

The Auditor-General
Audit Report No.1 2001–2002
Financial Statement Audit

**Control Structures as part of the
Audits of the Financial Statements of
Major Commonwealth Entities
for the Year Ended 30 June 2001**

Australian National Audit Office

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Canberra ACT
9 July 2001

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken examinations and inspections of the accounts and records of major Commonwealth entities as part of the audits of their financial statements in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of these audits, and the accompanying brochure, to the Parliament. The report is titled *Control Structures as part of the Audits of the Financial Statements of Major Commonwealth Entities for the Period Ended 30 June 2001*.

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

Yours sincerely



P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Foreword

Over the past year, the community has seen the collapse of a number of different corporate enterprises including one state government business authority in New South Wales.¹ Business collapses often raise issues about the way in which their operations were financed and whether sound business practices were adopted but they also serve to highlight the importance of corporate governance from both a performance and control perspective. This report emphasises the fundamental importance of corporate governance and is the first of two general audit assurance reports that will be forwarded to Parliament in calendar 2001.

The assurance focus of this report is on significant risk, control and related management issues within business and accounting processes and financial systems that support the financial statements of major Commonwealth entities² for the period ended 30 June 2001. The findings are based on the results of the Australian National Audit Office's (ANAO) interim audit activities conducted over the first nine months of the financial year ended 30 June 2001. A second report will follow in December 2001 on completion of the financial statement audits in September of this year. The second report will build on current findings and also concentrate on controls relating to the preparation and reliability of the financial statements. The December report will also address operational and financial management issues and their relationship to internal control structures and supporting internal controls.

This report also provides an update on the governance and financial arrangements adopted by public sector entities following the implementation in recent years of the Government's reforms aimed at achieving better practice financial management including accrual budgeting, accounting and reporting. It follows on from my year-end report, *Audit Report No.23 Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2000*.

¹ N.S.W. Parliament, *Inquiry into the Collapse of the New South Wales Grain Board*, Public Accounts Committee, Report No.128 [No.10/52], Sydney, 2001.

² Entities is the term used in this report to cover agencies and/or other bodies.

The issues raised in this report demonstrate the importance of having in place effective control structures that underpin reliable financial reporting and analysis and a robust accrual based outcomes and outputs framework. Internal control structures are integral to ensuring alignment in budgeting and financial reporting for management purposes and also to secure, and link, information streams to produce useful management information for decision-making. In that respect, the ANAO has provided a submission to the Joint Committee of Public Accounts and Audit (JCPAA) on the need for further definition and alignment of outputs and outcomes and related measurement processes as part of the Committee's current review of the Commonwealth's Accrual Budget Documentation.³

With internal control structures, a fundamental issue is the need for entities to continue to build risk awareness, strengthen business practices and systems of authorisation, enhance financial reporting and analysis, and integrate financial and non-financial information as part of the development of performance measurement frameworks. With regard to internal control matters, a primary focus for entities is the need to improve further reconciliation procedures, computer access, security and program change controls for both management and stakeholder assurance.

The ANAO will continue to assist entities, to the extent practicable, with advice and assistance on the adequacy of their internal control structures, including effective risk management, and specific internal controls in business and accounting processes and financial systems.

I would like to acknowledge the professionalism and commitment of my staff in undertaking the audit work which culminated in this report and in reporting back to the individual organisations concerned. I also record our appreciation for the cooperation of Chief Finance Officers and other relevant entity staff in preparing this report. Their combined efforts enabled the tabling of this report in a timely manner.



P. J. Barrett
Auditor-General

³ Joint Committee of Public Accounts and Audit, *Review of the Accrual Budget Documentation*, Canberra, 2001.

Executive Summary

Executive Summary

Introduction

1. This report mainly summarises issues relating to internal control structures, financial systems, controls and processes arising from the interim phase of the financial statement audits of major Commonwealth entities for 2000–2001. Examinations of such issues are designed to assess the reliance that can be placed on control structures, systems, specific controls and processes to produce complete, accurate and valid information for financial reporting purposes.

2. A second report will follow in December of this year following completion of the financial statement audits of entities. The ANAO will also report, at that time, on the operational and financial management issues arising out of the audits and their relationship to internal control structures.

Background

3. Over the past two years, the Australian Public Service (APS) has implemented a number of financial management and budgetary reforms designed to encourage a more efficient and effective public sector. The implementation of these reforms has generally been challenging in an environment of scarce accounting and financial skills and tight time deadlines. The reforms have impacted directly on entities' internal control structures, including business and accounting processes and financial systems. ANAO Audit Reports No.52 of 1999–2000⁴ and No.23 of 2000–2001⁵ have identified specific implementation and internal control issues where improvements were required. In particular, these reports highlighted the need for improvements in:

- information technology (IT) controls;
- asset management controls;
- accounting systems and controls, including financial reconciliation controls;
- functionality of financial management information systems;
- quality of management reporting and financial monitoring; and
- financial and accounting skills.

⁴ The Auditor-General, *Audit Report No.52, 1999–2000, Control Structures as Part of the Audits of Major Commonwealth Agencies for the Period Ended 30 June 2000*, ANAO, Canberra, 2000.

⁵ The Auditor-General, *Audit Report No.23, 2000–2001, Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2000*, ANAO, Canberra 2000.

4. Audit findings have been classified into two groups; first, those concerned with internal control structures and second, specific controls over financial systems and processes. These are summarised below.

Internal control structures

5. As part of the financial statement audit process, the ANAO seeks to ensure internal control structures comprise measures that contribute positively to sound corporate governance. The measures in place need to mitigate identified risks and reflect the specific requirements of each entity but for financial reporting purposes will normally include:

- a current corporate plan, and business risk assessment and operational plans;
- sound business practices;
- a senior executive group and audit committee which meet regularly;
- clearly specified systems of authorisation, recording and procedures;
- financial and accounting skills commensurate with responsibilities;
- a timely financial reporting regime; and
- an effective internal audit function.

6. Internal control structures have been enhanced in most entities over the past year. Entities have consolidated their activities in their implementation of suitable financial systems, covering, for example, banking, payroll and accrual based financial reporting. Other contributory factors to improvements include:

- greater managerial participation by executives and audit committees in ensuring issues relating to the control environment, business practices and risk management have been addressed and advanced; and
- the performance of accounting and financial groups in raising the quality of internal financial reporting on actual results and performance against budget. This has enabled management, for example, to monitor and review financial performance in a more timely and effective manner.

7. Nevertheless, improvements are still required with all entities generally acknowledging that enhancements are necessary in areas such as: building risk awareness and better management into operational processes; achieving consistency in systems of authorisation; enhancing the quality of financial reporting; and integrating financial and non-financial data as part of the development of performance measurement frameworks.

8. These are areas that the ANAO will look to monitor, and report on, further improvements over the coming year as well as to identify better practice for wider dissemination to entities.

Controls over financial systems and processes

9. This part of the audit concentrated on internal controls within significant business and accounting processes, and financial systems relating to key financial statement reporting elements. In most entities, key areas covered included appropriations and other revenues, payment of expenses, employment and related costs, cash management, asset management, and the IT environment.

10. Greater stakeholder assurance is provided by the improvements achieved in internal control and financial reporting in most entities over the past year. However, several entities continue to experience particular internal control difficulties. These will be the subject of further audit focus in the coming months leading to the preparation and audit of the annual financial statements. Significant internal control findings across entities include the following:

- IT controls—security controls need to be improved through, for example restricting access to authorised personnel thus reducing the possibility that unauthorised access can be gained to confidential and/or private, including security information or that unauthorised changes can be made to programs or data;
- business continuity planning also needs to be addressed effectively in a number of entities; and
- financial system reconciliation processes need to be enhanced relating to bank accounts, payroll processing, appropriations, interface systems and asset registers. Reconciliations are integral to ensuring the information in financial systems is complete, accurate and valid. Evidence indicates that most entities recognise the need to complete these reconciliations. However, there is inconsistency in the application of end of month procedures to ensure all reconciliations are prepared and reviewed in a timely and complete manner.

11. To overcome these deficiencies, entities will need to develop comprehensive IT risk analysis and control systems to mitigate these risks which demonstrate a sound accountability process as part of good corporate governance. This analysis will need to balance affordable IT security against expected costs. In addition, and in terms of adequate financial reporting, entities will need to introduce greater discipline into end of month procedures to ensure that all necessary steps are completed in a timely fashion.

12. These are also areas that the ANAO will review in future audit coverage.

Significant findings

13. The ANAO rates its findings according to a risk scale. Audit findings which pose a significant business, or financial risk, to the entity and which must be addressed as a matter of urgency, are rated as 'A'. Findings that pose a moderate business or financial risk are rated as 'B'. Findings that are procedural in nature, or reflect relatively minor administrative shortcomings, are rated as 'C'.

14. For the entities under review in this report, ANAO interim auditing has identified seventeen 'A' ratings, a summary of which is outlined in Appendix 1. Appendix 1 also contains a table outlining the number of A and B findings by entity. The Department of Defence has ten 'A' ratings. The Departments of Agriculture, Fisheries and Forestry; Environment and Heritage; Family and Community Services; Health and Aged Care; Health Insurance Commission; Treasury; and the Australian Taxation Office have one each.

Prospective issues to be addressed

15. The majority of the Commonwealth's financial activities are concentrated in taxation and excise revenue, welfare and benefit payments, other payment programs, defence and property assets, and debt financing. A relatively small number of Commonwealth entities manage the vast majority of the Commonwealth's financial activities. These entities operate the more significant and complex financial systems and are the subject of the majority of audit comments made in this report.

16. In aggregate, the audit findings are in relative proportion to the size and scale of activity undertaken by Commonwealth entities and indicate a risk range extending from moderate to significant exposure. Elimination of these findings will involve a compliance cost. Prudent governance standards dictate that these issues need to be resolved unless the compliance cost exceeds the benefits generated.

17. Commonwealth activity not only has to be controlled, it has to meet efficiency, effectiveness and ethical tests. For this to be achieved, there is a fundamental issue involving performance measurement. In this latter area, and in so far as financial stewardship is concerned, there is a need for entities to enhance performance information over time, particularly relating to program effectiveness or outcome measures and the contribution of outputs to intermediate and final outcomes.

18. The APS business environment has significant program outlays that involve major IT activities. These include large IT networks and information systems, together with complex technical environments, which are dynamic and diverse. These environments include different

physical access, and multiple logical access, methods that cover a myriad of work practices.

19. With IT security, every business initiative should include a focus on security at all levels of the organisation. IT security should be considered on a risk management basis, striking an appropriate balance between risk free security and affordable security. Risk management should define the performance measures in relation to IT security. The performance measurement processes should include forecasting capability of related events to enable problems to be identified and addressed. Suitable analysis should be conducted of such events to assess the degree of impact, amount of damage and/or disruption and frequency of occurrence. The establishment of data metrics would allow a sensible judgement to be made in this respect. As a result, appropriate reporting regimes should be developed over such issues as:

- virus protection, detection and occurrence;
- firewall architecture, unauthorised access and denial of services;
- password management and violation reporting;
- privileged access, procedures and monitoring; and
- security and audit trail logging, reporting and monitoring.

20. These issues will be examined by the ANAO and will feature in a subsequent audit report. We will be looking for the inclusion of the above structured data metrics in cost-benefit deliberations as part of entity risk management analysis.

Report timing and importance

21. This report's timing is significant in that it brings important matters to the attention of the Parliament in advance of completion of the audits of financial statements.⁶ Traditionally, the ANAO has reported the results of audits of financial statements in December each year, at the conclusion of the final audit. The purpose and timing of this report specifically recognises the increased responsibility being placed on entities to maintain effective control structures as part of good corporate governance. The ANAO is committed to the timely reporting of significant matters to assist the Parliament in its oversight of the financial aspects of public administration. The ANAO expects to report the final results of the audits to the Parliament in December 2001.

⁶ This practice commenced with the Auditor-General's Audit Report No.10 1999–2000, *Control Structures as part of the Audits of Financial Statements of Major Commonwealth Agencies for the Period Ended 30 June 1999*, ANAO Canberra, September 1999.

22. The changing public sector financial environment has necessitated an increased focus on the control structures that facilitate Chief Executive Officers (CEOs) meeting their responsibilities under the *Financial Management and Accountability Act 1997* or Boards under the *Commonwealth Authorities and Companies Act 1997*. As part of this shift, the audit of an entity's financial statements places greater emphasis on identifying significant business risks impacting on the entity and its financial operations, and an evaluation of the design and effectiveness of the control structures in place to mitigate those risks. This work is reported to entities so that any major weaknesses affecting the control structure can be rectified quickly and subsequent improvement in performance and accountability can result.

Structure of the report

23. Chapter 1 of this report is an introductory chapter outlining some of the reforms which have impacted on entities' internal control structures in recent years. The chapter briefly sets out the importance of internal control structures and how those are taken into account from a financial statement audit perspective.

24. Chapter 2 provides a summary of major issues relating to the internal control structures of Commonwealth entities examined.

25. Chapter 3 provides a summary of the entity controls over financial systems and processes from a financial statement audit perspective.

26. Chapter 4 outlines the results of internal control structure and business and accounting processes and systems examinations, for each entity covered, as part of the audits of their financial statements.

Control Structure Issues

1. Introduction to the Audit of Control Structures

Introduction

1.1 This report contains a summary of issues relating to the control structures and control environment of major Commonwealth entities arising from examinations of financial and related systems, controls and processes as part of the financial statement audits of entities to the year ended 30 June 2001. The report does not address broader financial management issues such as:

- progress achieved by entities in developing financial performance measurement systems;
- the performance of entities in reporting and analysing costs on an outputs and outcomes basis;
- issues associated with the management of asset and liabilities and the related capital user charge; and
- the overall financial position and performance of entities.

1.2 These issues will be examined together with ongoing control issues and reported in December of this year following completion of the financial statement audit of entities. The December report will also enable the ANAO to assess how well entities are managing their business and financial risks and how they are progressing in adopting better practice financial management.

Background

1.3 The ANAO has encouraged CEOs and boards of directors to implement effective corporate governance arrangements within their organisations. Within the context of the APS and Government owned businesses, corporate governance can be defined as *'the framework established by a governing body to ensure that stakeholders, primarily the Parliament, the Government and the Australian community, have assurance that the agency is fulfilling its responsibilities with due diligence and accountability'*.⁷ As such, it is reflected in an entity's corporate and other structures, its culture, its policies and the ways in which it deals with its various

⁷ Australian National Audit Office, *Controlling Performance and Outcomes, Better Practice Guide to Effective Control*, ANAO, Canberra, 1997, p. 3.

stakeholders. Corporate governance is concerned with structures and processes for decision-making and with the controls and behaviours that support effective accountability for performance outputs and outcomes (ie. results).

1.4 This focus on corporate governance was part of ensuring that APS accountability and performance imperatives remained in place given the level of change associated with Government's reform agenda, designed to encourage a more efficient and effective public sector. Key reforms implemented over the past two years have included:

- implementation of an accrual budgeting, accounting and reporting framework including the adoption of an outputs and outcomes approach;
- devolved banking and payroll arrangements;
- the move towards electronic commerce and more networked environments;
- implementation of the capital user charge;
- a new tax system including the Goods and Services Tax; and
- contestability of service delivery including market testing of corporate services.

1.5 These reforms involved the objective of moving to best practice financial management characterised by, '*professional financial input into strategic and operational business planning, a focus on results and the provision of high quality financial information and advice*'.⁸ The reforms also involved a focus on the efficient deployment of assets and the management of liabilities. The implementation of these reforms has been challenging in an environment of relatively scarce accounting and financial skills and tight implementation deadlines.

Corporate governance and internal control structures

1.6 An important element of corporate governance is an organisation's control structure, the key components of which comprise its overall control environment, its risk assessment and risk management processes, its information and communication arrangements, and its internal control measures, including monitoring and review. The control structure should be tailored to each organisation's specific needs but typically, it will be

⁸ Management Advisory Board, *Beyond Bean Counting, Effective Financial Management in the APS—1998 & Beyond*, Management Advisory Board, Canberra, 1997, p. 2.

reflected in measures such as an organisation's structure, its systems for processing and authorisation, its risk management and fraud control strategies, staff training plans, management review and oversight arrangements, the role of the executive and key business committees such as the audit committee.

1.7 In this environment of change, an effective internal control structure is vital. The latter is the primary focus of this report. The reforms have impacted directly on entities' internal control structures, including business and accounting processes and financial systems. ANAO Audit Reports No.52 of 1999–2000⁹ and No.23 of 2000–2001¹⁰ have highlighted implementation and internal control issues where improvements were required.

Defining and establishing an effective control structure

1.8 The *Financial Management and Accountability Act 1997* (FMA Act) requires the CEO to manage the affairs of the entity in a way that promotes effective, efficient and ethical use of Commonwealth resources for which the chief executive is responsible. The establishment and maintenance of an effective control structure significantly assists in meeting this requirement.

1.9 Control can be defined as:

a process effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of an agency's objectives. Controls will assist an agency with the efficiency and effectiveness of its program outcomes, reliable financial reporting and compliance with laws and regulations.¹¹

From an accounting and operational perspective, an effective control structure will enable the entity to maintain appropriate management control over its assets, liabilities, revenues and expenditures. The benefits ensuing from an effective control structure include:

- improved accountability through controls assurance;
- improved program and service delivery through efficient, effective and ethical use of resources;

⁹ Auditor-General, *Report No.23*, op. cit., Summary of Results, pp.25–27.

¹⁰ Auditor-General, *Report No.52*, op. cit., Summary of Results, pp.17–28.

¹¹ Controlling Performance and Outcomes, op. cit., preface.

- identification and minimisation of significant risks to achieving objectives; and
- achievement of a balance between the external demands for quality outcomes while maintaining effective internal governance.¹²

1.10 As such, the internal control structure will reflect an entity's leadership style, commitment to risk management, the quality of its business processes and its capacity to achieve required outputs and outcomes while, at the same time, safeguarding its assets and resources.

Understanding an entity's internal control structure

1.11 An important component of the ANAO's audit methodology is to obtain an understanding of an entity's internal control structure. This enables us to make a preliminary assessment of the risk of material error in an entity's financial statements and to plan an audit approach to minimise audit risk to an acceptable level. The ANAO therefore studies and evaluates an entity's internal control structure to assess its capacity to prevent and detect errors in business processes, accounting records and financial reporting systems. This understanding enables an assessment of control risk to determine the nature, timing and extent of audit testing necessary to form its opinion on the entity's financial statements. The ANAO recognises that the reliability of an entity's business processes, accounting records and financial systems can be enhanced through an effective control structure and this, in turn, can reduce the level of testing we need to undertake.

1.12 The internal controls within an entity's business and accounting processes and financial systems that relate to the authorisation, execution and recording of transactions should be:

reflected in the following general characteristics of a satisfactory control structure:

- *proper segregation of duties;*
- *system of authorisation, recording and procedures adequate to provide accounting control of assets, liabilities, revenues and expenses;*
- *sound business practices in performance of duties and functions by each area of the agency; and*
- *staff with capabilities commensurate with their responsibilities.*¹³

¹² *ibid.*

¹³ Grant Gay & Roger Simnett, *Auditing & Assurance Services in Australia*, Irwin McGraw-Hill, 2000, p. 305.

1.13 ANAO testing is directed towards the examination of these characteristics.

The ANAO's 2000–2001 audit cycle

1.14 Under section 57 of the FMA Act for agencies, and under clause 3, part 2 of Schedule 1 of the CAC Act for other bodies, the Auditor-General is required to report each year to the relevant Minister on whether the entity's financial statements have been prepared in accordance with the Finance Minister's Orders and whether they give a true and fair view of the matters required by those orders.

1.15 Since October 2000, the ANAO has completed its audit planning; updated its understanding of the business and corporate governance arrangements; assessed audit risk; and designed and completed interim testing up to 31 March 2001. The focus of this testing was on the adequacy of the internal control structure, as broadly outlined above. The result of this analysis and interim testing is outlined in the following chapters. All ANAO findings have been reported in detail; cleared through entities' management; and reported in summary to the relevant Minister(s).

1.16 The final phase of the audits will be completed in the April to September 2001 period and will be reported to Parliament in December 2001.

2. Internal Control Structures— Results from a Financial Statement Audit Perspective

Introduction

2.1 Corporate governance is built around the three basic elements of stewardship, leadership and control and in the last decade, Government entities have put in place many of the elements of good corporate governance. These have included corporate objectives and strategies; corporate business planning; audit committees; control structures including risk management; entity values and codes of ethics; identification of stakeholders; performance information and standards; evaluation and review; and a focus on client service. The major challenge has not only been to define the appropriate elements that an entity requires but also to ensure that all the elements of good corporate governance are integrated effectively into a coherent corporate approach and that they are well understood and applied throughout the organisation. Governance needs to be part of an entity's culture and permeate all levels of the organisation. It is simply not enough for an entity to state its corporate governance principles, it needs to operate and function by them.

Elements which contribute to financial statement assurance

2.2 From a financial statement audit perspective, the ANAO will focus on specific elements of the control, stewardship and leadership components of corporate governance. This is usually undertaken as part of the examination of entities' business and financial risks and the strategies, controls and actions in place to manage these risks. In doing this, the ANAO will look to ensure that the internal control structure comprises measures that contribute positively to corporate governance. These measures include:

- an executive group which meets regularly focussing attention on the outputs and outcomes that need to be achieved including the strategic directions, business planning, financial results and operational issues;
- an audit committee which meets at least quarterly addressing issues such as internal audit planning and results, risk assessment and the control environment relating to business and accounting processes and financial systems;

- an independent internal audit function which reports directly to the secretary and/or the chair of the audit committee and which works to an approved internal audit plan addressing compliance with policies and procedures, business and financial risks;
- an updated business risk assessment plan/register and fraud control plan which identifies inherent risks, controls which mitigate those risks and any further actions which may be required;
- systems of authorisation, recording and procedures;
- sound business practices;
- financial and accounting skills commensurate with responsibilities; and
- a monthly financial reporting regime which includes and comparison to budget, variance analysis and commentary.

2.3 The on-going performance and effectiveness of these measures is critical to the level of assurance that management and the audit process receive for financial statement purposes.

Results in summary

2.4 The cross entity results of interim audit testing for the major entities examined in this report as set out in Chapter 4 for the financial period 1 July 2000 to 31 March 2001 is as follows.

Audit committees and the executive

2.5 A well functioning audit committee will assist the CEO and the executive implement and maintain corporate, financial and risk governance arrangements appropriate to the objectives and business of the entity. In relation to business and financial processes and systems that impact on the preparation of financial statements, an effective audit committee does provide an objective view on:

- identification, assessment and management of business and financial risks;
- internal audit strategic and operational plans and results of the work completed including the implementation of recommendations;
- internal controls over the business and accounting processes and financial systems;
- findings from ANAO audits and the implementation of recommendations;
- compliance with accounting policies, procedures and legislative requirements; and
- quality of financial reporting and analysis.

Findings

2.6 ANAO personnel are often able to attend entity audit committee meetings as observers. ANAO audit observations are that entities generally have audit committees that are effective in assisting the CEO and the executive to foster and maintain an appropriate control culture. They have also been constructive in their input to improve financial reporting and analysis.

2.7 The implementation of agreed internal audit and ANAO audit recommendations is essentially the responsibility of the executive and management. The audit committee will normally provide valuable support to ensuring recommendations are implemented in a timely and effective manner. Deficiencies have been noted, however, with some committees and executives on their unwillingness to follow up the implementation performance of management to ensure that:

- recommendations have been implemented in a timely and effective manner; or
- a valid reason has been provided by management on why implementation is no longer appropriate.

2.8 It has also been noted that the effectiveness of some audit committees is limited when the committee is large with wide representation from all line areas. This tends to broaden the focus of the committee restricting the amount of time required in key areas.

2.9 Overall, from an ANAO financial statement perspective, while there is potential for improvement in some cases, particularly relating to the follow up of the implementation of recommendations, committees and executives are focused better and becoming a more valuable mechanism to assist CEOs meet their governance responsibilities.

Internal audit functions

2.10 An internal audit function is an integral component of the system of internal control and as such it is a source of assurance to the CEO, executive and audit committee on control, risk, financial and other corporate governance issues. In relation to business and financial processes and systems that impact on the preparation of financial statements, an internal audit function will normally focus on:

- reliability of the system of internal control within business and accounting processes and financial systems;
- compliance with accounting and financial policies and procedures and instructions;
- completing project reviews of systems, payments, other processes or irregularities which require investigation; and
- quality assurance of financial data to be included in the financial statements.

2.11 The ANAO's audit approach takes into account the work completed by internal audit and where appropriate reliance is placed on that work.

Findings

2.12 The ANAO has observed that entities generally have effective internal audit functions characterised by independence, effective working relationships with audit committees and the executive and output which is reliable for financial statement purposes. Issues noted from attendance at audit committee meetings and while reviewing internal audit planning, processes, findings and recommendations include:

- a number of entities have difficulty recruiting and maintaining skilled audit personnel, which often results in their work programs being behind schedule. Other entities have overcome this problem by co-sourcing their internal audit functions; and
- most internal audit functions still deliver the traditional role of compliance and control appraisal, which lacks focus on the broader governance and business risk issues.

2.13 There is potential for internal audit to broaden their scope by directing more attention to corporate governance issues and to provide increased support to the financial statement audit process by directing more effort to areas directly related to the preparation of financial statements. This, however, depends upon management priorities and the skill and knowledge base within the internal audit group. Overall, most internal audit compliance activities contribute to providing assurance on the financial statements of entities.

Risk management

2.14 Risk management is a fundamental obligation of CEOs and other executives, further emphasised in recent years as part of the financial management reforms and the introduction of the FMA Act. In the absence of formal risk assessments which link to business plans, strategies and related review process, it is difficult for CEOs to be assured that resources are deployed in an efficient, effective and ethical manner. A risk management plan that is subject to regular update can contribute to financial statement assurance through:

- identifying business and financial risks;
- assessing the significance of and prioritising risks according to relevant criteria;
- identifying processes required to minimise extreme, high and medium risks to acceptable levels; and
- ensuring there is appropriate risk awareness and management training.

Findings

2.15 The ANAO has noted that most entities have formal risk management plans that extend the responsibility for managing business and financial risk to all relevant areas in the organisation. Gains have been achieved in the past year in building risk awareness and management into business planning, operating practices and procedures. Further training and building of risk awareness and management into operating processes is still required.

2.16 Some entities, however, are yet to complete fully their formal risk management planning and to build risk management processes into operational procedures. These entities are working to complete this requirement in the period ahead.

2.17 From an ANAO financial statement perspective, risk management remains a critical assurance mechanism where improvements in training and processes are still required. Most entities have, however, made reasonable progress in the past year.

Systems of authorisation, recording and procedures

2.18 Systems of authorisation, recording and procedures ensure that transactions are processed, recorded and accounted for in accordance with the directives of the responsible governing body or person including board of directors, CEOs and other positions with delegated or statutory responsibilities.

2.19 The introduction of the accrual accounting framework on 1 July 1999 involved the implementation of new accounting and financial systems and modified business processes and practices. To ensure alignment entities were required to update their systems of authorisation, policies and procedures. Principal amongst these were entities' CEIs.

Findings

2.20 The ANAO assessment is that systems of authorisation, recording and procedures require improvement in the following areas:

- systems of authorisation need to be applied more consistently particularly relating to review and approval of key functions and control checks to ensure processes are operating as required; and
- education, information and communication processes relating to policies and procedures need to be strengthened to ensure all staff are familiar with requirements.

2.21 ANAO audits have indicated that all entities need to continue to achieve progress in these areas. Authorisation, recording and procedures will remain a critical focus of the audit process.

Sound business practices

2.22 The adoption of the accrual accounting framework, the output/outcomes approach, the focus on performance measurement and the move to a more results driven culture over the past two years has included a more commercial approach to operations within entities. This approach has been characterised by:

- a stronger focus on the management of service delivery costs, liabilities and assets;
- contestability of service delivery;
- greater financial input into strategic and operational business planning; and
- outsourcing of services and the development of partnership or alliance arrangements with suppliers.

2.23 These changes have meant that most entities needed to enhance their project management skills.

2.24 In this environment, it is critical that entities maintain sound business practices, which are subject to modification as circumstances change. Business practice issues include:

- regular financial and non financial (KPI) reporting processes;
- the costing and pricing of outputs delivered by an entity; and
- regular review of the performance and value of key assets/resources including intellectual property.

2.25 This also extends to the control over documents and information and can include:

- a register of contracts and agreements;
- documentation of key service arrangements with all significant suppliers and clients;
- pre-numbering of key documents;
- sequence checks on key processing documents used;
- safekeeping and checking of unused documents;
- maintenance of back up copies of IT files;
- undertaking security checks; and
- restricting access to confidential information.

Findings

2.26 ANAO interim audit results indicate that while progress has been achieved across entities, there remains inconsistency in completing these processes. All entities need to improve in one or more of these areas.

Financial and accounting skills commensurate with responsibilities

2.27 The move to accrual accounting required entities to acquire and develop new skills relating to:

- processing financial and accounting information including the implementation and management of financial management information systems;
- production of accrual financial information and reports to support decision-making and to assess performance against budget and operational targets; and
- development of budgets, financial plans and modelling related to strategic objectives.

Findings

2.28 A small number of entities have been able to achieve an optimum skill base through the specification of new financial and accounting roles and subsequent recruitment of qualified staff. Most entities have, however, been dependent upon the use of short term and medium term contractor and/or consultants to assist finance and accounting areas meet their commitments.

2.29 Although the use of contractors and consultants has decreased over the past year, most entities are still unable to acquire and retain accounting and finance staff given the tight employment market for people with these skills. There is a need for entities to manage their financial and accounting skills knowledge base to ensure there is not continued reliance on contractors and consultants without appropriate longer term management and/or service arrangements in place.

Financial reporting

2.30 Consistent with best practice financial management, entities should produce internal management reports for decision-making which are meaningful, timely and relevant. Better examples of internal financial reporting include a summary snapshot outlining overall performance and following this with a set of accrual based financial reports encompassing an operating statement, statement of financial position and cash flow statement accompanied by relevant notes or commentary including where appropriate a graphical presentation.¹⁴

¹⁴ *Beyond Bean Counting Effective Financial Management in the APS—1998 & Beyond*, op. cit., p. 57.

2.31 This form of management reporting enables CEOs and other senior management to take higher levels of assurance than would otherwise be the case given their responsibilities under the FMA and CAC Acts to ensure resources are expended effectively, efficiently and ethically. This assurance is also important in regard to the accuracy of the entity's annual financial statements. Comprehensive financial reporting may also enable the ANAO to reduce the extent of testing required to be undertaken to issue an audit opinion on the financial statements.

Findings

2.32 While some entities have achieved or are moving quickly to this enhanced level of financial reporting, most entities have yet to specify the additional accounting, financial system and skill requirements to achieve this standard of reporting. Deficiencies in financial reporting include:

- some entities produce periodic financial reports which are still largely cash rather than accrual accounting based;
- periodic financial reports which do not necessarily include all relevant information and which contain limited analysis and commentary; and
- financial reports that place limited emphasis on administered financial data and results.

2.33 Over the next one to two years most entities have plans to move to enhanced levels of financial reporting which will address the deficiencies noted above. Some entities have also begun the process of integrating their financial and non-financial reporting data as part of the process of establishing an integrated performance measurement framework. A move in this direction is necessary if entities are to obtain a more detailed understanding of their performance and from a financial perspective gain knowledge of:

- how resources are being consumed across major departmental activities;
- the cost behaviour of large expense items such as IT costs and their relationships to key business operations;
- the carrying costs of assets and liabilities and whether asset replacement strategies and liability reduction programs are appropriate; and
- whether the capital user charge is efficiently managed.

2.34 This information will enable entities to assess more reliably the efficiency and effectiveness of program expenditure, enhance corporate governance and the reliability of financial statements.

Conclusion

2.35 From a financial statement perspective, internal control structures have improved in most entities over the past year. A significant reason for this achievement is that entities have had the opportunity to bed down the implementation issues associated with the banking, payroll, accrual accounting and financial systems reforms initiated in the previous year. Other factors that have contributed to these improvements include:

- greater managerial participation by executives and audit committees in ensuring those issues associated with the control environment, business practices and risk management have been addressed. Most entities have instigated action to ensure that significant control and business practice deficiencies have been actioned and that risk awareness and management is built into business planning and operating processes. Internal audit has continued to make a contribution in this regard; and
- the performance of accounting and financial groups in raising the quality of internal financial reporting on actual results and performance against budget. This has enabled management to monitor better financial performance and position.

2.36 Despite these achievements, improvements are still required, with all entities generally acknowledging that advances are necessary in:

- building risk awareness and management into operational processes;
- integrating and building consistency into systems of authorisation and sound business practices;
- enhancing the quality of monthly financial reporting to include improved presentation and financial analysis;
- enhancing the quality of accounting, budgeting and financial skills; and
- integrating financial and non-financial data as part of the development of performance measurement frameworks.

2.37 These are areas that the ANAO will look to monitor improvements over the coming year.

3. Controls over Accounting and Financial Systems and Processes—Results from a Financial Statement Audit Perspective

Introduction

3.1 Financial statement auditing undertaken in the interim phase of an entity's audit will focus on the internal controls within significant business and accounting processes and financial systems. In most entities key areas covered will include:

- appropriations and other revenues;
- payment of expenses;
- employment and related costs;
- cash management;
- asset management; and
- the IT environment.

3.2 The extent of audit testing undertaken in these areas in the interim phase of an audit is a function of the ANAO's understanding of the entity's business, corporate governance arrangements, and the assessed level of risk within significant business and accounting processes and financial systems. Other aspects that are specific to the entity, such as contract management or benefit payments, may also be examined during the interim phase.

3.3 The final phase of the audit builds on the interim audit results through follow-on procedures and a more extensive focus on the verification of assets, liabilities and statutory reporting disclosures.

Results in summary

3.4 A summary of the results of interim audit testing for the major entities set out in Chapter 4, for the period 1 July 2000 to 31 March 2001, now follows.

Appropriations and other revenues

3.5 With the adoption of the accrual budgeting and reporting framework on 1 July 1999, entities acquired the responsibility of opening and managing their bank accounts and cash flows from month to month. Appropriations, both departmental and administered, represent the primary source of revenue for most entities. There are entities which also collect significant revenues in the form of taxation, excise and administered levies. Small amounts of other revenues are also generated from the sale of goods and services and from interest earned from cash funds on deposit.

3.6 ANAO interim testing has disclosed that control frameworks in entities relating to the collection, receipt and management of appropriations, levies and other revenues are generally effective. Where weaknesses were noted, they related to inconsistency in the application of one or more controls relating to the timely completion and review of the reconciliation process for bank, appropriation and other revenue accounts. This generally involved a process of verifying details recorded in the general ledger to independent sources such as bank statement reports and Finance Cash and Appropriation Management Module (CAMM) balances. Inconsistency in the application of reconciliation processes could potentially result in inaccurate recording, mismanagement, or the loss of funds.

3.7 Despite these control deficiencies, ANAO testing has confirmed that improvements have been achieved in reconciliation processes over the past 12 months. In the small number of cases where reconciliation issues are considered to be significant, the entities concerned have agreed to improve their processes over the remaining months of the financial year and process any necessary adjustments prior to the preparation of their annual financial statements. Entities where this issue is considered less significant have also agreed to undertake the necessary improvements.

3.8 Entities where control issues relating to appropriations and/or revenues have been noted include:

- Attorney-General's Department;
- Department of Defence;
- Department of Environment and Heritage;
- Department of Family and Community Services;
- Department of Immigration of Multicultural Affairs;

- Department of Transport and Regional Services; and
- Australian Taxation Office.

Details of the particular issues for each entity are outlined in Chapter 4.

Payments of expenses

3.9 The adoption of the accrual budgeting and reporting framework from 1 July 1999 involved entities implementing or contracting their own cheque production and electronic funds transfer (EFT) processes. Departmental appropriations are largely disbursed to meet employment costs and supplies relating to rental of premises, administrative costs, contractors and consultants costs and other services. Most entities also disburse administered funds on behalf of government on items such as grants, subsidies, benefits, levies and other forms of financial assistance.

3.10 In most entities, payment processes are well established. The ANAO's interim testing has disclosed that payment control frameworks are generally effective. That said, however, there is potential for a number of entities to be at risk of disbursing appropriations in breach of legislative requirements. For example, the Departments of Agriculture, Fisheries and Forestry, and Health and Aged Care are addressing issues in this respect. Other weaknesses noted again relate to inconsistency and/or inadequacies in regard to:

- bank reconciliation processes;
- segregation of duties;
- appropriate delegations;
- recovery of overpaid amounts;
- compliance with quality assurance processes;
- accuracy and validity of certain program payments; and
- IT access and security controls.

3.11 ANAO testing of payment processes has indicated that controls over payment processes have also improved over the past year, particularly in relation to reconciliation processes. However, further improvements are still required.

3.12 Reconciliation processes, segregation of duties, appropriate delegations and access controls, combine with other measures to provide an effective means of ensuring payments are valid, accurately recorded and that funds are not mismanaged or subject to endemic fraud. As noted above for appropriations and other revenues, entities have agreed to address these issues.

3.13 Entities where control issues relating to payments have been noted include:

- Department of Agriculture, Fisheries and Forestry—Australia;
- Australian Customs Service;
- Department of Defence;
- Repatriation Commission and the Department of Veterans' Affairs;
- Department of Environment and Heritage;
- Department of Family and Community Services;
- Department of Health and Aged Care;
- Health Insurance Commission;
- Department of Transport and Regional Services; and
- The Australian National University.

Details of the particular issues for each entity are outlined in Chapter 4.

3.14 The ANAO has also recently undertaken an Assurance and Control Assessment (ACA) Audit on *Payment of Accounts* (Audit Report No.52, 2000–2001) in selected entities, the findings of which are consistent with the above observations.

Employment and related costs

3.15 From 1 July 1999, the responsibility for the payment of employment and related payments was devolved to entities from the Department of Finance and Administration (Finance). In undertaking this responsibility, entities implemented appropriate human resource and financial management systems (HRMIS and FMIS) or contracted out this responsibility to external providers. Employment and related entitlements normally represent the largest departmental expenditure item or running costs. In many instances, personnel costs represent one of the larger liabilities entities will need to meet given, in particular, the accumulated recreation and long service leave balances.

3.16 FMIS and HRMIS systems, including those contracted to external providers, have been reasonably stable over the past year in most entities, with control frameworks assessed as generally effective. However, a number of entities continue to have difficulty with:

- reconciling costs incurred in their salary and personnel systems with balances recorded in their general ledger systems; and
- HRMIS deficiencies resulting in unreliable long service leave balances.

3.17 Given the significance of salaries as an expense item, those entities that do not have an integrated general ledger and HRMIS, require a reconciliation process that ensures that fortnightly payroll amounts are accurately recorded in the general ledger system. Without this reconciliation process, monthly financial reporting may not be accurate and could be potentially misleading to management and other internal users of financial reports. Payroll reconciliations needs to be addressed progressively, preferably fortnightly but at least monthly, to clear any differences prior to the preparation of the monthly or annual financial reports.

3.18 HRMIS deficiencies relating to the calculation of long service leave balances have been an on-going problem since 1 July 1999 for certain HR systems. Although the issue is progressively being resolved, a number of entities are yet to upgrade their system or complete the corrective programming required. This will necessitate a number of entities calculating their long service leave liability using alternative methods, such as computer spreadsheets, for the purpose of their annual financial statements.

3.19 Entities where control issues relating to employment and related costs have been noted include:

- Department of Communications, Information Technology and the Arts;
- Department of Defence;
- Repatriation Commission and the Department of Veterans' Affairs;
- Department of Environment and Heritage;
- Department of Finance and Administration;
- Department of Family and Community Services;
- Department of Immigration of Multicultural Affairs; and
- Department of the Treasury.

Details of the particular issues for each entity are outlined in Chapter 4.

3.20 The ANAO is currently undertaking an ACA audit on Payroll Management in selected entities. The results will be presented to the Parliament shortly.

Cash management

3.21 Departmental appropriations are deposited into entities' bank accounts each fortnight leaving them with the responsibility for managing their cash flows to ensure they have the necessary liquidity to meet their commitments as they fall due. Surplus funds are usually placed on overnight deposit with Finance as part of cash management and banking arrangements.

3.22 In this environment, it is essential that funds transferred to Finance and other accounts are approved and that bank reconciliation processes track the movement of funds to and from all bank accounts.

3.23 Given that cash management processes are integrally linked to the management of appropriations and receipts and also to the payment of employment and suppliers costs, control weaknesses generally related to inconsistency in the timely completion and review of bank reconciliations as noted above for appropriations, receipts and payments.

3.24 Entities where control issues relating to cash management have been noted include:

- Attorney-General's Department;
- Department of Defence;
- Repatriation Commission and the Department of Veterans' Affairs;
- Department of Transport and Regional Services; and
- Australian Taxation Office.

Details of the particular issues for each entity are outlined in Chapter 4.

3.25 The ANAO has also recently undertaken an ACA audit on entity banking in selected entities. The results will also be presented to the Parliament shortly.

Asset management

3.26 The effective management of physical assets including property, plant and equipment and intangible assets such as software, is necessary to ensure the latter are properly safeguarded, recorded, valued accurately and utilised in a way that maximises value to the Commonwealth. Integral to this imperative is the maintenance of appropriate asset registers recording details of all significant assets owned by the entity.

3.27 Asset management, particularly in relation to the maintenance of reliable asset registers, has been an issue of concern raised consistently by the ANAO in previous years. While improvements have been made in the past year across most entities, including increased compliance with Chief Executive Instructions (CEIs) on assets, issues that continue to be noted include:

- acquisitions and disposals not being recorded in a timely manner;
- assets on hand not being recorded on the asset register;
- asset registers not being regularly reconciled to financial systems; and
- depreciation rates not being consistent with the useful lives of assets.

3.28 Entities with one or more of these deficiencies are working to resolve these issues before 30 June 2001 to avoid the intense resource and time consuming activity experienced in previous financial years to improve the reliability of their asset registers for the purpose of their annual financial statements. The delays, and in some cases excessive costs, incurred in the past on managing assets could be avoided by entities strengthening their asset management policies and monthly processes relating to accounting for assets.

3.29 Entities where control issues relating to asset management have been noted include:

- Australian Customs Service;
- Department of Communications, Information Technology and the Arts;
- Department of Defence;
- Department of Environment and Heritage;
- Health Insurance Commission; and
- The Australian National University.

Details of the particular issues for each entity are outlined in Chapter 4.

3.30 The ANAO has also recently undertaken an ACA audit on Disposal of Assets in selected entities. The results will be reported to the Parliament shortly.

IT—environment, systems and processes

3.31 Commonwealth entities have a significant investment in IT. As entities take advantage of the advances in IT to achieve key business objectives and improve their service delivery, there is increasing reliance on interconnected computer systems and electronic information.

3.32 For most entities, IT is now a major component of business strategies and core business processes. The management of IT-related risks is now a key part of effective entity governance. Consequently, effective management of IT is critical to the success of an organisation. This criticality arises from:

- increasing dependence on information and the systems that deliver this information;
- increasing vulnerability to a wide spectrum of new threats;
- scale and cost of the current and future investments in IT; and
- potential for technology to change dramatically business practices, create new opportunities, and reduce costs.

3.33 Changes within entities, sometimes rapid but nevertheless constant, as a result of IT, are having, and will continue to have, significant implications for management and operational control structures. Indeed, the financial statement audit of entities is highly dependent on the effectiveness of computer and associated controls related to significant financial and business accounting systems.

3.34 The audit review of the IT control environment is therefore an important component in verifying that an appropriate internal control system has been established, and that it is operating as expected. An effective IT control environment should ensure the availability, security and integrity of information processing to support business objectives or requirements. Our review of the IT environment examines, amongst other things, the manner in which an entity has configured and operates its processing systems, as well as confirming the effective operation of key controls over time.

3.35 Significant issues noted from our reviews of entity IT control environments over the past two years have related to system implementation, computer access security, and program change controls. Issues identified and reported include the following.

System implementation issues

- continuing difficulties in finalising system implementation processes;
- continuing failure of many systems to achieve planned functionality;
- inadequate user involvement in system design, testing and training;
- lack of staff expertise in system management and reporting; and
- inadequate reconciliations with interface systems.

General IT control issues

- staff with access levels beyond required functionality;
- inadequate review of computer access and changes to computer programs;
- inadequate review and monitoring of access logs; and
- a lack of documented program change control procedures.

3.36 A particular issue over the past two years has been the difficulty faced by some entities in implementing and establishing effective financial systems, including those supporting payroll processing and other employee expenses. These financial systems have been essential to support new responsibilities as a result of the devolution of a large manner of financial processing, especially the support of accrual accounting, budget management and the overall responsibility for cash management and banking as noted earlier. It is in this area that the ANAO has seen the bulk of the improvement this year. Entities are now able to produce, at

a minimum, basic financial information and reporting to support most financial management activities. Opportunities still exist for improvement, particularly in relation to obtaining the systems functionality originally sought, thus enhancing the quality and presentation of financial reporting and the level of financial analysis.

3.37 While there has also been some action to address a number of the *general IT control* issues previously reported, there are control issues still to be addressed as well the ANAO has identified further matters for entities' consideration. Addressing control issues is fundamentally important for those entities which are in the process of outsourcing, or continue to outsource, their IT services to third party providers.

3.38 Issues that have been consistently noted across several entities this year include:

- review of user access privileges not being undertaken in a timely manner;
- excessive access levels and privileged access in the production environment;
- segregation of duties not enforced by security systems;
- programmer access within the production environment;
- audit trails of access logs not activated or not being monitored in a timely manner;
- security policies not formalised or not complied with;
- password characteristics not affording good access protection;
- lack of business continuity planning or the restriction of planning solely to the IT environment;
- change management procedures not formalised or not complied with; and
- system parameter and configuration settings not optimised to provide a high level of protection for the entity's information.

3.39 It is apparent that program and data file security, both at the system and application levels, is a primary area for improvement within a number of entities. Due to the dynamic nature of the changing IT environments within entities and the potential risks such changes introduce, implementing and maintaining effective security policies and procedures must be considered as an ongoing priority activity in order to protect the integrity of IT resources and maintain stakeholders' confidence.

3.40 Entities have generally acknowledged the improvements required and have indicated that control issues will be addressed in the period ahead.

Conclusion

3.41 In recent years, the ANAO has highlighted the need for significant improvement in internal controls relating to reconciliation processes, segregation of duties, asset control, system implementation and computer access, security and program change controls. ANAO interim audits indicate that, with the exception of IT controls, improvements have been achieved in internal control and financial reporting in most entities over the past year. Several entities, however, continue to experience more internal control difficulties than most. These will be the subject of further audit focus in the forthcoming months leading to the preparation and audit of the annual financial statements. Internal control issues which require improvement in nearly all entities are:

- general IT control issues—these controls restrict access to authorised personnel and reduce the possibility that unauthorised access can be gained to confidential information and that unauthorised changes can be made to programs or data. Limited progress has been achieved in the past year and our reports to management have stressed the need to further tighten access, security and change controls processes;
- business continuity planning also needs to be more effectively addressed in a number of entities; and
- reconciliation processes relating to bank accounts, payroll processing, appropriations, other revenues, interface systems and asset registers—reconciliations are integral to ensuring the information in financial systems is complete, accurate and valid. Evidence suggests that most entities recognise the need to complete these reconciliations but there is inconsistency in the application of end of month procedures to ensure all reconciliations are prepared and reviewed in a timely and complete manner. ANAO reports to entities' management on this issue have stressed the need to continue to improve end of month processes so as there is consistent application of reconciliation processes.

3.42 Part of the changes required by entities to overcome these deficiencies is the need to enforce greater discipline on end of month procedures to ensure that all necessary steps are completed in a timely manner. While some entities have established end of month checklists necessary to ensure a disciplined approach, most entities are yet to achieve the consistency and discipline essential to the task for adequate assurance to all stakeholders.

3.43 These are areas that the ANAO will review to assess improvements over the coming year.

Results of the Examinations
of Control Structures—by
Major Entity for the Year
Ended 30 June 2001

4. Results of the Examinations of Control Structures—by Major Entity

Introduction

4.1 This part of the report summarises the results of examinations of control structures of major individual Commonwealth entities as part of the interim audits of their financial statements for the year ended 30 June 2001. These entities primarily comprise the portfolio departments that manage the majority of the Commonwealth's financial activities and operate the more significant and complex financial systems. The Australian Customs Service, the Repatriation Commission and Department of Veteran Affairs, Centrelink, Health Insurance Commission, and Australian Taxation Office are also included, given their Budget significance. In addition, this part includes the results of the audit of the financial report of the Australian National University for the year ended 31 December 2000.

4.2 The ANAO's audits of Commonwealth authorities, companies and subsidiaries are performed on a continuous basis and are structured to meet Board commitments as well as the Commonwealth reporting deadline of September 2001. The results of the audit of these bodies will also be included in the Auditor-General's *Report on the Audits of Financial Statements of Commonwealth Agencies* expected to be tabled in December 2001.

4.3 The summary of each major entity's interim audit results contains:

- introductory commentary regarding its business operations;
- key business and financial risks;
- comments on selective corporate governance arrangements;
- audit results, including reference to the more significant issues identified;
- financial reporting; and
- conclusions.

4.4 In respect to the business and financial risks, these were identified and reported to each entity as part of the planning phase of each audit. They represent the ANAO's assessment of the key factors that give rise to the potential for material misstatement in the financial statements. The ANAO's work during the interim phase of the audit, which is the basis of this report, focuses on steps taken by entities to manage these risks.

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

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

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

4.7 This part of the report discusses the more significant matters identified (A and B) in separate sections for each entity. A table of the more significant matters is also included for each entity. The various tables track progress on matters raised from our audits of the 30 June 2000 financial statements. 'A' rated issues remaining unresolved at the time of the final phase of ANAO audits in July and August 2001, could result in a qualified audit report.

4.8 A summary of 'A' rated findings by entity is outlined in Appendix 1.

Department of Agriculture, Fisheries and Forestry—Australia

Business operations

4.9 The Department of Agriculture, Fisheries and Forestry—Australia (AFFA) has functional responsibility for Australian agricultural issues at a Commonwealth level. AFFA fulfils this role through a range of programs that assist primary producers, research, development and marketing bodies, conservation groups and regional areas.

4.10 The Australian Quarantine and Inspection Service (AQIS) provides meat inspection and quarantine services and forms a significant part of AFFA. AQIS operates on a cost-recovery basis and negotiates its fees with relevant industry bodies. AQIS reports both separately and as part of AFFA's consolidated financial statements.

4.11 The department is predominantly Budget funded and its appropriations for the 2000–2001 financial year cover:

- its price of outputs (including AQIS fees)—\$195.1 million; and
- administered appropriations—\$1655.8 million.

4.12 AFFA employs 2925 staff across Australia.

Key business risks

4.13 In order to manage its business risks the department addresses, as a priority, key issues relating to monitoring developments in the agriculture, fisheries and forestry industries and their effect on policy advice; quarantine policies and procedures; and the administration of primary industry levies.

4.14 In managing these business risks, disciplined management and operational policies, practices and procedures are required over: AQIS quality assurance processes; implementation of an appropriate AQIS fee structure to facilitate cost recovery from industry; monitoring of expenditure against administered appropriations; and the implementation of relevant supporting systems.

Corporate governance

4.15 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors that management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines the broad strategic directions of the department and is supported by divisional plans which detail activities and associated resourcing and performance information;
- senior executive meetings with business group heads to evaluate suggested areas for improvement;
- monthly monitoring of key areas by the Executive Leadership Team which focuses on strategic, operational and financial performance issues. This is complemented by monthly meetings of the AQIS Business and Finance Committee that focus on AQIS specific issues and financial performance;
- a monthly reporting regime which outlines actual versus budgeted departmental and administered activity across the various outputs and outcomes and provides an analytical review of performance; and
- an audit committee and finance sub-committee that meet regularly and actively focus on internal controls, management of financial risks, review of financial reporting, control of public money and assets, and regulatory compliance.

Audit results

4.16 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	2	1	0	1
B	8	8	0	0
	10	9	0	1

4.17 In the 1999–2000 audit, problems were encountered with implementation of the QSP financial management information system (FMIS) which caused difficulties in the preparation of financial statements.

4.18 This year, the audit results to date indicate that the majority of the department's systems and procedures will produce reliable information for financial reporting purposes. That said, however, the ANAO is unable to rely on the controls relating to the payment of primary industry levies from special appropriations. This is due to on-going concerns regarding monitoring and reconciliation of payments.

Reconciliation and monitoring of special appropriations

4.19 AFFA's Levies and Revenue Service collects primary industry levies and regularly makes payments to a number of research, development and marketing corporations. The amount to be paid to these various corporations is driven by a range of legislation. The funding for these latter payments is by way of special appropriations.

4.20 The ANAO has raised issues, both in 1999–2000 and this year, relating to the disbursement of primary industry levies due to concerns with AFFA's ability to reconcile its receipts from industry with the payments made to research, development and marketing corporations. The legislation that establishes the special appropriations states that the Commonwealth must pay amounts equal to the levies received, and the Official Public Account will be appropriated accordingly. The legislation also prescribes that the monies collected from each individual levy are to be expended for the benefit of the industry from which they were collected.

4.21 ANAO noted that there is no reconciliation of payments with receipts, raising concerns as to how AFFA assures itself that:

- it is meeting its legislative obligation to make payments equal to receipts;
- it is not in breach of its special appropriations and the Constitution by drawing amounts which are paid in excess of levies received; and
- the funds collected are distributed to ensure they are ultimately expended for the benefit of the industry from which individual levies were collected.

4.22 In 1999–2000, AFFA made distributions in excess of the relevant levies received. As a result, AFFA expended public money without an appropriation and, consequently, AFFA's 1999–2000 financial statements were qualified. Significant work is still required by the department to correct the issues noted in 1999–2000.

Financial reporting

4.23 Over the past year, AFFA has made improvements to its financial reporting processes. For the majority of 1999–2000, AFFA had a partly functional FMIS following implementation difficulties with QSP. After an internal restructure to achieve further alignment of projects with outputs, monthly accrual financial reports with analysis are now provided to the Executive Leadership Team and the AQIS Business and Finance Committee. The analyses of these reports include review of budget versus year to date actual expenditure, current year's to prior year's figures, and explanations for material variances. Reports for the AQIS Business and Finance Committee also predict final year balances and results by program to provide additional information relating to cost-recovery. Financial information is also available on AFFA's Intranet for review by operational areas as required.

Conclusion

4.24 The department has shown improvement in its processing and control environment in the previous 12 months and has accepted the ANAO recommendations aimed at enhancing the effectiveness of delegations and controls relating to the QSP FMIS. The department indicated that it will take immediate remedial action in relation to the controls relating to the payments of primary industry levies.

Attorney-General's Department

Business operations

4.25 The department is the central policy and coordinating element of the Attorney-General's portfolio and plays a key role in serving the people of Australia by providing essential expert support to the Government in the maintenance and improvement of Australia's system of law and justice.

4.26 The total appropriation for the department, including additional estimates for 2000–2001, is \$404.2 million. In summary, the appropriations for the year ended 30 June 2001 for the department comprise:

- special appropriations—\$29.5 million;
- administered appropriations—\$230 million;
- output appropriations—\$129.8 million; and
- departmental equity injections—\$15 million.

4.27 The department's average staffing level is 1214, including 646 staff of the Australian Protective Service and 17 staff of the CrimTrac agency.

Key business risks

4.28 In order to manage its business risks, the department addresses key issues relating to the timely and efficient delivery of effective legislative policy and advice which is generally subject to detailed external scrutiny.

4.29 In managing these business risks, disciplined management practices are required over the professional service areas of the department and supporting services, including human resources and financial management. Given the specialist staffing required, a critical risk management issue continues to be succession planning.

Corporate governance

4.30 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines broad strategic directions and is supported by operational plans which detail activities and associated resourcing and performance information;
- the executive which conducts weekly meetings with division heads and evaluates key issues;

- an audit committee that meets quarterly and actively focuses on internal controls, management of financial risks, review of financial reporting, control of finances, assets and regulatory compliance;
- a monthly reporting regime which reports actual versus budgeted departmental and administered activity across outputs and outcomes and provides an analytical review of performance; and
- an internal audit strategy and plan which addresses key departmental business and financial risks and covers relevant programs.

Audit results

4.31 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	2	2	Nil	Nil
B	6	6	7(a)	7
	8	8	7	7

(a) includes prior year issues re-rated in current year.

IT system access controls

4.32 The department utilises SAP as its financial management information and reporting system. During the audit of SAP and its operating environment, the ANAO noted an excessive number of users with inappropriate high level access to functions within the system, together with an excessive number of users with access to the privileged network administration function.

4.33 The department advised that user access has been reviewed and non-essential access eliminated. Procedures have also been introduced which will facilitate a regular review of such access.

Parliamentary appropriations and bank reconciliations

4.34 The department performs monthly reconciliations of appropriations received and daily reconciliations of its main bank accounts.

4.35 In relation to Parliamentary appropriations, the ANAO noted that there are reasonably large variances between the amounts recorded in the department's SAP ledger and the amounts recorded by Finance. Some of these variances are considered to be due to timing differences. However, they were not resolved in a timely manner.

4.36 With bank reconciliations, the ANAO noted that not all departmental bank accounts are reconciled and not all the reconciling items identified during the reconciliation process are listed/shown on the bank reconciliations. This has resulted in the department being unable to verify the accuracy of bank reconciliations.

4.37 In addition, the ANAO was unable to find any evidence that the above reconciliations were checked/reviewed by an officer independent of the transactions.

4.38 The department has advised of appropriate action taken, or proposed, to address these issues before 30 June 2001.

Financial reporting processes

4.39 The department has developed financial reporting processes that include monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows. The reports provide actual versus budget information on both an accrual and cash basis.

Conclusion

4.40 A number of departmental initiatives are evident which have addressed prior year audit findings. A number of fundamental control weaknesses were identified in this year's audit which pose moderate business or financial risks. The department has advised of appropriate remedial action.

Australian Customs Service

Business operations

4.41 The Australian Customs Service (ACS) is responsible for providing effective border management that, with minimal disruption to legitimate trade and travel, prevents illegal movement across the border, raises revenue and provides trade statistics.

4.42 As part of its role in the implementation of the Government's Tax Reform initiatives, ACS has responsibility for collection of GST on imported goods and, in some circumstances, of Wine Equalisation Tax (WET) and Luxury Car Tax (LCT). ACS also administers the Tourist Refund Scheme (TRS) and the compliance activity, in conjunction with the Australian Taxation Office in relation to the GST, WET and LCT for both imported and exported goods.

4.43 ACS also plays a key role in the fight against illicit drugs.

4.44 The total appropriations for ACS in the 2000–2001 Budget was \$429.2 million, of which \$7.0 million relates to an equity injection for the purchase of x-ray equipment to enhance capacity for drug detection and the payment for marine vessels.

4.45 The agency's average staffing level is 4165.

Key business risks

4.46 In order to manage its business risks, ACS addresses key issues relating to assessment and collection of Commonwealth revenue; safeguarding Australian coastal borders; protection of the community against illegal imports; goods being dumped into Australia; and detection programs to identify non-compliance with legislative requirements for revenue leakages and border control.

4.47 In managing these business risks, disciplined management and operational policies, practices and procedures are required over revenue protection and enforcement, compliance and regulatory standards including quality assurance programs. Central to this framework, is a comprehensive resource infrastructure covering trained staff supported by specialist assets and relevant information systems.

Corporate governance

4.48 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet ACS objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a structured framework for incorporating risk management into management and business processes;
- a monthly reporting regime to the executive that provides key financial information and critical performance measures;
- an audit committee that meets at least quarterly and which focuses on risk management and internal audit issues; and
- an internal audit strategy and plan that addresses key business and financial risks.

4.49 The ANAO noted scope for improvement including:

- finalising a number of key documents that were in the process of being updated, for example, CEIs, asset management and fraud control plans;
- improving reporting tools to ensure that information produced and compiled for management reporting and decision-making purposes is accurate; and
- ensuring that assessment of risk and threats extends from a strategic to an operational level.

4.50 ACS is in the process of taking steps to address these matters which are expected to be completed in the near future.

Audit results

4.51 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	1(a)	1	0	0
B	2	1	12(a)	13
	3	2	12	13

(a) include some prior year issues that were re-rated in current year.

Asset management system

4.52 ACS controls a significant portfolio of physical assets including specialised equipment. The audit found there was scope for improvement in the controls associated with asset management. In particular:

- a full stocktake of assets has not been undertaken since 1998–1999;
- the fixed assets register has not been reconciled to the general ledger since 30 June 2000;
- there is no asset management policy to ensure a consistent approach in the accounting for assets among business units; and
- assets were not promptly recorded in the assets register.

Reconciliations

4.53 Reconciliations are a fundamental control procedure to ensure information posted from various sources to the general ledger, which forms the basis for the production of the financial statements, is valid, accurate and complete. The ANAO noted that ACS has not been reconciling its subsidiary records with the general ledger. For example, the accounts receivable and payables subsidiary ledgers and the cheque settlement account are not reconciled to the general ledger. This was attributed to a system related problem. This matter is in the process of being resolved.

Commercial compliance—quality assurance program

4.54 As part of its overall quality assurance process to ensure the audits conducted under the National Compliance Improvement Plan are in accordance with appropriate standards, there is a requirement for a sample of audits from each industry group to be reviewed by the manager on a quarterly basis. ACS has not been complying with this procedure.

IT control environment

4.55 ACS maintains a complex IT environment. As IT impacts upon most aspects of ACS's business operations, the ANAO has again undertaken a review of the IT control environment. The review of controls includes the operating system, operations, database management, physical and logical security and general controls over change management and business continuity.

4.56 The ANAO review noted a number of concerns in relation to logical security, and the FMIS and HR applications (QSP and PeopleSoft respectively). Particular issues include the following:

- Logical security:
 - lack of procedures to review the manual logs of user identification and to ensure that password change requirements are adhered to;

- lack of adequate procedures to support the IT security policy;
- inadequate procedures over the resetting of passwords;
- inappropriate monitoring mechanisms for security management; and
- lack of security classification of data holdings.
- QSP application:
 - current procedures for processing payments allow manual amendments to be made to invoice data without additional authorisation;
 - no regular review of user (including privileged) access to ensure that access to security groups is commensurate with users' roles and responsibilities; and
 - the QSP default user (which increases the risks of unauthorised and inappropriate access to systems data and resources) has not been disabled.
- PeopleSoft application:
 - inadequate procedures for conducting a regular review of audit logs; and archiving the logs on a regular basis to an independent database.

Financial reporting

4.57 ACS reporting framework incorporates key financial and non-financial measures to monitor the organisation's performance and financial management by key business areas and by regions. Its reporting is integrated and translates the entity's strategic objectives into a useful performance measurement system that seeks to explain variances from actual to budget or expected outcomes of financial performance and details any areas that are of interest to the executive.

Conclusion

4.58 ACS needs to ensure that the control procedures which underlie the control framework are being monitored and improved. ACS is addressing these issues and has implemented a number of initiatives to enhance the control structure that should improve the financial statement preparation process at the end of 2000–2001.

Department of Communications, Information Technology and the Arts

Business operations

4.59 The Department of Communications, Information Technology and the Arts is responsible for providing strategic advice and professional support to the Government on wide ranging and rapidly changing policy areas including telecommunications; the information economy; broadcasting; the arts and cultural development; intellectual property; Australia's heritage collection and the Centenary of Federation. It also administers legislation, regulations, grants and incentives to industry and the wider community. The department comprises three sections, namely the core Department (including National Office for the Information Economy (NOIE)) and two 'outriders,' National Science and Technology Centre (NSTC) and Screensound Australia (Screensound). From 1 July 2000, the National Archives of Australia (NAA) became a separate agency.

4.60 The department's principal appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$198.4 million; and
- administered expenses and special appropriations—\$304 million.

4.61 The department's average staffing level is 975.

Key business risks

4.62 In order to manage its business risks, the department addresses key issues relating to:

- keeping pace with developments in communications, IT and the arts and their effect on policy advice; and
- maintaining adequate processes and controls for the effective administration of grant and incentive programs.

4.63 In managing these business risks, disciplined management practices are required over policy and project management activities, program administration, contract management, and key support services covering staff and financial management.

Corporate governance

4.64 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in-place to meet departmental objectives and the management of the business

risks associated with those initiatives. Measures that impact on financial assurance include:

- a corporate plan which outlines the strategic directions to meet objectives and which is supported by operational business plans;
- an executive management group that meets monthly and which focuses on departmental wide issues and monitors financial performance;
- a fraud, audit and evaluation committee that meets at least quarterly and which addresses risk management, internal audit planning and reporting, external audit activity, financial reporting and related compliance issues. A revised risk management plan was recently issued;
- a quarterly financial reporting regime; and
- an effective internal audit function.

Audit results

4.65 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	Nil	Nil	Nil	Nil
B	7*	7	18	18
	7	7	18	18

Note* National Archives of Australia issues have not been included as from 1 July 2000 NAA was no longer part of the department. Audit findings for NAA will be reported as part of the Auditor-General's *Report on the Audits of Financial Statements of Commonwealth Agencies* expected to be tabled in December 2001.

Core department

4.66 The ANAO has recommended that remedial action be taken with IT control issues relating to:

- enhancing change management procedures;
- formalising access request procedures;
- implementing enhanced segregation of duties for system administration functions;
- completing regular reviews of security and audit logs;
- restricting programmer access to production programs; and
- restricting access to sensitive functions and authorisation objects.

National Science and Technology Centre

4.67 The audit disclosed that NSTC has worked to strengthen its control environment over the past year. Areas where procedural improvements are still required relate to asset management, reconciliation of payroll data to the general ledger and the tightening of access to the '*Finance One*' financial management information system.

Screensound Australia

4.68 Screensound's control environment has strengthened over the past year but improvements are still required. Issues noted for improvement relate to IT access controls and passwords, end of month reconciliation processes over payroll, assets management, and supervision of transactions using the ReserveLink system.

Financial reporting

4.69 Over the past year, improvements have been achieved in the quality of financial data and reporting. Improvements are expected to continue in the year ahead as the department moves to strengthen further its end of month processes for its key business and accrual accounting processes.

Conclusion

4.70 Progress has been achieved in strengthening the control environment. However, further improvements are necessary, particularly in relation to the IT environment. The department has accepted ANAO findings and has agreed to implement remedial action.

Department of Defence

Business operations

4.71 The Department of Defence is responsible for achieving the single outcome of the prevention or defeat of the use of armed force against Australia and its interests.

4.72 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$17 114 million (included is funding of \$949 million for the commitment to East Timor); and
- administered appropriations—\$2205 million.

4.73 The department's current average staffing level is 92 957, including total permanent forces of 50 995, total reserves of 25 569, and total civilian staff of 16 393.

Key business risks

4.74 In order to manage its business risks, the department addresses key issues relating to the following:

- Peacekeeping Operations—Insufficient capability and preparedness for timely military responsiveness.
- Strategic Planning—The inability of the department to allocate effectively resources due to inadequate planning processes, most importantly asset procurement.
- Outsourcing—Inability to deliver or enhance current service levels whilst ensuring they are delivered in a cost-effective manner.
- Change Management—The potential threat to the department of not maximising resources made available for core Defence activities in an environment of significant organisational change.
- Corporate Governance—Inadequate processes and controls to provide appropriate assurance over the information being produced for operational and reporting purposes.
- Human Resources—Difficulties in recruiting and retaining adequately skilled staff to allow the department to achieve its business objectives.

4.75 The initial ANAO assessment of the risk of material misstatement in the 2000–2001 Defence financial statements was high. Contributory factors were considered to be:

- unrecognised assets;
- high asset capitalisation threshold;
- repairable items (RI)/inventory variances;
- system and data ownership matters; and
- associated management issues.

4.76 The ANAO interim audit has focussed on the material financial reporting risks flowing from these areas and the data streams of all material areas. ANAO current assessment of the risk of material error is still high.

Corporate governance

4.77 The ANAO's audit approach considers Defence's goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing Defence's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives.

Risk management

4.78 A significant focus through the interim audit was on the effectiveness of the risk management framework in assisting management with the early identification of risk factors that may inhibit Defence's ability to achieve its goals and objectives, including those which ultimately impact the financial statements.

4.79 The 1999–2000 Defence Annual Report stated that the department would have a strategic risk management policy in 2000–2001. This policy was to establish senior management's commitment to risk management; establish a Defence-wide standard for managing risk; and provide a framework for conducting risk management programs at all levels of the organisation. At the time of the audit, this strategic risk management policy was not in place. As a result, there was no coordinated Defence-wide risk management for nine months of 2000-2001.

4.80 Internal audit and consulting services feature significantly in the corporate governance framework and consume significant resources.

4.81 Internal Audit is strategically aligned to the departmental priorities. However, there are considerable management agreed Internal Audit recommendations which remain outstanding. Resolution of these

outstanding findings is important, not only from the standpoint of good governance and enhanced departmental performance, but more broadly from the impact on the department's overall reputation.

4.82 Better practice organisations with highly developed corporate capabilities have robust corporate systems and processes, manage the use of consultants in an active way, and experience relatively low rates of replacing key staff and staff generally. This is not the case in Defence, as there are ongoing system and staffing challenges to be resolved. The department's management does not have a robust controls framework and the decision between relying on preventative or detective controls with systems often appears to be made by default. Monthly management reports and Key Performance Indicators (KPIs) are still developing. The turnover of key staff is a significant issue, notably in the financial reporting area. There is a need for a coherent strategy that focuses on the building and retention of financial expertise.

Financial performance

4.83 The strategic capability of Defence is built upon the quality of the operational and financial analysis of competing strategic options. In terms of management accounts and performance, there is a fundamental issue involved. For the majority of 2000–2001, Defence has achieved a significant operating surplus which, at the end of February 2001, was \$1.8 billion better than expected. After assets identified and accounted for the first time, the 'normalised' operating surplus is approximately \$1 billion. A major reason for this result is that the level of expenses for suppliers, including inventory consumption, is significantly lagging the pro rata of full year plans. To meet accountability obligations, under the FMA Act, Defence needs to be assured that any resource consumption surges late in 2001 reflect management's operational requirements.

4.84 A pivotal accountability issue for management is the department's operating performance. The large operating surplus can be explained by either imprecise budget construction or design, emergence of unforeseen events, and/or overfunding. Given the way the budget is constructed and the quality of the management reports it is not possible to conclude confidently if Defence has had an excess allocation to its operations. Ideally, a mid-year budget review would allow forward projections to be adjusted, that is, the funding division between the operating budget and the capital acquisition budget. The systems being used for costing outputs and measuring performance against targets should be able to facilitate this analysis.

IT systems and processes

4.85 Defence key business systems (ROMAN, PMKeyS and SDSS) concentrate on financial management, personnel and logistics respectively.

4.86 ROMAN is the department's general ledger system. The ANAO interim audit concluded there are significant problems associated with the completeness of month-end procedures such as clearing account review, monthly journal entries and bank reconciliations. This is exacerbated by the failure by some groups to transfer key information to the Chief Finance Officer's Group (CFOG). For example, a \$435 million finance lease effective 1 July 2000 was not updated into ROMAN. In addition, the detailed monthly management reports are not always timely and do not include important information such as accounts receivable, fuel consumption and some employee entitlements. This compromises the ability of Defence executive management to make fully informed resource allocation decisions.

4.87 PMKeyS is the department's human resource management system. A significant effort is still required to implement an adequate control environment for PMKeyS. One of the major issues is that security policies and procedures are not supported by an adequate risk assessment of the system, for example, current security procedures may not prevent unauthorised changes to the information stored within the application. Lack of clear data ownership also means that monitoring controls over the changes are not carried out in a consistent and reliable manner. The combined effect of these two weaknesses results in an information integrity risk being in excess of the tolerable level for audit reliance. The ANAO will perform other audit procedures to assure itself regarding the reasonableness of global personnel expenditure. The corollary to this is that Defence management can only have limited confidence in the quality of the information produced from PMKeyS.

4.88 SDSS is the department's logistical management system. SDSS continues to be unreliable for financial reporting purposes. In these circumstances, the ANAO has to validate inventory data (eg. perform stock counts at Defence sites progressively throughout the year) to ensure that the financial statement audit work is defensible. This financial year, the ANAO has again consistently found large quantity variances in repairable items and variable inventory results. The system precludes an efficient audit process and logically must restrict management's operational ability in the specialist military equipment support function.

4.89 The overall concluding comment regarding IT is that there are weaknesses involving password strength and access rights within the operating systems supporting these applications. The ANAO has not

noted any breaches of the IT infrastructure security mechanisms. As part of the ANAO's year-end work, there will be an examination of the implication of security breaches on the total reported figures.

Financial reporting issues

4.90 The take-up and timing of information for financial reporting purposes remains a critical issue. Senior management acknowledge that data gathering and data accuracy continues to be problematic. In summary, data ownership and management issues result in, *inter alia*:

- insufficient understanding and incomplete information regarding significant accounting adjustments relating to assets first found, and slow progress in resolving the capitalisation policy issue;
- ongoing significant quantity variances and price anomalies in the SDSS repairable item and inventory holdings; and
- the control framework that should provide Defence management with the confidence that basic accounting procedures are completed needs strengthening. Examples of important processes such as bank reconciliations, clearing account reviews, and month-end adjustments not being performed, continue to emerge.

Audit results

4.91 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues Resolved prior to March 2001</i>	<i>New Issues to March 2001</i>	<i>Issues superseded by 2001 interim findings</i>	<i>Closing Position at March 2001</i>
A	13	3	2	2	10
B	41	10	11	8	34
	54	13	13	10	44

Asset capitalisation threshold

4.92 At 30 June 2000, Defence analysis indicated that assets not recognised on the balance sheet could be up to \$1.8 billion. This is because assets with a cost of less than \$25 000 were generally not recognised on the balance sheet. In the 2000–2001 financial year, the department has initiated an extensive program of asset grouping for capitalisation. The successful completion of the asset capitalisation project should ensure that the 2000–2001 financial statements are not materially misstated because of this policy issue.

Recognition of assets

4.93 Over the last two financial years, the department has processed \$2.6 billion of adjustments to Equity in relation to the recognition of assets. At the time of the audit the department was anticipating assets first found of \$1.6 billion for 2000–2001. The recognition and completeness of asset recording therefore continues to be an area of significant risk for the department. As well there are insufficient controls to give Defence management confidence over asset completeness. Adjustments for unrecognised assets and liabilities processed in 2000–2001 will significantly impact the operating position of the department.

Repairable Item (RI) quantity variances

4.94 Warehouse site visits conducted in 2000–2001 have indicated some large repairable item (RI) quantity variances in up to 27 per cent of line items, demonstrating that the business processes and stocktake procedures that are designed to give the department a high degree of confidence in SDSS RI quantities across the warehouse sites are deficient. The value of repairable/rotatable items that are not tracked or recorded for financial reporting requirements is at present unknown. This uncertainty in the number and location of repairable items compromises the purchasing, supply and disposal decision process.

4.95 The Defence Materiel Organisation (DMO) is reviewing data to determine which sites warrant 'one-off' 100 per cent stocktakes. These stocktakes are expected to be completed before the end of fiscal 2001.

Ownership of data

4.96 The lack of ownership of data and the attendant mechanisms that ensure the flow of validated reliable data from the groups to the CFOG continues to be a major management and financial reporting issue. If personnel are not specifically assigned the responsibility for the ownership, reconciliation and review of data, there is an increased risk that incorrect information will be incorporated into the monthly management and financial reports, and ultimately the financial statements.

4.97 In the 2000–2001 interim audit there have been numerous indicators that major action is required in a number of areas. These include:

- lack of formal definition of PMKeyS data ownership;
- asset purchase accounts are not well understood or managed. The department was unable to explain the basis for a \$367 million adjustment that impacts revenue;
- reconciliations are not always performed. For example, the ACT collectors receipt account was not reconciled for six months;

- clearing accounts are not always managed adequately, for example, the Net Pay Clearing Accounts;
- end of month procedures such as fuel adjustments, software capitalisation, and federation fund transfers are not regularly performed;
- lease information is not reliably transferred to the CFOG. For example, a \$435 million finance lease effective 1 July 2000 was not advised; and
- debtors are not adequately recorded and managed.

SDSS: functionality, pricing and classification

4.98 SDSS financial reporting is not timely and is compromised by data integrity issues. Until this situation is improved, the accuracy of the monthly management reports will continue to be unreliable.

4.99 Large scale reviews of obsolescence, pricing and classification have been undertaken. However, there still remain some residual problems relating to prices and classification of some items. In December 2000, a sample of 13 324 items (across all Services) was sent out for confirmation of their classification. Results of this exercise are yet to be finalised.

4.100 There are currently inadequate processes in place to ensure that items, which are incorrectly priced, are identified and prices corrected. This issue indicates a lack of review upon data entry and a lack of consequent analysis by individual warehouse managers. This issue is being worked through with Defence officials so that a definitive conclusion (result) can be reached.

Defence Capability and Investment Committee (DCIC) function

3.101 DCIC does not presently coordinate with DMO in respect of planned changes which may affect the obsolescence provision. Any changes to combat platform useful lives will also affect the amount of support inventory required.

4.102 In addition, the DCIC decisions in relation to specialist military equipment (SME) useful lives do not feed into the useful lives assigned to those assets for financial statement purposes, thus creating a significant risk that depreciation and the asset's written down value will be misstated.

ROMAN: unauthorised access to payment files

4.103 A specialist IT team has permanent access to the ROMAN payment file. A member of this team could fraudulently modify the payment file without detection.

PMKeyS

4.104 In the 1999–2000 financial year, the ANAO reported that security administrators were not supported by appropriate security policies and procedures. PMKeyS Production Support has now created documents relating to PMKeyS security policies and procedures. ANAO review of these documents has identified further areas for improvement. A formalised risk assessment of the various components of PMKeyS has not been conducted by the department.

4.105 As noted in previous audit reports, gaps in the control environment and financial expertise, coupled with fundamental problems in business processes, system design and functionality, continue to inhibit the department's attempts to manage to pre-determined targets.

4.106 Data integrity around Long Service Leave accruals, Annual Leave, Sick Leave and other leave entitlements is poor. This means that the department can only place limited reliance on system data for resource allocation and budgeting decisions.

4.107 In addition the HR system:

- does not produce complete employee cost reports that allow effective and efficient cost monitoring and analysis;
- (its) interface with the general ledger does not accurately distinguish between employee cash and accrued expense; and
- users' access rights and the privileged access of the Security Administration Team are not adequately monitored. This increases the risk of fraud and error.

Conclusion

4.108 Issues regarding data ownership and system access continue to be of concern. Also related, are the consequential management decision implications flowing from the timeliness and quality of monthly reporting. Part of the improvement process will be the necessity for investment decisions, about asset useful life changes and inventory obsolescence considerations, to be aligned to the department's monthly financial reporting process.

4.109 The loss of key financial reporting staff, together with the lack of timely reports, has made it difficult for Defence management and the ANAO to identify significant improvement in financial management processes and information. It is clear, however, that there have been major improvements, in a systems sense, to ROMAN and, to a lesser extent, PMKeyS.

4.110 The department has indicated that it generally agrees with the audit findings and has specified a number of project initiatives to address the deficiencies. Although some issues have a long-term focus, it is anticipated that most issues will be progressively addressed in 2001-2002.

Repatriation Commission and the Department of Veterans' Affairs

Business operations

4.111 The Repatriation Commission is responsible, under the *Veterans' Entitlements Act 1986*, for granting pensions, allowances and other benefits; and providing treatment and other services through hospitals and institutions, or community facilities to veterans.

4.112 The Department of Veterans' Affairs (the department), in its role of providing administrative support to the Repatriation Commission, delivers its responsibilities by making pension, allowances and other benefit payments to veterans and other entitled persons. The department also administers the commemoration program and the *Defence Service Homes Act 1918*. These activities require the department to deal with complex demographic and geographic issues in serving the veteran community.

4.113 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$246 million and
- administered appropriations—\$8.4 billion.

4.114 The department maintains an average staffing level of 2400 across Australia.

Key business risks

4.115 In order to manage its business risks, the department addresses key issues relating to the assessment, processing and payment of benefits to veterans.

4.116 In managing these business risks, disciplined management and operational policies, practices and procedures are required over the management of decentralised and devolved program and administrative processing activities. Integral to this framework are significant IT systems and applications.

Corporate governance

4.117 The ANAO's audit approach considers the department's goals and priorities, objectives and strategies, along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focussed on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which includes performance standards and key result areas;
- the Executive Management Group which assesses the overall performance of the department through balanced scorecard reporting, exception reporting against key result areas, financial reviews, human resource/workforce planning and continuous improvement opportunities;
- the National Audit and Fraud Committee which meets at least quarterly and focuses on risk assessment, internal audit, external audit and fraud control. A primary issue is aligning the strategic audit coverage with the department's overall risk assessment;
- monthly financial reporting of relevant information;
- a strategic risk management policy which is supported by a formal risk management plan (currently being finalised) that outlines the strategies for implementing the policy. The department has also recently conducted a comprehensive risk assessment exercise; and
- an internal audit strategy and plan which is aligned to the overall risk assessment for the department. Internal audit findings are ranked in terms of priority, although this approach could be enhanced by grading in terms of likelihood and consequence of risk.

Audit results

4.118 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	19	14	7	12
	19	14	7	12

IT control environment

4.119 The IT control environment is a significant element of the department's control structure which is based on mainframe and mid-range computer platforms that run the department's critical business and financial application systems.

4.120 The ANAO has recommended that priority be given to strengthening controls relating to IT access security. This recommendation follows the department's internal audit review of access security. In addition, further reviews of access security for the Benefit Payment Systems and the DOLARS financial management information system have revealed the following issues:

- lack of regular review of staff access to computer systems;
- a need to update system security plans for the Benefit Payment Systems; and
- lack of supporting documentation for current DOLARS user access profiles.

Benefit processing

4.121 The assessment, processing and payments to veterans are elements of the key business process of the department which is delivered through a number of IT application systems. The department has decentralised operations. Consequently, the provision of accurate data input is reliant on state offices. This risk is managed through a quality assurance (QA) and monitoring process. The timeliness of the QA review of transactions processed through these systems, effective analysis of the QA results, and immediate preventive action resulting from such review, are significant management controls over the accuracy of data and records.

4.122 The income support QA program has been re-engineered through the use of PC based QA software (QUASARS). The program provides reliable information for financial statement purposes. However, inconsistencies were identified in the format of QA reviews of compensation payments across all states. As well, there was no consolidation of national QA results. Notwithstanding that the review of QAs did not identify significant financial errors, there is a need for a complete evaluation and quantification of QA errors and subsequent action taken on critical errors.

4.123 In addition, the QA review of transactions processed through the recently developed integrated payment system (IPS) has not been implemented. This has led to additional audit coverage, in order to obtain the required assurance.

4.124 Management needs to assess the priority and adequacy of resources devoted to critical QA processes so that monitoring and remedial action can be undertaken in a timely manner. The department recognises the weakness noted and is reviewing the QA program as a whole to introduce software to cover QA across all benefit systems.

Financial management information system

4.125 The department's financial management information system (DOLARS) is well established and subject to on-going review and modification. The review of QA processes and results observed indicated a significant improvement since 1999–2000. However, there has been an increase in the number of critical errors following implementation of the GST and the recurrence of critical errors over a number of periods. As a result, further assurance had to be obtained on payments made by the department. It was recommended that adequate training be given and action taken to avoid the recurrence of such errors.

4.126 In the past, concern has been raised regarding significant direct invoice processing. Direct invoices are processed without raising purchase orders. This bypasses industry best practice relating to purchasing control over quantity and price. In addition, the department is now responsible for its own cash management function as a part of the devolved banking reform process. Direct invoice processing can create potential for inaccurate cash forecasting and inappropriate cash management. The ANAO recommended that, in accordance with the risk management strategy, consideration be given to amending the above process.

Personnel system

4.127 A reconciliation of information held in the department's personnel system (PAHRIS) to the balances recorded in the general ledger system was not being performed. Failure to carry out reconciliations between the general ledger and the personnel system reduces the level of assurance over the accuracy of information held in the general ledger. Given the significance of personnel costs, the department was advised that reconciliations should be performed on a regular basis.

Cash management

4.128 An effective cash management process encompasses regular and timely reconciliations of bank accounts with the general ledger. Delays were noted in the completion of reconciliations of the departmental Head Account, Administered Receipt Account and Administered Payment Account. Regular reconciliations are crucial to ensuring effective control over funding levels and cash management.

Financial reporting

4.129 Monthly reports of actual against budgeted departmental expenditure are distributed for review by each state and branch manager and discussed in the quarterly meeting of the Corporate Resources Committee. The report includes a profit and loss statement, balance sheet and cash flow statement as well as a summary analysis of the department's financial performance and state of affairs. Currently, administered expenditure is analysed at a division level. There is an opportunity for a consolidated report to be provided to the Executive Management Group to assist with managing the funding for the department. The Corporate Resources Committee is planning to implement a formal reporting process for administered expenditure.

Conclusion

4.130 Progress has been achieved in aspects of financial management and accountability over the past year but improvements are still required in the IT control environment, quality assurance over benefit processing, and reconciliation processes. The department has advised of appropriate remedial action.

Department of Education, Training and Youth Affairs

Business operations

4.131 The Department of Education, Training and Youth Affairs is responsible for assistance and support programs that aid all Australians to achieve in a learning society. The department does this through an integrated and balanced approach to the provision of education services and facilitating the training needs of all Australians with a particular focus on Indigenous and young people. The department has two key business processes, being grants administration and contract management.

4.132 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$210.5 million; and
- administered appropriations—\$11 788.2 million.

4.133 The department's average staffing level is 1350 across Australia.

Key business risks

4.134 In order to manage its business risks, the department addresses key issues relating to policy advice and the provision of comprehensive education and training opportunities for Australian citizens. These issues involve relationship management with both external service providers and service recipients.

4.135 In managing these business risks, disciplined management and operational policies, practices and procedures are required over policy advising and program management activities, grant administration and the Higher Education Contribution Scheme.

Corporate governance

4.136 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing department's strategies, the ANAO focussed on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- the department's corporate direction as outlined in the corporate plan with short term priorities being assessed on an annual basis and reflected in the business plans of each work unit. A strategic risk management plan and risk assessment process has been developed through the Corporate Leadership Group, taking into account the high

priority risks and risk minimisation strategies identified by all divisions, which links the critical success factors set down in the corporate plan;

- the executive which conducts regular meetings with division heads focusing on key issues. The executive has also implemented detailed business planning and reporting processes to enhance divisional performance;
- the Audit and Business Assurance Committee which meets quarterly and actively focuses on internal and external audit, risk management and fraud issues, as well as monitoring departmental performance;
- a monthly reporting regime which reports actual versus budgeted departmental and administered activity across the department's outputs and outcomes. Included in this process is an analytical review of performance; and
- an internal audit strategy and plan which addresses key business and financial risks and covers all programs administered by the department.

Audit results

4.137 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	2	1	3	4
	2	1	3	4

IT environment

4.138 The IT control environment was examined as an integral part of the ANAO interim audit program. Examination extended to the operating platforms and major applications that contribute information to the financial statements. Several areas for improvement were identified and reported to management. Recommendations were made relating to:

- authorisation of change control processes;
- processes relating to default accounts/passwords; and
- the change control environment.

Financial reporting processes

4.139 The department has developed strong financial management processes that provide monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows. The reports provide actual versus budget information on both an accrual and cash basis allowing management to assess reliably the department's financial position and operating performance. A variance analysis is also provided to management.

Conclusion

4.140 The department has an adequate internal control structure and is in a sound position to produce reliable information for its annual financial statements. The department has agreed to action ANAO recommendations.

Department of Employment, Workplace Relations and Small Business

Business operations

4.141 The role of the Department of Employment, Workplace Relations and Small Business is to promote an efficient labour market and improved workplace relations and productive performance of Australian enterprises. The department's most significant business process is the management of contracts associated with the employment program.

4.142 The department contributes to the achievement of four government outcomes, namely:

- an efficient and equitable labour market that links people to jobs and promotes the transition from welfare to work;
- flexible and fair workplace relations at the enterprise level;
- an improved operating environment for small business; and
- electronic access to government information and services.

4.143 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$392.9 million; and
- administered appropriations—\$1354.5 million.

4.144 The department's average staffing level is 2081 across Australia.

Key business risks

4.145 In order to manage its business risks, the department addresses key issues relating to contracts associated with the employment program for Job Network and the Work for the Dole Scheme. Critical elements include the legal and probity issues associated with tender selection and contract management.

4.146 To deal with these business risks, disciplined management and operational policies, practices and procedures are required over decision-making processes covering job seeker applicants. In addition, there is a need for robust IT integrity processes designed to ensure proper controls over payment processing.

Corporate governance

4.147 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business

risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which has a strategic risk assessment process covering the main areas of business for allocation of resources and assessment of group and state business plans;
- executive/management arrangements including a business planning process that forms the basis of monthly evaluation of key milestones by the Corporate Leadership Committee;
- a committee framework that includes the Corporate Leadership Committee, the Financial Management and Audit Committee and the Fraud Sub-Committee;
- a reporting regime which includes a monthly accrual financial report that provides the executive and operational areas with key financial information; and
- a review and monitoring framework, including a strategic audit plan and an annual audit work plan endorsed by the Financial Management and Audit Committee and approved by the executive. The current fraud control plan was implemented in September 1999, based on a fraud risk assessment, and is currently being updated. All groups and state offices are identifying their fraud risks and formulating fraud control action plans from which the next departmental fraud control plan will be developed.

4.148 The Financial Management and Audit Committee is re-examining and re-defining its role and responsibilities. As well, the department's risk management arrangements are evolving.

Audit results

4.149 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	17	6	6	17
	17	6	6	17

IT environment and applications

4.150 An IT audit was undertaken of the Business Information System Financial Management Information System (BIS FMIS), Integrated Employment System (IES), Program Administration and Statistical System (PASS), and Financial Efficiency Strategic Planning System (FINEST) applications, as well as the mainframe and mid-range environments within which they operate.

4.151 In respect of the mid range environment and the BIS FMIS, control weaknesses were identified at the operating system level relating to unauthorised access to financial files and data. Access weaknesses were also identified in relation to the application system. The ANAO has performed testing in order to obtain reasonable assurance that unauthorised access has not occurred during the period under review.

Financial reporting

4.152 The department has acknowledged the identified deficiencies and put in place a monthly accrual financial reporting regime that provides the department's executive and operational areas with financial information in relation to its financial position and operating performance. The reports provide financial information by organisational groups and by output on budget versus actual results.

Conclusion

4.153 The department has acknowledged the control weaknesses noted above and has responded positively to the ANAO's findings and has advised of remedial action.

Department of the Environment and Heritage

Business operations

4.154 The Department of the Environment and Heritage consists of three autonomous units involved in the following operations:

- *Environment Australia*—the provision of advice on and implementation of policies and programs for the protection and conservation of the environment. This includes assistance to the Australian community to appreciate and conserve Australia’s natural and cultural heritage places for present and future generations.
- *Bureau of Meteorology*—the provision of meteorological and related hydrological and oceanographic services for the Australian community.
- *Australian Antarctic Division*—the maintenance of an Australian presence at stations on the Antarctic continent and the pursuit of Australia’s antarctic interests involving the protection of the antarctic environment and the conduct of scientific research.

4.155 The department’s appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$528.8 million; and
- administered appropriations—\$135.1 million.

4.156 The department’s average staffing level is 2554 across Australia.

Key business risks

4.157 In order to manage its business risks, the department addresses key issues relating to:

- *Environment Australia*—introduction of the new environment legislation and financial systems;
- *Bureau of Meteorology*—management of commercial services; and
- *Australian Antarctic Division*—changing the nature of operations and the implementation of an asset and inventory register.

Corporate governance

4.158 The ANAO’s audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department’s strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines the department’s strategic direction;

- weekly executive meetings which focus on operational and performance issues;
- the activity of relevant committees, namely, the Executive Group, the Information Technology Steering Committee and the Program Evaluation and Audit Committee;
- a monthly executive financial reporting regime which focuses on financial performance; and
- an annual audit plan set by the Program Evaluation and Audit Committee after consideration of critical success factors, key process and areas of high risk. The plan is aligned with the department's corporate and business planning strategies.

4.159 The department needs to formalise a risk management strategy identifying key risks and relevant mitigation plans.

Audit results

4.160 The following table provides a summary of the status of prior year issues and 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
Environment Australia				
A	3	3	1	1
B	6	3	5	8
	9	6	6	9
Bureau of Meteorology (refer para 4.162)				
A	0	0	0	0
B	1	0	0	1
	1	0	0	1
Australian Antarctic Division				
A	0	0	0	0
B	3	2	8	9
	3	2	8	9
Department of the Environment and Heritage (total)				
A	3	3	1	1
B	10	5	13	18
Total	13	8	14	19

Environment Australia

4.161 Control weaknesses were observed with:

- appropriations/revenues—an access issue exists with accounts receivable processing for other revenues. Users having incompatible duties are able to process incorrect or unauthorised receipts or credit notes in the SAP accounts receivable system;
- payments to suppliers—segregation of duties issues exist with respect to payments. It was noted that some users have incompatible duties, which may impact on the integrity of the data;
- payments to employees—issues were identified within the control framework relating to payroll systems. The most significant issue related to the lack of reconciliation of payroll data to the general ledger. Other control weaknesses related to the lack of segregation of duties in the advance payments process, access to ReserveLink and monitoring controls over changes to payroll data;
- asset management—Environment Australia has recently finalised its asset management policy. Currently, Environment Australia's asset register is not accurate or complete. The controls surrounding asset management are still being defined and implemented. The ANAO identified weaknesses in relation to the number of system users with access to asset related functions, the lack of timely updating of asset records, and lack of completion of reconciliations between the asset register and the general ledger; and
- IT environment—an IT review focusing on control issues was undertaken of the SAP administration, general ledger and related modules. The review also covered change control procedures, business continuity and disaster recovery planning. The review disclosed that work is still required to eliminate weaknesses in system security and access, inappropriate segregation of duties in change control procedures, and business continuity planning.

Bureau of Meteorology

4.162 Interim audit work for the Bureau of Meteorology had not been completed at the time of preparation of this report. Findings arising from subsequent audit work will be reported in the ANAO's December 2001 Audit Report.

Australian Antarctic Division

4.163 Control weaknesses were observed with:

- asset and inventory management—the division will be implementing in the current financial year a new fixed asset register module that interfaces with the existing FMIS. This will allow automatic monthly updating to the general ledger. As a result, processing of additions, disposals and other asset transactions in the current system has not been completed. The division has material inventories including research stations, clothing and maps. A number of control weaknesses were noted in relation to inventory valuation and stocktake procedures;
- appropriations/revenues—the ANAO noted control weaknesses in relation to the lack of formal agreements for the provision of services on a commercial basis, independent system-based approval of debtor write-offs, and lack of reconciliation of debtor balances to the general ledger;
- payments—control weaknesses were noted in relation to payment recording processes and also the lack of reconciliation of creditor balances to the general ledger; and
- IT environment—an exposure was noted in relation to the infrequent changing of passwords for the financial management information system.

Financial reporting

4.164 The department provides the executive and operational areas with financial information on the department's financial position and operating performance. The reports provide information by outcome on budget versus actual results.

Conclusion

4.165 Improvements have been achieved in the past year. However, the control environments for Environment Australia and the Australian Antarctic Division need improvement. The department has responded positively to the ANAO's findings and has advised of remedial action.

Department of Family and Community Services

Business operations

4.166 The Department of Family and Community Services (FaCS) is the principal policy formulation and advising body within the Family and Community Services portfolio. According to ministerial requirements, and within the relevant legislative framework, FaCS is responsible for implementing the Government's income security policies and delivering services for people with disabilities, families with children, community support, family relationships and welfare housing.

4.167 FaCS' service delivery obligations are undertaken by 'service providers', including Centrelink, State and Territory governments and state-based Non-Government Organisations.

4.168 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$2158 million; and
- administered appropriations—\$53 665 million.

4.169 The department's average staffing level is 5573 across Australia.

4.170 FaCS incorporates the Child Support Agency (CSA), CRS Australia (CRS) and the Social Security Appeals Tribunal (SSAT). However these organisations maintain separate identities. The comments provided below principally relate to FaCS' core business operations, and not those of CSA, CRS and SSAT, unless otherwise stated.

Key business risks

4.171 In order to manage its business risks, the department addresses key issues relating to the development of timely and effective policy advice. Separate to this requirement is the need to provide sound financial accountability processes over key service providers.

4.172 In managing these business risks, disciplined management and operational policies, practices and procedures are required over the adequacy of business management arrangements across the department (including CRS, CSA and SSAT). This necessarily involves implementing robust financial and human resource management systems which enable the provision of timely, accurate and secure information.

Corporate governance

4.173 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines strategic directions supported by operational business plans;
- an executive board which meets fortnightly, focusing attention on key departmental outcomes and the related strategic, financial and operational issues;
- an audit committee which meets at least quarterly focussing on risk management and the control environment, particularly relating to financial systems, accounting processes, audit planning and reporting including related assurance issues;
- preparation of monthly financial data and reports for review and analysis by branches, executive directors and the board;
- an internal audit strategy and plan which addresses key financial and business risks; and
- updated risk management and fraud control plans.

4.174 The on-going operation and effectiveness of these measures are critical to the level of assurance that the department and the ANAO require for financial statement purposes. Other issues noted, including aspects that need further enhancement, are discussed below.

Risk management

4.175 In the previous financial year, the ANAO recommended that FaCS undertake a high level risk assessment against existing controls, including those provided by other service entities, to determine the adequacy and effectiveness of existing mechanisms. The department has since focussed attention on:

- improving the controls over financial systems and accounting processes, particularly through the implementation of reconciliation checks, resulting in enhanced financial reporting;
- refining key FaCS risks by adopting a more structured approach to strategic risk management and by further integrating risk management into all elements of business planning and program and service delivery; and
- clearing outstanding internal audit and ANAO recommendations by

ensuring they have either been effectively implemented or discarded on the basis that they are no longer relevant.

4.176 The on-going effectiveness of these improvements will be monitored over the remaining period of the audit.

4.177 Over recent months, FaCS has also updated its analysis of the inherent risks faced by its key service providers when administering its programs. The analysis needs to consider, as part of developing an agreed and appropriate assurance framework, progressive reporting on:

- the quantum of funds disbursed by benefit type;
- inherent risks faced by the service provider for each benefit type and the controls, policies and procedures that it has in place to address these risks;
- review mechanisms that are in place to test the effectiveness of these controls, policies and procedures;
- changes made to applications and processes and the nature of testing and review procedures undertaken;
- results of internal audit and other testing undertaken, such as sampling, and, where deficiencies have been noted, the financial impact of those deficiencies and the corrective action taken; and
- the accuracy of processing achieved for each benefit type against agreed criteria, including legislative requirements.

4.178 The data and other information required to meet this type of assurance criteria need to be clearly defined.

Financial reporting processes

4.179 The department has improved the reliability of its financial reporting over the past year. Currently, monthly transaction reporting of results incorporating budget versus actual data is provided to branches. Monthly reporting is also provided to the executive board. However, while some analysis is included with the reports, planned improvements also involve the production of data at a lower level, thus enabling more meaningful financial analysis to be performed.

4.180 On the basis that it will provide increased financial statement assurance to management, the ANAO supports the above initiative and other measures that result in the availability of analysis to accompany transaction reports. In time, this action should lead to a better understanding of program costs and overheads and should also lead to better links between financial and non-financial measures. A suggested key financial metrics table has been discussed with senior management. Such a table will be of assistance to the department in the modelling of future financial reporting needs.

Audit results

4.181 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO for the department as a whole (including CRS and CSA).

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	2	1	0	1
B	4	4	8	8
	6	5	8	9

Administered appropriations and payments

4.182 In previous years the ANAO has drawn attention to the need for timely and accurate reconciliation processes to be in place between FaCS and Centrelink for administered appropriations disbursed by Centrelink for the payment of benefits. FaCS is currently in the process of implementing an enhanced monthly reconciliation process to ensure that the information provided to it by Centrelink is complete and accurate. The timely completion of this process, prior to 30 June 2001, is critical to obtaining adequate assurance as to the quantum of administered expenditure disbursed by Centrelink.

Student Financial Supplement Scheme

4.183 Financial data associated with the Student Financial Supplement Scheme (SFSS) represents a significant part of the department's financial statements. Concerns were raised in the 1999–2000 financial statement audit in relation to discrepancies between data provided by Centrelink and confirmations received from the Commonwealth Bank of Australia. At the instigation of FaCS, a comprehensive review of the accounting treatment of the SFSS is currently being undertaken in conjunction with Centrelink. This review is nearing completion and will result in increased reliability of the financial data. Implementation of the review recommendations should ensure accurate maintenance of data.

Child Support Agency (CSA)

4.184 The audit highlighted the following issues that should be addressed to ensure the adequacy of the control environment and the reliability of information contained within the financial statements:

- the accuracy of payroll entitlement calculations needs to be reviewed to ensure the reliability of personnel information;
- controls over the integrity of ATO data transfers need to be enhanced to ensure the completeness of each transfer;

- confirmation procedures in relation to ATO charges need to be established to clear outstanding unresolved amounts;
- monthly reconciliation processes need to be established over appropriation revenue;
- reviews of IT system access listings should be performed on a regular basis to ensure that unauthorised access has not occurred; and
- the provision for doubtful debts policy relating to administered receivables should be reviewed and revised as appropriate.

Conclusion

4.185 The department has strengthened its control environment over the past year. Progress is still required. Consequently it is important that FaCS and CSA resolve the issues outlined above. The department has agreed to the ANAO comments and accepted the recommendations aimed at strengthening controls and related procedures.

Centrelink

Business operations

4.186 Centrelink is an autonomous statutory authority, established under the *Commonwealth Service Delivery Agency Act 1997*, and is located in the Family and Community Services portfolio. It is the principal service delivery organisation within the portfolio and is responsible for linking Australian Government welfare services.

4.187 Centrelink's customers include retired people, families, sole parents, people looking for work, people with a short-term incapacity, people with a disability, carers, widows, primary producers, students, young people, Indigenous people, and people from diverse cultural and linguistic backgrounds.

4.188 Centrelink operates under a purchaser/provider framework and obtains the majority of its funding through business partnership arrangements, on a fee for service basis, with client entities that purchase Centrelink's services. Centrelink's estimated total revenue from client entities and other sources for the year ended 30 June 2001 is \$1762.2 million.

4.189 Centrelink operates an extensive customer service centre network across Australia and employs approximately 21 000 people.

Key business risks

4.190 In order to manage its business risks, Centrelink addresses key issues relating to its control and security frameworks and the integrity of its information systems for managing client information and for disbursing payments to benefit recipients.

4.191 In managing these business risks, disciplined management and operational policies, practices and procedures are required over the operations of its customer service centres which necessarily have complex case management issues. Supporting this approach, is the need for complex IT systems and applications, which are designed to not only meet operational requirements, but also the requirement to undertake and reflect relevant accountabilities.

Corporate governance

4.192 The ANAO's audit approach considers goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing Centrelink's strategies, the ANAO focused on the key initiatives in place to meet Centrelink objectives and the management of the business risks

associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines strategic directions and which is supported by operational business plans;
- a board of management which determines corporate strategy; provides guidance to senior management; and reviews the overall business plans and significant policies to ensure that its obligations to client agencies and other stakeholders are met;
- an audit committee that ensures Centrelink operates with appropriate financial management and internal controls;
- a reliable and comprehensive monthly accrual based financial reporting regime which also integrates financial and non financial performance information; and
- a review and monitoring framework, including an assessment and compliance review process over benefit payments, and an audit and evaluation function over the control environment and financial statement process.

Audit results

4.193 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	1*	0	10	11
	1	0	10	11

Note * The 'B' finding raised in March 2000 related to the development of an over-arching risk assessment. This finding included a number of IT issues that had been noted in prior years. Progress has been made in addressing these issues with remaining issues distilled into the closing position number of issues noted at March 2001 above.

Systems impacting client entities

4.194 A number of audit issues have been raised with Centrelink, which if appropriately addressed, should increase the level of assurance over the correctness of benefit payments. The significant audit issues and recommendations are outlined below.

Risk management

4.195 During the interim phase of the 1999–2000 financial statement audit, the ANAO noted that Centrelink had established a number of key risk management strategies that focussed on critical elements of its business. It was also noted that Centrelink was at the stage of incorporating these strategies into an integrated organisational risk management framework. The ANAO recommended that priority be given to the development of a high-level risk management strategy focussing on the critical components of Centrelink’s business. It was considered that a strategy of this nature would provide a valuable insight into those areas where assurance processes require attention and identify any residual risks not controlled adequately or controlled excessively.

4.196 During the interim phase of the 2000–2001 financial statement audit, the ANAO noted that Centrelink has commenced development of a high-level risk management strategy. Specifically, Centrelink’s Board has endorsed a strategic risk management plan. Phase one in the development of a risk registration regime has been completed. This regime encompasses the collation of existing information into an integrated framework and the production of reports on business risks, payment correctness and the adequacy of controls.

4.197 Prior to the completion of the 2000–2001 financial statement audit, the ANAO will undertake a progressive assessment of the effectiveness of Centrelink’s risk management framework and strategies.

IT systems and controls

4.198 Reliance on the ongoing integrity of Centrelink’s core application systems is critical to ensure services are delivered in an accurate and timely manner. These systems have been developed over a number of years and are designed with various system controls and business rules. Recommendations have been made in the following areas to improve internal controls:

- monitoring of SAP security;
- reviewing the number of users with access to production data;
- undertaking follow up of payment discrepancies;
- performing reconciliations of ‘unpresented cheques’ to the CHRIS system;
- reviewing tolerable error escalation factors as part of the payment reconciliation process;
- monitoring rule changes;
- updating documentation of reconciliation procedures;

- developing contingencies over financial system back up logs; and
- updating documentation for financial system security policies and procedures.

Centrelink's financial statements

4.199 The results of the interim audit indicated that key elements of the internal control structure and significant business processes are effective. An issue that does, however, need to be rectified is the reconciliation between the general ledger and the payroll system.

Financial reporting

4.200 Over the years, the ANAO has noted the improvements achieved in monthly financial reporting. Monthly financial reporting is considered to be effective and timely. Moves to integrate further financial and non-financial reporting are supported on the basis that it provides increased financial statement assurance to all stakeholders.

Conclusion

4.201 The control framework over financial statement business and accounting processes is operating effectively. In the context of the control environment for client administered disbursements, Centrelink should address the control issues noted above. Centrelink has responded positively to ANAO recommendations.

Department of Finance and Administration

Business operations

4.202 The department's role is to assist the Government achieve its objectives by providing policy advice and services. Finance accomplishes this by contributing to three key outcomes: sustainable government finances; improved and more efficient government operations; and an efficiently functioning Parliament.

4.203 Finance's operations are diverse, ranging from Budget preparation and managing a large domestic and overseas property portfolio, to providing cars and drivers for Senators and Members of Parliament.

4.204 The department has entered into a large number of outsourcing arrangements for the provision of human resource management, financial reporting, Internal Audit, office services, IT services and Comcover's Client Services. In addition, the department has recently entered into a strategic alliance with PricewaterhouseCoopers to manage the non-defence property portfolio.

4.205 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$473 million; and
- administered appropriations—\$4048 million.

4.206 Finance's average staffing level is 741.

Key business risks

4.207 In order to manage its business risks, the department addresses key issues relating to:

- delivering government reforms and priorities;
- providing high quality advice and service; and
- contributing to sustainable government finances.

4.208 In managing these business risks, disciplined management practices are required over preparation and support in delivery, of the Commonwealth budget, policy advice and organisational management, property management, contract management, grants and subsidy payments, administration of Commonwealth Superannuation and administration of Commonwealth Insurance.

Corporate governance

4.209 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the

department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives.

4.210 The department recognises the need for an effective internal control structure as part of good corporate governance and aims to ensure it is reflected in its organisational arrangements including its planning, structures and processes, internal controls, its ethics, reputation and standards of behaviour. Over the past year, the department has worked to strengthen its control structure to respond better to business and financial risks. Key elements of the control structure which contribute positively to financial assurance include:

- an executive which meets weekly and considers a wide range of operational and strategic issues;
- upgraded financial management reporting arrangements that include the Finance Management Branch commencing the presentation of accrual based reports to the executive;
- an audit committee with the prime responsibility of assisting the Secretary meet his corporate governance responsibilities with a particular emphasis on the control environment and financial reporting responsibilities. The committee meets quarterly and maintains an active internal audit program, a focus on risk management and financial statement issues; and
- comprehensive reviews of CEIs, operational guidelines, financial procedures and fraud control plan.

4.211 The ANAO has noted that the department has focussed increased attention on improving the controls over financial systems and accounting processes resulting in enhanced financial reporting.

Audit results

4.212 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	3	3	4	4
	3	3	4	4

4.213 The department's key systems concentrate on financial, personnel, and parliamentary salaries and expenses. These systems include QSP, AURION and SAP respectively.

4.214 QSP is the department's primary financial system. One of the major issues, to deal with this financial year, is security policies and procedures not supported by a risk assessment of the system. In the absence of such a risk assessment, an effective preventative control over unauthorised changes to data is not assured. In addition, privileged system access was made available to persons outside of their sphere of responsibilities.

4.215 SAP is the department's financial system for recording parliamentarians' expenses and payroll function. The major issues that need to be addressed are inadequacies surrounding passwords and access controls to SAP. In addition, security improvements are required over SAP privileged user profiles. The effect of these weaknesses, in addition to the absence of reconciliations and adequate end of month procedures, is an information integrity risk that can adversely impact the reliability of the financial information.

4.216 A number of other procedural matters have been identified and are being addressed by Finance management.

Financial reporting

4.217 The department has developed strong financial reporting processes that provide monthly reports on administered and departmental revenues, expenses, assets and liabilities and cash flows. The reports provide actual versus budget information on an accruals basis, allowing management to assess reliably the department's financial position and operating performance.

Conclusion

4.218 The department continues to strengthen its internal control structure. Finance management has agreed with the ANAO findings and accepted the recommendations aimed at strengthening controls and procedures.

Department of Foreign Affairs and Trade

Business operations

4.219 The Department of Foreign Affairs and Trade aims to advance the interests of Australia and Australians internationally. The department is responsible for providing passport and consular services and provision of a network of Australian Embassies, High Commissions, Consulate and Multilateral missions, as well as other activities to achieve its aims and to support other Commonwealth entities in achieving their related aims.

4.220 The department's key business processes relate to the provision of:

- passport services;
- consular services;
- provision of Overseas Post Network; and
- provision of services to attached entities.

4.221 The department's principal appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$685.6 million; and
- administered appropriations—\$160.2 million.

4.222 The department's average staffing level is 3377 in Australia and overseas.

Key business risks

4.223 In order to manage its business risks, the department addresses key issues relating to:

- maintaining effective relations with other countries and the ability to influence global and regional developments to protect Australia's interests;
- maintaining a secure and effective overseas network; and
- meeting client expectations and demands for consular and passport services, including the requirement to have continued security over passport operations.

4.224 In managing these business risks, disciplined management and operational policies, practices and procedures are required over foreign and trade policy and related diplomatic activities. Integral to this are human resource management (including the retention of skilled staff) and sound financial management processes and systems that support a large network of overseas posts.

Corporate governance

4.225 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines departmental strategic directions and which is supported by operational business plans;
- an executive committee that meets fortnightly and which oversights the performance of the various divisions; considers departmental wide issues; and monitors financial results;
- a review which includes divisional evaluations, overseas post and state office evaluation reviews;
- an audit committee that meets quarterly and directs internal audit coverage and focuses attention on risk management and fraud control planning; and
- a financial reporting regime which is strengthening its accrual based reporting.

4.226 While progress is still required, the ANAO has noted that the department has focussed increased attention on improving the controls over financial systems and accounting processes resulting in enhanced financial reporting.

Audit results

4.227 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	2	2	4	4
	2	2	4	4

4.228 As part of the audit process, any opportunities for improvement, or matters that may impact on the department's current risk strategies are raised with management. A number of departmental initiatives are evident which have enhanced the overall control structure and should aid in financial statement preparation at year end. However, continuing weaknesses were noted in the area of IT access security which require

resolution before systems will be able to achieve their full potential. Particular issues relate to:

- strengthening access controls to the department's financial and human resource management systems to restrict the possibility of unauthorised access;
- improving password controls over application security to protect the integrity of systems data and programs; and
- the review of user access listings to check that unauthorised access has not occurred.

Financial reporting

4.229 Over the past year, the department has significant improvement to its financial reporting processes and capabilities. This follows the challenges experienced in the previous year associated with the implementation of the SAP financial system in Central office and overseas posts. Improvements are expected to continue in the quality of financial reporting and the level of financial analysis available as the department moves to further strengthen its end of month reporting processes.

Conclusion

4.230 The department has achieved improvements in its financial reporting and internal control structure and has responded positively to ANAO findings and recommendations.

Department of Health and Aged Care

Business operations

4.231 The role of the Department of Health and Aged Care, as set out in its mission statement, is *'to lead the development of Australia's health and aged care system.'* The department's key business processes relate to:

- the provision of expert advice and analysis to the Government;
- implementation of new government policy in a manner which addresses both individual and population needs and focuses on quality and outcomes to improve the delivery of health and aged care;
- promotion of investment in preventative and early intervention practices, through the identification of best practice and effective service delivery incentives;
- supporting health and medical research activities, and working with the States and Territories to set priorities and strategic directions for developing progressive policies and reforms to provide an internationally recognised health care system to all Australians; and
- the administration of grant and subsidies payments.

4.232 The department's appropriation funding for the year ended 30 June 2001 is represented by:

- its price of outputs—\$653 million; and
- administered appropriations—\$25.6 billion.

4.233 The department's average staffing level is 3067 across Australia.

Key business risks

4.234 In order to manage its business risks, the department addresses key issues relating to:

- the delivery of timely health care policy to ensure adequate health services are available to all Australians; and
- the administration of aged care payments.

4.235 In managing these business risks, disciplined management and operational policies, practices and procedures are required over the implementation of grant programs in a decentralised environment. Central to this requirement, is the department's ability to monitor the quality of accommodation and care to the aged and frail. These activities are supported by comprehensive IT systems.

Corporate governance

4.236 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which outlines the broad strategic direction supported by divisional operational plans;
- a departmental management committee which is chaired by the Secretary and assesses the overall performance of the department's operations;
- major committees including the Performance Assessment Committee, the Human Resource Management Committee, the Information and Privacy Protection Committee and the Finance Committee;
- an audit committee that meets at least quarterly and which focuses on risk assessment, internal audit activities, external audit activities, and fraud control;
- a monthly reporting regime which reports actual versus budgeted departmental and administered activity; and
- an Audit and Fraud Control Branch which develops an internal audit strategy and plan and coordinates the departmental risk management plan.

4.237 The department's ability to achieve disciplined stewardship of resources would be enhanced by:

- an increased financial management skill-base in Central Office commensurate with the size and complexity of the department's operations and budget;
- an improved financial management reporting structure to provide executive management with meaningful and sufficiently high level strategic financial advice and analysis; and
- refining its approach to risk management by ensuring all key areas prepare risk plans consistent with the high level plan prepared for the department as a whole. Furthermore, all plans could then be consolidated and prioritised on a departmental-wide basis and used to underpin the development of operational business plans.

Audit results

4.238 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	1	1	1	1
B	1	1	12	12
	2	2	13	13

4.239 With the implementation of a new Financial Management Information System (FMIS), a considerable number of control weaknesses have been identified. This partly explains the significant increase in findings from the prior period.

Administered payments

4.240 The major disbursements of Administered Appropriations are towards personal benefits (46 per cent of administered expenditure), grants (40 per cent) and subsidies (14 per cent) payments. A number of control issues were raised in relation to administered payments.

Identification of overpayments and their recovery

4.241 When overpayments occur in relation to community and aged care facilities, recoveries are made either against future advances or repayments from the provider. The ANAO has identified a number of instances where recovery action was still to be taken to recover the overpayments. There is no information available in the department's payment system as to when, or whether, the outstanding amount has been recovered.

Recoveries not recorded on the system

4.242 Further to the above, very few of the ongoing recoveries have been recorded on the department's FMIS. In most instances, the recovery is recorded on the system after the receipt of the cheque/payment. Without an adequate system to monitor and to report the amount of the outstanding debts, it is not possible to ensure recoveries are properly managed and that financial data is complete and accurate.

Delegation to pursue recovery of debt

4.243 In some instances, a delay of four to ten months between the payments of subsidies and final recovery of overpayments has been observed. The decision to recover gradually the overpayments over a

period of time is made on a case by case basis by staff who are involved in processing the payments. Such instances of 'lengthy' recovery impacts on the accuracy of the financial statement balances, particularly if made over two financial periods. Of particular concern is the absence of any Central Office instructions/directions as to when, and how, the decision to recover the overpayments is made.

Payroll tax supplement payments

4.244 There is no evidence of the department checking the validity of payroll costs claimed by providers of community and aged care services. Furthermore, there is the potential for adverse publicity for the department if incorrect payments were made for payroll tax supplementation due to false claims lodged by providers. This issue was raised in the prior year audit findings. However, to date, the department has not adequately addressed this issue. Moreover, the proposed changes to the way the Payroll Tax Supplement payments are calculated as at 1 January 2001, creates additional problems in terms of system readiness, complexity of calculations and lack of staffing resources.

Built-in controls in aged care payment system—SPARC

4.245 Instances were noted where the information entered into the aged care system (SPARC) or the manner in which payment was made, was contrary to the built in controls of the system. The business rules within the system are created to reflect the policies of the department. Any alternative method of making payments increases the risk of incorrect and invalid payments.

4.246 As the SPARC system holds liabilities under the \$200 threshold for adjustment against the next advance payment, reliance is placed on manual controls for the identification of these balances. ANAO found a number of such cases where the department has not followed up and paid the outstanding amounts.

Authenticity of a delegate's signature

4.247 Instances were noted where the signatures on forms used for aged care assessment/reassessment were not verified as appropriately authorised. Authorisation listings were not always regularly updated. Further, on numerous occasions there was no indication that such signatures had in fact been checked. In these circumstances, the department has a risk of accepting fraudulent/ invalid assessments and, consequently, making invalid payments.

Subsidies paid to providers from incorrect appropriation

4.248 The department put in place a contingency plan to ensure that, in the event an aged care facility closed down, beds would be available in an alternative facility to provide care for displaced residents. The contingency plan consisted of an agreement whereby alternative facilities would receive payments to ensure care, and accommodation services were immediately available, to provide seamless care to residents from closed facilities.

4.249 Legal advice obtained by the department indicates that section 83 of the *Aged Care Act 1997* allows for the making of such grants. The issue raised here is the source of appropriation funding for those payments.

4.250 It is ANAO's view that moneys appropriated for residential care grants or subsidies could not be utilised for the agreements in question because there were no specific aged care individuals in mind at the time of making the payments under the agreements. Consequently, the criteria set out in section 20 of the Act were not satisfied. Section 20 states that *'subsidy cannot be paid ... for providing residential care to a person unless that person is approved under this Part as a recipient of residential care.'* The department's lawyers support this view. Nevertheless, the special appropriation for residential care subsidies, under section 20 of the Act, was originally used by the department to make the payments related to the agreements.

4.251 Alternative appropriations could have been used for the purpose. For example, appropriations for restructuring could have been utilised.

4.252 By drawing from appropriations under section 20 of the Act without authority, the department breached section 83 of the Constitution. Section 83 states that no money shall be drawn from the Treasury of the Commonwealth except under appropriation by law. The department has subsequently reversed the charge against the incorrect appropriation and charged the payment against the correct appropriation. The department has also provided specific systems training for relevant payments staff.

SAP system implementation

4.253 The department replaced the FINEST system with SAP FMIS in December 2000. At the time of the audit, controls within the SAP FMIS were not of the standard of a mature system. Controls that should be improved include:

- the level of audit trail within SAP;
- control over privileged user access; and
- segregation of duties in areas such as vendor creation, invoice entry, journal entry, and asset management.

4.254 While some level of audit trail exists within SAP at present, changes to tables containing master data and critical system information are not logged.

4.255 It is not unusual, at the time of implementing complex systems such as SAP, that key implementation staff have elevated levels of access to assist in a smooth transition. However, approximately five months after going 'live', the former implementation team continued to have highly privileged user access to SAP.

4.256 SAP FMIS was implemented without 'work-flow processing' and is largely driven by a paper based system of input. While the physical documents demonstrate the requirements for segregation of approval and delegation, these same controls do not generally exist within SAP. In some instances segregation, such as the creation of an invoice and its subsequent approval, does occur through procedural measures, even though access control within SAP allows the one officer to complete both steps. It has, however, been observed that, at times, this procedural requirement has been bypassed. For example, this has occurred with the processing of invoices at the time of a large backlog.

4.257 While SAP allows transactions to be processed without separate authorisation within the system, it is essential that some independent review of SAP transactions be undertaken on a regular basis. While the department has plans to implement this control, it is generally not yet in place.

Responsibility for IT controls

4.258 The department has outsourced the delivery of its IT processing including mainframe and server administration and management. The outsourcing arrangement provides for the outsourcer to manage the configuration and operation of the mainframes and servers including, as required, change management, security configuration, control and privileged user access, and the business resumption plan. Although the department has outsourced the service delivery of its IT infrastructure, it retains the responsibility for ensuring that effective controls are in operation. The ANAO reviewed the existence of formal processes to provide assurance relating to:

- control over privileged user access;
- system administration;
- configuration management;
- change management;
- physical environment;
- IT security policy; and
- business resumption planning.

4.259 The ANAO considers that the department is meeting its obligations in the above areas. Notwithstanding the above, there is still some progress to be made in developing appropriate security arrangements for SAP and subsidiary IT platforms.

Financial reporting

4.260 Over the past year, the department has made improvements to its financial reporting process. In the current financial period, a new FMIS has been implemented and a new personnel system was implemented in April 2001. It is expected that the implementation of these two systems will enhance the financial reporting ability of the department and assist in management reporting.

Conclusion

4.261 In the departmental context, audit work undertaken on the controls over IT systems and business processes indicate that there are weaknesses relating to the security of the department's primary FMIS system, SAP.

4.262 With administered program expenditure, the ANAO also noted weaknesses relating to controls associated with program management within the aged care division.

4.263 The department generally agrees with these findings and is undertaking steps to address ANAO recommendations.

Health Insurance Commission

Business operations

4.264 The Health Insurance Commission (the commission) is a Commonwealth statutory authority that supports the delivery of quality health care to Australian residents. This is achieved by providing the Australian community with convenient access to government benefit payments and a range of health insurance products. Among the commission's main activities are the administration of Medicare, the Pharmaceutical Benefits Scheme (PBS), and the Premium Reductions Scheme (30 per cent Rebate Scheme). The commission also administers a number of health incentive programs and grant schemes as well as processing the payment of benefits for the Department of Family and Community Services (FaCS), the Department of Veterans' Affairs (DVA) Treatment Accounts and the Office of Hearing Services.

4.265 All commission activities are conducted within the policy framework set by the Government and other relevant legislative requirements. The commission focuses on the operational service delivery of the programs and payments within that policy and legislative framework.

4.266 In 1999–2000, the commission received administered funding of \$12.6 billion for benefit and other payments. The commission also received \$392 million in operational revenues for the processing of the payments, from the relevant entities. The cost of providing these services totalled \$416 million.

4.267 The commission had an average staffing level of 4400 across Australia.

Key business risks

4.268 In order to manage its business risk, the commission addresses key issues relating to significant health care benefit payments. Critical issues include:

- identification and management of fraud and inappropriate practices;
- administration of the 30 per cent Rebate Scheme; and
- management of service level agreements with other entities.

4.269 In managing these business risks, disciplined management and operational policies, practices and procedures are required over benefit administration which is supported by the commission's IT infrastructure, including associated operating and accounting systems.

Corporate governance

4.270 The ANAO's audit approach considers the commission's goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the commission's strategies, the ANAO focussed on the key initiatives in place to meet commission objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- the commission's strategic plan which includes key performance measures and formal risk management policies;
- regular board meetings;
- a framework of committees which include the Audit Committee, the Fraud and Service Audit Committee, Business Outcomes and Human Resource Committee;
- six monthly financial reporting of actual results against budget; and
- a comprehensive internal audit function.

Audit results

4.271 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>Status of prior issues at March 2001</i>	<i>Prior issues still to be tested*</i>	<i>New issues to March 2001</i>	<i>Closing position at March 2001</i>
A	4	3	1	0	0	1
B	32	7	25	11	6	20
	36	10	26	11	6	21

Note * Items within the 'prior issues still to be tested' column relate to five issues which are yet to be tested and six issues which are outside the scope of this year's audit and will be tested as part of the IT 'firewall' testing in future years.

Finnet (SAP R/3) review

4.272 An update review of the financial management system, FINNET (SAP R/3) was conducted following ANAO's initial review in 1999–2000. The objective was to determine the effectiveness of the key controls within the system and to complete testing to ensure the reliability of the information provided to the commission. Areas noted for improvement are as follows:

- SAP R/3 Basis Security—Current controls need to be strengthened

over assignment and review of privileged and general user access, and setting of appropriate system parameters.

- **Financial Accounting**—There is still no utilisation of the SAP R/3 reporting functionality and no change to the transaction codes and general ledger structure to complement an efficient reporting process and management trail.

4.273 The commission has delayed remedial action as the SAP R/3 system is currently being upgraded.

30 per cent Rebate Scheme

4.274 The internal controls surrounding payments made under the 30 per cent Rebate Scheme need to be strengthened to ensure the accuracy and validity of the payments made to the Health Funds. In the past, the commission has had limited legislative power to obtain the necessary information to substantiate claims made by the Health Funds. During 1998–1999, the commission advised that effective controls would be in place after the passing of legislative amendments. However, this process was not effective due to system change constraints. This issue requires the continued attention of management to ensure the accuracy and validity of payments and to ensure internal controls are strengthened. Expenditure under this scheme is in excess of \$1.5 billion.

4.275 The commission is addressing the issue by arranging for the provision of audit certificates from each Health Fund as at the end of the financial year. The commission is reliant on post audit certification processes for the confirmation of the expenses made in relation to this Scheme. Monitoring of this process remains a major issue. The outcomes are problematical until receipt of audit certification occurs.

Medicare and the Pharmaceutical Benefits Scheme

4.276 In addition to reviewing the accounting processes and controls surrounding payments, assurance is obtained from the results of the various compliance reviews conducted by the commission's Professional Review Division (PRD) on fraud and inappropriate practices. Review of the major prior year findings has shown little progress in resolving the issues that the ANAO highlighted in previous years. Issues still remaining include:

- controls surrounding the eligibility of non-concessional PBS claim recipients; and
- quality control procedures within both PBS and Medicare.

IT control environment

4.277 The ANAO has reviewed the commission's IT control environment to identify any control weaknesses that currently impact, or have the potential to impact, on the commission's accounting systems and processes. The scope of the review addressed controls in logical and physical security, mainframe operations, business continuity management and change management.

4.278 While enhancements have been made to the commission's IT control environment, in the case of logical security the following issues should be addressed:

- inappropriate access privileges of staff; and
- assignment and review of access as it relates to job role and responsibility, as well as to the organisational structures.

Compensation payments

4.279 The commission administers compensation payments and revenue collection on behalf of DHAC. Compensation payments rely on a voluntary disclosure system whereby the claimants supply the information to the commission in order to receive payment.

4.280 During previous reviews of the compensation program, the ANAO found a number of issues that were drawn to the attention of the commission's management. These issues are summarised below and remain unresolved in 2000–2001:

- the general ledger structure used to account for the program does not readily facilitate effective management and reporting of the balances and transactions;
- a memorandum of understanding or service level agreement is not being utilised to ensure that agreed processes and procedures are being carried out efficiently and effectively; and
- inherent limitations exist in the process to determine the level of past benefits paid to claimants. Subsequently, the commission is forced to rely on the provision of client statutory declarations to assess payments made and hence establish amounts owing.

Reconciliations

4.281 A number of reconciliation issues have been noted during the ANAO's audit process. Reconciliations are a fundamental management control which ensure the validity, accuracy and completeness of information contained in the general ledger. Without adequate attention to the procedures required, the validity of reconciliations is undermined. Areas of concern include:

- some PBS reconciliations were incomplete; formats for the preparation of reconciliations were outdated; and the appropriate level of attention to detail was not being provided;
- there are no comprehensive procedures or daily processes for Benefit Reconciliation, Update, Cheque, Enquiry (BRUCE) system reconciliations;
- BRUCE reconciliations were not always signed as reviewed by a second officer;
- reconciliation of some banks accounts has not been performed on a timely basis; and
- a number of reconciliations could not be located during testing.

4.282 It was recommended that the commission periodically review the reconciliation procedures being followed to ensure that the outcomes of work performed are in accordance with the intentions of management.

Asset management and recording

4.283 The ANAO has noted areas which require further attention in relation to aspects of asset management. Asset issues have continued to arise due to resourcing constraints and a lack of clearly defined responsibilities. These issues are currently being evaluated with corrective action being implemented. The major issues include:

- numerous assets with a zero book value are still recorded in the asset register;
- asset capital expenditures are being written off as repairs and maintenance expenses rather than being capitalised;
- an asset stocktake is not planned for this year;
- proceeds from sale on disposal of assets are not being recorded in the asset register; and
- a register of portable and attractive asset items is not maintained.

Financial reporting

4.284 Improvements have been achieved in management reporting. The information currently provided to management includes explanation of variances from budget at a high level as well as assumptions utilised in deriving forward projections. It is in a similar format to that in the statutory financial statements.

Conclusion

4.285 Improvements are required to the internal control structure. The commission's management has responded positively to ANAO findings and the associated recommendations. In a number of cases, the commission has already taken action to address some aspects of the deficiencies identified by the ANAO. The commission has advised that high priority has been placed on resolution of all matters.

Department of Immigration and Multicultural Affairs

Business operations

4.286 The Department of Immigration and Multicultural Affairs (DIMA) is responsible for providing lawful and orderly entry and stay of people; and promoting a society that values Australian Citizenship, appreciates cultural diversity, and enables migrants to participate equitably.

4.287 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$779.7 million; and
- administered appropriations—\$145.8 million.

4.288 The department's average staffing level is 3949 in Australia and overseas.

Key business risks

4.289 In order to manage its business risks, the department addresses key issues relating to:

- the issue of incorrect visas;
- non-compliance by immigrants/visitors with visa conditions;
- the identification and management of unauthorised arrivals; and
- inappropriate administration of detention functions.

4.290 In managing these business risks, disciplined management and operational policies, practices and procedures are required over policy and program management activities, including compliance and regulatory standards and contract management. Central to this requirement is adequate support services, including human resources and financial management, together with relevant secure IT systems.

Corporate governance

4.291 The ANAO's audit approach considers departmental goals and priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a fortnightly meeting of the management board which focuses on departmental-wide operational issues and monitors performance;

- a finance committee which examines proposals to ensure they are consistent with stated objectives and that costs are contained within budget before submission to the management board;
- an audit and evaluation committee that meets quarterly and which focuses on risk management, internal audit planning and results, ANAO audit activity, compliance checks and financial reporting;
- a strong monthly reporting regime that includes detailed accrual reporting of all operational areas and variance analysis of results against budget; and
- a review and monitoring program including an internal audit function. The department's fraud control plan was recently updated and a risk management strategy is currently under review.

Audit results

4.292 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	9	7	6	8
	9	7	6	8

Reconciliation regime

4.293 SAP is an integrated financial management information system (FMIS) linked to a variety of modules including receipting, banking and payments processing. Where information is input into SAP from other systems, it is essential that a formal reconciliation regime is maintained to ensure the integrity of the data within the general ledger.

4.294 ANAO testing noted that:

- appropriation details recorded in the department's general ledger were not reconciled to the information held in Finance's appropriation management system;
- items in bank clearing accounts were not followed up and cleared in a timely manner; and
- the payroll reconciliation was not reviewed by an independent officer.

4.295 It was recommended that the department include follow-up of bank clearing accounts and the completion of appropriation reconciliations in their end of month procedures. It was further recommended that completed reconciliations are reviewed and signed-off by a supervisory officer.

IT control environment

4.296 The ANAO has completed reviews of the SAP R/3 financial management Information system and the Integrated Client Support Environment (ICSE) application and raised a number of issues in relation to access security. The issues include the following:

SAP R/3

- lack of regular review of user access to the system;
- programmers having inappropriate access to the production system;
- non-compliance with change control procedures; and
- inadequate monitoring of critical system tables.

ICSE

- lack of regular review of redundant user access; and
- formal change control procedures need to be developed.

4.297 The ANAO notes that SAP security is currently being reviewed as the department prepares to upgrade the application to version 4.6C. Consequently, the ANAO plans to revisit SAP security as part of the final audit process.

Financial reporting

4.298 Improvements have been achieved in the quality of financial data, reporting and analysis. A detailed accrual based financial report is produced each month. Advancements are expected to continue in the year ahead as the department moves to strengthen further its end of month procedures for its business and accrual accounting processes.

Conclusion

4.299 The department has strengthened its financial reporting and internal control structure over the past year. The department has accepted the ANAO findings and agreed to implement ANAO recommendations aimed at further strengthening its controls and procedures.

Department of Industry, Science and Resources

Business operations

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

4.301 The department's appropriation funding for the year ended 30 June 2001 covers:

- its price of outputs—\$249.1 million; and
- administered appropriations—\$904 million.

4.302 The department's average staffing level is 1567 in Australia and overseas. The department is responsible for the administration of various programs involving the payment of funds to third parties. The management of the payment of grants and subsidies is currently being moved from the relevant individual divisions to a service provider arrangement with the AusIndustry Division as part of the 'One-Stop-Shop' arrangement.

Key business risks

4.303 In order to manage its business risks, the department addresses key issues relating to:

- stakeholders and funding recipients that do not meet their objectives/performance criteria; and
- emerging globalisation of industry which may create new challenges to the continued relevance of the department's activities.

4.304 In managing these business risks, disciplined management practices are required over reputation risk associated with advice provided by the department and the ability to remain cost effective in delivering services for the Commonwealth. The major financial risks relate to the management of grant expenditure and cash management processes.

Corporate governance

4.305 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place

to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance are discussed below.

4.306 The department is currently undertaking a number of initiatives to revise and strengthen its governance arrangements. Included as part of this approach is a review of the department's current and future business needs; examination of risks facing the department; and evaluation of threats and exposures. The review will result in the development of a business risk plan and revised fraud control plan.

4.307 Over the past two years, the department has revised its management structure to align better with changed responsibilities resulting from the Administrative Arrangement Orders, accrual budgeting and reporting reforms, including the delivery of outcomes and outputs, and to strengthen financial governance. These revisions extend to responsibility for executive management as well as for corporate management and day to day financial administration. The new arrangements have been supported with the development of updated CEIs and relevant guidelines, along with a range of education and training aimed at enhancing financial management and responsibility/accountability.

4.308 The ISR Leadership Team consisting of the Secretary and key senior management meets monthly to review departmental activity, including financial activity, and has established mechanisms to monitor progress and emerging issues.

4.309 In addition, the department has established a number of senior management committees as part of its governance structure as follows:

- Portfolio Managers Meetings—consists of ISR members and Heads of AGSO, IP Australia, AGAL, AUSLIG, ASDA and ASC. Meetings are held weekly to consider and coordinate views on portfolio activities.
- Budget and Finance Committee—is designed to assist the ISR Leadership Team by providing advice in respect of expenditure and budget allocations.
- Departmental Audit and Evaluation Committee—is responsible for providing assurance to the Secretary on the efficiency, effectiveness and probity of activities, particularly in relation to the expenditure of allocated funds and the preparation of the financial statements and management issues which arise during audit processes.

Audit Result

4.310 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	3	3	0	0
B	8	6	0	2
	11	9	0	2

4.311 The department has moved to address many of the control deficiencies reported at this time last year, which required the ANAO to adjust its audit approach towards heavier substantive audit procedures.

4.312 The ANAO intends to place reliance on the controls that support the recording and processing of expenditure and receipts through the department's corporate financial and human resource management systems (Finance One and Open Aurion). This includes the recording of assets, payroll and other employee expenses, purchasing and accounts payable, and the maintenance of an effective general ledger.

4.313 A number of instances were noted where the new process and control arrangements were still being bedded down. These matters have now been largely resolved. A number of specific issues have been referred for further attention, including:

- Business Resumption Planning (BRP); and
- IT security policy.

Business resumption planning

4.314 The department has not formally assessed and addressed the risk it faces from the loss of, or disruption to, its systems. Normal practice is for an organisation to assess the risks that it faces from disruption to business operations and as a result of such analysis, develop strategies to address the business risks identified.

IT security policy

4.315 For an organisation to be able to implement adequate and appropriate IT security controls, it should have an approved IT security policy. This policy would normally be developed following a risk analysis of threats to the department's IT environment and addressing the IT security needs of the organisation, including the impact of outsourcing. The current departmental IT Security policy, which was developed in 1997, covers only security issues for desktop and notebook users, not for

the overall IT infrastructure, and does not take account of new systems and outsourcing of the management of IT facilities.

Prior year issues

4.316 The controls report presented to the Parliament for the 1999–2000 financial year identified significant weaknesses in a number of areas covering management, and IT and manual processes that support financial processing, including:

- financial management and reporting;
- timely and appropriate reconciliations of the department’s resources and systems;
- a control environment that allows for the identification and resolution of control weaknesses in an efficient and timely manner; and
- the production of accurate financial information for management and statutory accounting purposes.

4.317 By the end of 1999–2000, the department had made significant advances in addressing these through:

- realignment of management responsibility and reorganisation of the corporate functions;
- recruitment and training of specialist resources;
- review and improvement of control structures, both manual and computer orientated;
- development of practices and processes (CEIs and formal processes for crucial activities); and
- introduction of training programs aimed at all levels of staff.

Petroleum Retail Marketing Sites Act 1980

4.318 As a result of concerns raised during 2000, regarding the accuracy of returns provided to ISR under the *Petroleum Retail Marketing Sites Act 1980*, a limited review of the quality assurance processes implemented by the department to administer the Act has been completed.

4.319 The department required that companies provide returns and initiate independent audits of past returns that date back to 1998. In addition, the department has reviewed and revised its compliance programs by agreeing to new compliance arrangements with companies, including:

- development of compliance programs by companies;
- ongoing independent audit of annual returns;
- examination of internal company records;

- development of new reporting guidelines; and
- continued investigation of possible identified breaches.

4.320 The ANAO's assessment is that the processes that have been established by the department provide stronger grounds for assurance that the returns provided by companies meet the requirements of the Act.

Financial reporting

4.321 During 1999–2000, the department pursued a number of initiatives to address its management reporting requirements. The department has indicated that it will continue to strengthen its financial management reporting regime as it is a critical element of the department's financial governance processes.

4.322 Corporate Finance Branch has been reorganised and strengthened, allowing it to develop more effectively a range of initiatives to support the management of departmental finances through more effective budget and expenditure control.

4.323 Management reporting to the ISRLT is now more detailed and is performed on a monthly basis. The reporting process also includes substantial feedback from Divisions.

Conclusion

4.324 The department has established a sound control environment overall. Further, the department has managed to address many of the control deficiencies reported at this time last year.

Joint House Department

Business operations

4.325 The Joint House Department is responsible for the operation and maintenance of an effective and functioning legislative building for the Parliament of Australia which preserves its value as a heritage complex and raises public awareness of the Australian Federal Parliamentary system and the Parliament House building. The department's key business processes relate to:

- management of a contemporary heritage building;
- provision of services and amenities to Parliamentarians, visitors and staff;
- capital works and refurbishments; and
- building life cycle planning.

4.326 The department's appropriation funding for the year ended 30 June 2001 comprises:

- its price of outputs—\$32.5 million; and
- administered appropriations—\$6.7 million.

4.327 The department's average staffing level is 267.

Key business risks

4.328 In order to manage its business risks, the department addresses key issues relating to:

- its ability to deliver building services to its clients including Parliamentarians, visitors and staff;
- the adequacy of building management and planning; and
- maintenance of satisfactory stakeholder relations particularly with Parliamentarians and visitors.

4.329 In managing these business risks, disciplined management practices are required over supporting corporate and engineering services to ensure there is cost effective and efficient service delivery.

Corporate governance

4.330 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan which sets strategic directions and which is supported by operational business plans;
- quarterly executive board of management meetings which focus on operational issues especially where timetable and operational targets need close monitoring and review;
- an audit committee that meets at least quarterly and which focuses on internal audit, ANAO audit activity, risk management and fraud control issues;
- a risk management plan which identifies major operational risk areas for Parliament House and strategies to manage these risks;
- an asset management plan which addresses the requirement to keep Parliament House and supporting infrastructure to a high standard for the next 200 years;
- a monthly financial reporting regime informing the departmental executive on how the department is fulfilling and managing its operations within the overall budget; and
- an internal audit strategy and plan which addresses key business and financial risks.

Audit results

4.331 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Resolved issues</i>	<i>Continuing issues</i>	<i>New issues to 30 April 2001</i>	<i>Closing position at 30 April 2001</i>
A	0	0	0	0	0
B	1	1	0	3	3
	1	1	0	3	3

4.332 The department had IT control environment exposures. Specific audit findings requiring comment were:

- a number of users have powerful access privileges that allow, in some instances, circumvention of authority checks. The department has advised that action has been taken to delete such access from user accounts;
- a privileged SAP account had not been locked and still had powerful access rights attached. The department has advised that it has now restricted the account and changed the password to prevent unauthorised use; and

- a number of users were given duplicate user accounts; one to carry out regular use and the other one for superuser functions. As a result, unnecessary accounts have been produced which increases the risk of inappropriate access. The department has advised that it has now closed the duplicate superuser accounts in production.

Financial reporting

4.333 Over the past year, the department has strengthened its financial analysis and reporting processes, for both its departmental and administered activities. Accrual based financial reports are regularly provided to management on actual versus budget performance, enabling a reliable assessment of the department's financial position and operating performance.

Conclusion

4.334 The department has strengthened its financial reporting and internal control structure. The department agreed with ANAO findings relating to IT controls and has taken remedial action.

Department of the Prime Minister and Cabinet

Business operations

4.335 The Department of the Prime Minister and Cabinet is responsible for providing support to the Prime Minister and for delivering a coordinated approach to the development, implementation and management of government policies. Included with the department's responsibilities are the:

- Office of the Status of Women;
- Office of Indigenous Policy (until 30 January 2001); and
- AUSPIC—Government Photographic Services.

4.336 The department's appropriation funding for the year ended 30 June 2001 comprises:

- its price of outputs—\$61 million; and
- administered appropriations—\$25 million.

4.337 The department's average staffing level is 381.

Key business risks

4.338 In order to manage its business risks, the department addresses key issues relating to:

- the delivery of quality policy advice and services to the Prime Minister and other stakeholders; and
- effective policy advice/coordination on a whole of government basis, including identification of emerging issues.

4.339 In managing these business risks, disciplined management practices are required over policy and project management, contract management, information security and support services including human resources and financial management.

Corporate governance

4.340 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- an executive committee which oversights the operational performance of the various divisions; reviews departmental wide issues; and monitors financial performance;

- a well established and reliable monthly financial reporting regime; and
- an audit committee which meets quarterly and focuses on the efficiency and effectiveness and probity of activities including risk assessment and management, internal audit planning and results, ANAO audit activities and fraud control.

Audit results

4.341 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000*</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	7	4	0	3
	7	4	0	3

Note* Some IT issues outstanding at September 2000 were not reviewed prior to March 2001 and thus have been reported as being unresolved. These will be reviewed in the end of financial year audit.

4.342 The results of the audit indicated that departmental systems and procedures have the potential to produce accurate and complete information for financial reporting purposes. As part of the audit process, opportunities for improvement, or matters that may impact on the department's current risk strategies, are raised with departmental management. A number of matters concerning IT security, monitoring of backups and change control procedures were raised. Recommendations were made in the context of tightening the IT control structure to provide greater assurance over the integrity of computer programs and information.

4.343 The department has indicated that it will take immediate remedial action in relation to IT security and the monitoring of back ups. In respect of change control procedures, it has indicated an acceptance of the need to manage the risk involved.

Financial reporting

4.344 Over the past year, improvements have been achieved in the quality of financial data and reporting. Improvements in the quality of financial reporting are expected to continue in the year ahead as the department moves to strengthen further its end of month procedures for its key business and accrual accounting processes.

Conclusion

4.345 The department has strengthened its internal control structure over the past year. The control framework was generally found to be operating satisfactorily for financial statement reporting purposes. Improvements are required in relation to the IT control environment. The department has responded positively to ANAO recommendations.

Department of Transport and Regional Services

Business operations

4.346 The Department of Transport and Regional Services (DoTRS) is the portfolio department charged with promoting economic, social and regional development by enhancing Australia's infrastructure performance. The department conducts research, analysis and safety investigations; provides safety information and advice based on those investigations; and performs a range of regulatory functions. The department is also responsible for the provision of services to Australia's external territories.

4.347 The department's appropriation funding for the year ended 30 June 2001 comprises:

- its price of outputs—\$200 million;
- administered appropriations—\$2783 million;
- departmental capital—\$4.829 million; and
- administered capital—\$3.811 million.

4.348 The department employed 879 staff across Australia.

Key business risks

4.349 The department's outputs and administered programs involve a diverse range of activities undertaken to meet the needs of a variety of different stakeholder groups. In delivering these services, the department is operating in an environment of increasing focus on outcomes, more contestable services, devolution of responsibility for financial management and greater expectations of accountability for performance. Within this environment, the major business risks facing the department relate to the ability of management systems and processes to support the delivery of these diverse responsibilities, together with the maintenance of an appropriate workforce capability.

Corporate governance

4.350 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- fortnightly meetings of the executive board, which focuses on departmental-wide issues and monitors financial performance;

- an audit committee that meets at least quarterly and which focuses on risk management and strategic issues;
- a monthly financial reporting regime that includes variance analysis of the department's financial position as compared to internal budgets and presentation of reports to the executive board;
- an internal audit plan which addresses compliance, business and financial risks;
- an increased focus by the department on risk management (including the development of a Fraud Control Plan). Risk management is in the process of being integrated into the business planning for the department; and
- an independent internal audit function which reports directly to the audit committee.

Audit results

4.351 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	4	2	7	9
	4	2	7	9

Cash management

4.352 Following recommendations by the ANAO last year, the department has implemented a register for bank accounts. This is an important step in ensuring the department has appropriate controls over cash management.

4.353 Bank reconciliations assist in identifying errors and discrepancies in the receipting and payment processes, as well as providing the opportunity to help detect fraud. While reconciliation processes had improved from previous years, the audit identified the need for further improvement in the following areas:

- the department was unable to evidence the completion of all necessary reconciliations for bank accounts held in Territory offices;
- at the time of audit, supporting documentation could not be located for a number of reconciliations performed at the Canberra Office; and
- there was inadequate evidence of independent review of reconciliations.

4.354 The department has subsequently advised that all of the Canberra based accounts have been reconciled throughout the year and that only one original reconciliation is now unable to be located, although a copy is held. The department advises that all reconciliations have been independently reviewed but acknowledges that the reviewing officer has not indicated this by signing off on eight of the 51 reconciliations.

4.355 The department has implemented a number of changes to procedures in order to ensure that all accounts are reconciled on a regular basis and that reconciliations are appropriately reviewed and filed. These include delegating responsibility for reconciliation management to a senior level manager and introducing Chief Finance Officer oversight of the process. In addition, reconciliations for all main bank accounts are now being conducted on a fortnightly basis with plans to move to weekly reconciliations shortly. The greater regularity of reconciliations facilitates their completion and provides more timely assurance in relation to the integrity of financial information.

IT environment

4.356 Further improvements are required in relation to general controls surrounding the IT systems and the ability of the systems to generate financial information.

4.357 The department continues to utilise the SAP financial and human resources management information system in Canberra and Perth, and the SUN system in the Christmas and Cocos Islands. The ANAO notes there are plans to consolidate on SAP for all locations in the coming year.

4.358 The ANAO found IT controls to be generally effective in managing the risks that have the potential to impact upon the integrity of the financial statements. Matters raised with management included:

- access control policies and procedures for the SAP environment;
- access control policies and procedures for the SUN Environment on Christmas Island; and
- business continuity planning on Christmas Island.

SAP access control

4.359 The department has made good progress at implementing a number of recommendations made in relation to access control following the 1990–2000 audit. However, the audit noted some areas where further improvement can be made. These relate to privileged access granted to some users through association to powerful SAP profiles.

4.360 The department has in place controls which will detect inappropriate use of these privileges and has advised that investigations have not, to date, revealed any inappropriate use of access privileges. That said, however, and in order to prevent inappropriate access to the systems occurring in the first place, the ANAO has recommended that a regular review of SAP access be undertaken to ensure the principle of least privilege is always maintained.

4.361 The department has advised that it has reviewed and restricted the number of users with privileged access rights.

Christmas Island

Segregation of duties

4.362 The audit noted a lack of segregation of duties over accounts payable processing at Christmas Island with current arrangements allowing the potential for fraudulent transactions to be processed. The department has accepted ANAO recommendations aimed at improving the segregation duties.

Review and update of access to Sun System

4.363 The audit identified the need for access to the financial management information system to be reviewed on a regular basis to ensure only appropriate officers have system access.

Business continuity plan

4.364 The department does not have in place an appropriate business continuity plan for computer facilities at Christmas Island. Consequently, the department faces a risk of its computer systems being unavailable for an extended period and of associated disruption to business activity. There is also the risk of financial data being lost or corrupted. The ANAO recommended management co-ordinate the production of a business continuity plan, utilising the assistance of Advantra for all island territories.

Recognition of marine revenue

4.365 The department utilises the Cargo Tracking System to issue debit advice notes in relation to shipping activities at the Island. The audit noted that the debit advice notes were not issued in a timely manner and that details of these debtors were not provided to Christmas Island Administration on a timely basis so as to ensure appropriate recognition, and follow up, of revenue.

Financial reporting

4.366 Over the past year and a half, the department has strengthened its financial reporting process. In particular, the process of completing a 'hard close' set of financial statements, on top of the standard monthly reporting, has shown to be a valuable experience in the preparation of financial statements. The department is adapting these processes to ensure the financial statements are produced in a timely manner, with a reasonable level of quality assurance.

4.367 The quality of monthly reports is continuing to improve, and are now relied upon for management purposes. The reports are broken down to a divisional level, and report actual versus budget, with analysis on significant variances.

Conclusion

4.368 Management has responded positively to ANAO findings. Action to address the deficiencies is planned and priority has been given to ensuring all matters are cleared prior to the end of the financial year.

Department of the Treasury

Business operations

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

4.370 In 2000–2001, administered funding includes government revenues of \$26.2 billion. The department also received \$71.9 million for running costs.

4.371 The department had a staffing level of 548 (exclusive of the Royal Australian Mint) at 30 June 2000.

Key business risks

4.372 In order to manage its business risks, the department addresses key issues relating to:

- grant payment administration under the inter-governmental agreement;
- investment and International Monetary Fund management; and
- Royal Australian Mint administration.

4.373 In managing these business risks, disciplined management practices are required to be supported by relevant information systems, including human resources and financial management.

Corporate governance

4.374 The ANAO's audit approach considers departmental goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the department's strategies, the ANAO focused on the key initiatives in place to meet departmental objectives and the management of the business risks associated with those initiatives. Measures which impact on financial assurance include:

- a pro-active risk management process which includes a comprehensive business risk assessment;
- the executive board which meets fortnightly and is responsible for high level policy and management issues;

- a framework of committees, including the executive board, corporate services committee and audit committee. The audit committee provides a primary focus for the evaluation of the operations of the policies and procedures put in place by the Secretary and the executive board;
- a monthly reporting process to cover key financial information; and
- an effective internal audit unit and fraud control plans.

Audit results

4.375 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	1	0	0	1*
B	5	4	0	1
	6	4	0	2

Note* The closing position at March 2001 highlights a category A finding, which was raised in 1999–2000. This finding related to the SAP R/3 system and while the ANAO acknowledges that some of the previous years issues have been resolved, the current year's financial statement audit work is not yet completed. Therefore no conclusion on the above can be drawn at this time. Any remaining issues are still to be resolved.

Personnel management and salaries reconciliations

4.376 Although the salaries reconciliations were being performed on a regular basis, they were not signed off as prepared, nor evidenced as reviewed, by a separate officer. Furthermore, there was a lack of audit trail/supporting documentation in the performance of the reconciliations. These reconciliations are an important management control to ensure the validity, accuracy and completeness of employee information contained in the general ledger. Without review by a second officer, or adequate supporting documentation, the validity of the reconciliation is undermined.

4.377 Salary reconciliations have been an issue in prior years, predominantly because of the lack of formal reconciliation processes. Neither Personnel nor the Accounting Unit perform formally documented reconciliations of accrued employee benefits. This process is hindered by the fact that recreation and long service leave balances are combined in the one general ledger account. Management is currently working on a system modification to allow the balances to be separately reconciled.

IT systems and controls

4.378 The department experienced difficulty with its financial management information system, SAP R/3, following its implementation in July 1998. As part of the 1999–2000 audit, deficiencies were noted relating to access controls, system management, accuracy of data and staff training. Progress has been achieved over the past year. However, at the time of this report, the ANAO had yet to complete its review to ensure that all necessary improvements have been achieved.

Conclusion

4.379 Management has responded positively to the above findings and the associated recommendations. In most cases, the department has already taken action to address the deficiencies identified by the ANAO. A high priority has been placed on resolution of all matters prior to the end of the 2000–2001 financial year.

Australian Taxation Office

Business operations

4.380 The Australian Taxation Office's (ATO) role is to manage and shape taxation, excise and superannuation systems that give effect to the government's social and economic policy and fund services for Australians. Through these systems, the ATO is the Government's principal revenue collection agency. The ATO's key business processes relate to revenue collection and compliance. Revenue collection can be further categorised into the following processes:

- Registration;
- Income Returns Processing;
- Activity Statement Processing (including Business Activity Statement (BAS) and Instalment Activity Statement);
- Cash Management; and
- Debt and Lodgement Enforcement.

4.381 There have been significant changes to the business and operational environment within the ATO in recent years. In particular, the ATO continues to undergo substantial changes in the way key business processes operate as a result of Tax Reform.

4.382 The ATO has worked towards ensuring that new and revised arrangements meet their obligations under the Taxpayer Charter and minimise any impact on taxpayers. The ANAO has found that the tight timetables to implement the systems to support tax reform have resulted in lower level functionality being left out of system releases. Changes to existing systems to integrate with tax reform have also experienced delays.

4.383 The ATO systems, processes and staff have been under considerable strain coping with the large volume of returns, processing problems, associated congestion and data contamination that has accompanied the introduction of the Activity Statements. As errors and processing problems are identified, the ATO has focused on error containment.

4.384 The total appropriation for ATO in 2000–2001 was \$1979 million. The average staffing level is 19 132 across Australia.

Key business risks

4.385 In order to manage its business risks, the ATO addresses key issues relating to:

- tax administration covering policy and reform;
- self management and voluntary compliance; and
- maintaining community confidence.

4.386 In managing these business risks, disciplined management and operational policies, practices and procedures are required over complex business, regulatory and compliance activities, which need to be supported by specialist staff. Fundamental to this requirement is the need for comprehensive IT activities and supporting systems.

Corporate governance

4.387 The ANAO's audit approach considers ATO goals, priorities, objectives and strategies along with the critical success factors management considers are necessary to achieve them. In reviewing the ATO's strategies, the ANAO focused on the key initiatives in place to meet the ATO's objectives and the management of the business risk associated with those initiatives. Measures which impact on financial assurance include:

- a corporate plan and the associated planning framework;
- an executive board that meets at least monthly and has a formal biannual corporate governance process;
- a committee framework including an audit committee. The Audit Committee meets at least quarterly and focuses attention on risk assessment, internal audit activities and fraud control;
- a monthly financial reporting regime which provides actuals versus budget expenditure and revenue;
- an internal assurance branch that has a planned risk based coverage of the ATO's activities; and
- a fraud control plan.

Audit results

4.388 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding from 1999–2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001 (a)</i>
A	2	2	1	1
B	5	3	10	12
	7	5	11	13

Note (a) prior year issues re-rated.

4.389 With tax reform initiatives, particularly activity statement processing, the ANAO has concluded that further work is required to ensure an adequate control environment.

Activity Statements processing

4.390 The introduction of the Activity Statement has been a major challenge. The tight deadlines associated with the development of the framework and new systems required to implement the tax reforms have placed considerable pressure on ATO resources. As a result, some systems were introduced without full functionality and changes to existing systems to integrate with the tax reforms have been postponed.

4.391 Problems arose when the new systems were implemented, particularly in the area of data capture and the delayed introduction of quality assurance processes. This caused incorrect data to be recorded by the activity statement processing systems resulting in the contamination of taxpayer account information and a limited number of incorrect refunds being issued to taxpayers.

4.392 When the significant data accuracy problems were identified, the ATO responded by extending the manual refund review processes to include all but the small value refunds and a number of additional edit and review processes. These procedures will help to significantly reduce the incidence of new incorrect debit and credit balances on taxpayer accounts. The ATO is undertaking a number of reviews to identify and resolve prior errors in taxpayer account data. The ATO has agreed to pursue a structured and comprehensive review to cleanse taxpayer account data.

4.393 In the new processing environment, taxpayer payment patterns, processing lags, data accuracy problems and taxpayer errors result in the collection of revenue which cannot be immediately identified and allocated to the relevant categories of revenue. For most months, the amount of unallocated monies has ranged between \$3 billion and \$5 billion although it did rise to around \$6.5 billion at the end of April 2001 (reflecting the due date for the March quarterly statement). A major portion of the unallocated monies relates to timing differences that will resolve themselves within three months.

4.394 Of concern is the comparatively small percentage of non-timing differences related to data accuracy and taxpayer errors. The ability of the ATO to identify and resolve the non-timing differences may impact on the accuracy of the revenue split (ie. GST and other revenue), at the end of the financial year. The ATO needs to complete a detailed analysis of the non-timing differences and develop a strategy for a structured cleansing of the taxpayer account data, along with measures for minimise the re-occurrence of these differences.

4.395 Given the current problems with activity statement processing, the ANAO will need to undertake additional examination of the various processes that are necessary to manage, control and rectify the identified problems. Additional work is required to assist management and the ANAO to determine the extent to which reliance can be placed on the activity statement process for the purpose of the financial statement audit.

IT environment

4.396 The ATO has undertaken considerable work over the past year to address the issues raised by the ANAO in previous years. A large number of these matters has now been addressed or are in the process of being addressed. Issues that remain outstanding include management of access to privilege user functions and facilities and the overall management of user access to applications.

Firecall

4.397 In 1999–2000, the ANAO raised issues in relation to the use of system privileges by IT staff. The primary issues raised related to the range of access provided to these staff through access profiles and the use of the security system, Firecall. The ATO has reduced the usage of Firecall and has established new arrangements to control Firecall access. However, ANAO noted that monitoring of the use of Firecall is not occurring, indicating that the new arrangements are not yet fully effective.

4.398 These findings indicate that more focus is required in developing, implementing and enforcing appropriate security policies to ensure the integrity of taxpayer data and key business applications on the mainframe environment.

Income Return Processing—quality management

4.399 Income Return Processing covers the receipt of Income Tax Returns and issuing a Notice of Assessment. Although the ANAO found the quality management system for Income Return Processing to be more visible and reliable than in prior years, there are still opportunities for improvement in the quality of supporting documentation and procedures.

Debt and lodgement enforcement—reconciliations and quality management

4.400 The ANAO has raised concerns with non-pursuable (written-off) debt as some regional offices have incomplete or incorrect reconciliations with significant unresolved discrepancies. In addition, there is a lack of national coordinated reconciliation procedures. The ATO is actively pursuing the resolution of these reconciliation issues. The ANAO has also recommended improvements to aspects of quality assurance processes that the ATO is examining.

Cash management—reconciliation

4.401 Due to system problems the ATO has been unable to reconcile the Refund Drawing Account since the beginning of this financial year. The reconciliation of the drawing account is critical for the completion of the financial statements. The ATO has advised that it is resolving a number of system problems that prevented the reconciliation being successfully undertaken and will implement manual processes to ensure the account is reconciled by the end of the financial year.

Conclusion

4.402 The ATO has improved the general IT control environment through the implementation of a significant number of previous ANAO findings mainly relating to IT security.

4.403 The main issue for resolution in 2000-2001 is in the area of activity statement processing and data cleansing. The department has responded by taking or proposing appropriate steps to strengthen the respective controls.

4.404 These issues will be reviewed, together with completion of debt write-down processes which occur by way of write-offs, waivers, and remission activities, in the end of financial year audit. Evaluation of risk mitigation practices and compliance strategies over the administration of tax revenue will also feature significantly as part of the final audit for 2000-2001.

The Australian National University

Business operations

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

4.406 The total operating expenses of the ANU for the 2000 calendar year amounted to approximately \$407 million, against total operating revenue of approximately \$417 million, which included approximately \$257 million in Commonwealth government grants.

4.407 The ANU employed a total of 3260 full-time equivalent staff at 31 December 2000.

Key business risks

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

Corporate governance

4.409 The ANU is governed by a 22 member Council which may receive advice on any matter relating to the academic work of the University by two academic boards, the Board of the Institute of Advanced Studies (BIAS), and the Board of the Faculties (BTF). The Vice-Chancellor is the CEO of the ANU and is responsible for the overall leadership and management of resources. A five member independently constituted audit committee oversees and reviews the operations of the internal audit function and provides advice and assurance to the ANU Council on accountability and audit related matters. The ANU's internal audit function has been contracted out to a chartered accounting firm.

Audit results

4.410 The following table provides a summary of the status of prior year issues as well as 2000–2001 audit issues raised by the ANAO.

<i>Ratings</i>	<i>Issues outstanding at March 2000</i>	<i>Issues resolved prior to March 2001</i>	<i>New issues to March 2001</i>	<i>Closing Position at March 2001</i>
A	0	0	0	0
B	2	2	2	2
	2	2	2	2

Financial statement audit report

4.411 The ANU signed its financial statements for the year ended 31 December 2000 on 6 April 2001. A qualified audit report was issued on the same date.

4.412 Specific audit results requiring comment are as follows.

ANU qualification

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

Assets register

4.414 The University replaced its asset management and recording system as at 1 January 2000 as part of its year 2000 upgrade. This system replacement coincided with a major revaluation of all assets as at 31 December 1999, thereby causing considerable difficulties in bringing revalued assets to account. These issues had adverse flow-on effects on the calculation of depreciation, gain/loss on sale of assets, and final asset values as at 31 December 2000. These effects have given rise to concerns over accounting for fixed assets and other system issues that should be addressed by the ANU in the near future.

*Non-compliance with established procedures for the authorisation/
approval of payments*

4.415 During the audit, the ANAO noted numerous payments, which had not been appropriately authorised/approved within the delegation limits specified in the University's CEIs. In many instances, it was noted that, either the position held by an approving officer was not listed in the delegations, or the delegate had exceeded the limit of his/her delegation. This is an ongoing issue, which has been raised by both the ANAO and the University's internal auditors in prior years.

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



Canberra ACT
9 July 2001

P. J. Barrett
Auditor-General

Appendices

Appendix 1

Significant Findings by Major Entity

1. The following table sets out 'A' rated findings (significant business or financial risks) identified in the interim audit of entities as part of the 2000–2001 financial statement audit cycle.

Entity	No of 'A' findings	Explanatory Comment
Defence	10	The data streams, business processes and accounting policies that facilitate the population of management information in the major IT systems are inadequate in key areas. The major IT systems are disjointed with significant exposures in access controls. The HR system also has major weaknesses in changes controls, data ownership and data integrity. The logistics system has major data integrity issues and deficient supporting business processes. In general, the operational and financial reporting (accountability) ramifications of these deficiencies are not well understood.
Agriculture, Fisheries and Forestry	1	The issue relates to the disbursement of primary industry levies to research, development and marketing corporations. To meet its legislative requirements, AFFA should be able to reconcile receipts relative to the payments made.
Environment and Heritage	1	There is minimal reconciliation of employee expenses and employee provisions to assess the integrity of the employee-related information recorded in the general ledger.
Family and Community Services	1	The department should complete a high level risk assessment. Some progress has been achieved to date and a final assessment will be made as part of the final audit phase in July and August of this year.
Health and Aged Care	1	A contingency plan is in place to ensure that alternative aged care facilities can be arranged when unforeseen circumstances arise. Grants were made to the alternative facilities from a special appropriation for residential care in order for beds to be available as necessary. Legal advice indicates that the special appropriation for residential care should not be used to make such grants.

continued next page

Entity	No of 'A' findings	Explanatory Comment
Health Insurance Commission (HIC)	1	The internal controls surrounding payments made under the 30 per cent Rebate Scheme are not sufficient to ensure the accuracy and validity of the payments made to the Health Funds. Legislative amendments were made in order for HIC to obtain the necessary information to substantiate the claims but system constraints have yet to be resolved to ensure the system operates effectively.
Treasury	1	As part of the 1999–2000 audit, deficiencies were noted relating to FMIS, access controls, systems management, accuracy of data and staff training. The ANAO is yet to complete its review to ensure that all necessary improvements have been achieved.
Australian Taxation Office (ATO)	1	The Activity Statement implementation has resulted in issues relating to the effective capture of data and the corruption of client account information. This has resulted in incorrect refund payments. Although the ATO has responded by implementing a number of quality assurance measures, these data accuracy problems may effect the ATO's ability to produce reliable and accurate accounts receivable balances for its 30 June 2001 financial statements.

2. Further details on each of these findings, and on the 'B' rating findings, are included in the individual entity summaries contained in Chapter 4 of this report. A table summarising the number of 'A' and 'B' findings follows.

Table of 'A' and 'B' Ratings by Entity

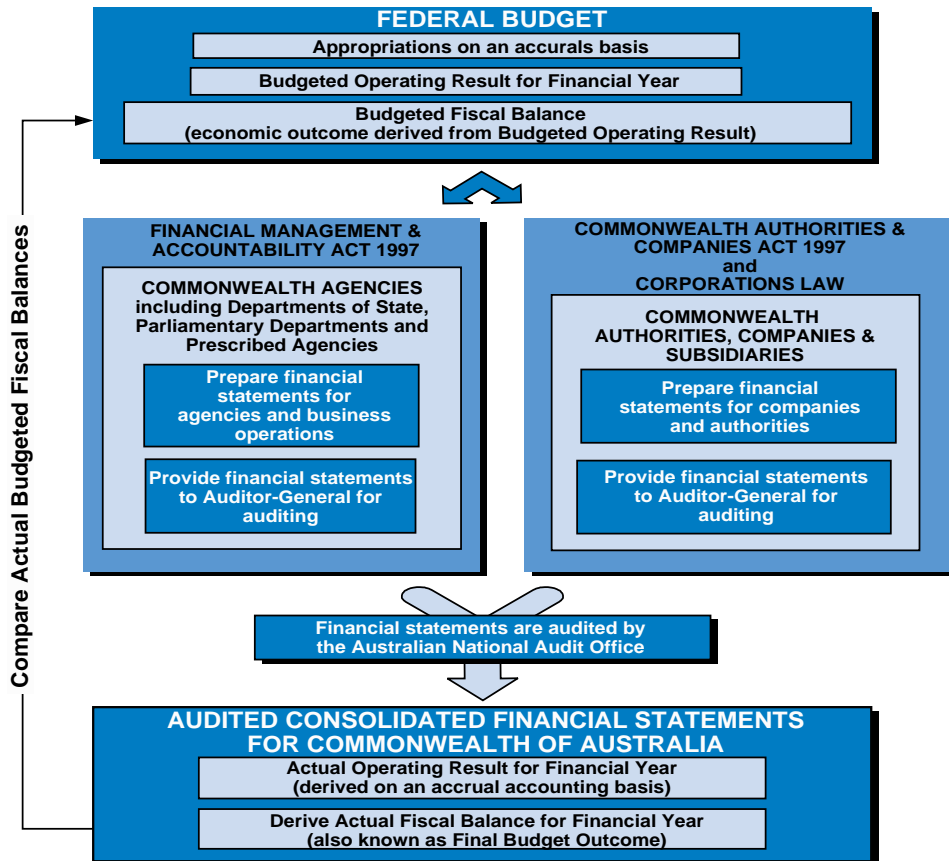
Entity	Rating	
	A	B
Department of Agriculture, Fisheries and Forestry	1	0
Attorney-General's Department	0	7
Australian Customs Service	0	13
Department of Communications, Information Technology and the Arts	0	18
Department of Defence	10	34
Repatriation Commission and the Department of Veterans' Affairs	0	12
Department of Education, Training and Youth Affairs	0	4
Department of Employment, Workplace Relations and Small Business	0	17
Department of the Environment and Heritage	1	18
Department of Family and Community Services	1	8
Centrelink	0	11
Department of Finance and Administration	0	4
Department of Foreign Affairs and Trade	0	4
Department of Health and Aged care	1	12
Health Insurance Commission	1	20
Department of Immigration and Multicultural Affairs	0	8
Department of Industry, Science and Resources	0	2
Joint House Department	0	3
Department of the Prime Minister and Cabinet	0	5
Department of Transport and Regional Services	0	9
Department of the Treasury	1	1
Australian Taxation Office	1	12
Australian National University	0	2
Total	17	224

Appendix 2

Accounting and Auditing Framework

The financial reporting framework

The Commonwealth public sector is made up of a number of types of entities, each of which has distinct financial reporting requirements. The financial reporting framework is summarised in the diagram below, followed by more detailed discussion of its various components.



Commonwealth Government of Australia

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

The financial statements for the year ended 30 June 2000 and the audit report therein were published by Finance in October 2000.¹⁵ The results of the audit of those financial statements were reported to Parliament in the *Auditor-General Report No.23 Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2000*.

Commonwealth agencies

Commonwealth agencies are those organisations that are legally part of the Commonwealth Government that are subject to the provisions of *the Financial Management and Accountability Act 1997*. They include departments of State, Parliamentary departments and prescribed agencies.

The Act requires the chief executives to prepare financial statements for their agencies and designated business operations in accordance with the Finance Minister's Orders (FMOs). The FMOs require compliance with Australian Accounting Standards and Consensus Views of the Urgent Issues Group (UIG). They also require that agencies have regard to Australian Statements of Accounting Concepts and the Explanatory and Guidance Notes to Commonwealth Accounting Policies as issued by Finance. To the extent that there is any inconsistency between the requirements of the FMOs and UIG Consensus Views, the UIG Consensus views prevail.

Commonwealth authorities and subsidiaries

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

The Act requires the governing bodies of authorities to prepare financial statements in accordance with the FMOs. Directors must also ensure that subsidiaries prepare financial statements in accordance with the Corporations Law (where applicable) and the *Commonwealth Authorities and Companies Act 1997*.

Commonwealth companies and subsidiaries

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

¹⁵ Commonwealth Government of Australia, *Consolidated Financial Statements for the Year Ended 30 June 2000*, October 2000.

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

Other Bodies

The ANAO also audits the financial statements of other entities controlled by the Commonwealth or where the Commonwealth has significant influence. These consist primarily of trusts or joint ventures entered into by controlled Commonwealth bodies.

Financial statement audit scope

The chief executives of agencies, and the directors of governing bodies of other agencies, are responsible for the records, controls, procedures and organisation that underlie the information in the financial statements and the preparation of these statements. The independent audit of the financial statements, conducted in order to express an opinion on them, involves review of, among other matters, the above factors where their effect on the financial statements could be material¹⁶.

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

Whilst entity control structures are evaluated as an integral part of the audit process, only those systems and controls on which it is intended to place reliance for the purpose of determining audit procedures leading to audit opinions on the financial statements are evaluated in detail. In some audits, audit procedures concentrate primarily on substantiating the amounts appearing in the financial statements and do not include a detailed evaluation of systems and internal controls.

¹⁶ Materiality means, in relation to information, that information which is omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the financial report or the discharge of accountability by the management or governing body of the entity.

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

The audit report on financial statements

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

If the auditor is not satisfied the financial statements are true and fair, the audit report is modified with the reasons being indicated.

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

An opinion containing an 'emphasis of matter' is used to draw attention to a matter that is relevant to the readers of the financial statements, but is not of such a nature that it prevents an unqualified audit report being issued. In many cases, an 'emphasis of matter' relates to inherent uncertainty about an aspect of the financial statements where the outcome is contingent upon future events and the effects of the matter are not capable of reasonable measurement at the date the audit report is signed.

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