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Assurance and Control Assessment Audit

Management of Bank Accounts by Agencies

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Australian National
Audit Office

Canberra ACT
17 September 2001

Dear Madam President
Dear Mr Speaker

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

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

Ian McPhee
Acting 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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Abbreviations/Glossary

ANAO	Australian National Audit Office
APS	Australian Public Sector
CEIs	Chief Executive's Instructions
CEO	Chief Executive Officer
CSA	Control Self Assessment
Finance	Department of Finance and Administration
FMA Act	*Financial Management and Accountability Act 1997*
OPA	Official Public Account
RBA	Reserve Bank of Australia

Summary and Recommendations

Summary

Introduction

1. On 1 July 1999 agencies[1], covered by the *Financial Management and Accountability Act 1997* (FMA Act), became responsible for the establishment, operation and management of their own bank accounts, payment arrangements and cash-flow management. This meant that agencies were now responsible for ensuring adequate working capital for their operations, for funding asset replacement and for discharging liabilities as and when they fall due. Under the new arrangements, to encourage a stronger focus on cash-flow planning and management, agencies would receive interest on their departmental account balances and meet overdraft[2] charges. Agencies would also be able to place surplus departmental funds in term deposits administered by the Reserve Bank of Australia (RBA) on behalf of the Department of Finance and Administration (Finance). At the same time agencies began receiving their departmental appropriations on a fortnightly basis to meet their operational requirements. Agencies' appropriations were reduced by an estimate of the likely amount of interest earned in 1999–2000.

2. In the year ended 30 June 2001 FMA Act agencies received cash, through appropriations, totalling over $28 billion for agency purposes[3] (compared to approximately $27 billion for the year ended 30 June 2000).

3. Since the introduction of the new banking arrangements, agencies have been managing aggregate cash balances (in departmental bank accounts and term deposits) averaging some $2.7 billion per month during 2000–2001 (some $2.2 billion per month during 1999–2000).

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1 Agencies are defined in section 5 of the *Financial Management and Accountability Act 1997* (FMA Act) and includes a Department of State, a Department of the Parliament or an Agency prescribed under the FMA Regulations.

2 Currently, all major Commonwealth transactions are facilitated through the Official Public Account (OPA), which is the Commonwealth's central account, one of a large number bank accounts held with the Reserve Bank of Australia (RBA). These accounts—which include drawing, advance and receipt accounts-are treated by the RBA as if they are part of one set-off account for the purpose of interest and overdraft calculations. Under this arrangement, an 'overdraft' in an agency bank account does not represent a 'borrowing'. The interest charge is part of the Finance incentive arrangements and is levied by Finance.

3 Agency purposes includes those items controlled by agencies, but does not include Administered items as these are items which are controlled by the Government and are managed or oversighted by agencies on behalf of the Government.

4. Effective management of bank accounts reflects an agency's success in collecting and banking revenue promptly and making payments no earlier than necessary having regard to service delivery objectives. Success in both these areas is critical to ensuring effective cash-flow management.

Audit objectives

5. The main objectives of the audit were to determine whether:

- agencies have implemented appropriate risk management strategies for the new banking arrangements which came into operation on 1 July 1999; and
- cash funds are being managed in accordance with the appropriate legislation, the Commonwealth's agency banking guidance[4] and generally accepted accounting practices.

6. The audit was undertaken in seven agencies subject to the requirements of the FMA Act and covered the period of operation of the new arrangements from July 1999 to December 2000. An audit of agencies' implementation of the transactional banking requirements will be the subject of a separate Auditor-General's report later this year.

Audit conclusion

7. The ANAO concluded that, in respect to the day-to-day operation of bank accounts, the internal control framework established by agencies was generally satisfactory. However, the Chief Executive's Instructions (CEIs) related to banking had not been updated in some agencies to reflect the new arrangements. The audit found that agencies' practices were not always consistent with the policies and procedures established by their internal control frameworks. In addition, better practices could be achieved by agencies through improvements in their internal control framework, including the adoption of process risk assessments, the development of appropriate performance measures and increased use of monitoring and review mechanisms.

8. The audit also concluded that, when the new banking arrangements were introduced, agencies' investment strategies were initially conservative and were more related to earning interest to the extent of the amount by which their appropriations had been reduced.

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4 *Agency Banking Framework-Guidance Manual,* Department of Finance and Administration, July 1999 and Finance Circulars.

In addition, as the cash-flow management processes required further development and enhancement, the quality of information initially provided on future cash needs was fairly basic. As agencies became more settled with the new banking arrangements and their internal processes developed, the level of funds, and the period of investment, increased significantly reflecting *inter alia* more active cash management.

Summary of audit findings

9. Central to an effective internal control framework is the understanding that control is a process, effected by the governing body of an agency, senior management and other employees, designed to provide reasonable assurance that risks are effectively managed to ensure the achievement of the agency's objectives. The framework relies on five key control components. The audit findings against each of the components were as follows.

Risk assessment

10. Generally, the management of bank accounts in the Commonwealth has been construed as a simple low risk process. This was reasonable when the Commonwealth's banking arrangements were centrally managed and controlled. However, with the introduction of the new arrangements agencies were faced with new risks associated with managing the opening and closing of bank accounts, investment of available monies, the relationship with their banker and the fees and charges associated with the operation of bank accounts. Agencies now have a responsibility to manage and monitor these risks and to ensure proper controls, including authorisation, segregation of duties, access and adequate physical security.

11. The audit found that most agencies had not undertaken process level risk assessments following the introduction of the new banking arrangements. As a result, the ANAO noted very few examples where the design of controls had been adapted to take account of process level risks, such as the risk that management lacked adequate information to make decisions about cash-flow needs and future investments. In addition, in some agencies, the fraud control plan had not been revised to address the risks associated with the new banking arrangements. Experience shows that agencies can improve their understanding and management of risk through the use of process level risk assessments and the development of an appropriate cost-benefit approach to the implementation of controls. By implementing these measures, responsible managers will be provided with the tools to identify, manage and mitigate risks relating to the new banking arrangements.

Control environment

12. The audit found most agencies had up-to-date CEIs that included banking and cash management and had developed suitable guidance material and procedures to support the CEIs. The remaining agencies were in the process of updating their CEIs and supporting material and procedures. The ANAO considers agencies can improve efficiency and control effectiveness by: formalising and ensuring the completeness, and adequate communication, of related policy and procedures; and formalising training programs to provide greater certainty and credibility across staff.

Investment strategy

13. In relation to the development of strategies for investing surplus funds, the audit found that agencies had established, or were in the process of establishing, suitable investment strategies and related policies and procedures. The strategies adopted were initially quite conservative and were more related to earning interest, to the extent of the amount by which agencies' 1999–2000 appropriation had been reduced, rather than towards meeting the longer-term objectives envisaged. It was noted, however, that as agencies became more settled with the new banking arrangements and the differential between the overnight and term deposit interest rates increased, the average term deposit increased significantly reflecting *inter alia* more active cash management.

Control activities

14. The audit found several instances of non-compliance with the CEIs and related policies and procedures, including basic controls such as the accurate and timely reconciliation of bank accounts, the maintenance of a central register of authorised signatories on bank accounts, and the appropriateness of user access to computer applications.

15. Bank reconciliations are an essential internal control over cash balances. Determining a correct cash balance (whether daily, fortnightly or monthly) is the foundation of good cash management decisions, cash-flow forecasting, and the preparation of accrual accounts. Over the years, the non-performance of this control has been highlighted in ANAO reports on the results of the audit of agencies' financial statements. At the time of the audit, agencies were continuing to experience difficulties with this basic control. However, recent reviews of bank reconciliations undertaken as part of financial statement audits have shown improvement in compliance with this control.

16. The ANAO considers agencies can improve the efficiency and effectiveness of their banking arrangements through the implementation of management controls that are appropriately designed to monitor specific control activity, particularly the timely completion and review of bank reconciliations. Agencies should also ensure computer security controls are effectively designed, so that access is restricted to only those staff who require access. As well, the controls should be enforced as intended to ensure effective segregation of duties and appropriate computer system access.

17. The audit also found that many agencies have rationalised their bank account structure, while a number of others are awaiting the outcome of market testing of their transactional banking arrangements before reviewing the number of bank accounts.

Information and communication

18. The audit found that, while agencies prepared management reports which detailed performance against established targets for cash balances and interest earned, only limited action by management was evident on the basis of the information provided in the reports. In addition, agencies do not use normal performance measures for cost of processing, timeliness and quality of transactions. Agencies need to improve the quality of operational reporting produced on a periodic basis, and implement periodic performance measurement to enhance the effectiveness of cash management.

Cash management

19. The audit examined the processes by which agencies collect information on cash balances available for investment. While agencies had developed processes by which information on future cash requirements was collected, they required further development and enhancement to provide an effective cash management regime, including a longer term analysis of anticipated cash-flows. As a result, departmental bank accounts had incurred interest penalties on overdrafts; short-term investments were redeemed early; and significant balances were held in the overnight bank accounts that attracted lower interest earnings. While each of the above circumstances was contemplated in the Finance *Agency Banking Guidelines*, sound cash management processes should minimise the need to overdraw bank accounts or require the early redemption of investments. Further, where agencies' cash-flow management indicates a need to either overdraw a bank account or redeem an investment early, the choice should be based on some cost-benefit analysis.

20. Previous audits[5] have identified a lack of awareness of the time value of money or of good cash management practice in agencies. These audits have drawn attention to a number of key principles of cash management that formed the basis of the ANAO Better Practice Guide to Cash Management.[6]

Monitoring and review

21. Effective monitoring and review provide assurance and feedback on whether organisational objectives are being achieved efficiently and effectively. This control element also provides an on-going check on the effectiveness of the control structure. The audit found that some agencies relied on periodic reviews by internal audit as the principal method of encouraging continuous improvement; while the other agencies had not conducted any formal review to ensure compliance with the established internal control framework. The ANAO considers there are opportunities to enhance agencies monitoring and review activities through a better understanding and use of process level risk assessment and performance measurement data, as well as building-in control self assessment mechanisms which are an increasing part of modern management approaches.

Sound and better practices

22. The audit identified examples of both sound business practices and better practices currently used by a number of the agencies reviewed. While many of the sound business practices would be expected to exist in all agencies reviewed, this was not the case. To provide agencies generally with some insight into sound and better practice being adopted, details of these approaches have been included in the Report. These are summarised in table 1 below.

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5 Audit Report No.22, 1993–94, *Cash Management in Commonwealth Government Departments*; Audit Report No.10, 1994–95, *Cash Management in Commonwealth Government Departments*; and Audit Report No.36, 1996–97, *Commonwealth Natural Resource Management and Environment Programs*.

6 *Cash Management in the Commonwealth Public Sector*, ANAO, March 1999.

Table 1

Sound and better practices in agency banking

Control framework component	*Sound and better practices*
Risk assessment	• Risk assessments were reviewed by internal audit and endorsed by the Audit Committee. • A steering committee was established to oversee the implementation of the new banking arrangements. • A post implementation review was undertaken to identify continuous improvement issues.
Control environment	• Updated Chief Executive's Instructions, policies and procedures are provided to staff using the agencies' intranet and new staff are informed of their existence and relevance through formal induction programs. • Post implementation reviews provided assistance in establishing responsibilities for managing the function. • The level of competence and qualifications required had been documented to ensure that on-going training develops requisite skills and knowledge. • The procedure manual was used as a training tool with questions included at the end of each chapter to assist with a review of the topics covered to reinforce the knowledge gained.
Control activities	• Automated bank reconciliation processes were being developed to address the issue of timely completion and review. • Accountability for the provision of timely cash-flow forecast information has been established by nominating specific liaison officers. • The number of payment runs had been reduced from daily to twice weekly or weekly following analyses of future cash needs by agencies. • Periodic reviews of logical access to systems were undertaken. • Implementation of effective controls surrounding all dealings with on-line banking facility, including dual signatories, minimum alphanumeric password length and locked and coded safe storage of banking system access card.
Information and Communication	• An incentive scheme is being trialed to encourage the provision of timely and accurate cash-flow forecasts from program areas.
Monitoring and review	• Internal audit has been used to conduct both compliance and quality assurance reviews.

23. The ANAO has produced three better practice guides that are relevant to the management of bank accounts by agencies and these are available on the ANAO web site www.anao.gov.au. The guides are:

- *Paying Accounts*, November 1996;
- *Management of Accounts Receivable*, December 1997; and
- *Cash Management*, March 1999.

Reports to agencies

24. The ANAO provided a report on the results of the audit to each agency reviewed that included a number of detailed, specific recommendations relevant to that agency. Agencies advised the ANAO of remedial action proposed or taken in response to the recommendations made.

Recommendations

The following recommendations are made in response to the findings of the audit and reflect the ANAO's research into better practice. The audit findings and the issues that lead to these recommendations are discussed in detail in Chapter 2 of this Report and are presented under the five components of the internal control framework.

Risk assessment

Recommendation No. 1
Para. 2.20

It is recommended that agencies review and strengthen, where required, their risk management framework, including their fraud control plan, to formally address the process level risks associated with the new banking arrangements.

Control environment

Recommendation No. 2
Para. 2.45

It is recommended that agencies ensure the control framework for agency banking is supported by their Chief Executive's Instructions, related policies and procedures, and longer term investment strategies.

Control activities

Recommendation No. 3
Para. 2.70

It is recommended that agencies:

- Review their management and computer control activities, including requirements related to protection of logical system access and on-line banking system; and
- Extend their program of bank account rationalisation by undertaking a cost-benefit analysis to identify an appropriate balance between administrative efficiency in transaction and reconciliation processes, reducing bank fees and charges and facilitating better cash management.

Information and communication

Recommendation No. 4 Para. 2.84

It is recommended that agencies enhance their systems and processes for the collection of information on future cash requirement so that they can maximise the opportunity to invest surplus funds.

Recommendation No. 5 Para. 2.85

It is recommended that, where agencies' cash-flow management indicates a need to either overdraw a bank account, or redeem an investment early, the decision should be based on an appropriate form of cost-benefit analysis to improve decision-making.

Recommendation No. 6 Para. 2.86

It is recommended that agencies review the quality of operational reporting produced on a periodic basis and implement periodic performance measurement against suitable agreed targets for senior management.

Monitoring and review

Recommendation No. 7 Para. 2.94

It is recommended that agencies include monitoring and review of performance measurement activity as a tool to improve the banking and cash management functions. Clearly specified procedures should be developed for implementing any action arising from the findings of the performance measurement reports and widely disseminated to decision makers.

Responses to the recommendations by agencies included in the audit

Agencies have agreed with all the recommendations with a number indicating that corrective action had been undertaken recently or was in progress.

Audit Findings and Conclusions

1. Introduction

This chapter describes the new agency banking arrangements and details of the agencies included in the audit. It also outlines the scope and objectives of the audit and the audit criteria used.

New agency banking arrangements

1.1 On 1 July 1999, new agency banking arrangements applied to agencies covered by the *Financial Management and Accountability Act 1997* (FMA Act). These agencies included Commonwealth departments, Parliamentary departments and prescribed agencies under the FMA Act. All agencies were required to establish and manage their own bank accounts and their payment arrangements; take responsibility for their cash management (processing payments and receipts); manage the relationship with their banker; and meet bank fees and charges associated with the operation of agency accounts.

1.2 Under the previous arrangements, each agency was required to advise Finance of the amount of funds required to be drawn down by that department, to make payments from the Commonwealth's centralised Official Public Account (OPA) held within a group account arrangement with the RBA.

Transactional banker arrangements

1.3 With the introduction of the new agency banking arrangement agencies would open and operate their own bank accounts at a 'transactional' banker of their choice. At least three bank accounts were required to reflect the fundamental difference in the activities of government agencies between departmental and administered funds.[7] In addition, each agency was expected to satisfy itself of the continuing operational needs of existing bank accounts.

[7] op. cit., *Agency Banking Framework — Guidance Manual*, p.21.

1.4 Under the new agency banking arrangement, agencies would execute service agreements with the transactional banker for banking services to address issues such as: processing of receipts and payments; various record keeping activities; transmission of instructions and information relating to transactions / balances; and the current schedule of bank fees and charges. The new arrangements also require the service agreement to include the need for compliance with core service requirements (protocols). These protocols included the maintenance of the group set-off arrangement which ensures that Commonwealth funds held by transactional bankers were pooled and efficiently transferred overnight (sweeping arrangement) to the RBA. Since the aggregate overnight balances with the 'transactional' banker will always be zero, it meant that the relationships between 'transactional' bankers and agencies (or the Commonwealth) did not extend to the payment of interest.[8]

Incentive regime

1.5 With the responsibility for planning and managing the cash-flows firmly in the hands of agencies, Finance encouraged better cash management practices by introducing some commercial arrangements via the incentive regime. This allowed agencies to earn daily interest on the overnight aggregate credit balances of their departmental bank accounts and provided agencies with access to term deposit arrangements administered by the RBA (on behalf of Finance) for periods ranging from seven days to 12 months. The interest differential between the overnight account balances and term deposits provided a strong incentive for agencies to actively manage their cash balances.

1.6 The creation of term deposits required agencies to transfer cash balances from their departmental account to a designated account with the RBA. The Minister for Finance and Administration determined the applicable interest rates. The rates of interest as at 1 July 1999, 3 July 2000 and 29 June 2001 are shown in Table 1.1.

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8 Finance Circular No. 1999/01.

Table 1.1

Interest rates between 1 July 1999 and 29 June 2001

Term of cash holding	*Interest rate 1 July 1999 (per cent)*	*Interest rate 3 July 2000[9] (per cent)*	*Interest rate 29 June 2001 (per cent)*
Overnight	3.75	2.00	2.00
Term deposit (average rate for terms ranging from 7 days to 12 months)	4.72	5.92	4.86

Source: Department of Finance and Administration

Note: Monthly average interest rates are included in the graph at Figure 2.1.

1.7 The placement of term deposits with the RBA (Central Bank) was an administrative arrangement that had been established by Finance as part of the incentive regime. Under the agency banking arrangements, agencies do not have independent investment powers over their departmental cash balances, although they have discretion over the placement of term deposits with the RBA.[10]

1.8 Agencies are able to access their term deposits before the maturity date. However, consistent with normal commercial practice, a penalty is imposed if an agency breaks a term deposit. This involves the loss of interest for the placement period of the term deposit.

1.9 The expected interest earnings by agencies from the overnight aggregate credit balances of the departmental accounts and term deposits were offset by reduction in agency appropriations equivalent to the estimate of the likely amount of interest earned in 1999–2000 and again in 2000–2001. This approach was introduced to provide incentives for agencies to improve their cash management while at the same time seeking to ensure that there would be no effect on the Commonwealth Budget.

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9 The interest rate for overnight account balances dropped to 2.0 per cent on I July 2000 which was a Saturday

10 *Agency Banking Framework-Guidance Manual,* Department of Finance and Administration July 1999, p. 42.

1.10 Another feature of the incentive regime was the introduction of the overdrawing arrangement by which agencies were permitted to overdraw their departmental accounts. This is an internal arrangement administered by Finance. However, there are restrictions placed on the use of the overdrawing arrangement. It should not be used in a way that will allow an agency's expenditure to exceed the limits imposed by appropriation and it cannot be used as a means of raising working capital. Agencies are charged an 'overdraft fee' on the overnight aggregate debit balance of the departmental account at a daily rate equivalent to the overdraft rate that the RBA applies to the Commonwealth as a whole (5.95 per cent in July 1999, 7.4 per cent in July 2000 and 6.45 per cent in June 2001).

Financial and administrative framework

1.11 The FMA Act, Financial Management Accountability Regulations and Orders established the financial framework for the management of bank accounts. An important part of this framework is the Chief Executive's Instructions (CEIs), issued pursuant to the FMA Act, which provide policy information to the staff of the agency. Chief Executive Officers (CEO) also provide procedural guidance in support of the CEIs to staff. In addition, under the FMA Act, the Minister for Finance and Administration has delegated the powers relating to the conduct of banking business with banks to the CEO of agencies. The FMA Act also permits the CEO to delegate all or some of these powers to any agency official through an internal instrument of delegation.

1.12 Finance also issued the *Agency Banking Framework—Guidance Manual* in July 1999.

Market testing

1.13 Government policy requires agencies to conduct some form of competitive selection process (or other market testing processes) in a reasonable timeframe in making its final choice of 'transactional' banker.

Other audit coverage

1.14 No specific audit of agency banking processes has been conducted since its introduction on 1 July 1999. However there have been a number of continuing findings from ANAO financial statement audits regarding the quality and timeliness of bank reconciliations within many agencies.

1.15 The effectiveness of tender processes for the choice of transactional banker and the effectiveness and efficiency of agencies' implementation of the transactional banking requirements will be the subject of a separate Auditor-General's report later this year.

This audit

The agencies

1.16 Seven Commonwealth agencies were included in this audit and ranged in size from:

- two large agencies with outlays in excess of $10 billion;
- three medium agencies with outlays between $1 billion and $10 billion; and
- two small agencies with outlays below $1 billion.

1.17 All agencies are subject to the requirements of the *Financial Management and Accountability Act 1997*. Agencies selected were not necessarily representative of all agencies' banking and cash management functions, but they do provide an informative cross-section of experience.

Objectives

1.18 The main objectives of the audit were to determine whether:

- agencies have implemented appropriate risk management strategies for the new banking arrangements which came into operation on 1 July 1999; and
- cash funds are being managed in accordance with the appropriate legislation, the Commonwealth's agency banking guidance[11] and other accepted accounting practices.

Audit evaluation criteria

1.19 The audit findings and recommendations are organised in accordance with the framework detailed in the ANAO's *Better Practice Guide to Effective Control, Control Structures in the Commonwealth Public Sector, Controlling Performance and Outcomes*[12]. Summary detail is provided in Appendix 1.

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

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11 *Agency Banking Framework Guidance Manual,* Department of Finance and Administration, July 1999, Revisions, July 2000. Additional guidance available includes a Complementary Guide, Banking Delegations, and Finance Circulars.

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

1.21 The criteria have been adapted and expanded to take account of the diverse risks and operations of an agency banking and cash management function. Development of the criteria also considered better practice in commercial and government sector banking and cash management functions.

Audit Methodology

1.22 The audit was undertaken in accordance with ANAO *Auditing Standards* during the period September 2000 to July 2001.

2. Audit Findings-Internal Control Framework

This chapter discusses the findings and recommendations of the audit against each component of the internal control framework.

Introduction

2.1 Central to the internal control framework is the understanding that control is a process, effected by the governing body of an organisation, senior management and other employees, designed to provide reasonable assurance that risks are managed to ensure the achievement of the agencies' objectives.[13]

2.2 The framework relies on the five key control elements specified in the ANAO Better Practice Guide-*Controlling Performance and Outcomes*. These are detailed below:

- Risk assessment;
- Control environment;
- Control activities;
- Information and communication; and
- Monitoring and review.

2.3 The framework has been adapted and organised to reflect key operational and risk aspects of agencies' management of bank accounts.

Explanation of categorisation of observations

2.4 The ANAO's observations are presented in two distinct categories: 'Audit findings' and 'Sound and better practices'.

2.5 *Audit findings* generally detail control weaknesses contributing to a breakdown in both efficiency and effectiveness of the control structure. *Sound and better practices* relate to business practices that, if adopted, would strengthen the control structure and lead to improvement in effectiveness and efficiency.

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

Risk assessment

Introduction

2.6 Risk assessment is the starting point for the development of an appropriate control framework for the management of agencies' bank accounts. A formal risk assessment process provides the necessary information to properly design controls that are both complete and cost effective. A sound risk assessment also provides the basis for ensuring responsibility for managing risks is properly allocated to managers who understand the risks and can be held accountable for their management through the operation of the control framework. Managers should ensure a complete and effective control framework is put in place to properly support the agencies' objectives.

2.7 The assessment and management of risks in banking processes should aim to balance the cost of control against the likely benefits. As noted in the then MAB/MIAC publication[14]:

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

2.8 Generally, the management of bank accounts in the Commonwealth has been construed as a simple low risk process. This was reasonable when the Commonwealth's banking arrangements were centrally managed and controlled. However, with the introduction of the new arrangements, agencies were faced with new risks associated with managing the opening and closing of bank accounts, investment of available monies, the relationship with their banker and the fees and charges associated with the operation of bank accounts. Agencies now have a responsibility to manage and monitor these risks, and to ensure proper controls including authorisation, segregation of duties, access and adequate physical security.

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

Business benefits of risk assessments

2.9 Formal risk assessment undertaken against an established risk framework that takes account of the costs and benefits of controls, assists an organisation to apply consistent and defensible approaches to the management of risks, including those risks associated with the operation of bank accounts. Process level assessments are the basis for subsequent design of all aspects of the control environment, specific control activities, information and communication processes, and monitoring and review procedures. The process level risk assessment can enhance control structures, detect control weaknesses, prevent control breakdown and increase operational efficiency.

Audit findings and comment

2.10 The following table summarises the audit findings.

Table 2.1

Risk assessment

Principle	Implementation of an effective risk assessment framework is a central element of the management of bank accounts.
Audit evaluation criteria	Management is aware of, assesses, analyses and mitigates/ takes advantage of risks that impact upon an agencies' goals and objectives. Management considers risk assessments at both the organisational level (outputs, program) and process level (function, task). Risk assessments can be combined with fraud control planning.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • All agencies have implemented some form of organisational risk assessment that includes banking arrangements. • Some agencies have undertaken a process risk assessment, but generally agencies have not identified the controls that mitigate the identified risks. • Fraud Control Plans have not been updated to address the risks associated with the introduction of the new banking arrangements.
Sound and better practices noted	The audit noted the following: • Risk assessments were reviewed by internal audit and endorsed by the Audit Committee. • A steering committee was established to oversee the implementation of the new banking arrangements. • A post implementation review was undertaken to identify continuous improvement issues.

Risk assessments

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

2.12 The audit observed that risk management activities generally commence with an *organisational* risk assessment. This means that the organisation formally identifies its risks within the context of the breadth of its organisational activity. These risks would then be evaluated and sourced to activities or functions. The audit found that many agencies had adopted a pro-active approach to risk assessment activities that focus on providing a formally documented framework that identified, analysed and assessed the key risks to the organisation. These frameworks provide useful tools for effective *organisational* risk management.

2.13 The audit also found that with the introduction of the new banking arrangements, agencies, as part of their implementation plan, reviewed the continued appropriateness of the previous assessment of organisational risks and associated controls. In some cases the review extended to the identification of the process level risks, however, in other cases agencies relied on the high-level organisational risk assessment. The ANAO noted very few examples where the design of controls had been adapted to take account of process level risks. However, in a number of other cases the design of the controls was based on addressing the organisational risks rather than the process level risks.

2.14 Formal process level risk assessments provide managers with the requisite knowledge to manage the risks and associated opportunities. Risk assessment elements provide the basis for effective and efficient management of banking arrangements. While the organisational risk assessment provides management with the necessary knowledge and understanding to manage risk, further development of risk assessment activity related specifically to the management of the banking arrangements is required to fully understand the control requirements. A better understanding of process level risks should lead to a better understanding of control issues and, as a result, many of the control weaknesses described in this Report could have been detected, sourced and resolved.

Fraud control plans

2.15 Fraud control is integral to internal control, which in turn is central to corporate governance. The Commonwealth Fraud Control Policy requires Chief Executives to be responsible for:

> *fostering an environment within their agencies which makes fraud control a major responsibility for all public sector staff, for articulating clear standards and procedures to encourage minimisation and deterrence of fraud, and for the detection and prosecution of offences should they occur.*[15]

2.16 Fraud control policies should reflect an agencies wider operating environment and be an integral part of the agencies planning regime. Fraud control plans should, in turn, be linked to the broader objectives of an organisation as outlined in its corporate plan, the directions specified in its business plan and the activities of individual work areas. Importantly, the fraud control plan should be subject to regular review to take account of changing conditions.

2.17 The audit found that while a number of the agencies examined as part of this audit had reviewed their fraud control plans[16] since July 1999, the plans had not been updated to address the risks associated with the new banking arrangements.

2.18 Agencies that had relied on a review of their organisational risks indicated that in implementing the new banking arrangements a minimalist approach was adopted in that only the 'necessary' controls were introduced.

Better practice

2.19 The audit noted that implementation of the new banking arrangements was more successful in agencies that established a steering committee to oversee the implementation, developed an implementation plan, undertook a post implementation review to identify continuous improvement issues and where internal audit reviewed the risk assessments.

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[15] Commonwealth Law Enforcement Board, 1994, *Best Practice for Fraud Control-Fraud Control Policy of the Commonwealth.*

[16] The ANAO has undertaken a series of audits of agencies' fraud control plans, including: Audit Report No.45, 2000–2001, *Management of Fraud Control*; Audit Report No.22, 2000–2001, *Fraud Control in Defence*; Audit Report No.16, 2000–2001, *Australian Taxation Office Internal Fraud Control Arrangements*; Audit Report No.6, 2000–2001, *Fraud Control Arrangements in the Department of Health and Aged Care*; Audit Report No.5, 2000–2001, *Fraud Control Arrangements in the Department of Industry, Science and Resources*; Audit Report No.47, 1999–2000, *Survey of Fraud Control Arrangements in APS Agencies*; and Audit Report No.4, 1999–2000, *Fraud Control Arrangements in Employment, Education, Training and Youth Affairs*.

Risk assessment—recommendation

Recommendation No.1

2.20 It is recommended that agencies review and strengthen, where required, their risk management framework, including their fraud control plan, to formally address the process level risks associated with the new banking arrangements.

Implementing the recommendation

2.21 The strategic importance of the new banking arrangements and the complexity of business and operational risks faced by agencies indicate that there are risks associated with the activity which require formal identification and management.

2.22 The extent of, and the resources committed to, risk assessment should reflect the costs and strategic importance of the new banking arrangements to the agency. Further, the risk framework needs to be determined from an overall agency perspective.

2.23 To be effective, managers should address a complete set of risks. While managers would usually nominate fraud and misappropriation of monies as the major risk, other risks also need to be considered. Examples of risks, which are not usually considered in designing banking control frameworks, include the following:

- Reputation risk: the risk to agencies' reputation as effective cash managers should insufficient cash be available as and when it is required.
- Long-term strategic risk: the risk that the agency is unable to manage its balance sheet, particularly its accrued annual and long service leave liabilities and asset replacement needs.

Control environment

Introduction

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

2.25 Agencies should establish a control environment that clearly sets out management responsibilities and promotes sound principles of active management, including continuous improvement. Appropriate and up-to-date CEIs detailing the agencies policies and procedures are fundamental to achieving such an environment. Section 6(1) of the Financial Management and Accountability Regulations authorises the Chief Executive to issue instructions. Most agencies also issue procedural instructions supporting the CEIs.

2.26 Commonwealth agencies use various mechanisms to implement an appropriate control environment. In this audit, the environment was examined by reference to key issues in the areas of *process*, *structure* and *people*:

- *Process*—agencies establish appropriate documentation for policies and procedures that provide the base on which specific control activities are built. As well, it is necessary to maintain the effectiveness and efficiency of these policies and procedures by ensuring their completeness, including provision of up-to-date documentation;
- *Structure*—agencies structure the function to allow for clear responsibilities, accountabilities and transparency, including the centralisation of processes where cost effective to do so; and
- *People*—the need for senior management to establish a control environment that clearly defines key personnel responsibilities and accountability, as well as promoting these through effective training and communication programs. This will include the appropriate training and use by staff of the information systems supporting the activity.

Business benefits of an effective control environment

2.27 An effective control environment will ensure that banking policies, procedures and practices are aligned with overall corporate strategy and objectives. Such an environment establishes a control consciousness within which specific operational controls are applied. It provides the framework which supports management's ability to rely on the integrity of processing as well as contributing to cost effective processing.

Audit findings and comment

2.28 The audit findings in this section are summarised in Tables 2.2 Process, 2.3 Structure and 2.4 People. They have been separated according to the categorisations described above.

Table 2.2
Process

Principle	Effective policies and procedures ensure all personnel have access to a documented framework.
Audit evaluation criteria	There are effective and efficient policies and procedures that reflect the agencies' governance responsibilities.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Most agencies had up-to-date, or were in the process of updating, CEIs and supporting guidance material and procedures. • Most agencies' cash management policies, including investment strategies, are based on short-term objectives.
Sound and better practices noted	The audit noted the following: • Updated CEIs, policies and procedures are provided to staff using the agencies' intranet and new staff are informed of their existence and relevance through formal induction programs.

Policies and procedures

2.29 Agencies use various mechanisms to document and communicate policies and procedures. All recognise the importance of this framework in establishing a sound basis for processing. The existence of policies and procedures is a key element for preventing possible control breakdown, should, for example, the organisation experience high turnover in personnel. These mechanisms include the use of CEIs, policy statements and procedures.

2.30 The audit noted that most agencies had up-to-date CEIs that included banking and cash management and developed guidance material and procedures to support the CEIs. The remaining agencies were in the process of updating the CEIs and supporting material and procedures. These agencies have been operating since 1 July 1999 without adequate policies and procedures.

Investment strategy

2.31 Prior to 1 July 1999, each agency accessed funds, as required, to make payments from the Commonwealth's centralised OPA held within a group account arrangement with the RBA. Processing of payments was conducted largely through Finance. The Department of the Treasury undertook an aggregate cash and debt management function on the Commonwealth's behalf on the basis of forecasts from agencies of daily cash-flows.

2.32 From 1 July 1999, agencies were required to establish, operate and manage their own bank accounts and payment arrangements, including cash-flow management. Under the new arrangements, to encourage a stronger focus on cash-flow planning and management, agencies would receive interest on their departmental account balances and meet overdraft charges. At the same time agencies began to receive their departmental appropriations on a fortnightly basis. Agencies would also be able to place surplus departmental funds in term deposits administered on behalf of Finance by the RBA.[17] The arrangements included interest:

- earned on the overnight aggregate credit balances of departmental bank accounts;
- earned on term deposits nominated by the agency for periods from one week to 12 months; and
- charged on overdrafts at a rate that had regard to the overdraft rate that the RBA applied to the Commonwealth.

2.33 As a result of the new banking arrangements, agencies' appropriations in 1999–2000 and again in 2000–2001 were reduced by an estimate of the interest likely to be earned in the respective years.

2.34 The Finance Agency Banking guidelines indicate that the payment of interest on departmental cash balances provided an incentive for agencies to make better decisions about the timing of expenditure and improve collection of departmental receipts. By focussing on accurate forecasting of cash requirements and management of payment obligations, an agency could maximise its interest earnings and minimise recourse to overdraft facilities.[18]

2.35 The audit assessed whether agencies had established policies and procedures to achieve the above objectives.

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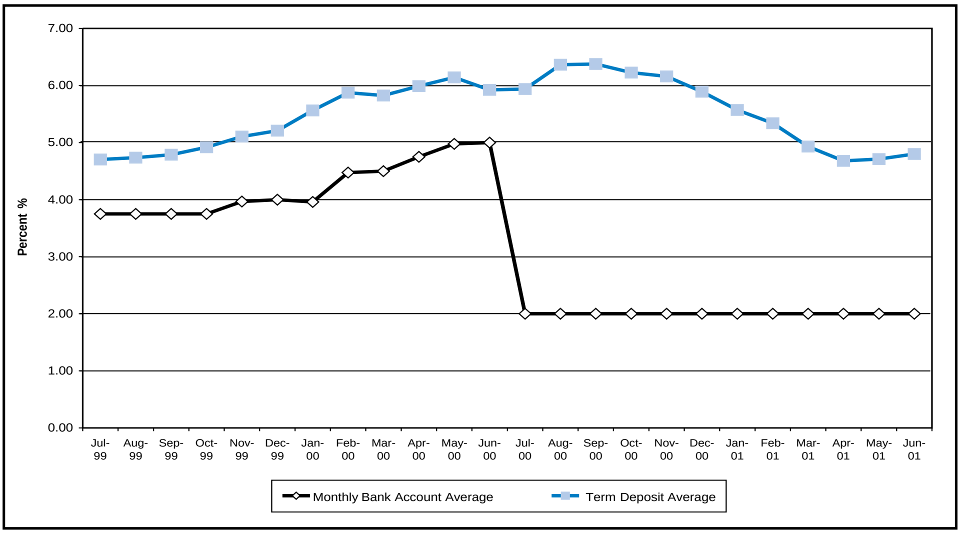
17 *Agency Banking Framework—Guidance Manual*, Department of Finance and Administration, second edition, July 1999.

18 ibid. Section 8.

2.36 The audit found that agencies had established, or were in the process of establishing, suitable investment strategies and policies and procedures in support of the strategy. The investment strategies generally had established targets for investment interest. However, these targets were initially quite conservative and were more related to earning interest to the extent of the amount by which the 1999–2000 appropriation had been reduced, rather than directed towards meeting the strategic issues of the '*adequacy of working capital, the provision for replacement of assets over time and accruing for employee entitlements*'[19]. It was noted, however, that as agencies became more settled with the new banking arrangements, and the differential between the overnight and term deposit interest rates increased (Figure 2.1), the average amount and length of term deposits increased significantly.

Figure 2.1

Interest rate differential between Bank Account and Term Deposit



Source: Department of Finance and Administration

2.37 Figure 2.2 below shows the aggregate amount of cash held in departmental bank accounts and term deposits by the seven audited agencies from July 1999 to June 2001. The monthly amounts represent an average of the aggregate daily balances. Further analysis indicates that the aggregate amount of cash held by the audited agencies averaged approximately $928 million per month over the two years. Figure 2.3 shows, for the audited agencies, a progressive increase in the level of cash held in term deposits (high interest bearing) compared to cash held in departmental bank accounts (low interest bearing) from July 1999 to June 2001.

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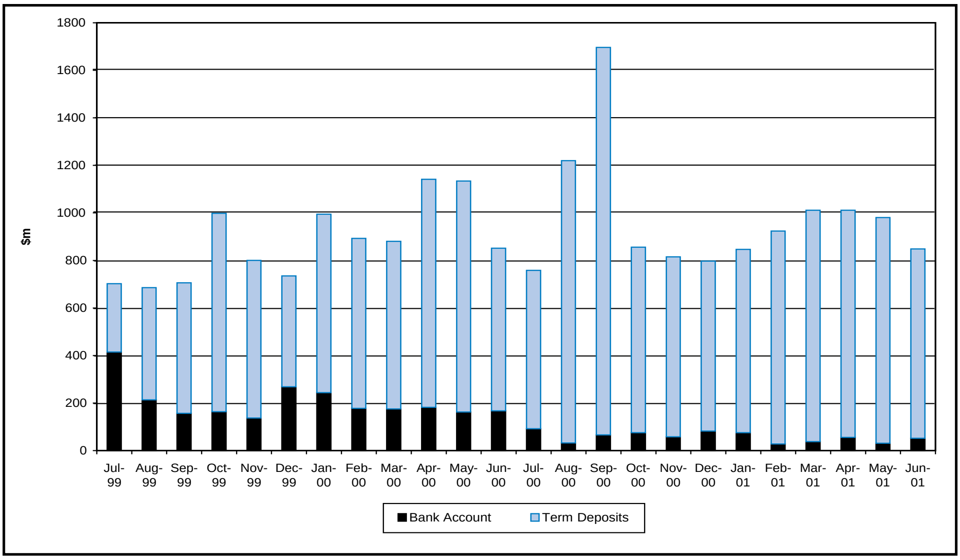
19 ibid. Section 8.

Figure 2.2

Aggregate cash holdings of the seven audited agencies comprising departmental bank accounts and term deposits

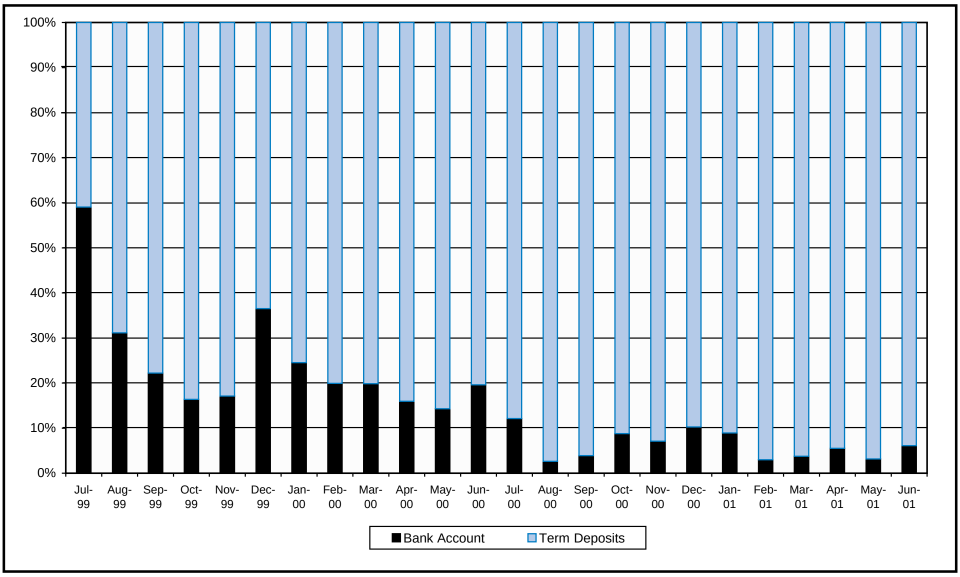


Source: Department of Finance and Administration

Note: The monthly amounts represent an average of the aggregate daily balances.

Figure 2.3

Proportion of aggregate cash holdings of the seven audited agencies in departmental bank accounts and term deposits



Source: Department of Finance and Administration

Table 2.3
Structure

Principle	The internal structure of the area responsible for the agencies banking activities should reflect the agencies' needs, and through allowing for clear responsibilities and accountabilities and supporting its strategic directions.
Audit evaluation criteria	The function is structured in a way that efficiently meets the needs of the organisation, allowing for clear responsibilities and accountabilities.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Appropriate structures have been established to manage the function. • Most agencies had entered into agreements with the RBA, while some agencies are now market testing their transactional banking arrangements.
Sound and better practice noted	The audit noted the following: • Post implementation reviews provided assistance in establishing responsibilities for managing the function.

2.38 The audit found that most agencies have established separate centralised units or designated individual positions to manage the banking and cash management function. In addition, two agencies were considering the rationalisation of the number of payment processing centres.

Agreement with transactional banker

2.39 Part A section 4 of the Finance *Agency Banking Guidelines* indicates that agencies have choice and flexibility in tailoring the transactional banking and related services they seek from the market. Agencies were able to initiate competitive tendering and contracting or other market testing processes prior to 1 July 1999. Agencies choosing not to undertake a competitive selection process prior to 1 July 1999 were required to establish a service agreement with the RBA. However, a competitive selection process would still need to be undertaken in a reasonable timeframe. The agreements with the RBA were required to incorporate adherence to core service requirements or protocols related to cash management and banking functions outlined in the Guidelines.

2.40 The audit found most agencies had entered into agreements with the RBA, while a number of agencies are now market testing their transactional banking arrangements.

Table 2.4
People

Principle	Key personnel demonstrate an understanding of their role in the agencies' control structure and how this impacts on its banking activity.
Audit evaluation criteria	Senior management takes a pro-active approach to risk and control which ensures key personnel are aware of governance responsibilities, through training and communication.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Most agencies could improve their agency banking training programs, through the development of long-term training strategies.
Sound and better practice noted	The audit noted the following: • The level of competence and qualifications required had been documented to ensure that on-going training develops requisite skills and knowledge. • The procedure manual was used as a training tool with questions included at the end of each chapter to assist with a review of the topics covered to reinforce the knowledge gained.

2.41 The audit observed that training programs were generally directed towards immediate needs and limited focus had been placed on establishing a training program that addressed longer-term needs.

2.42 All agencies had provided training to staff in the use of the general ledger and the banking software. Further, one-off training, when upgrades or new modules were introduced, had taken place. This is consistent with the agencies' general approach to training, that is to provide staff with training on an 'as required' basis. At many of the agencies, training programs could be improved through their formalisation and structuring consistent programs that are directly aligned to operational needs.

2.43 Agencies used a variety of mechanisms to encourage an ethical culture that valued internal control and to communicate these messages to their people. These tools included newsletters, complemented by the use of the Intranet, to promote an awareness of fraud and control issues throughout the agency.

Overall conclusion

2.44 The audit concluded that agencies could improve efficiency and control effectiveness by formalising and ensuring the completeness, and adequate communication of, related policies and procedures; and by developing longer term investment strategies.

Control environment—recommendations

Recommendation No.2

2.45 It is recommended that agencies ensure the control framework for agency banking is supported by their Chief Executive's Instructions, related policies and procedures, and longer term investment strategies.

Implementing the recommendations

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

2.47 The nature of management's approach in this area clearly has an impact beyond the banking and cash management function. The words and actions of management establishes the atmosphere for the implementation and maintenance of an effective control structure across financial management and operational activity—in effect enhancing the agency's corporate governance and approach to risk management. Key matters within this category include:

- people—the need for senior management to establish a control environment that clearly defines key personnel responsibilities and accountability, as well as promoting these through effective training and communication programs;
- process—the agency's policies and procedures should be complete and effectively communicated in order to reflect the agencies' governance responsibilities; and
- structure—the structure of the function should make sense in terms of the agency's needs, and allow for clear responsibilities and accountabilities.

Control activities

Introduction

2.48 Control activities refer to that group of specific controls that, within an effective control structure, mitigate unacceptable risks to assist the achievement of business objectives. They operate as the agencies' front line of defence in ensuring basic controls exist such as segregation of duties, authorisation, completeness, accuracy, timeliness and system security. The nature, timing and extent of control activities should reflect the potential loss (monetary or otherwise) to the agency if the risks eventuate. The cost of implementing a particular control procedure needs to be measured against the priority attached to mitigating the risk.

Business benefits of control activities

2.49 An effective framework includes both preventative and detective controls that minimise the impact of risks and contributes to the efficient and effective delivery of quality outcomes. Control activities should be clearly documented in procedure manuals and job descriptions, and be available to staff responsible for their implementation. Control activities are broadly categorised as management, organisational, authorisation, operational or computing controls[20].

Audit findings and comment

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

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

2.51 Each of the above is addressed in the following sections of the report.

Management controls

Table 2.5

Summary of management controls

Principle	Management reviews the operation of control activities.
Audit evaluation criteria	High level supervision and review. These controls include management's monitoring of other specific control measures.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Many agencies could improve the design and operation of basic management controls. • Some agencies need to improve monitoring of bank reconciliations to ensure there is timely completion, review and clearance of discrepancies.
Sound and better practices noted	The audit noted the following: • Automated bank reconciliation processes were being developed to address the issue of timely completion and review.

[20] op. cit., *Controlling Performance and Outcomes*, p. 22.

2.52 The audit found a majority of agencies did not use one or more of the following basic management controls:

- timely completion and review of bank reconciliations;
- comparison of cumulative interest on daily balances for a quarter against the quarterly interest payment received;
- review the reasons for overdrawing the bank account or breaking term deposits;
- review of weekly or fortnightly actual cash balances compared to forecast cash balances; and
- review of weekly investment activity, such as interest earned compared to internal targets.

2.53 The audit found that some agencies had not undertaken bank reconciliations in a timely manner and, in some cases, this extended over a number of months. In addition, discrepancies between the agencies accounting records and the bank statements remained unexplained in a number of reconciliations undertaken. Bank reconciliations are an essential internal control over cash balances and facilitate good cash management and the lack of timely reconciliations may impact on cash management decisions. Over a number of years, the inadequate performance of this control has been highlighted by the ANAO in a number of reports on the results of the audits of Commonwealth entities financial statements. In particular, in Audit Report No.52, 1999–2000, the ANAO noted that:

> *…generally reconciliations of the cash control accounts in ledgers to bank statements were either:*
>
> - *not being performed;*
> - *were performed on an irregular basis; or*
> - *were not being performed properly.*
>
> *As a result, there is the risk that agency cash and bank accounts can be used for unauthorised purposes and the true cash position for financial reporting purposes will not be ascertained.*[21]

2.54 Recent reviews as part of financial statement audits have shown an improvement in the effectiveness of this control.

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21 Audit Report No.52, 1999–2000 *Control Structures as Part of the Audits of Financial Statements of Major Commonwealth Agencies for the Period Ended 30 June 2000*, p. 21.

2.55 With regard to bank reconciliations, new technology should facilitate the effective operation of bank reconciliations. Agencies now have the ability to extract data on their transactions from their transactional banker in order to reconcile details on a daily basis. The ability of agencies to obtain the data on a daily basis enables agencies to resolve issues more quickly and, as a result, has transformed the reconciliation process into a less imposing activity. However, two agencies are still experiencing timeliness problems in reconciling uncleared items. In addition, as noted in ANAO Audit Report No.23, 1999–2000:

> *There are cases where banking solutions in newly implemented FMIS are inadequate, resulting in an inability to perform basic cash balance reconciliations, thus increasing not only the risk of inefficient use of cash assets, but also the risk of fraud and error.*[22]

2.56 Agencies were not undertaking a review of the quarterly interest payments received to establish the completeness and accuracy of interest earned.

2.57 In addition, the audit found that most agencies had not undertaken a review of the reasons for using the overdraft arrangements or breaking a term deposit. The ANAO considers an analysis of the cost involved with either option should be documented to support the decision. This will demonstrate that the returns on investment decisions are being maximised. Regular reviews of interest earned compared to targets will also ensure that investments decisions are being optimised.

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22 Audit Report No.23, 1999–2000, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2000*, p. 24.

Organisational controls

Table 2.6

Summary of organisational controls

Principle	The organisation of banking arrangements supports segregation of duties; use of efficient banking mechanisms; and provides adequate physical security.
Audit evaluation criteria	Derived from the way the function is structured and includes: • well-defined responsibilities and segregation of functions for agency banking and cash management personnel; • the structure of banking and cash management; and • physical controls over related assets and documentation.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • A small number of agencies needed to improve their segregation of duties. • A small number of agencies had bank account structures that caused an unnecessary administrative burden.
Sound and better practice noted	The audit noted the following: • Accountability for the provision of timely cash-flow forecast information has been established by nominating specific liaison officers.

Segregation of duties

2.58 The audit found that most agencies had formally defined the structure and activities of the section responsible for agency banking, however, agencies needed to formally document the individual responsibilities of staff.

Rationalisation of bank accounts

2.59 Part 5 of the *Agency Banking Framework—Guidance Manual* noted that:

> *In the interests of efficient cash management each agency will be expected to review all its accounts with a view to rationalisation and efficiency, and satisfy itself of the continuing operational need for the accounts. Minimising the number of separate accounts supports administrative efficiency in transaction and reconciliation processes, contains bank fees and charges, and facilitates better cash management.*[23]

2.60 The audit found that, since 1 July 1999, many agencies have rationalised their bank account structure. A number of others are awaiting the outcome of their market testing before reviewing the number of bank accounts. The audit also found that while agencies indicated that they had conducted reviews to establish the continued need for bank accounts,

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23 op. cit., *Agency Banking Framework Guidance Manual*, p. 25.

limited documentation was available to support the decision to maintain the number of bank accounts. Several agencies also indicated that the current number of bank accounts was necessary for operational reasons, although it was planned to review the number as part of the tender process relating to banking services.

Authorisation controls

Table 2.7

Summary of authorisation controls

Principle	Transactions are appropriately authorised.
Audit evaluation criteria	These controls operate at the individual transaction level. These include access, authorisation, approval and checking controls.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Appropriate authorisation and delegations to release payment files and to invest surplus cash balances as term deposits were in place. • The reasons for opening bank accounts were being reviewed and monitored by agencies. • An appropriate number of cheque signatories to operate the bank accounts had been established.

2.61 The audit found that authorisation and delegation levels related to the release of payment files and the opening and closing of bank accounts were in place.

Operational controls

Table 2.8

Summary of operational controls

Principle	Transactions and related records are accurate and complete.
Audit evaluation criteria	These controls are concerned with the completeness and accuracy of processing and controls to ensure timeliness of transactions.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Instances of non-compliance with policy and procedure occurred in many agencies. • Appropriate controls were in place for the processing of payment and investment transactions. • Reviews on the reasonableness of bank fees and charges were being conducted.
Sound and better practice noted	The audit noted the following: • The number of payment runs had been reduced from daily to twice weekly or weekly following analyses of future cash needs by agencies.

Compliance with policies and procedures

2.62 The audit found instances of non-compliance with policies and procedures in most agencies. Non-compliance with policies and procedures included:

- Bank reconciliations were not completed in a timely manner. The non-compliance with this control and, as a result, its effectiveness has been raised by the ANAO in the last two financial statement audit reports.[24]
- A central register of authorised signatories on bank accounts had not been kept.
- User access to computer applications had not been complied with and access was not monitored.
- Material variations in expected cash-flow had not been advised to the cash management unit.

2.63 The audit found adequate operational controls concerned with the completeness and accuracy of processing were in place.

Computer controls

Table 2.9

Summary of computer controls

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

24 op. cit., Audit Report No 52, 1999–2000, p. 21 and Audit Report No 23, 1999–2000, p. 20.

Access and logical security controls

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

- lack of appropriate controls to ensure adequate logical access security;
- inadequate review and approval of users' access to systems;
- inadequate review and monitoring of access logs which record activity relating to the security environment; and
- system access rights were greater than functionally necessary.

2.65 The adequacy of computer access and security over data has been a continuing theme in audit reports over the past few years.[25]

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

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

Overall conclusion

2.68 In general, agencies were found to have organisational and authorisation control activities that supported segregation of duties and provided adequate physical security and ensured transactions were appropriately authorised. However, the audit noted instances of non-compliance with policies and procedures in most agencies. The design of controls could be improved to enhance efficiency, for example, through the wider use of management controls (those that relate to the monitoring of specific activities, such as reviewing reports associated with interest earned).

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[25] ibid. p. 26.

2.69 Computer access and physical control continues to be one area where agencies could make significant improvement.

Control activities—recommendations

Recommendation No.3

2.70 It is recommended that agencies:

- review their management and computer control activities, including requirements related to protection of logical system access and on-line banking system; and
- extend their program of bank account rationalisation by undertaking a cost-benefit analysis to identify an appropriate balance between administrative efficiency in transaction and reconciliation processes, reducing bank fees and charges and facilitating better cash management.

Implementing the recommendations

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

Information and communication

Introduction

2.72 Information and communication are critical for performance reporting, decision-making, both within the agency and externally, and the achievement of strategic objectives. Performance information needs to be identified, captured analysed and communicated on a timely basis and also in a form that enables people to make decisions and carry out their responsibilities. Accordingly, information systems (both computer and manual) need to be in place to capture and process data in meaningful ways. [26]

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

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[26] op. cit., *Controlling Performances and Outcomes*, p. 26.

Business benefits

2.74 Effective information and its communication help agencies establish whether resources are being directed towards the achievement of desired outcomes in the most efficient, effective and ethical way.

2.75 Performance reporting assists agencies understanding of whether the banking and cash management function is meeting the needs of the agency. It also contributes to continuous improvement and enables staff to undertake and monitor their own operational activities.

Audit findings and comment

2.76 The following table summaries the audit findings.

Table 2.10
Information and communication

Principle	The right information is provided to the right people at the right time.
Audit evaluation criteria	Management regularly communicates relevant information throughout the agency to assist in the achievement of its objectives. Information includes both: • Operational data (related to transactions and sourced from the agency banking and cash management function). • Performance data or indicators (related to the agency banking and cash management function).
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Processes by which information on future cash requirements were collected were immature in nature and required enhancement. • Agencies produce a number of operational performance reports although limited review of, and action taken as a result of these reports, was evident.
Sound and better practices noted	The audit noted the following: • An incentive scheme is being trialed to encourage the provision of timely and accurate cash-flow forecasts from program areas.

Cash management

2.77 The audit found that while agencies had developed processes by which information on future cash requirements was collected, they required further development and, in a number of agencies, the information initially provided was generally limited to advice on forthcoming major transactions. The ANAO considered that agency's processes required enhancement to provide an effective cash management regime, including a longer term analysis of anticipated cash-flows. This is particularly important as agencies now receive their departmental appropriations on a fortnightly basis.

2.78 The audit also noted that, as a result of the cash-flow processes requiring further development and enhancement, agencies' departmental bank accounts had gone into 'overdraft'; short-term investments were redeemed early; and significant balances were held in the overnight bank accounts that attracted lower interest earnings. While each of the above circumstances were contemplated in the Finance *Agency Banking Guidelines*, sound cash management processes should minimise the need to overdraw bank accounts or require the early redemption of investments. Further, where agencies' cash-flow management indicates a need to either overdraw a bank account or redeem an investment early, the choice should be based on some cost-benefit analysis.

2.79 The audit found that agencies' cost-benefit analyses had not been adequately documented.

Operational information and communication

2.80 The audit noted many agencies produce effective and timely operational reports that include actual and budget cash balances which are compared to forecasts and targets. They also compared the year to date totals of interest earned against a predetermined target. However, it does not appear that these reports are communicated effectively to management. Only limited action has been taken by management on the information provided.

Performance information and communication

2.81 The audit found that most agencies do not use normal performance measures for cost of processing, timeliness and quality of transaction. In the absence of this information, management lacks sufficient knowledge to make informed decisions on the performance of the function.

2.82 The audit noted that in regards to cash management decisions, agencies have not reported the instances when the overdrawing arrangement has been accessed or term deposits have been cancelled prior to maturity. This information is a useful performance measure for the banking and cash management function.

2.83 One agency is trialing a new incentive scheme to encourage program areas to provide timely and accurate cash-flow forecasting information. The program areas are required to complete a cash-flow forecast spreadsheet and are judged on the accuracy and timeliness of this information. Acceptable performance will be noted if cash expenditure is within five per cent of the cash forecast. Reports on performance are provided by the banking and cash management function.

Information and communication—recommendations

Recommendation No.4

2.84 It is recommended that agencies enhance their systems and processes for the collection of information on future cash requirement so that they can maximise the opportunity to invest surplus funds.

Recommendation No.5

2.85 It is recommended that, where agencies' cash-flow management indicates a need to either overdraw a bank account, or redeem an investment early, the decision should be based on an appropriate form of cost-benefit analysis to improve decision-making.

Recommendation No.6

2.86 It is recommended that agencies review the quality of operational reporting produced on a periodic basis and implement periodic performance measurement against suitable agreed targets for senior management.

Implementing the recommendations

2.87 An effective banking and cash management process is built on a set of well-defined and clearly stated objectives. These objectives articulate the desirable performance results that the agency wants from that process. In monitoring a process so that it achieves it key objectives, the agency must select appropriate performance measures. Appropriate performance measures can lead to improvements in a business process. Therefore to build and to continuously improve an effective process, an agency should establish:

- **key objectives** to articulate the performance results the agency expects from the process;
- **output and outcome measures** to determine whether the key objectives are achieved; and
- **activity measures** to monitor the performance of those activities that are instrumental in achieving the key objectives.

Monitoring and review

Introduction

2.88 Monitoring and review is the final component of an effective control structure and is closely linked to information and communication. In addition to performance monitoring, the effectiveness of the control structure itself also needs to be monitored and reviewed.[27] Control monitoring and review can be undertaken in two ways, by on-going monitoring such as control self assessment and by separate reviews and evaluations by using either the Internal Audit function or specialist consultants. On-going monitoring built into normal operations tends to be more effective than separate evaluations.

Business benefits

2.89 Monitoring and review provide assurance and feedback on whether program objectives are being achieved efficiently and effectively. The control element also provides an on-going check on the effectiveness of the control structure.

Audit findings and comment

2.90 The following table summaries the audit findings.

Table 2.11
Monitoring and review

Principle	Monitoring and review takes place on an appropriate periodic basis that enables the agency to check the control structure and ensure the agency's strategic objectives are achieved.
Audit evaluation criteria	Management activities demonstrate a continuous improvement approach, including quality assurance, performance monitoring, control self assessment or independent review of the effectiveness of control activities.
Audit findings	In relation to the seven agencies reviewed, the audit found the following: • Agencies internal audit activity of the banking and cash management function has been limited. • Most agencies prepare periodic reports to monitor cash management, but have not established adequate performance measurement to quantify performance of the banking and cash management function. • Agencies do not use control self assessment as a monitoring and review tool.
Sound and better practices noted	The audit noted the following: • Internal audit has been used to conduct both compliance and quality assurance reviews.

[27] op. cit., *Controlling Performances and Outcomes*, p. 30.

2.91 The audit found that agencies could improve the monitoring and review of the banking and cash management function to ensure both organisational and control objectives are being achieved efficiently and effectively. In addition to the monitoring of performance measures, the effectiveness of the control structure itself also needs to be monitored and reviewed. Control monitoring and review can be undertaken in various ways including:

- by on-going monitoring which is an inherent part of the process, such as control self assessment; and
- by separate periodic reviews and evaluations, such as internal audit.

2.92 Three agencies have used Internal Audit to monitor the banking and cash management function primarily by undertaking compliance reviews, but also through monitoring key organisational risks. The other agencies do not conduct any formal reviews to ensure compliance with the policy and procedures of the agency.

2.93 None of the agencies included in this audit has adopted formal control self assessment processes as a mechanism to build in regular monitoring and review as a normal part of the control process.

Monitoring and review—recommendations

Recommendation No.7

2.94 It is recommended that agencies include monitoring and review of performance measurement activity as a tool to improve the banking and cash management functions. Clearly specified procedures should be developed for implementing any action arising from the findings of the performance measurement reports and widely disseminated to decision makers.

Implementing the recommendation

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

2.96 Separate evaluations, such as internal audit reviews or process reviews, undertaken from time to time can also be a useful monitoring and review tool. They look at the effectiveness of control structures from another perspective and often provide the opportunity for on-going monitoring procedures to be revisited.

2.97 The scope and frequency of monitoring and review activities will depend primarily on an assessment of risks and the effectiveness of on-going monitoring. The greater the on-going monitoring, the less need there will be for separate evaluations. It is also important to note that the effectiveness and appropriateness of the control structure can change as the environment changes.

2.98 While the governing body of an organisation is responsible for the control framework, individual senior and line managers can facilitate operational improvement through taking responsibility. The ANAO has identified control self assessment which is a reporting process where managers are actively responsible for their own areas in developing, assessing, maintaining and monitoring their controls, as a better practice in monitoring and review activity[28]. This usually involves the completion of self assessment checklists to confirm that control processes and procedures are clearly understood, implemented and are operating effectively. The checklist data can be collated along with other financial and operational performance data into reports.

Canberra ACT	Ian McPhee
17 September 2001	Acting Auditor-General

[28] op.cit., *Controlling Performance and Outcomes.*

Appendices

Appendix 1

About the Audit

Assurance and Control Assessment audits

Assurance and Control Assessment (ACA) audits are undertaken under the general performance audit provisions of the *Auditor-General Act 1997*. They examine the internal control structures supporting common business support activities and processes that are not specifically covered by financial statement or other performance audits. Audit evaluation criteria are based on the five interrelated components of the control structure[29]; namely:

- risk assessment;
- control environment;
- control activities;
- information and communication; and,
- monitoring and review.

Audit objectives

The main objectives of the audit were to determine whether:

- agencies have implemented appropriate risk management strategies for the new banking arrangements which came into operation on 1 July 1999; and
- cash funds are being managed in accordance with the appropriate legislation, the Commonwealth's agency banking guidance[30] and generally accepted accounting.

Audit evaluation criteria

Table A1 shows the audit evaluation criteria mapped against the components of the internal control framework. Each agency's management of banking and cash management was assessed against these criteria.

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29 op. cit., *Controlling Performance and Outcomes*.

30 *Agency Banking Framework—Guidance Manual, Department of Finance and Administration, July 1999, Revisions July 2000, Complementary Guide, Department of Finance and Administration, Banking Delegations, and Finance Circulars, Department of Finance and Administration.*

Table A1

Audit Evaluation Criteria

<table>
<tr><th colspan="2">Risk assessment</th></tr>
<tr><td colspan="2">Management is aware of, assesses, analyses and mitigates/takes advantage of risks, which impact upon an organisation's goals and objectives. Management considers risk assessments at both the organisational level (outputs, program) and process level (function, task). Risk assessments can be combined with fraud control planning.</td></tr>
<tr><td colspan="2">Control environment</td></tr>
<tr><td colspan="2">Management demonstrates commitment to ensuring well controlled business operations, including the following:</td></tr>
<tr><td>People</td><td>Senior management takes a pro-active approach to risk and control which ensures key personnel are aware of governance responsibilities, through training and communication.</td></tr>
<tr><td>Structure</td><td>The function is structured in a way that efficiently meets the business needs of the agency, allowing for clear responsibilities and accountabilities.</td></tr>
<tr><td>Process</td><td>There are effective and efficient policies and procedures that reflect the agencies' governance responsibilities.</td></tr>
<tr><td colspan="2">Control activities</td></tr>
<tr><td colspan="2">Management has established activities to assist an organisation's objectives, including the following:</td></tr>
<tr><td>Management Controls</td><td>High level supervision and review. These controls include management's monitoring of other specific control measures.</td></tr>
<tr><td>Organisational Controls</td><td>Derived from the way in which the function is structured and includes:
• well-defined responsibilities and segregation of functions for agency banking and cash management;
• the structure of banking and cash management; and
• physical controls over related assets and documentation.</td></tr>
<tr><td>Authorisation Controls</td><td>These controls operate at the individual transaction level. These include access, authorisation, approval and checking controls.</td></tr>
<tr><td>Operational Controls</td><td>These controls are concerned with the completeness and accuracy of processing and controls to ensure timeliness of transactions.</td></tr>
<tr><td>Computer Controls</td><td>These controls are concerned with the way a computer processes data. They include controls over unauthorised access to the computer and assurance of completeness and accuracy of data.</td></tr>
<tr><td colspan="2">Information and communication</td></tr>
<tr><td colspan="2">Management regularly communicates relevant information throughout the agency to assist in the achievement of its objectives. Information includes both:
• operational data (related to transactions and sourced from the agency banking and cash management function); and
• performance data or indicators (related to the agency banking and cash management function).</td></tr>
<tr><td colspan="2">Monitoring and review</td></tr>
<tr><td colspan="2">Management activities demonstrate a continuous improvement approach, including quality assurance, performance monitoring, self assessment or independent review of the effectiveness of control activities.</td></tr>
</table>

Performance information

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

- understanding and research—September and October 2000;
- in-depth fieldwork—October to December 2000 and January 2001
- recommendations—January to March 2001; and
- reporting—March to August 2001.

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

The elapsed time from the commencement of the audit to tabling this Report was twelve months and the total cost was $369 000.

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