisations consider the risks associated with devolution. Unless such risks are considered, it is likely, as was found in this audit, that, in some organisations, individual sections contract separately with the same suppliers for the same products.

4.4.12 The audit found petty cash floats between $5000 and $43 000 in the organisations reviewed. These organisations used petty cash extensively for employee reimbursement of expenses and travel advances. Some organisations also used multiple petty cash floats. The ANAO considers there are opportunities in all organisations to increase efficiency by using direct credit to bank account arrangements as well as credit cards for minor purchases and travel reimbursements.

4.4.13 Some organisations regularly pay employees though the payment of accounts function. This includes both off-cycle payments, such as termination of employees, and expense reimbursements. As a result, employees are established as suppliers on the master file. This impacts the size and integrity of the master file; increases the risk of fraud; and is inefficient.

4.4.14 While most organisations have eliminated the majority of manually prepared cheques in favour of system generated cheques, the volume of payments processed by EFT was low. In addition, organisations continue to make individual payments to suppliers notwithstanding that their FMISs are able to consolidate multiple payments due to a supplier into one payment. Electronic billing arrangements with suppliers were still developing.

Physical controls

4.4.15 Most organisations had well-established physical controls over cheque stock and orderly filing systems that ensured necessary documentation to support transactions can be easily sourced. However, there were significant opportunities to increase efficiency through the use of scanning and electronic storage. Electronic storage can be employed as a useful tool to provide easy access to on-line information throughout the organisation. For example, hard copy source data for payments can be scanned, stored and then accessed through an Intranet.

Authorisation controls

Table 4.8

Principle	Payments are appropriately authorised.
Audit evaluation criteria	These controls operate at the individual transaction level. These include access, authorisation, approval and checking controls.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • The authorisation process in most organisations is highly manual and inefficient. • Corporate bills for credit cards are sometimes paid prior to complete authorisation of individual statements. • Some organisations have incomplete listings for authorisation of EFT transactions and bank account signatory listings.
Sound and better practice noted	The audit also noted the following: • On-line authorisation of credit card and telephone accounts through the FMIS, or e-mail which enabled this process to be efficient and provided easy access for travelling managers.

4.4.16 The audit found that authorisation and delegation levels were generally appropriate to the level of risk and value of transactions within the payment of accounts function. Most organisations had appropriate and complete bank account signatory listings. However, two organisations had only one authorisation for EFT transactions, where two staff with independent passwords would be more appropriate.

4.4.17 While the audit indicated appropriate authorisation of payments, the process in most organisations was highly manual. Authorisation processes can be improved through greater utilisation of technology and better design of processes. In particular, the audit found limited and inconsistent use of purchase orders. As a result, there was no formal record of purchase approval or contract with suppliers. Better practice encourages the authorisation of purchases. This means that the separate authorisation of invoices can be replaced by matching invoices against a previously approved purchase order. The use of technology, through on-line recording of purchase orders and automated approval or release mechanisms, can greatly enhance efficiency.

4.4.18 In addition, the audit found that invoices for corporate credit cards were paid prior to complete authorisation of individual statements. This arose from delays in authorisation due to distribution processes or absence of managers. Some organisations, however, had set up arrangements with credit card and telephone service providers for on-line billing which were combined with Intranet functionality, ensuring timely authorisation. The audit noted that all organisations recognised the need to avoid the interest payment and card cancellation consequences of late payment.

Operational controls

Table 4.9

Principle	Payments and related records are accurate and complete. Payments are made on a timely basis.
Audit evaluation criteria	These are concerned with two main areas: the *completeness* and *accuracy* of processing; and controls to ensure *timeliness* of transactions.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • There were opportunities to reduce the number of checking mechanisms in some organisations. • At some organisations, bank reconciliation procedures required improvement. • Supplier statement reconciliations were not performed in some organisations. • Some organisations employed less effective manual controls rather than system based controls to track the timing of payments.
Sound and better practice noted	The audit noted the following: • Data was checked on a sample basis to ensure completeness and accuracy of operations. • Daily on-line bank reconciliations were performed on a regular, complete and timely basis.

Completeness and accuracy

4.4.19 Most organisations had adequate controls to ensure the checking of the accuracy of payments. Comprehensive checking of data and system reports, as well as reconciliations, were undertaken to ensure completeness and accuracy of operations. It was noted that, as organisations become more familiar with the functions of their FMIS, fewer processing errors occurred. As a result, organisations had been able to reduce the extent of checking for process errors.

4.4.20 The audit found bank reconciliations in some organisations were incomplete.

4.4.21 The audit also found that many organisations did not perform supplier statement reconciliations. While reconciliation of all supplier statements may not be necessary, a risk-based approach to periodic reconciliation of major supplier accounts is a useful internal control mechanism to monitor the status of the supplier relationship. The ANAO suggests records of these reconciliations be retained for a period of time in order to assist staff should future disputes arise.

Timeliness

4.4.22 Most organisations had control frameworks that facilitate payments being made on a timely basis. Most organisations used system functionality to record payment dates and select payments based on these records. However, there were exceptions. The audit noted that, in several organisations, late payments resulted from delayed authorisation. Generally, this occurred in organisations that did not use their FMIS to manage the timeliness of payments or in circumstances where authorisation was required from other areas of the organisation. Simple controls, such as date stamping of invoices upon receipt, assists in monitoring this issue.

4.4.23 The audit also found that organisations did not track performance related to the timing of payments, for example, the opportunity costs associated with discounts not taken or interest foregone.

Computing controls

Table 4.10

Principle	There are controls that provide a secure and effective information systems environment for the processing of payment of accounts.
Audit evaluation criteria	These are concerned with the way a computer processes data. They include controls over unauthorised access to the computer and completeness and accuracy of data.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Five of the agencies lacked controls to ensure adequate logical security of FMIS related to payment of accounts. • Some organisations did not adequately restrict access into the ReserveLink terminal.
Sound and better practice noted	The audit noted the following: • Periodic review of logical access to payment of accounts system modules. • Implementation of effective controls surrounding all dealings with on-line banking facility, including dual signatories, minimum alphanumeric password length and locked and coded safe storage of banking system access card.

4.4.24 Many of the organisations lacked controls to ensure adequate logical security of their FMIS. For example, organisations did not have processes to regularly review system access. In some organisations, segregation of computer access to payment of accounts functions, such as processing and approving payments and setting up new supplier master files, was inadequate.

4.4.25 Specific examples of control weaknesses included supervisors with administrator access to the system. As a result, they were able to process and pay invoices as well as authorise them. In another organisation, too many employees had administrator access.

4.4.26 The audit noted opportunities for organisations to improve logical security through simple redesign of password controls. This included for example, extending required password lengths; requiring passwords to be alphanumeric; and implementing periodic change procedures.

4.4.27 The audit also found that some organisations had not adequately restricted access to the ReserveLink terminal through which transactions were authorised. Access to ReserveLink terminals should be protected by physical security, passwords and the requirement for dual authorisation. Without adequate access controls, the risk of manipulation of data prior to electronic transmission is not mitigated. Other organisations had implemented effective controls that ensured access to on-line banking was limited to specific individuals through logical security password mechanisms and physical security surrounding access cards.

Overall conclusion

4.4.28 In general, organisations were found to have operational control activities that succeed in ensuring the authorisation and timeliness of payments, although the audit noted a high level of individual exceptions. These exceptions impact the overall effectiveness of this function. However, because control activities tend to overlap in their objectives, the core objectives of authorisation and timeliness were being met.

4.4.29 The design of controls could be improved to enhance efficiency, for example, through the wider use of management controls (those that relate to the monitoring of specific activities, for example review of changes to supplier master files). In general, the comprehensive re-design and restructuring of control activity through wider use of risk assessment and greater understanding of performance measurement would enhance this set of controls to ensure more efficient and cost-effective outcomes.

4.4.30 The organisations could take greater advantage of computerised controls for the authorisation of payments and, while completeness, accuracy and timeliness controls operate effectively, improvements can be gained through the better use of technology. Access to FMIS and payment of accounts data could also be improved.

Control activities—recommendations

Recommendation No.6

4.4.31 It is recommended that organisations review the design of their control activities in the context of available proven technology.

4.4.32 Consideration should also be given to the design of the controls in each of the following areas—management, organisational, operational and authorisation controls. Increased use of technology will often enable manual processes and controls to be replaced by more efficient system controls. Well considered risk assessment and performance measurement are recommended as useful tools in this process.

Recommendation No.7

4.4.33 It is recommended that organisations:

- examine supplier relationships and related levels of procurement in the context of continuous improvement, including mechanisms such as on-line ordering, electronic billing and bulk billing;
- increase the use of credit cards, with appropriate training and guidance, as mechanisms to assist in removing the need for cash;
- eliminate processes to pay employees through the payment of accounts function. This includes removing off-cycle salary related payments and reimbursements of employee expenses. Processing through the payroll system by EFT can also increase efficiency; and
- educate managers and personnel on the significance of information system security in providing a secure control environment for payment of accounts processing. This should include informing employees of requirements related to protection of logical system access, supplier master file data, and access to EFT and on-line banking systems.

Implementing the recommendations

4.4.34 The principal recommendation in this area related to increasing the use of technology to replace manual processes and controls. The use of technology can have a positive impact on all areas of control activities. For example:

- replacing cheque payments with EFT payments;
- implementing on-line reconciliation processes;
- selecting payments due using system records; and
- using on-line authorisation.

4.4.35 In general, the development of controls is an area where there are opportunities for efficiency and effectiveness improvements. However, the design of controls needs to be considered in the context of a complete understanding of all related controls because there is always a risk of duplicating control activities.

4.5 Information and Communication

Introduction

4.5.1 Information and communication are critical for performance reporting, decision making, both within the organisation and externally, and the achievement of strategic objectives. Performance information needs to be identified, captured, analysed and communicated on a timely basis. It needs to be in a form that enables people to carry out their responsibilities simply and with confidence. Accordingly, information systems (both computer and manual) need to be in place to capture and process data in meaningful ways to the various users.

4.5.2 Performance measurement is widely recognised as a key tool by which organisations can monitor performance. One of the main advantages of performance measurement is that it enables organisations to express the results of a business process in quantitative, not qualitative, terms.

4.5.3 With particular reference to the payment of accounts process, performance measurement allows organisations to clearly quantify results. By providing reliable, quantifiable data to evaluate business processes, performance measurement allows organisations to provide feedback about current performance and to set relevant, identifiable goals (targets) for future improvement. Moreover, it has long been acknowledged that, in general, '*what gets measured gets done*'. That is, the practice of simply measuring a task or activity focuses direct attention on it, and as a result, people will naturally strive to improve the result. It is therefore integral to any continuous improvement environment.

4.5.4 Further, performance measurement is also integral to any internal control environment. When monitored consistently, performance measures help an organisation identify process problems as they occur, often well before the problems adversely affect outputs and outcomes.

4.5.5 All organisations, regardless of geography or sector, share some common goals, for example to deliver products and services with the highest quality, at the lowest cost, and in the shortest amount of time. Therefore, it is vital that organisations choose performance measures that reflect cost, quality, and time concerns.

Business benefits

4.5.6 Effective information and communication helps organisations establish whether resources are being directed towards the achievement of desired outputs and outcomes in the most efficient, effective and ethical way.

4.5.7 Performance reporting assists organisations understand whether the payment of accounts function is meeting the needs of the organisation. It contributes to continuous improvement and enables staff to undertake and monitor their own operational activities, which can further be used as a tool in building staff confidence and morale.

Audit findings and comment

Information and communication controls

Table 4.11

Principle	The right information is provided to the right people at the right time.
Audit evaluation criteria	Management regularly communicates relevant information throughout the organisation to assist in the achievement of its objectives. Information includes both: • Operational data (related to transactions and sourced from the payment of accounts function); and • Performance data or indicators (related to the payment of accounts function).
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Organisations do not include data on discounts taken within operational reporting. • Most organisations could increase the use of technology as a tool in information communication for performance improvement. • The format of operational reporting at some organisations could be significantly improved through using visual aids and tailoring the information to the target audience. • Most organisations did not use adequate performance measurement to quantify performance of the payments of accounts function.
Sound and better practices noted	The audit noted the following: • The organisation's Intranet was used to distribute reporting. • Performance data review was part of a service level agreement and related service standard reporting. • Error rates were recorded for different processing centres for use in process improvement.

Operational information and communication

4.5.8 The audit noted that many organisations produced effective and timely operational reports, including transaction reports and variance analysis, that enable operational management to understand and review payments made on its behalf. This included reporting on payments by section or cost centre against budget and related variance analysis. These reports were commonly produced on a monthly basis and included visual presentation of system reporting, but the quality and relevance of such reporting varied. Some organisations tailored reports to meet the specific needs of the audience.

4.5.9 However, the audit found that organisations do not include data on discounts taken within operational reporting. In general, management considered this area insignificant or that it was the responsibility of operational managers to manage payment terms. The observations mirror the lower priority given to cash management than to other aspects of payment of accounts management.

Performance information and communication

4.5.10 The audit found that most organisations do not use regular performance measures for cost of processing, timeliness and quality of transactions. Without this information, management lacks sufficient knowledge to make informed decisions on the performance of the function. The development of this performance information will be particularly important as organisations begin to market test their corporate functions.

4.5.11 One organisation reports on performance data as part of a service level agreement and related service standard reporting. The following performance measures are used on a monthly basis: timeliness of payments, accuracy of payments and coding, and monitoring of cash flow. This data was used to understand the function as well as enhance the relationship between the function and the organisational sections it served.

4.5.12 Another organisation recorded and reported error rates of different processing centres for use in process improvement. This was a useful tool in understanding additional training requirements for the organisation.

Overall conclusion

4.5.13 The audit found that organisations had usually implemented effective processes to provide *operational reporting* to the sections that they serve. In general, information is identified, captured, analysed and communicated on a timely basis in a form that enables people to make decisions and carry out their responsibilities. Information systems are extensively used to capture and process data in meaningful ways, and increasingly as a primary communication tool. In some organisations, operational reporting could be improved through better presentation of information and the increased use of technology.

4.5.14 However, organisations have not adopted the notion of measuring performance of the payments of accounts functions. Communication of this kind of information is critical for *performance reporting* and decision-making, both within the organisation and externally. Without this information, organisations lack adequate knowledge of the performance of the payment of accounts function and hence the ability to make meaningful decisions about the role of the payment of accounts function in achieving the organisation's strategic objectives. This is particularly important as agencies move to market testing of their outputs as required under the accrual budgeting system.

Information and communication—recommendation

Recommendation No.8

4.5.15 It is recommended that organisations:

- review the quality of operational reporting produced on a periodic basis. Organisations need to ensure the relevance of the information to the target audience; the presentation of information in user-friendly formats; and the use of technology as a communication tool; and
- implement periodic performance measurement to enhance understanding and the effectiveness of the payment of accounts function. Implementation should involve the identification and definition of performance measures, periodic reporting of these performance measures, and appropriate review.

Implementing the recommendation

4.5.16 Continuous improvement in operational reporting could be enhanced through knowledge sharing across Commonwealth organisations in terms of report presentation and communication techniques that maximise the effective use of technology.

4.5.17 An effective payment of accounts process is built on a set of well-defined and clearly stated objectives. These key objectives articulate the ideal performance results that the organisation expects from that process. To monitor a process so that it stays focused on reaching the key objectives, the organisation must choose appropriate performance measures. In addition, careful selection of the performance measures can take an organisation a long way toward improving a business process. Thus, to build, and then continually improve, an effective process an organisation has to establish:

- **key objectives** to articulate the performance results the organisation expects from the process;

- **output and outcome measures** to determine whether the key objectives are reached; and
- **activity measures** to monitor the performance of those activities that are instrumental in reaching the key objectives.

4.5.18 Further information is provided at Appendix 4 on performance measurement and key performance indicators relevant to the payment of accounts process. Organisations can use this data to establish at least preliminary, or intermediate, measures. Once, performance measurement is in place, these measures can be altered periodically to reflect changes in the operating environment and changes in key objectives.

4.6 Monitoring and Review

Introduction

4.6.1 Monitoring and review is the final component of an effective control framework. It is a key element of an organisation's continuous improvement process that ensures the organisation implements effective processes and tools to monitor and review relevant data. An effective monitoring and review environment includes use of both periodic reviews, such as those undertaken by Internal Audit and external consultants, as well as in-built review mechanisms, such as control self assessment (CSA) and either, or both, internal and external review of performance measures.

Business benefits

4.6.2 Monitoring and review provides assurance and feedback on whether program objectives are being achieved efficiently and effectively. The component also provides an on-going check on the effectiveness of the control structure. Activity in this area significantly impacts continuous improvement. Periodic monitoring and review is often aligned with the sharing of ideas, both across the organisation and externally. This is associated with the benefits of obtaining independent and objective views. In-built monitoring and review mechanisms, such as control self-assessment, encourages ownership of controls as well as enhancing the control structure.

Audit findings and comment

Monitoring and review

Table 4.12

Principle	Monitoring and review takes place on an appropriate periodic basis that enables the organisation to check the control structure and ensure the organisation's strategic objectives are achieved.
Audit evaluation criteria	Management activities demonstrate a continuous improvement approach, including quality assurance, performance monitoring, self-assessment or independent review of the effectiveness of control activities.
Audit findings	In relation to the eight organisations reviewed, the audit found the following: • Verbal intent to implement continuous improvement is often not supported by visible action. • Organisation's Internal Audit activities have not been sufficient to identify many of the control weaknesses noted during this audit. • Organisations do not monitor performance measurement data. • Organisations do not use control self assessment as a monitoring and review tool.
Sound and better practices noted	The audit noted the following: • A plan had been developed to use Comcover specific risk management software to assist in the delegation of management of risks within the function to managers of the function.

4.6.3 The audit found that organisations could improve the monitoring and review of payment of accounts operations to ensure that both organisational and control objectives are being achieved efficiently and effectively. In particular, this could be achieved through the introduction of monitoring and review of performance measures and through the use of CSA.

4.6.4 Monitoring and review is the final component of an effective control structure and is closely linked to information and communication. In addition to the monitoring of performance measures, the effectiveness of the control structure itself also needs to be monitored and reviewed. Control monitoring and review can be undertaken in various ways including:

- by on-going monitoring which is an inherent part of the process—for example, control self assessment; and,
- by separate periodic reviews and evaluations—for example, Internal Audit.

4.6.5 Most organisations indicated their support for continuous improvement of the payment of accounts processing. However, in some organisation's this was not supported by formal action.

4.6.6 Organisations' Internal Audit activities have not been sufficient to identify control weaknesses (for example, in relation to those documented elsewhere in this report). Most organisations use Internal Audit to monitor the function. This commonly occurs through organisational risk assessment or through compliance reviews. Decisions based on knowledge from organisational risk assessments often lead to the consideration of payment of accounts as low risk. This, in turn, means that management do not allocate resources to the monitoring and review of payment of accounts functions.

4.6.7 Most of the organisations included in this audit were not regularly reviewing performance measures related to the payment of accounts function. It is noted in Section 4.4 that such information is not produced by most organisations.

4.6.8 None of the organisations included in this review has adopted formal CSA processes as a mechanism to build in regular monitoring and review as a normal part of the control process. Organisations more commonly use periodic process reviews as a tool to continuously improve the control process.

Monitoring and review—recommendation

Recommendation No.9

4.6.9 It is recommended that organisations:

- increase their monitoring activity of the payment of accounts function as part of effective control and improved performance;
- initiate appropriate action to ensure the quality, rigour and relevance of Internal Audit activities as a periodic monitoring and review tool; and
- include appropriate monitoring and review of performance measurement activity as a tool to improve the payment of accounts function. Clearly specified procedures should be developed for implementing appropriate action based on the performance monitoring information and related reports.

Implementing the recommendation

4.6.10 Monitoring and review is a central part of an organisation's continuous improvement processes. On-going monitoring built into normal operations tends to be more effective than separate ad hoc evaluations. On-going monitoring can be achieved through traditional management and supervisory activities, by control self-assessment, and by encouraging staff to identify breakdowns, redundancies, duplications and gaps in control procedures.

4.6.11 Separate evaluations, such as Internal Audit reviews or process reviews, undertaken from time to time are also a useful monitoring and review tool. They take a fresh look at the effectiveness of control structures and often provide the opportunity for on-going monitoring procedures to be revisited.

4.6.12 The scope and frequency of monitoring and review activities will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring. The more on-going monitoring, the less need for separate evaluations. Importantly too, the effectiveness and appropriateness of the control structure can change as the environment changes. These can be wide-reaching and can range from, for example, changes in available technology, in systems and in organisational structure.

4.6.13 While the governing body of an organisation is responsible for the control framework, individual senior and line managers can facilitate operational improvement through taking personal responsibility. The ANAO has identified CSA as a better practice in monitoring and review activity.[13] CSA is the reporting process where managers are actually responsible for developing, assessing, maintaining and monitoring controls in their respective areas. This usually involves the completion of self-assessment checklists to confirm that control processes and procedures are clearly understood, implemented and are operating effectively. The checklist data can be collated along with other financial and operational performance data into reports, graphs and charts that measure actual performance against expectations.

Canberra ACT	P. J. Barrett
18 June 2001	Auditor-General

[13] op. cit., Controlling Performance and Outcomes, ANAO.

Appendices

Appendix 1

About the Audit

Assurance and Control Assessment Audits

Assurance and Control Assessment (ACA) audits are undertaken under the general performance audit provisions of the *Auditor-General Act 1997*. They examine the internal control structures supporting common business support activities and processes that are not specifically covered by financial statement or other performance audits. Audit evaluation criteria are based on the five interrelated components of the control structure[14]; namely:

- risk management;
- control environment;
- control activities;
- management information and communication processes; and
- monitoring and review processes.

Audit objectives

The main objectives of the audit were to determine whether organisations implemented risk management strategies for the processing of accounts and payment for goods and services has been properly authorised. The audit also reviewed progress since the payment of accounts audit undertaken in 1996.

Audit evaluation criteria

Table 1 shows the audit evaluation criteria mapped against the components of the internal control framework. Each organisation's management of the payment of accounts was assessed against these criteria.

[14] op. cit., Controlling Performance and Outcomes, ANAO.

Table 1

Audit Evaluation Criteria

<table>
<tr><th colspan="2">Risk Assessment</th></tr>
<tr><td colspan="2">Management is aware of, assesses, analyses and mitigates/takes advantage of risks, which impact upon an organisation's goals and objectives. Management considers risk assessments at both the organisational level (outputs, program) and process level (function, task).</td></tr>
<tr><th colspan="2">Control Environment</th></tr>
<tr><td colspan="2">Management demonstrates commitment to ensuring well controlled business operations, including the following:</td></tr>
<tr><td>People</td><td>Senior management takes a pro-active approach to risk and control which ensures key personnel are aware of governance responsibilities, through training and communication.</td></tr>
<tr><td>Process</td><td>There are effective and efficient policies and procedures which reflect the organisation's governance responsibilities.</td></tr>
<tr><td>Technology</td><td>Information systems are used as a strategic resource.</td></tr>
<tr><td>Structure</td><td>The function is structured in a way that efficiently meets the business needs of the organisation, providing for clear responsibilities and accountabilities.</td></tr>
<tr><th colspan="2">Control Activities</th></tr>
<tr><td colspan="2">Management has established activities to assist an organisation's objectives, including the following:</td></tr>
<tr><td>Management Controls</td><td>High level supervision and review. These controls include management's monitoring of other specific control measures.</td></tr>
<tr><td>Organisational Controls</td><td>Derived from the way in which the function is structured. These include:
• well-defined responsibilities and segregation of functions for payment of accounts personnel;
• the structure of payment functionality and related mechanisms including the use of bank accounts, credit cards, bulk invoicing and petty cash; and
• physical controls over related assets and documentation.</td></tr>
<tr><td>Authorisation Controls</td><td>These controls operate at the individual transaction level. These include access, authorisation, approval and checking controls.</td></tr>
<tr><td>Operational Controls</td><td>These are concerned with two main areas, that is, the completeness and accuracy of processing and controls to ensure timeliness of transactions.</td></tr>
<tr><td>Computing Controls</td><td>These are concerned with the way a computer processes data. They include controls over unauthorised access to the computer and assurance of completeness and accuracy of data.</td></tr>
<tr><th colspan="2">Information and Communication</th></tr>
<tr><td colspan="2">Management regularly communicates relevant information throughout the organisation to assist in the achievement of its objectives. Information includes both the following:
• operational data (related to transactions and sourced from the payment of accounts function); and
• performance data or indicators (related to the payment of accounts function).</td></tr>
</table>

Monitoring and Review
Management activities demonstrate a continuous improvement approach, including quality assurance, performance monitoring, self assessment or independent review of the effectiveness of control activities.

Performance Information

Planning for this audit commenced in September 2000 with research into payment of accounts practices and private industry experience. Fieldwork was undertaken as follows:

- understanding and research—September and October 2000;
- in-depth fieldwork—October, November and December 2000
- recommendations—December 2000 and January 2001; and
- reporting—February to June 2001.

The ANAO provided a report on the results of the audit to each organisation reviewed as part of the audit that included a number of detailed, specific recommendations relevant to those organisations.

The elapsed time from the commencement of the audit to tabling this Report was nine months and the total cost was $450 000. The audit was undertaken on a project managed basis by Arthur Andersen.

Appendix 2

1996 FCA Audit and Better Practice Guide

FCA audit 1996

During 1996, the ANAO undertook a financial control and administration audit of the payment of accounts function across a number of Commonwealth organisations.

The report presented to Parliament on 25 November 1996, titled *Payment of Accounts*, concluded that the payment of accounts function was being administered satisfactorily within the context of the financial legislative and management framework. However, the ANAO did recommend that better practices could be achieved by:

- changes to the management and organisational framework for the payment of accounts; and
- increased use of advanced information technology.

The findings and recommendations presented in the report were not necessarily attributable to a particular agency, but instead concentrated on an 'across-the-board' perspective. Areas of improvements to the management and organisational framework of the payment of account function included:

- management reporting and performance measurement;
- the use of risk management processes; and
- increased flexibility in organisations' terms of payment.

The ANAO indicated that organisations should assess the cost-effectiveness of adopting electronic commerce capabilities at the earliest possible time. Until such time of the development and implementation of an electronic commerce service, the ANAO advised that the organisations take greater advantage of their current technologies available for the payment of accounts. In particular, the following processes and technologies:

- automated matching of payments with purchase orders and receipt of goods and services information;
- automated sorting, aggregation and batching of claims;
- the making of payments by direct credit card instead of by cheque; and
- automated management information and performance reports.

The findings of the report are summarised below:

- Most agencies could not identify the total cost of payment of accounts function. However, ANAO estimates, based on data provided by agencies, indicated that Commonwealth costs were higher than in the private sector.
- Certain accounting controls, organisational and processing arrangements, and management reporting and performance measurement mechanisms required improvement to enable agencies to exercise better management of the payment of accounts function.
- Agencies were making limited use of risk management in the verification of payments and there was little apparent recognition of the need of functional risk assessments at the agency level.
- The payment by due date policy introduced in 1987 has, by and large, achieved its objective of having accounts paid on time. However, a focus on strict compliance with the policy led to some inflexibilities in the process.
- Despite direct credits being the Commonwealth's preferred mode of payment, a large number of payments were still being made by cheque. This was largely because of the limited payment advice information that accompanied direct credits.
- A high proportion of payments between agencies operating on the Commonwealth Public Account were made by cheque on the same payment terms as payments to external suppliers. Cost savings from reduced cheque production and handling, and from reduced cheque follow-up action by receiving agencies could be achieved.
- Several accounts payable systems operated by agencies would benefit from increased automation.

Better Practice Guide 1996

Following the audit conducted in 1996 the ANAO prepared and published an accompanying handbook[26]. As noted in the Handbook, the overriding principle to be adopted in accounts payable is to *'pay the supplier not process the paper'*. In this regard significant improvements and efficiencies can be achieved by forming alliances with strategic suppliers and establishing business rules for both parties. Technology was identified as the key enabler that permits implementation of an appropriate structure and efficient processes.

Current better practices

As part of the 2001 audit further research into better practices was undertaken and the results are summarised below. The Arthur Andersen resource 'Global Best Practices' has been used in preparing this summary of the ways leading organisations achieve high performance. The matters discussed provide an insight into how business processes can be improved.

Strategic alliances

Better practice is to sole source where possible and to enter into a medium to long term contractual relationship with a supplier. This approach provides the opportunity to develop and extend existing clustering arrangements (for example in areas such as travel and information technology infrastructure) to other goods and services and to make greater use of the economic leverage implicit in such relationships.

Vendors with whom strategic alliances are formed may be involved in developing better ways to process accounts payable. This could include:

- the use of summary invoicing;
- transfer of responsibility for accuracy to suppliers;
- agreement of performance standards (cost, quality and delivery) and performance guarantees;
- alignment of supplier and buyer databases to allow simplified update of information;
- parallel development of electronic data/document interchange and reporting;
- development of supplier procedures to cover delivery requirements and handling of exceptions to allow redesigned payment processes to be implemented; and
- involvement of payment of accounts staff in the development and negotiation of standard terms and conditions and customised terms and conditions for large contracts.

Organisational structure

Better practice suggests that the authority to approve and the responsibility for expenditure should be as close as possible to the decision-maker committing the organisation to the payment. This approach flows through to certification for payment once the goods and services are received.

Centralised processing benefits include achievement of a higher degree of specialist expertise, establishment of centres of excellence that develop and enforce common practices and standards and the achievement of cost-efficiencies through co-locating of systems and staff. It also provides other benefits such as the ability to consolidate payments to suppliers.

It is also considered that benefit is achieved through the co-location of accounts payable and purchasing staff. Through a multi-function approach achieved by cross training, staff are made more aware of the independencies of these two activities. It also provides a more flexible workforce which is more responsive to peak workload periods.

Technology

The implementation of electronic commerce and the development of buyer/supplier relationships are contemporary initiatives that will continue to impact favourably on the payment of accounts functions of all organisations in the foreseeable future. A common feature of changes in payment of accounts practices is the increasing reliance on technological solutions to make value-added processes more efficient and to eliminate non-value added processes altogether.

The two principal innovations in this area have been the move toward the full integration and/or interfacing of financial systems and the increasing use of electronic commerce—primarily electronic data/ document exchange and electronic payment.

A fully integrated/interfaced system could exhibit some or all of the following features:

- electronic purchase order which extracts details from database of approved suppliers and which is authorised electronically;
- quantity, price and account code entered once only, on the purchase order;
- electronic notification of receipt of goods/services;
- automated three-way matching of invoice, purchase order and notification of receipt;
- supplier and account code details extracted automatically from purchase order for payment;
- automatic check for duplicate payment; and
- cheque payment/direct credit automatically scheduled based on terms of trade taken from supplier database.

Payment mechanisms

The emphasis in reviews of payment processes is to reduce the number of steps in paying accounts. Better practice indicates the use of between three and five steps to complete the entire process. A range of innovations have contributed to this, including the following:

- Evaluated Receipt Settlement—agreements with suppliers to pay for goods upon receipt, thus eliminating the need for invoices. This involves the suppliers shipping document (or telecommunicated shipping advice) being used to determine the quantity of goods supplied. The quantity data (subject to verification by the receiving section) is extended at the purchase contract price and terms in effect at the time of shipment to calculate the amount owed and payment due date.
- Standing Payments—establishment of regular (usually monthly) or lump-sum payments for recurring transactions based on expected usage levels, with periodic adjustments. This approach is particularly relevant to suppliers that provide goods or services on a regular basis, such as utility providers and fleet managers.
- Differentiated payment—adopting effective abbreviated certification procedures, particularly for low-dollar-value claims, has the potential to significantly reduce the amount of time spent on payments of accounts.

These better practices were considered as part of the audit across each activity of the control framework. Further discussion of better practices observed as part of this audit is included in Table 1.1 and in Section 4.

Appendix 3

Payment of Accounts Risk Model

This model can be used as the starting point in identifying and organising the sources, risk drivers and risk indicators for managing the key process level risks within the payment of accounts function. It is based upon a summary of data from the Arthur Andersen Business Risk Model. Risks are summarised in three key categories.

1. Environment Risk: ***Environment risk arises when there are external forces that could significantly change the fundamentals that drive a organisation's overall objectives and strategies.***

2. Process Risk***: Process risk is the risk that business processes:***

- ***are not clearly defined;***
- ***are poorly aligned with business strategies;***
- ***do not perform effectively and efficiently in satisfying customer needs;***
- ***do not add to shareholder wealth; or***
- ***expose significant financial, physical and intellectual assets to unacceptable losses, risk taking, misappropriation or misuse.***

3. Information for decision making risks: ***Information for decision making risk is the risk that information used to support strategic, operational and financial decisions is not relevant or reliable.***

Risk	Definition	Example
1. Environment Risk		
Legal Risk	The risk that a organisation's transactions, contractual agreements and specific strategies and activities are not enforceable under applicable law. Changes in laws and litigation claims and assessments can also result in increased competitive pressures and significantly affect an organisation's ability to efficiently conduct business.	Billing arrangements between an organisation and its suppliers are not documented. Consequently, the organisation is required to alter its payment process.
2. Process Risk		
2.1 Operations Risks		
Customer Satisfaction Risk	The organisation's processes do not consistently meet or exceed customer expectations because of a lack of focus on the customer. Without a constant drive toward customer satisfaction and continuous improvement, the organisation will neither understand nor accept the product characteristics or service elements necessary to remain competitive and will fail to improve its products and processes.	An organisation that is continually late in making payments to vendors is faced with increased costs in the form of late penalties and interest charges assessed by the vendors.
Human Resources Risk	The personnel responsible for managing and controlling an organisation or a business process do not possess the requisite knowledge, skills and experience needed to ensure that critical business objectives are achieved and significant business risks are reduced to an acceptable level.	Personnel responsible for processing accounts payable do not understand the business; therefore, they are unlikely to identify unusual items requiring investigation prior to payment.
Efficiency Risk	Inefficient operations threaten the organisation's capacity to produce goods or services at or below cost levels incurred by competitors or world class performing companies.	The purchasing, payables and receiving systems are not integrated and do not use technology resulting in manual efforts to match invoices with supporting documentation.

Risk	Definition	Example
Performance Gap Risk	Inability to perform at world class levels in terms of quality costs and/or cycle time performance due to inferior internal operating practices and/or external relationships threatens the demand for the organisation's products or services.	The organisation makes payments later than its competitors because organisation policy requires excessive authorisation before invoices are approved for payment.
Cycle Time Risk	Unnecessary activities threaten the organisation's capacity to develop, produce and deliver goods or services on a timely basis.	The controller approves all invoices at the time the invoice is vouched and again prior to payment, although the controller has never found an exception during the second review. This activity delays payment of invoices, but does not add value.
Compliance Risk	Non-compliance with customer requirements, prescribed organisational policies and procedures or laws and regulations may result in lower quality, higher production costs, lost revenues, unnecessary delays, penalties, fines, etc.	Payments to suppliers do not agree with the contractual agreement resulting in deteriorating vendor relations and increased administration to resolve discrepancies.
2.2 Empowerment Risk		
Leadership Risk	The organisation's people are not being effectively led, which may result in a lack of direction, customer focus, motivation to perform, management credibility and trust throughout the organisation.	An accounts payable supervisor provides minimal training for new employees which results in unauthorised payments and increased processing errors.
Authority/Limit Risk	Ineffective lines of authority may cause managers or employees to do things they should not do or fail to do things they should. Failure to establish or enforce limits on personnel actions may cause employees to commit unauthorised or unethical acts, or to assume unauthorised or unacceptable risks.	An accounts payable manager exceeds his/her authority by approving expenses that could result in budget limits being exceeded.

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Risk	Definition	Example
Outsourcing Risk	Outsourcing activities to third parties may result in the third parties not acting within the intended limits of their authority or not performing in a manner consistent with the organisation's strategies and objectives.	An organisation with sensitive legal expenses outsources its accounts payable function. These sensitive issues are leaked to the press because the employees of the accounts payable firm do not have any loyalty to the organisation. Employees of a organisation which provides accounts payable services cannot accurately distinguish between purchase orders that have been properly approved and those that have not been, for their client. This results in the payment of unauthorised purchase orders.
Performance Incentives	Unrealistic, misunderstood, subjective or non-actionable performance measures may cause managers and employees to act in a manner inconsistent with the organisation's objectives, strategies and ethical standards, and with prudent business practice.	Managers reward employees based on the quantity of invoices processed which results in an unacceptable increase in inaccurate payments.
Change Readiness Risk	The people within the organisation are unable to implement process and product/service improvements quickly enough to keep pace with changes in the marketplace.	An organisation does not have the skilled employees necessary to implement new electronic data interchange technology. Consequently, it is unable to process its accounts payable as efficiently as required.
Communications Risk	Ineffective communication channels may result in messages that are inconsistent with authorised responsibilities or established performance measures.	Employees in the accounts payable process do not realise that they are needlessly performing some of the same procedures because they do not communicate effectively with each other.
2.3 Information Processing/Technology Risk		
Relevance Risk	Irrelevant information created or summarised by an application system may adversely affect users decisions.	In determining which suppliers to pay, management relies upon the accounts payable trial balance. However, trial balances are generated only once per month, often resulting in poor payment decisions.

Risk	Definition	Example
Integrity Risk	This risk encompasses all of the risks associated with the authorisation, completeness, and accuracy of transactions as they are entered into, processed by, summarised by and reported on by the various application systems deployed by an organisation. These risks pervasively apply to each and every aspect of an application system used to support a business process and are present in multiple places and at multiple times throughout the application systems.	A new accounts payable employee accidentally enters accounts payable information into the accounts receivable system. As a result, the accounts payable balance is understated and vendor payments are late.
Access Risk	Failure to adequately restrict access to information (data or programs) may result in unauthorised knowledge and use of confidential information, ***or*** overly restricting access to information may preclude personnel from performing their assigned responsibilities effectively and efficiently.	Accounts payable employees are not assigned passwords resulting in unauthorised employees entering information into the system.
Availability Risk	Unavailability of important information when needed threatens the continuity of the organisation's critical operations and processes.	The accounts payable supervisor suddenly resigns. As there has been no transition and no other individual has a good understanding of the accounts payable process or the location of supplier records, the organisation is unable to process vendor invoices or payments effectively and efficiently.
Infrastructure Risk	The risk that the organisation does not have the information technology infrastructure (eg. hardware, networks, software, people and processes) it needs to effectively support the current and future information requirements of the business in an efficient, cost-effective and well-controlled fashion.	The organisation's system is unable to assign indicators to purchase orders and receivers which allow employees to identify necessary information to process the corresponding invoices.
2.4 Integrity Risks		
Management Fraud Risk	Intentional misstatement of financial statements or misrepresentation of the organisation's capabilities or intentions may adversely affect external stakeholders' decisions.	Management holds back unpaid invoices to understate year-end liabilities and budget performance.

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Risk	Definition	Example
Employee Fraud Risk	Employees, customers, suppliers, agents, brokers or third-party administrators – individually, or in collusion, perpetrate fraud against the organisation, resulting in financial loss or unauthorised use of physical, financial or information assets. There is also potential for legal exposure, negative publicity (embarrassment) and an adverse impact on operations (loss of confidence by customers, suppliers or providers of finance).	An accounts payable processor, in collusion with an employee from purchasing, creates phoney purchases and fraudulent payments to an account under their control. An accounts payable employee modifies an invoice for a party related to the employee, resulting in an improper overpayment.
Illegal Acts Risk	Illegal acts committed by managers or employees expose the organisation to fines, sanctions, and loss of customers, profits and reputation, etc.	An organisation receives a fee for transacting purchases and payments for an organisation involved in an illegal business.
Unauthorised Use Risk	Unauthorised use of the organisation's physical, information or financial assets by employees or others exposes the organisation to unnecessary waste of resources and financial loss.	An employee in the payables department leaks confidential vendor pricing information to interested outside parties.
Reputation Risk	Damage to the organisation's reputation exposes it to loss of integrity and causes the Government embarrassment.	Organisations reimburse inappropriate employee expenses and this is leaked to the press.
2.5 Financial Risk		
Cash Flow Risk	Exposure to lower returns or the necessity to borrow due to shortfalls in cash or expected cash flows (or variances in their timing).	Inability to pay invoices on a timely basis results in late penalties and interest charges being assessed to the organisation.
Opportunity Cost Risk	The use of funds in a manner that leads to the loss of economic value, including time value losses and transaction costs.	An organisation is required to make payment on overdue invoices before its suppliers will ship any new product. The organisation must choose which vendors to pay with its limited funds based upon which product is most crucial to continue its operations.

Risk	Definition	Example
3. Information for Decision Making Risks		
3.1 Operation Risks		
Contract Commitment Risk	Lack of relevant and/or reliable information concerning contractual commitments outstanding as of a point in time may result in subsequent incremental contractual commitment decisions that are not in the best interest of the organisation.	Failure of the organisation to monitor an instalment payment plan results in missed payments on the vendor contract.
Performance Measurement Risk	Nonexistent, irrelevant and/or unreliable non-financial measures may cause erroneous assessments of and conclusions about operational performance.	The organisation makes decisions about the level of employees in the payment of accounts function without understanding performance measurement.
Alignment Risk	Failure to align business process objectives and performance measures with enterprise-wide and/or operating unit objectives and strategies may result in conflicting, uncoordinated activities throughout the organisation.	The organisation's objective to develop strategic alliances with selected suppliers is endangered by a decision to place these suppliers on extended payment plans by the accounts payable department.
3.2 Financial Risks		
Accounting Information Risk	Over-emphasis on financial accounting information to manage the business may result in the manipulation of outcomes to achieve financial targets at the expense of not meeting customer satisfaction, quality and efficiency objectives.	An organisation decides that the accounts payable process is too costly, so they decrease the number of employees in that area. This results in an increase in cycle time and late payments.
Financial Reporting Evaluation Risk	Failure to accumulate relevant and reliable external and internal information to assess whether adjustments to or disclosures in financial statements are required may result in the issuance of misleading financial reports to external stakeholders.	The organisation fails to obtain relevant information related to accounts payables for which invoices have not yet been received and thus the related liability on the financial statements is materially misstated.

Appendix 4

Payment of Accounts Performance Measures

To ensure that they receive constant feedback throughout the business process, organisations often take a two-pronged approach by monitoring two different types of performance measures: outcome measures and activity measures.

Outcome measures: keeping score

Outcome measures report the results of a process and let organisations know how well they are performing in a particular area of their business. The outcome measures are usually chosen based on the organisation's overall business goals and are intended to demonstrate the impact of a process on the organisation's finances, efficacy, and efficiency. Senior management analyses outcome measures to keep score on organisation performance and to help control and allocate resources for improvements.

For example, even though the responsibilities of the senior managers of a organisation (such as the Chief Finance Officer) extend beyond processing accounts payable, they may choose to analyse the outcome measures relevant to that process, including:

- the total costs to finance accounts payable as a percentage of revenues; and
- the number of accounts payable staff per $1 million in budget allocation.

By analysing the relevant outcome measures, senior managers can trace the impact of the accounts payable process on the organisation's overall cash flow and revenues stream. In fact, regular examination of outcome measures helps senior managers determine how efficiencies in a particular business process contribute to the overall health of the organisation.

Activity measures: driving improvement

While outcome measures look at the results of a process, activity measures detail the journey along the path toward those results by tracking improvements in process-specific activities over a period of time. And where outcome measures address issues of importance to the organisation as a whole, activity measures address issues of concern to the individuals in charge of carrying out those process-specific activities.

For example, the midlevel managers of an organisation, who are directly responsible for processing accounts payable, monitor activity measures such as:

- the average number of days to edit and review an invoice;
- the average number of errors on payments; and
- the average percentage of invoices paid on time.

By monitoring specific activity measures rigorously, midlevel managers identify problems in a business process as soon as they occur. The timely alerts to problems in the business process creates opportunities for managers to take immediate action to solve the problems before they affect the organisation's overall position. Midlevel managers also use activity measures as a motivational tool by showing the employees how constructive changes in the way they perform activities directly improve the results of the activity measures; and how such improvements often lead to better outcome measures as well.

In fact, cost, quality and time-based performance measures function as a unit to provide a comprehensive evaluation of business performance follows:

- **Cost-based measures** cover the financial side of performance; for example, measures such as 'cost to finance accounts payable' reflect the impact that a business process has on the organisation's bottom line;
- **Quality-based measures** assess how well a organisation's products or services meet customer needs; for example, measures such as 'average number of days to resolve payer's requests and inquiries' offer reliable information about the quality of service provided by the organisation; and
- **Time-based measures** focus on the efficiency of the process; for example, measures such as 'the average days in accounts payable' track the cycle time of a process.

Table 2 shows key objectives for the accounts payable process, the outcome measures associated with each objective, and the activity measures that drive each outcome measure. The list provides a starting point from which organisations may select a set of five to nine measures to track. To start tracking performance, an organisation chooses one or two key objectives and begins measuring the corresponding outcome and activity measures. As these objectives are attained, the organisation may change its focus to other objectives and their related measures.

Table 2

Key Objectives

Key Objective	***Outcome Measures***	***Activity Measures***
Strong cash flow	Cost to finance accounts payable	• Late fees and interest charges • Amount of lost prompt-payment discounts
Accurate invoice payments	Number of accounts payable transactions with errors	• Average number of errors on invoice vouchers • Number of duplicate payments and overpayments • Percentage of checks processed manually • The percentage of invoices that the organisation processes via EDI; or the percentage of invoices that the organisation processes electronically by an alternative method to EDI
Efficient systems with adequate capacity	Average days in accounts payable	• Average number of days to edit, review, and approve an invoice • Percentage of invoices edited • Percentage of invoices reviewed by a supervisor or manager
	Capacity for processing invoices and payments	• Number of suppliers that use invoiceless processing • Number of suppliers that use summary invoicing • Percentage of purchases on purchasing cards • Percentage of payments that the organisation makes with electronic funds transfer (EFT)
Effective supplier relationships	Supplier satisfaction as reported on surveys	• Percentage of invoices paid on time • Number of supplier inquiries • Average number of days to resolve supplier requests and inquiries

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