

The Auditor-General
Audit Report No.29 2002-03
Audit Activity Report

Audit Activity Report: July to December 2002

Summary of Outcomes

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of Australia 2003

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Canberra ACT
7 February 2003

Dear Madam President
Dear Mr Speaker

In accordance with the authority contained in the *Auditor-General Act 1997*, and pursuant to Senate standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present this report of the results of our audits and audit related services over the first half of 2002–2003. The report is titled *Audit Activity Report: July to December 2002*.

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

Yours sincerely



P. J. Barrett
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Abbreviations/Glossary

AASB	Australian Accounting Standards Board
ACA	Audit and Control Assessment
AHCAs	Australian Health Care Agreements
ANAO	Australian National Audit Office
ANU	Australian National University
APS	Australian Public Service
APSC	Australian Public Service Commission
ATO	Australian Taxation Office
BSC	Balanced Scorecard
BPG	Better Practice Guides
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CFS	Consolidated Financial Statements
CLERP	Corporate Law Economic Reform Program
CobiT	Control Objectives for Information and Related Technology
CSA	Child Support Agency
DEO	Defence Estate Organisation
DEST	Department of Employment, Science and Training
DEWR	Department of Employment and Workplace Relations
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DVA	Department of Veterans' Affairs
ETM	Economic Transactions Method
FaCS	Department of Family and Community Services
FBO Report	Final Budget Outcome Report
Finance	Department of Finance and Administration
FRC	Financial Reporting Council
FMA Act	<i>Financial Management and Accountability Act 1997</i>
GBE	Government Business Enterprises
GFS	Government Finance Statistics

HCSL	HIH Claims Support Limited
Health	Department of Health and Ageing
HIC	Health Insurance Commission
HR	Human resource
IASB	International Accounting Standards Board
IGD	Inspector General Division
IIF	Innovation Investment Fund
HR	Human resource
MAB/MIAC	Management Advisory Board/Management Improvement Advisory Committee
IT	Information technology
PDMS	Performance Data Management System
PSM	Protective Security Manual
SDSS	Standard Defence Supply System
SME	Specialist Military Equipment
SPA	Strategic Partnership Agreement
TLM	Taxation Liability Method
UMP/AMIL	United Medical Protection Limited and Australasian Medical Insurance Limited

1. Introduction

This chapter discusses the role of the Australian National Audit Office (ANAO) and the integration of its audit themes and outputs in order to respond positively to the needs of Parliament and public sector bodies.

1.1 The role of the ANAO is to assist the Auditor-General to carry out his duties and responsibilities under the *Auditor-General Act 1997* and other relevant legislation. Ultimately, the ANAO seeks two outcomes:

- the independent assurance of Commonwealth public sector financial reporting, administration, control and accountability; and
- a more efficient Australian Commonwealth public sector implementing better practices in public administration.

1.2 The ANAO achieves these ends through the delivery of an integrated audit service that is designed to assist the Parliament in its work as well as Commonwealth bodies in the achievement of improved performance and accountability. The outputs delivered encompass a range of products and services that include performance audits, financial statement audits, business support process audits, protective security audits, benchmarking studies and better practice guides. To achieve its objectives, the ANAO also organises and participates in conferences, seminars and workshops aimed at disseminating better practice and lessons learnt from auditing activity.

1.3 This report is the twelfth in a series of reports tabled at six monthly intervals. It summarises audit and other related ANAO activities for the period 1 July to 31 December 2002. The purpose of the report is to:

- inform the Parliament of the major issues the ANAO is examining in working with agencies to encourage, and provide assurance about, a better performing and more accountable public sector;
- provide the Parliament with a consolidated summary of the audit reports tabled in the last six months, as well as details of better practice guides and other audit services provided in the period; and
- focus on, and highlight, some of the major lessons learned from the audit services provided by the ANAO from July to December 2002.

1.4 The ANAO's principal client is the Parliament. Within this context, Parliamentary Committees are the main focus for contact and liaison. The Joint Committee of Public Accounts and Audit (JCPAA), a statutory committee comprising members from both houses of Parliament, has particular responsibilities in relation to the ANAO. For example, the ANAO consults with

the JCPAA on the Parliament's audit priorities. The JCPAA also considers the operations and performance of the ANAO; reports to the Parliament about the Auditor-General's functions and powers; and makes recommendations to the Parliament on the annual budget for the Office. The JCPAA reviews all ANAO reports, a selection of which is subject to quarterly public hearings. On occasions, the Committee may decide to conduct a more broadly based inquiry into matters arising from an audit.

1.5 In August 2002, the JCPAA released Reports 390 and 391. *Report 390—Review of Auditor-General's Reports 2001–2002—First, Second and Third Quarters* detailed the outcome of the Committee's review of the following audit reports:

- Audit Report No. 3, 2001–02, *The Australian Tax Office Administration of Taxation Rulings*;
- Audit Report No. 4, 2001–02, *Commonwealth Estate Property Sales*;
- Audit Report No. 11, 2001–02, *Administration of the Federation Fund Program*; and
- Audit Report No. 22, 2001–02, *Personnel Security—Management of Security Clearances*.

1.6 Audit Report No. 3, *The Australian Tax Office Administration of Taxation Rulings*, focused on the operation of the Australian Taxation Office's (ATO) administration of taxation rulings. The Committee acknowledged the complex taxation matters dealt with and the rigorous review and approval processes employed by the ATO in issuing its public rulings. As well, the Committee encouraged the ATO to continue to improve its processes to enhance the clarity and content of public rulings. The Committee considered that the ATO should monitor and assess the effectiveness and efficiency of procedures it has implemented to control the production of Private Binding Rulings and to ensure their quality.

1.7 Audit Report No. 4, *Commonwealth Estate Property Sales*, focussed on the sale of Commonwealth properties, and examined whether the property sale represented value for money to the Commonwealth. The Committee considered that the Department of Finance and Administration (Finance) should have given greater attention to providing the Government with ongoing advice about the hurdle rate, especially as economic factors were changing rapidly. In addition, it considered that Finance should have considered the whole-of-life costs and benefits for each property to ensure that the Commonwealth achieved the best value-for-money and actions taken were in its best interests. The Committee made six recommendations, the first being that Finance accept all seven recommendations made by the ANAO in Audit Report No. 4.

1.8 When reviewing Audit Report No. 11, *Administration of the Federation Fund Program*, the Committee noted that the time gap between decisions and announcements in the Major Projects program varied markedly. The Committee believed that the Federation Fund program could have been better managed from the start if a Commonwealth agency had been formally assigned a coordinating role and given monitoring responsibilities before actual applications were sought. It considered that this would have facilitated better sharing of experience and expertise across administering departments for the Federation Fund program.

1.9 Audit Report No. 22, *Personnel Security—Management of Security Clearances*, reviewed a number of agencies to determine whether organisations were managing security clearance and vetting processes effectively and efficiently and in accordance with Commonwealth policy and the Protective Security Manual (PSM) 2000. The Committee recommended that:

- all agencies allocate the resources necessary to bring their security clearance processes in line with the requirements of the PSM;
- all agencies make changes to their Human Resource Management Information System to support management reporting in relation to security clearances and appropriate access to security clearance information; and
- the Attorney-General's Department report to the JCPAA on the cost effectiveness of the Department's maintaining a central database of security clearances.

1.10 The JCPAA Report 391 was a review of Independent Auditing by Registered Company Auditors. It was the first time that the JCPAA had undertaken an inquiry into private sector issues. The Committee wished to explore the extent to which it was necessary to enhance the accountability of public and private sector auditing following recent corporate collapses both within Australia and overseas. The Committee was also keen to determine where the balance lay between the need for external controls through government regulation and the freedom for industry to self-regulate. This inquiry, which has been influential in shaping current debate on audit independence, resulted in 13 recommendations being made in relation to corporate governance, financial reporting and the auditing framework. It was also pleasing to note the support of the Committee in relation to the value added by the wider public sector audit mandate relating to performance auditing.

1.11 Report 392, published in October 2002, was the JCPAA Annual Report 2001–2002. It provided information on the following:

- membership of the Committee;
- the highlights of the year;

- the purpose of the JCPAA, its objectives and methods of operation;
- a summary of the reports tabled and its other activities;
- details on work in progress; and
- statements of the Committee's Meetings and Hearings and their expenses.

1.12 ANAO reports are used by other Committees as well. The Joint Standing Committee on Electoral Matters released its report *The Integrity of the Electoral Roll: Review of ANAO Report No. 42 2001–02, Integrity of the Electoral Roll* in October 2002. The Committee recommended that the ANAO conduct a follow-up audit to this audit so that the Committee could review the Australian Electoral Commission's progress in implementing the recommendations, well in advance of the next Federal Election. The Auditor-General agreed to include this follow-up audit in the ANAO's work program for 2003–04.

ANAO performance audit themes

1.13 When determining its audit program the ANAO takes into consideration the environment in which the Australian Public Service (APS) operates. Over recent years, a number of factors have significantly affected this environment, including a requirement for:

- a more responsive, contestable public service;
- greater collaboration between agencies/stakeholders/levels of government; and
- an increased focus on governance.

1.14 These factors are considered by the ANAO when determining audit coverage. As well, the ANAO has regard to the need to provide Parliament with an assurance, over time, of public sector performance and financial reporting, administration, control and accountability. To this end, for 2002–03, the ANAO identified the following performance audit themes that underpinned its audit work program:

- human resource management including workforce planning;
- financial management and reporting;
- performance management and reporting;
- procurement and contract management;
- application of information technology and resources; and
- service delivery.

1.15 While it is possible to make progress on such issues and put in place remedial and/or better practices either during the course of an audit or relatively soon after its completion, the reality is that substantial change is often only possible over the medium to longer term. This makes it somewhat more difficult to assess the impact of an audit or indeed, of the audit program at particular points in time.

1.16 The following discussion examines recent developments and issues in relation to governance and the ANAO's performance audit themes.

Human resource (HR) management including workforce planning

1.17 Effective HR management is essential for the production of agency outputs and outcomes. Moreover, effective HR management can have a significant impact on agency financial performance as employee expenses are high, being about 11 per cent of total expenses for budget funded agencies¹. Costs associated with individual aspects of HR management are also high. While the total cost of learning and development is not known, agencies estimated that they spent \$109 million on formal learning and development².

1.18 Prior to the introduction of the *Public Service Act 1999* (PS Act), the APS, as a whole, largely operated under the same administrative arrangements and regulations. As well, the previous public service legislation detailed specific processes that agencies were required to adopt. Therefore, previously individual agencies had limited flexibility, and even scope, to develop human resource policies that met agency specific needs.

1.19 Agencies now have the responsibility to manage HR so that they can choose how to best produce outputs and achieve required outcomes. With the implementation of the principles-based PS Act, within the bounds of the *Financial Management and Accountability Act 1997* (FMA Act) and the *Commonwealth Authorities and Companies Act 1997* (CAC Act), agencies can now largely tailor human resource policies to suit their particular needs. As well, agencies can develop suitable, complementary process arrangements to implement their new policies. It is therefore essential that HR management continue to adopt, or adapt, appropriate business practices. In particular:

- a strategic approach that covers all aspects of HR management;
- effective HR planning; and
- HR performance measurement, monitoring and reporting.

¹ General government sector, *Consolidated Financial Statements for year ended 30 June 2002*, Commonwealth Government of Australia, December 2002.

² Auditor-General Report No. 64 2001-02, *Management of Learning and Development in the Australian Public Service*.

1.20 Performance information and its collection, reporting and monitoring is a critical tool for public sector management and accountability. As such, the tool applies to HR management as much as it does to other agency operations. However, there is evidence that, although the monitoring and evaluation of HR related activities is almost unanimously accepted, the extent of performance measurement may, in practice, be restricted to a small number of activities³. The ANAO notes that the limited scope of HR performance measurement restricts its potential usefulness. Evaluation at this level does not support, for example, the development of comprehensive learning and development strategies that target priority needs to ensure the right people have the right skills at the right time.

Financial management and reporting

1.21 There have been a number of significant developments in the private and public sectors in recent months in relation to governance, financial management and reporting. In relation to the private sector, the government announced policy proposals on audit regulation and corporate disclosure. In particular, it released the Corporate Law Economic Reform Program known as CLERP 9, which proposes a fundamental reshaping of the financial reporting framework, strengthened disclosure and audit requirements. It builds on existing institutions and clarifies responsibilities to focus on the quality of financial reporting. It includes 41 proposals to ensure that Australia enhances its effective disclosure framework; aims to define better practice and provide the structures and incentives for a fully informed market. It also complements the JCPAA's inquiry referred to in paragraph 1.10. While this program is specifically established for the private sector, it clearly impacts on the public sector. For example, it highlights Parliamentary and public concern about the importance of proper disclosure and the need for Australian organisations to appropriately harmonise local accounting and auditing standards with those overseas.

1.22 Another recent development was the announcement by the Financial Reporting Council (FRC) that it had formalised its support for the adoption by Australia of international accounting standards by 1 January 2005⁴.

1.23 The FRC is established under the *Australian Securities and Investments Commission Act 2001*. It is the peak body responsible for the broad oversight of Australia's accounting standard setting process for the private, public and not for profit sectors. The FRC supports the Australian Accounting Standards Board (AASB) and the AASB's work towards harmonising its standards with those of the International Accounting Standards Board (IASB). From a private enterprise viewpoint, a single set of high quality accounting standards which are accepted

³ *ibid.*

⁴ Bulletin of the Financial Reporting Council 2002–04 — 3 July 2002.

in major international capital markets will greatly facilitate cross border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas. From a public sector perspective, a single set of high quality, global accounting standards that require comparable information will aid transparency. In particular, over time, they will facilitate an improved comparison between the operations of the public sector and private enterprise for those functions that could be provided by either group.

Performance management and reporting

1.24 Performance management and reporting are topical issues in both private and public organisations. As discussed in paragraph 1.21, the government announced strengthened disclosure (and audit) requirements for private enterprise as part of CLERP 9⁵. As well, a major ongoing concern of Parliament has been the standard of performance reporting. While the current accrual budgeting and reporting arrangements have only been in place since 1999–2000, there has been a strong focus on improved performance information and accountability since the mid 1980s. Agency performance in relation to this has been extensively monitored by Parliament and the ANAO. While this monitoring will continue, the focus will broaden with particular attention being paid to ensuring that agencies successfully integrate accountability requirements with management systems as a means of improving performance information and achieving better results.

1.25 The JCPAA, Senate Finance and Public Administration Legislation Committee and the ANAO have found that the quality of agency performance information and the associated framework can, and should, be improved. For example, JCPAA Report No. 388, *Review of Accrual Budget Documentation*, identified the many significant issues that should be addressed including:

- breadth of outcome statements—many outcome statements were considered by the Committee to be too broad and far reaching and this reduced accountability;
- continuity of information—year-by-year continuity of information for comparative purposes was considered desirable so that trends could be identified;
- level of aggregation of outputs—a high level aggregation of outputs was undesirable as this hindered transparency; and
- performance information accuracy—the provision of accurate performance and costing information was important for accountability.

⁵ Press release No. 56, Treasurer and Parliamentary Secretary to the Treasurer, *Government announces policy proposals on audit regulation and corporate disclosure*, 18 September 2002.

1.26 The ANAO in Audit Report No. 18, 2001–02, *Performance Information in Portfolio Budget Statements* also raised issues about performance measurement and, particularly, effectiveness indicators that did not actually measure outcome performance. Another important issue was data quality and questioning whether the data had appropriate relevance, accuracy, timeliness, accessibility, interpretability and coherence.

1.27 Following the tabling of the JCPAA Report No. 388, *Review of Accrual Budget Documentation*, the Auditor-General approved the conduct of an audit on Annual Performance Reporting and the concurrent production of a Better Practice Guide to address a number of the Committee's recommendations. It is planned to table the report of this audit later in 2003. The objectives of the audit are to determine whether the agencies included in the audit have:

- established a sound performance information framework for ongoing and annual performance reporting;
- analysed, used and relied on the performance information for annual reporting, decision-making and management; and
- developed performance information systems that include assurance arrangements to ensure data used for performance management and reporting are accurate and complete. Testing will be undertaken using an indicative sample of data for both performance information and costing systems.

Procurement and contract management

1.28 From a government perspective⁶, outsourcing has the capacity to improve service quality; provide access to specialist expertise; enable a focus on the key elements of operations; formalise accountability requirements; achieve cost savings; and forge mutually beneficial partnerships with the private sector. The specific requirements for outsourcing (and any other Commonwealth procurement exercise) are articulated in *Commonwealth Procurement Guidelines and Best Practice Guidance*⁷. The core principle within this framework is value-for-money. This principle is supported by a requirement that activities related to procurement, including contract management, should be undertaken in a transparent and accountable manner. The guidelines also require agencies to ensure that activities associated with procurement, including contract management are undertaken efficiently, effectively and ethically and promote industry development.

⁶ The Hon. Peter Slipper, MP, Speech, *Commonwealth Government Outsourcing Corporate Services and IT*, 13 March 2002.

⁷ Department of Finance and Administration, *Commonwealth Procurement Guidelines and Best Practice Guidance*, February 2002.

1.29 Agencies can outsource functions in full or in part. However, Parliament insists that they cannot outsource their responsibility or overall accountability. The Government recently reinforced this point in noting that:

agencies remain accountable for the delivery of services, even where the service delivery is provided by the private sector. Central to the accountability principle is the need to maintain awareness of client needs and how they are being met.⁸

1.30 To this end, under the Senate Order for Department and Agency Contracts, it is incumbent on FMA agencies to place on the Internet lists of contracts of \$100 000 or more by the tenth day of the Spring and Autumn sittings of Parliament. Among other things, the lists must indicate whether the contracts contain any confidentiality provisions. The Order provides for a new contracting accountability framework. It is based on the general principle, sometimes called the reverse onus principle, that information in contracts should not be made confidential unless there is good reason to do so.

1.31 Outsourcing contractual arrangements must also take into consideration the need to maintain information security and privacy. The outsourcing contracts reviewed in an ANAO audit on information technology (IT) outsourcing⁹ placed certain obligations on the private sector service providers in regard to ensuring that agency data held on the outsourced IT infrastructure was protected to identified security and privacy standards. That audit, and a subsequent audit of fraud control in the Australian Taxation Office,¹⁰ found that agencies had not developed adequate strategies for monitoring the providers' compliance with those obligations, and recommended improvements in this regard.

Application of information technology and resources

1.32 Rapid advances in technology offer both opportunities and challenges in the converging business environment. Two major risks inherent in the shift to electronic delivery and decision-making is that of security and privacy. For example, Senator The Hon Richard Alston referred to one such risk and the consequences:

One of the challenges facing Government and businesses when dealing electronically is the uncertainty of the identity of the other party...Failure to properly authenticate a transacting party may lead to situations such as the illegal transfer of funds.¹¹

⁸ Australia, Senate 2002, Debates (Proof), 14 May, p. 1369.

⁹ ANAO Audit No. 9 2000-01, *Implementation of Whole-of-Government Information Technology and Infrastructure Consolidation and Outsourcing Initiative*.

¹⁰ ANAO Report No.16 2000-2001, *Australian Taxation Office Internal Fraud Control Arrangements*.

¹¹ Senator The Hon Richard Alston, Media Release, *On-line authentication-a guide for government managers*, 16 July 2002.

1.33 The delivery of services via the internet has also introduced new risks and exposures that can result in a legal liability for government. Well-designed security and privacy policies can minimise such risks and liabilities, while informing agencies' clients of important aspects of the standard of service they can expect to receive. Agencies should, therefore, identify and address risks associated with the use of information technology and treat these risks in a systematic manner in accordance with now well-documented better practice.

1.34 In addition, there are accountability issues for agencies, and consequent evidentiary issues for their auditors, when traditional forms of record-keeping are overtaken by the outputs of new technology. For example, agencies need to make links in the chain of decision-making which have largely, or totally, shifted out of paper records. One consequence is that audit trails have to be embedded in electronic records and/or archival data tapes. This is important in terms of agencies' capacity to demonstrate accountability to the Parliament and for their own management purposes.

Service delivery

1.35 More and more APS agencies are turning the traditional service delivery model around to focus on the customer, rather than on the process of delivery. One aim is to make it easier for people to access information about work, training, education, housing, tax benefits and other government services through a common 'gateway' involving a variety of agencies.

1.36 Increasingly, Commonwealth agencies will be expected to work successfully in partnership with other Federal, State and Local Government agencies and in some cases, the private sector, to ensure access to public services. Service delivery priorities will need to focus on how well stakeholder expectations have been met, including for customers and client agencies.

1.37 As part of this environment, there has been recognition that the use of the internet to deliver services has the capacity to both improve, and reduce, the cost of service delivery. An example is the Government Online initiative that has significantly improved service delivery by making it possible for the public to access a full range of services without needing to know, specifically, which agency would provide the desired service. However, there has also been concern expressed about equity of access to government services through technology for those who do not have such ready access. For example, although 52 per cent of Australian households are connected to the internet¹², certain groups such as the Aboriginals and Torres Strait Islanders and those over the age of 55 have a much lower access to the internet.

¹² The National Office for the Information Economy, *The Current State of Play: Australia's Scorecard*, April 2002.

1.38 It is, therefore, desirable for agencies that deliver services to consider a range of complementary options that, together, best meet the needs of their various clients. An example of this is the Commonwealth Regional Information Service, which provides specific information about Commonwealth government programs, particularly for people in remote and rural regions. This service is based around the Commonwealth Regional Information Directory (2002–03), a compilation of information on issues such as health, education and taxation. This directory can be obtained in hard copy from the Department of Transport and Regional Services (DoTaRS) or can be accessed via the internet. As well, DoTaRS provides an information line on a 1800 number.

Report outline

1.39 Audit findings from performance audits and financial statement audits are summarised in the following chapters. Appendix 1 provides a short summary of each of the reports tabled between 1 July 2002 and 31 December 2002. Complete copies of all audit reports are available at <http://www.anao.gov.au>. Appendix 2 indicates that no Better Practice Guides (BPGs) were completed in the last six months. Appendix 3 lists the performance audit and other audit services being undertaken as at 1 January 2003. Appendix 4 lists presentations and papers given by the Auditor-General and ANAO staff during the period 1 July 2002 and 31 December 2002.

2. Performance Audit Themes

The key issues arising from performance audits tabled between 1 July 2002 and 31 December 2002 are summarised in this chapter. These are arranged on the basis of the ANAO's performance audit themes for 2002–03 that are listed below. In this chapter, these themes are used to discuss specific aspects of public administration observed in the last six months.

2.1 The objective of ANAO performance audits is to improve agencies' administration and accountability by providing to the Parliament, the Executive, boards, management and the community with independent evaluation and assurance on the economy, efficiency and administrative effectiveness of the management of Commonwealth public sector entities by:

- undertaking in a cost-effective manner a program of audits designed to evaluate the performance, economy, and efficiency of the activities of Commonwealth public sector entities;
- identifying good practices and recommending ways of improving the economy, efficiency and effectiveness of the administration of Commonwealth public sector entities;
- encouraging and assisting entities to remedy shortcomings and poor practices by improving systems and controls; and
- identifying and promulgating good management principles, practices and ethical behaviour that are applicable to the wider public sector.

2.2 The Auditor-General has a mandate, under the *Auditor-General Act 1997*, to undertake, at his discretion, performance audits of all Commonwealth bodies other than Government Business Enterprises (GBEs) and in relation to persons employed under the *Members of Parliament (Staff) Act 1984*. Performance audits of wholly owned GBEs and persons employed under the *Members of Parliament (Staff) Act* may, however, be undertaken by the Auditor-General where requested by the responsible Minister, the Minister for Finance or the Joint Committee of Public Accounts and Audit (JCPAA).

Agency Cooperation

2.3 One of the aims of the performance audit process is to assist public sector bodies in identifying improvements to public administration and accountability. This is best achieved if the relationship between the ANAO and the audited body is one of professional cooperation, including timely access to relevant staff and records. To facilitate the achievement of such an environment, the ANAO consults with agencies during the planning stages; provides the audited body with information on the audit objectives and approach early in the life of the

audit; maintains open and regular communications with the audited body on progress throughout the audit; and advises the audited body of the audit conclusions and proposed recommendations as soon as practicable. The ANAO also encourages the input of senior program managers during the course of an audit to ensure the audit team is fully informed of matters affecting the administration of programs or functions.

2.4 The achievement of maximum value gained from an audit can be facilitated by management and staff of the audited body providing access, assistance and information to the ANAO in a timely manner. For example, a proposed report of a performance audit is sent to the audited body for comment pursuant to section 19 of the *Auditor-General Act 1997*. This legislation provides that, if the recipient of the proposed report gives written comments to the Auditor-General within 28 days after receiving the proposed report, the Auditor-General must consider those comments before preparing a final report. The 28 days should be viewed as an upper limit. Agencies should aim to provide the ANAO with early advice on any actions taken, or proposed, in response to any issues raised, explanations regarding the audit findings and the audited body's view in relation to the relevance and practicality of proposed audit recommendations. While the ANAO has allowed extension of time for initial and subsequent responses, increasingly protracted delays add unrecoverable costs to an audit; increase the risk of the timeliness of the report information to Parliament being lost; and disrupt the audit program, with adverse impacts on other agencies. Agency performance in this regard will continue to be monitored and consideration given to remedial action if necessary. Nevertheless, the ANAO recognises the practical problems of agencies providing responses to reports when Ministers and Ministers' offices are involved. This is a matter that needs further attention.

Governance

2.5 The ANAO undertakes an on-going planning approach to ensure that its outputs are effectively integrated for maximum impact and continue to meet the needs of Parliament, the government and public sector entities. The ANAO reviews its planned approach annually as part of its budget preparation and brings the results together in the Audit Work Program. The Audit Work Program is developed against the background of the Australian Public Service (APS) environment, including the business risks that are likely to impact on the APS during the period under review. These risks are taken into account when themes to be addressed in the annual performance audit work program are identified. The themes for 2002–03, as indicated earlier, were:

- human resource management, including workforce planning;
- financial management and reporting;

- performance management and reporting;
- procurement and contract management;
- application of information technology and resources; and
- service delivery.

2.6 In reports tabled in the last six months, the ANAO made 82 recommendations aimed at improving the efficiency, administrative effectiveness and accountability of public sector service delivery. Agencies agreed with 77 of the recommendations, three with qualification. No recommendation was disagreed.

Human resource (HR) management, including workforce planning

2.7 The production of outputs in the APS is dependent on good performance management and workforce planning. Therefore, agencies should have appropriate strategies in place to identify and provide these skills. Otherwise, services may not be delivered efficiently and effectively. In the period July to December 2002, the ANAO tabled two reports that considered HR governance issues as part of the audit. These issues included:

- workforce planning, including people management;
- performance management; and
- learning and development.

2.8 Audit Report No. 11, 2002–03 *Medicare Customer Service Delivery* Health Insurance Commission (HIC) reviewed the effectiveness of HIC’s approach to customer service delivery to the Australian public as customers of Medicare. The ANAO found that HIC is a customer-focused organisation that is effectively delivering services under the Medicare program. The audit highlighted the need to measure the important dimensions of key interactions between HIC and its customers. It emphasised how critical it was for the human resource management function to support service delivery and for customer service staff to have the skills, knowledge and resources to effectively perform in their roles.

2.9 In Audit Report No. 17, 2002-03 *Age Pension Entitlements* the ANAO examined Centrelink’s actions in response to issues raised in two previous audits: Audit Report No. 34, 2000–01, *Assessment of New Claims for the Age Pension by Centrelink* and Audit Report No. 9, 2001–02 *Learning for Skills and Knowledge—Customer Service Officers (CSOs)—Centrelink*. The New Claims audit concluded that there were a number of topics in the processing of Age Pension where, at the time of the audit, the knowledge of CSOs was generally deficient.

The audit noted that the planning and delivery of training was decentralised across the Centrelink network. As a result, the priority accorded to training, the methods for determining the need for training and the quality of delivery could vary significantly from one office to another.

2.10 The ANAO found that Centrelink had made satisfactory progress in improving its ability to assess the technical training needs of staff and in delivering training consistently. However, the ANAO concluded that Centrelink should consider improving CSO technical assessment skills as the proportion of errors found in customer records varied significantly depending on whether processing by CSOs involved simple or complex assessments.

Financial management and reporting

2.11 The APS receives approximately \$170 billion annually for its administration to produce its various outputs. It is therefore expected to manage these funds efficiently, ethically and transparently. In view of this, the ANAO's audit activity has addressed financial governance arrangements in APS agencies so that Parliament and other stakeholders are provided with suitable assurance in relation to financial management and reporting.

2.12 The ANAO has tabled six audits over the last six months that have addressed financial management issues, two of which are summarised in the following paragraphs. These audits fall into two broad categories namely:

- management of agency funds; and
- management of administered expenses and revenues.

2.13 Audit Report No. 10, 2002-03 *Management of International Financial Commitments* quantified the current value of Treasury's commitments to international financial institutions and the bilateral support packages it administered. In assessing Treasury's management of these financial commitments and the related exposures, the ANAO found that Treasury had effectively managed its relationship with international financial institutions. However, the audit found that the governance framework and financial management practices for administering Australia's obligations could be improved by:

- comprehensively documenting administrative procedures to mitigate risks associated with staff turnover and the irregular nature of transactions;
- enhancing performance measurement and reporting to encourage a management focus on administering international financial commitments at the lowest possible long-term cost, consistent with an acceptable degree of risk exposure; and

- explicitly identifying and quantifying financial risks in relation to proposed expenditure commitments, consistent with the emphasis on agency risk management outlined in the revised framework for Commonwealth foreign exchange risk management that was introduced with effect from July 2002.

2.14 The audit on the *Management of the Innovation Investment Fund (IIF) Program* (Audit Report No. 12, 2002–03) found that, within the IIF program, the Commonwealth licenses fund managers to invest Commonwealth and private sector venture capital into new technology companies. The Department of Industry, Tourism and Resources and the Industry Research and Development Board have structural, contractual and administrative arrangements in place to protect the Commonwealth from contingent liability, losses from poor performing investments, and payments outside contract conditions. The selection of fund managers was consistent with program guidelines and supported by due diligence advice and probity audit, which found that the process was fair and equitable. However, the selection process was subject to limited planning.

Performance management and measurement

2.15 Performance information, its assessment and reporting are critical elements of sound public sector management and for monitoring and improving performance. It is the foundation for agency accountability and transparency and has been described as follows:

Evidence about performance that...enable(s) judgements to be made on the extent to which program activities are achieving the desired results.¹³

It promotes external accountability enabling Commonwealth agencies to establish performance standards and assure Parliament and other stakeholders, including the general public, that they have achieved those standards. In the last six months, the ANAO has tabled six audit reports in relation to this issue, two of which are discussed in the following paragraphs.

2.16 The cross-agency audit on *The Administration of Grants (Post Approval) in Small to Medium Organisations* (Audit Report No. 16, 2002–03) assessed whether appropriate risk management strategies for grant programs had been implemented, and whether grants had been administered in accordance with appropriate legislation, Commonwealth guidance and other accepted internal controls. In relation to performance measurement and reporting issues, the audit found organisations were regularly reviewing performance indicators. However, the analysis and reporting of performance against these indicators varied. The audit found that this variability could be addressed, in part, through organisations adopting a formal self-assessment process as a mechanism to

¹³ ANAO/Finance, 1996: Better practice principles for performance information.

incorporate regular monitoring and review. The ANAO considered that organisations would benefit where they enhanced mechanisms to assist in monitoring and reviewing grants administration through the use of appropriate performance indicators and/or information.

2.17 Audit Report No. 21, 2002–03 *Performance Information in the Australian Health Care Agreements*, examined whether the Department of Health and Ageing (Health) had the performance information necessary to administer the Australian Health Care Agreements (AHCAs). Overall, the ANAO found that the performance information used to support the administration of \$31.7 billion in Commonwealth financial assistance to the States and Territories, should be expanded in order to enable more comprehensive monitoring as to whether the Commonwealth’s objectives and conditions of federal funding are being met. Health had only partial performance information on the effectiveness and efficiency of the AHCAs. A key issue was the absence of a long-term plan to address development of indicators on efficiency, quality, appropriateness, accessibility and equity of health services.

Procurement and contract management

2.18 As the procurement of goods and services has become increasingly important for many APS agencies, and because the sums of money involved in this activity is frequently large, the ANAO completed four audits in the last six months that focussed on procurement and contract management issues including the accountability, transparency and management of the tendering process. Two of these audits are summarised in the following paragraphs.

2.19 Audit Report No. 14, 2002–03 *Health Group IT Outsourcing Tender Process* focussed on the management of the probity aspects of the Health Group IT outsourcing tender process. The audit was undertaken following a request from the Senate Finance and Public Administration References Committee after concerns about the process were raised during its 2001 Inquiry into the Government’s IT Outsourcing Initiative.

2.20 The audit identified a number of areas in which the handling of the probity issues that arose during the tender process could have been improved to provide more transparency, accountability and rigour to the competitive tendering processes. On the basis of the evidence available, the ANAO was not able to provide an assurance that no tenderer unfairly gained a competitive advantage in the Health Group tender process. Limitations in the documentation available, the apparent misunderstanding by some relevant parties of the extent to which they could rely on assurances provided by external advisers in finalising the tender, and the elapsed time since the tender activity, prevented the ANAO from reaching a firm conclusion on the question. As well, deficiencies documenting

the actions and deliberations undertaken on significant issues affecting the tender process, together with inconsistencies in individual's recollections of events that occurred in mid-1999, did not allow the ANAO to conclude that probity issues that arose during the course of the tender process were appropriately and effectively managed.

2.21 Audit Report No. 8, 2002–03 *The Senate Order for Department and Agency Contracts* (September 2002) was a cross agency audit that was also conducted in response to a request from the Senate Finance and Public Administration References Committee. The audit examined all FMA agencies' progress in complying with the Senate Order for Department and Agency Contracts for listing contracts of \$100 000 or more on the Internet and selected agencies' progress in addressing the new accountability framework for dealing with confidential information in contracts. The framework focuses on the principle that information in contracts should not be protected as confidential unless there is a good reason to do so. The audit concluded that most agencies were complying with the Senate Order requirements and that most of the selected agencies had put in place suitable mechanisms to advise contractors of the accountability requirements of the Commonwealth. The audit also concluded that the majority of the contracts examined in the audit had been inappropriately listed on the Internet as containing confidential information mainly because the contracts had been entered into before agencies had had time to change their contracting policies to take into account the new accountability framework.

Application of information technology and resources

2.22 Over the last decade, the use of information technology in the APS has not only increased considerably but has also become more sophisticated. While the use of such technology can markedly improve efficiency and effectiveness of operations, it is important for agencies to ensure that it does not result in reduced accountability and transparency. In relation to this issue, the ANAO tabled three audits in the period July–December 2002 that considered various aspects of the use of information technology and resources. Two of these audits are summarised below.

2.23 The audit on *The Australian Taxation Office's (ATO) management of its relationship with tax practitioners* (Audit Report No. 19, 2002–03) considered ATO's use of information technology and telecommunications (especially via its call centres and IT-based services) to provide service support to tax agents. The ANAO found that, although the ATO provides extensive IT support for tax agents, the IT-potential to support cost-effective and reliable service delivery was not being fully realised by either the ATO or the tax agents. The ATO recognised that telephone services require ongoing, specific attention (in relation to technology

and service management) to derive consistent improvements in performance in terms of access, timeliness and quality of service.

2.24 While the audit on the *Balanced Scorecard—Centrelink* (Audit Report No. 9, 2002–03) essentially focussed on Centrelink’s use of the balanced scorecard (BSC) to understand and communicate its performance against its strategic goals, it indicated that Centrelink had used Information Technology extensively to support the use of the BSC throughout the agency. The Performance Data Management System (PDMS) provided BSC information on-line at each level so that all business units could prepare their own detailed reports on particular aspects of performance. It also allowed comparisons to be made with other groups with similar characteristics (for example, inner city Customer Service Centres) as a basis for improving for performance. The PDMS was useful to Centrelink because it made information available to the approximately 24 000 staff working in locations across Australia.

Service delivery

2.25 Over the last decade the delivery of government services have been influenced by a number of factors including initiatives such as government online, shared service delivery, one-stop shops and outsourcing for the provision of goods and services. These initiatives have directly and indirectly raised the profile of service delivery and focussed the attention of the public on receiving value for money. Two of the ANAO’s reports tabled in this period addressed this theme.

2.26 Audit Report No. 7, 2002–03 *Client Service in the Child Support Agency Follow-up Audit*, found that a strength of the Child Support Agency (CSA) was its continuous improvement process in relation to the delivery of a high level of client service. To this end, CSA had demonstrated a willingness to implement administrative, technological and human resource strategies to improve its service delivery. These strategies included faster telephone responsiveness, simplified correspondence, expanded services to rural and remote communities, better complaints handling and a more comprehensive introduction package for new clients. The audit found that although CSA had embraced client input and extensively measured its business, client satisfaction remained at an average level and there was scope for further improvement. In particular, the CSA should:

- provide more accurate and consistent advice;
- explain decisions more clearly;
- fulfil obligations made by staff;
- improve the application of rules for case management; and
- improve many aspects of the Change of Assessment process.

2.27 Notwithstanding the successful use of technological and management tools, CSA has found that client service is mainly dependent on the skills, attitude and commitment of front line staff. While these staff generally performed quite well, the audit found that there were clear avenues for improvement—which could be promoted by increasing the accountability of staff for their decisions and advice.

2.28 Audit Report No. 20, 2002–03 *Employee Entitlements Support Scheme* found that the Department of Employment and Workplace Relations (DEWR) had not provided payments at its target level of timeliness. The target was originally to pay 80 per cent of claims in 12 weeks. This was subsequently amended to 80 per cent in 16 weeks. The ANAO found that it was actually taking DEWR six months to clear 80 per cent of its claims. A small number of claimants had waited over a year-and-a-half to be paid. It was also taking DEWR too long to respond to ineligible claimants to advise them that they were not entitled to assistance. Appeals were taking much longer than the target time to be resolved. The audit found that there were opportunities for DEWR to improve client service by developing a system to track the processing of claims and the better management of appeals.

3. Financial Statement Audits

Financial audits and other financial audit activities conducted by the ANAO during the period July to December 2002 are summarised in this chapter.

3.1 The ANAO undertakes financial statement audits of all Commonwealth agencies and bodies (described here as entities) each year. The *Financial Management and Accountability Act 1997* (FMA Act), the *Commonwealth Companies and Authorities Act 1997* (CAC Act) and the *Corporations Act 2001* prescribe the need for entities to prepare financial statements and arrange for their audit.

3.2 Financial statement audits are an independent examination of the financial accounting and reporting of public sector entities. The results of the examination are presented in a standard format audit report. That report expresses the audit opinion on whether the financial statements as a whole, and the information contained therein, fairly reflect the results of each entity's operations and their financial position. The disclosures and management representations made in the financial statements by the entity are assessed against relevant accounting standards as well as legislative and other reporting requirements.

3.3 The audit opinion on the financial statements adds credibility to the financial statements. It is not an absolute guarantee of their veracity or reliability and is formed on the basis of reasonable evidence, not certainty. It also does not provide any direct comfort in relation to the absence of fraud or other irregularity. Nevertheless, ANAO auditors are constantly on the look-out for any indications and/or evidence of fraud or unethical behaviour.

3.4 The results of financial audits, together with any important findings arising from the audits, are reported directly to the responsible Minister at the completion of the audit, and progressively to executive management of each entity. If matters are not regarded as material to the audit opinion but are nevertheless of audit interest, a decision may be made by an audit manager, with approval, to conduct a separate investigation after the financial statement audit is completed.

3.5 The audit report on the financial statements, which contains the audit opinion, is included together with the financial statements of each entity, in its Annual Report tabled in the Parliament. This report is the principal vehicle by which the Parliament and the public are able to hold an entity accountable for its financial performance.

3.6 The Auditor-General also produces reports to the Parliament that summarise the outcomes of all financial statement audits. The first report, Audit Report No. 67, 2001–02 *Control Structures as part of the Audits of the Financial Statements of Major Commonwealth Entities for the Year Ended 30 June 2002*, summarised issues

regarding financial systems, controls and processes arising from the interim phase of the financial statement audits of major Commonwealth entities for the year ended 30 June 2002. Audit Report No. 25, 2002–03 *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002* draws together the overall results of the financial statement audits of Commonwealth agencies and entities. Together, these reports summarised the results of the audits of financial statements of all Commonwealth entities for 2001–02.

Audits of financial statements

3.7 The ANAO formed an opinion and reported on the financial statements of 257 Commonwealth entities for the period ended 30 June 2002, including the Commonwealth Government of Australia Consolidated Financial Statements. These entities are diverse in size, function and location. As mentioned above, the results of this work were reported in Audit Report No. 25, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002*, tabled on 23 December 2002.

3.8 Four qualified audit reports were issued for a variety of reasons, but predominantly for departures from financial reporting requirements and matters relating to limitations of the scope of audits.

3.9 The ANAO also included ‘matters of emphasis’ in reports on the financial statements of a further ten entities. These references drew attention to issues which would be considered significant to the readers of the financial statements but which did not, of themselves, justify an audit qualification.

The consolidated financial statements and the final budget outcome

3.10 At the close of each financial year the Government prepares two key financial reports:

- the Commonwealth Government of Australia Consolidated Financial Statements (CFS) which are prepared and audited pursuant to sections 55 and 56 of the FMA Act to present the financial results and the financial position of the Commonwealth; and
- the Final Budget Outcome Report (FBO Report) which is prepared pursuant to Section 18 of the Charter of Budget Honesty 1998 (the Charter) to present Commonwealth budget sector and Commonwealth general government sector fiscal outcomes for a financial year.

3.11 Each financial report serves different purposes and is based on different sets of external reporting standards.

3.12 The CFS are prepared on an accrual basis in accordance with applicable Australian Accounting Standards (AAS), including *Financial Reporting by Governments* AAS 31, and other mandatory professional reporting requirements in Australia and statutory requirements. The CFS is a general purpose financial report which discloses the assets controlled and liabilities incurred by the Government, the Government's revenues and expenses, and its related cash flows. Reporting under this framework provides a consolidated overview of the financial performance and position of the Government.

3.13 Consistent with the requirements of the Charter of Budget Honesty, the FBO Report is based on the Australian Bureau of Statistics accrual Government Finance Statistics (GFS) framework as well as on AAS. The Charter also requires that departures from applicable external reporting standards be identified.

3.14 The FBO Report, which is required to be produced within three months of the end of each financial year, comprises:

- unaudited information;
- general government sector budget aggregates with an analysis of final budget outcomes;
- Commonwealth financial statements in accordance with GFS;
- unaudited general government financial statements in accordance with AAS 31, *Financial Reporting by Governments*; and
- updated federal financial relations data.

3.15 An explanation is provided in the FBO Report of the key differences between the GFS aggregates and their counterparts prepared on the basis of Australian Accounting Standards.

The harmonisation of the CFS and GFS frameworks

3.16 As noted earlier, the CFS and FBO reports serve different purposes and are based on different sets of external reporting standards. The CFS are prepared on an accrual basis in accordance with applicable AAS, including AAS 31. Whereas the FBO report, consistent with the requirements of the Charter, is based on the GFS as well as on AAS.

3.17 The Budget Estimates and Framework Review recently completed by the Department of Finance and Administration (Finance), and approved by the Government¹⁴ recommended that Finance continue to work towards the development with the Australian Accounting Standards Board (AASB) of an

¹⁴ Department of Finance and Administration September 2002 *The Budget Estimates and Framework Review*

Australian Accounting Standard for government that is harmonised with the Government Finance Statistics framework.

3.18 The drive for harmonisation comes from the desire to have one outcome reporting framework. The two frameworks often result in confusion and difficulties in interpreting information. While a considerable amount has been done to harmonise the reporting frameworks, significant differences remain, including in respect of the treatment of: revaluation of assets; foreign exchange gains and losses; interest flows related to swaps and other financial derivatives; and acquisition of defence weapons platforms.

3.19 The ANAO supports harmonisation towards a single reporting framework as a means of overcoming user concerns. The development of such a framework through an industry specific accounting standard is primarily a matter for the AASB's due process for promulgating accounting standards. However, its development will need the support of respective stakeholders involved in public sector accounting. These issues also need to be considered in the broader context of Australia's commitment to adopt international accounting standards by 2005.

Potential audit of FBO Report

3.20 While the CFS are audited, the FBO Report is not currently subject to audit. In this context, and in addressing a recent JCPAA Review¹⁵, the ANAO confirmed its willingness to audit the FBO Report if requested to do so but this was a matter for the Government and Parliament to decide. The issue of relevant standards to be used would be central to such an audit.

3.21 An audit of the FBO Report would, in the first instance, entail a review of the general government sector component of the CFS, to ensure consistency of input to, and presentation of, the FBO Report. Secondly, a component of such an audit would include a review of the Commonwealth financial statements to determine adherence with the relevant GFS framework.

Timing for financial statement preparation

3.22 The *Charter of Budget Honesty Act 1998* requires the FBO Report to be tabled by 30 September of each year. To meet this deadline, all material entities forming part of the CFS are currently required to produce audit cleared material financial statement balances by 15 August of each year. This timetable continues to present significant challenges to most entities involved, including the ANAO.

¹⁵ *Joint Committee of Public Accounts and Audit Report 388: Review of Accrual Budget Documentation*, June 2002, Canberra.

3.23 To ensure success in meeting the 15 August timetable, entities and the ANAO need to bring forward as much of the financial statements preparation and audit processes as practically possible prior to 30 June of each year.

3.24 There has been an increase in the average time taken to prepare financial statements over that achieved last year. However, the performance of individual entities in preparing their financial statements has been mixed, with some entities improving but others deteriorating in performance.

Audit of the CFS 2001–02

3.25 As mentioned previously (paragraphs 3.10–21), the CFS fulfill a key stewardship obligation of the Government to report its financial performance during the reporting period and, consequently, are an important element of open and accountable government.

3.26 The Minister for Finance and Administration is required under Section 55 and Section 56 of the FMA Act to table audited financial statements of the Commonwealth Government of Australia in each House of Parliament, as soon as practicable after the end of the financial year. The CFS for the year ended 30 June 2002 were signed on the 20 November 2002 and the audit report was issued on 21 November 2002.

Audit report

3.27 The audit report expressed an opinion containing three qualifications and an ‘emphasis of matter’, which are explained in detail below. Two qualifications were the result of differences in accounting policies and the associated disclosures in the CFS. The third qualification covered two limitations of scope. The ‘emphasis of matter’ was due to inherent uncertainty regarding two components of the Commonwealth Government’s liability position.

Qualifications

Taxation Revenue

3.28 As in past years, the CFS for 2001–02 have been prepared using the taxation liability method (TLM). This method recognises taxation revenue at the time when tax payments are due and payable. The adoption of TLM does not conform with AAS 31 *Financial Reporting by Governments*, in that it does not recognise all taxation revenue, assets and liabilities in the period in which the underlying transactions occur.

3.29 In contrast, the Australian Taxation Office (ATO) has continued to recognise taxation revenue in its annual financial statements on an accruals basis

using the economic transactions method (ETM). Under ETM, taxation revenue is recognised in the period when underlying economic activity giving rise to a taxation obligation actually takes place. As a result, the ATO reports estimates of accrual revenues in relation to taxation assessments that will be raised in the following reporting period; the amount of revenue reported takes into account estimated refunds; and/or credit amendments to which taxpayers may be entitled. This treatment is also consistent with the requirements of taxation legislation wherein a taxation liability exists prior to a formal assessment.

3.30 The ETM basis of estimating taxation revenue for accounting purposes is stronger both conceptually and on legal grounds than the TLM and, most importantly, clearly meets the requirements of AAS 31. The TLM is aligned to modified cash accounting. This view is supported both by expert legal and accounting advice and reflects the basis on which the Commissioner for Taxation has prepared his financial statements in recent years (which were unqualified).

3.31 The use of TLM, rather than ETM, has a material effect on the CFS. The financial effects of employing the former approach are as follows:

- the operating result for the year is understated by \$2.8 billion (2001: overstated by \$9.1 billion); and
- there are understatements as at 30 June 2002 in accrued revenues of \$25.7 billion (2001: understatement of \$21.6 billion), in liabilities of \$18.1 billion (2001: \$16.8 billion). Reported net liabilities are overstated by \$7.6 billion (2001: \$4.8 billion).

3.32 The difference between TLM and ETM revenue is the result of ETM revenue being recognised at an earlier point in the taxation cycle, other things being equal. In a growing economy, ETM revenue would generally be higher than TLM revenue. For this reason, the use of TLM in the current financial year has contributed to the size of the deficit reported in the CFS. A qualified audit opinion was issued on the 2001–02 CFS due to TLM being used as the basis for the recognition of taxation revenues.

3.33 Currently, the use of the TLM method is consistent with the treatment adopted for the 2001–02 Budget. The Departments of Finance and Administration and Treasury take the view that the ETM method does not currently provide a reliable measure of taxation revenue recognition for both budget and actual reporting purposes. Both departments recognise that the comparable reliability of the two methods should be reviewed in future years. The Minister for Finance and Administration has been made aware of the issues involved.

Goods and Services Tax and Related Grants Expense

3.34 As in the previous year, the CFS for 2001–02 have been prepared without recognising the GST as a revenue of the Commonwealth Government.

3.35 The Commonwealth Government's reason for excluding GST and associated grant payments to the states is based on the argument that the GST is a State tax collected by the Commonwealth in an agency capacity, in accordance with the intent of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.

3.36 From an accounting perspective, the GST is a Commonwealth revenue. It is imposed under Commonwealth legislation and the Commonwealth Government therefore controls the revenue raised. The Government's decision to enter into an agreement to pass the GST revenue collected to the States is a separate transaction conducted to meet its particular objectives.

3.37 The Commonwealth Government's control of the GST revenue is also illustrated by the fact that the distribution of GST revenue is based on population share adjusted by a relativity factor embodying per capita financial needs. The relativity factor is determined by the Commonwealth Treasurer based on advice given by the Commonwealth Grants Commission and following consultation with the States and Territories. Thus, the actual distribution will only coincidentally reflect the amount of tax collected within the jurisdictions of the beneficiary governments, so that there is no direct connection between the tax revenue arising in, and the tax revenue returned to, a particular State or Territory.

3.38 The financial effects of not recognising the GST as a Commonwealth revenue are to understate the net result for the period and to overstate net liabilities as at period end. The financial effects of not recognising the GST, calculated by reference to the amounts that would have been recognised had all other tax revenue been recognised on an accrual basis, are as follows:

- The consolidated statement of financial performance for the 2001–02 year involves an understatement of revenues by \$27.6 billion (2000–01: \$27.5 billion), expenses by \$26.9 billion (2000–01: \$23.8 billion) and hence the net result by \$0.7 billion (2000–01: \$3.7 billion).
- The consolidated statement of financial position as at 30 June 2002 involves an understatement of accrued revenues by \$4.7 billion (2000–01: \$3.8 billion) and liabilities by \$0.3 billion (2000–01: \$0.1 billion), and hence an overstatement of net liabilities by \$4.4 billion (2000–01: \$3.7 billion).
- The consolidated statement of cash flows, total operating cash inflows and outflows are each understated by \$23.1 billion (2000–01: \$19.2 billion) (that is a difference which takes account of GST-related cash flows within the Commonwealth Government).

3.39 This treatment of GST in the CFS is contrary to the treatment adopted in the financial statements of the administering agencies. The ATO has reported the GST as a Commonwealth tax and the associated payments to the states and

territories are recognised by the Department of the Treasury as grant expenses. In addition, the Australian Bureau of Statistics treats GST as a tax of the Commonwealth Government for statistical purposes.

3.40 For the reasons set out above, the GST should be recognised as revenue of the Commonwealth Government in the CFS. The CFS audit opinion includes a qualification in relation to the omission of GST from the CFS.

Department of Defence Inventory and Repairable Items

3.41 A qualification contained in the audit report on the 2001–02 financial statements of the Department of Defence (Defence) has been carried forward to the CFS audit opinion. The Defence audit report was qualified on the basis of limitations of scope over inventory and that part of the Specialist Military Equipment (SME) balance involving repairable items which is managed by the logistics Standard Defence Supply System (SDSS). This, in turn, impacted both on the inventory and SME balances reported in the CFS. A limitation of scope on the auditor's work arises when sufficient appropriate audit evidence does not exist to support a reported balance.

3.42 Controls over the SDSS system were inadequate to protect the integrity of data supporting the inventory balance reflected in the Defence financial statements and consolidated into inventory in the CFS. Users of the SDSS system were able to enter information directly into the price field without sufficient controls. The ANAO and Defence agreed that the cumulative financial effect of inventory prices that had been inadvertently adjusted or incorrectly calculated could not be assessed confidently, despite assurance work undertaken for a sample of items from the total population of some 1.7 million inventory line items.

3.43 In addition, ANAO fieldwork in the 2001–02 financial year identified significant issues relating to the price integrity of explosive ordnance on the COMSARM logistics system. A statistical test of explosive ordnance did not support the reported balance due to a lack of supporting documentation and business process problems, particularly in relation to price variations in contracts.

3.44 For these reasons, there was insufficient appropriate audit evidence to support the reported balance of CFS inventory due to Defence system inadequacies, thus resulting in a limitation of scope of the audit work. Given the scope limitation, the audit opinion was qualified as to the effect on the financial statements of such adjustments, if any, as might have been required had the limitation not existed.

3.45 Similarly, there was insufficient appropriate audit evidence to support the reported figure for repairable items, which forms part of the SME balance in

the Defence financial statements and consolidated into the SME balance in the CFS. Inadequate controls and problems with key business processes around the SDSS logistics system resulted in a significant range of uncertainty about the repairable items balance.

3.46 In light of these deficiencies, there was an inadequate basis to support the reported repairable items balance in the CFS. This resulted in a limitation of scope of audit, with a similar affect on the audit opinion, as described above.

HIH Claims Support Scheme and Medical Defence Organisation Assistance Package

3.47 An emphasis of matter, which is not a qualification of the audit opinion, concerning inherent uncertainties over certain liabilities contained in the audit report of the Department of the Treasury's 2001–02 financial statements has also been carried forward in the CFS audit opinion. During 2000–01, the Commonwealth Government entered into an arrangement with HIH Claims Support Limited (HCSL) to provide assistance to policyholders suffering financial hardship as a result of the failure of the HIH Insurance Group. The CFS and the Department of Treasury's financial statements recognise a liability of \$496 million (2001: \$640 million) for this support, based on an independent actuarial assessment. However, there is an inherent uncertainty regarding the measurement of the Commonwealth's liability. The actuarial assessment noted that, due to the relative immaturity of the Scheme, and because at the time of the assessment a significant portion of the major claim types were yet to be reviewed by the claims managers, the result remains highly uncertain and requires close monitoring.

3.48 In addition, the Commonwealth Government has committed to provide indemnity to the provisional liquidator of United Medical Protection Limited and Australasian Medical Insurance Limited (UMP/AMIL). The CFS and the Department of the Treasury's financial statements recognise a liability of \$500.8 million for this support, based on an independent actuarial assessment. There is an inherent uncertainty regarding the measurement of the Commonwealth's liability. The uncertainty is exacerbated by the instability in the number and risk composition of incidents and claims notified in recent years, and by uncertainty regarding the effects on claims costs of recent legislative changes and the visiting medical officers initiative in NSW.

Audit and Accounting Issues

Executive Remuneration

3.49 As with previous CFS, these financial statements do not include disclosure of the remuneration of Ministers or Executive Officers of Commonwealth entities. Whilst the accounting standards do not currently require the disclosure of this information, its inclusion within the CFS would generally be seen as a positive contribution to enhanced accountability and better practice financial reporting.

3.50 Debate has continued during 2001–02 over the proposed disclosures of remuneration and benefits at the whole of government level including Ministers. Events over the past twelve months within the corporate arena, and the ensuing demands for increased disclosure, continue to highlight the importance of transparency and accountability. It would be good practice for the Commonwealth to provide such disclosure in the CFS for future financial years.

Controlled Entities

3.51 In the 1999–2000 financial year, the ANAO formed the view that the Commonwealth has control over the Australian National University (ANU). While the ANU is not consolidated in the CFS; relevant grants and investments are recognised through the Department of Employment, Science and Training. The ANAO continues to recommend that the ANU should be consolidated in the CFS.

Tax Expenses Previously Offset Against Revenue

3.52 In prior years, Family Tax Benefit and Private Health Insurance rebates, which are described as tax expenditures, were accounted for as offsets against taxation revenue within the CFS. This treatment has also been applied to financial statements of the ATO, including the 2001–02 financial statements.

3.53 For the 2001–02 CFS, the offset has been reversed resulting in the disclosure of additional tax revenue and additional personal benefit expenditure of \$505 million. The ANAO agrees that, conceptually, under the accounting framework, there is merit in not offsetting such revenues and expenditures. However, in the ANAO's recently completed audit of the ATO's 2001–02 financial statements, we agreed with the ATO that more assurance work was required to be confident about the reliability of the measure of Family Tax Benefit and Private Health Insurance rebates.

3.54 In addition, there are many other tax arrangements currently described as tax expenditures. These arrangements are disclosed in the 2001 Tax Expenditure Report Estimates, published by Treasury. The ANAO considers it

is necessary for a detailed review to be performed on all tax expenditure arrangements to determine the consistency of accounting treatment and the reliability of the measurement of tax expenditures. We have recommended to the Department of Finance and Administration that this review be undertaken by the relevant agencies in the near future so that its findings can be incorporated into the 2002–03 CFS.

Canberra ACT
7 February 2003



P. J. Barrett
Auditor-General

Appendices

Appendix 1

Audit reports tabled in the period 1 July to 31 December 2002

Audit Report No.1 2002–03

Performance audit

Information Technology (IT) at the Department of Health and Ageing

Department of Health and Ageing (Health)

The objectives of the audit were to determine whether Health's management and operation of selected information technology (IT) systems:

- met industry better practice;
- met quality and service delivery parameters set by Health and, if applicable, the government; and
- operate effectively, efficiently and economically.

The audit methodology involved the application of selected CobiT (Control Objectives for Information and Related Technology) components, a framework of internationally accepted standards, to determine if Health's policies, practices and procedures were likely to meet its business objectives. That is:

- met the IT customer requirements by planning, implementing and maintaining quality management standards and systems;
- established a common understanding of the required internal level of service through service level agreements;
- safeguarded information against unauthorised use, disclosure, modification, damage or loss by the application of logical access controls;
- monitored the achievement of the performance objectives set for the IT processes; and
- implemented a structure of relationships and processes to direct and control IT and related processes.

The CobiT processes reviewed by the ANAO were: Managing IT Quality, Defining and Managing IT Service Levels, Ensuring IT Systems Security, Monitoring the IT Processes and IT Governance. Additionally, three major Health

applications (representing systems that process approximately \$3.9 billion of expenditure) were evaluated and tested against the selected CobiT processes.

The audit concluded that, overall at the operational level, Health's application systems reviewed during this audit were delivering the required business outputs in an effective and controlled manner, and within acceptable error rates. However, unresolved department-wide IT governance issues were identified that present risks to the optimal management and operation of IT. The absence of a department-wide quality management framework, specification of service delivery targets, and monitoring of IT were the primary issues that must be addressed in order to ensure IT investments were optimised and that the gap between IT business risks, control needs and technical issues was bridged.

The audit made two recommendations that were directed at improving the overall governance of IT within the department. The audit acknowledged that, as a result of Health's *IT Strategic Review*, the department had recognised the issues that need to be addressed and was in the process of addressing them.

Audit Report No.2 2002–03

Performance audit

Grants Management

Aboriginal and Torres Strait Islander Commission

The audit examined the Aboriginal and Torres Strait Islander Commission's (ATSIC's) grant management practices. The audit sought to determine: if ATSIC provided fair and equal access to funding; the risks to the grants program; if decision-makers received the key information that they needed in order to make informed funding decisions; and, if ATSIC staff complied with grants procedures. The ANAO did not examine the appropriateness of the funding decisions made by regional councils.

The ANAO concluded that while ATSIC continued to improve its management of grants funding there were still several administrative areas that required attention. ATSIC had developed effective policies and procedures for administering grants, which generally meet better practice standards. However, these policies and procedures were often inconsistently put into practice by regional offices.

The ANAO found that the financial management of grants, especially funds releases and acquittals, was sound. However, ATSIC's management of non-financial matters did not show the same strengths. Processes, such as clear documentation and undertaking the required number of field visits to monitor grants, required improvement. While ATSIC had made the application documentation more user-friendly, many regions did not publicly call for funding submissions that limited the openness and competitiveness of the grants program.

The ANAO also found that often ATSIC was the primary funder of services to indigenous communities in many regions and this was inconsistent with its role to provide funding that supplemented that from other government agencies.

The ANAO made five recommendations that related to the identification of funding needs, the administration of grants management, accountability and risk management. ATSIC agreed to all the recommendations, one with qualification noting the difficulty of systematically identifying funding needs.

Audit Report No.3 2002–03

Performance audit

Facilities Management at HMAS Cerberus

Department of Defence

HMAS Cerberus is a Navy base situated south-east of Melbourne, Victoria. As a major Navy training establishment, it conducts initial recruit training, and specialist category training in areas such as communications and engineering. The Australian Defence Force (ADF) Schools of Catering and Physical Training are situated there, as is a major health centre for operational and training needs. The health centre and other facilities at HMAS Cerberus were re-developed several years ago.

Allegations about Defence Estate Organisation's (DEO) facilities management at HMAS Cerberus and other Defence bases in Victoria were investigated by Defence's Inspector-General Division (IGD) in 2000. The IGD reported in February 2001 that it had found procedural and managerial deficiencies in certain DEO activities and that about half the allegations investigated were either proved, or at least supported, by available evidence.

In August 2001, the then Minister for Defence announced that, in response to continuing concern over facilities management at HMAS Cerberus, he had asked the Australian National Audit Office (ANAO) to conduct an independent investigation. The ANAO agreed to review these matters.

The ANAO's audit confirmed the findings made by IGD in relation to facilities management and maintenance problems at HMAS Cerberus. These included cases of inadequate contract management and inconsistencies in holding contractors accountable for performance, inadequate documentation and record keeping and breaches of procurement requirements and guidelines.

The ANAO made three recommendations relating to tender evaluation and contractor performance monitoring. Defence agreed with the recommendations, one with qualification.

Audit Report No.4 2002–03

Summary of outcomes

Audit Activity Report: January to June 2002

Cross Agency

The report summarised performance, financial audit and other related activities for the ANAO in the period January to June 2002. Key issues arising from performance audits tabled in this period were summarised against ANAO themes of:

- human resource management including workforce planning;
- financial management and reporting;
- performance measurement and reporting;
- procurement and contract management;
- application of information technology and resources; and
- service delivery.

Financial audit activities undertaken by the ANAO during the period January to June 2002 were also addressed and, in particular, issues in relation to the following were discussed:

- audits of financial statements;
- internal control environment;
- information systems;
- controls over financial systems and processes; and
- prospective issues.

The challenge faced by entities to further embed sound financial management practices into the timing of their operations for financial statement preparation was noted.

Appendix 1 of the Activity Report provided a short summary of each of the audits tabled between 1 January 2002 and 30 June 2002. Appendix 2 provided an outline of the Better Practice Guides completed in the relevant period.

Audit Report No.5 2002–03

Performance audit

The Strategic Partnership Agreement between the Department of Health and Ageing and the Health Insurance Commission

Department of Health and Ageing (Health) Health Insurance Commission (HIC)

The audit examined the implementation of the Strategic Partnership Agreement (SPA) and other arrangements between Health and HIC, for the management and administration of Medicare and the Pharmaceutical Benefits Scheme.

Health predominantly exercises a policy and leadership role within the Health portfolio, while HIC delivers a range of health services directly to the public and members of the health industry. Both agencies recognise the importance of working together, as partners in their respective roles, to maximise their performance in the achievement of health portfolio outcomes.

The audit found that administrative arrangements between Health and HIC generally acted to support a co-ordinated implementation of Medicare and the Pharmaceutical Benefits Scheme. It also found that the SPA incorporates essential elements of a governance framework for the relationship, including joint management structures, a performance monitoring and reporting framework, and protocols for communication between the policy agency and the administrative agency. The ANAO concluded that administrative arrangements supporting the provision of funding for Medicare and PBS benefit payments were sound.

The ANAO considered that, while well co-ordinated and effectively administered, the Health–HIC relationship would benefit from a greater clarity of each agency’s accountability obligations. In particular, it would benefit from a more explicit treatment and understanding of Health’s obligations for ensuring the efficient, effective and ethical expenditure of departmental resources, which fund the majority of HIC’s operations.

The ANAO made three recommendations addressing the issues of: greater clarity of accountability obligations; the development and maintenance of key documentation describing programs delivered under the SPA; and encouraging Health and HIC to undertake a program of external benchmarking of HIC’s core service delivery activities. Health and HIC agreed with the three recommendations.

Audit Report No.6 2002–03

Performance audit

Fraud Control Arrangements in the Department of Veterans' Affairs

Department of Veterans' Affairs (DVA)

The objective of the audit was to determine if DVA had implemented fraud control arrangements that were consistent with the Fraud Control Policy of the Commonwealth and whether these arrangements operated effectively. The ANAO reviewed arrangements for the development of the department's fraud policy, fraud risk assessment and fraud control plan within the core functional areas of the department that were responsible for these activities. The audit also examined the operational procedures and guidelines that were in place to implement the department's fraud policy.

The ANAO concluded that, overall, DVA had developed an appropriate fraud control policy, with supporting fraud risk assessments and that operational procedures were consistent with the requirements of the Fraud Control Policy of the Commonwealth. DVA communicated widely the standards of conduct expected of its officers and its commitment to promoting an ethical workplace culture in the department.

The department was taking action to enhance the knowledge of its officers in contract management skills. A number of activities were also conducted with 'customers' and external service providers to improve their awareness of their obligations and ethical responsibilities when dealing with the department.

DVA systematically monitored progress in implementing its fraud control strategies and relevant recommendations of internal audit reports. However, a specific performance assessment framework that included appropriate performance indicators, which the department could then use to assess its performance in controlling fraud on an ongoing basis, had not been developed.

Sound operational procedures existed for the conduct of fraud investigations, the referral of cases for prosecution and the administrative recovery of losses. However, the Fraud Control Management Information System was not performing as expected.

The ANAO made six recommendations aimed at improving the efficiency and effectiveness of the fraud control arrangements in DVA that addressed induction training, performance information, management information systems, quality assurance, internal fraud investigations, fraud staff qualification and training and the standardisation of travel allowance claims procedures under the Repatriation Transport Scheme. DVA agreed with all six recommendations.

Audit Report No.7 2002–03

Follow-up audit

Client Service in the Child Support Agency Follow-up Audit

Child Support Agency (CSA)

The objectives of the follow-up audit were to assess the CSA's implementation of the recommendations in Audit Report No. 39, 1997–98 *Management of Selected Functions in the Child Support Agency* and the associated Joint Committee of Public Accounts and Audit Report No. 367, *Review of Auditor General's Reports 1997–98*. As well, the audit sought to broadly assess the performance of the CSA in delivering quality client service since the previous ANAO audit.

The ANAO found that the CSA placed a strong emphasis on addressing the issues and recommendations in the previous ANAO audit and the associated JCPAA report. The CSA adopted a holistic approach to overseeing these recommendations, implementing them as part of a fundamental restructure of its business. As a result, since the previous ANAO audit, the CSA had improved many aspects of client service. This included faster response to telephone enquiries, simplified correspondence, expanded services to rural and remote communities, better complaints handling and a more comprehensive introduction package for new clients. Nevertheless, client satisfaction remained at the previous level. There was scope for improvement in certain areas, in particular, the CSA could have provided more accurate and consistent advice; explained decisions more clearly; fulfilled obligations made by staff; improved the application of case-locking rules; and improved many aspects of the Change of Assessment process.

The CSA's collection performance was high, particularly when benchmarked against international standards. However, the magnitude of arrears and timeliness of payments remained a problem for many CSA-Collect payees, who were owed, on average, over \$2100 at 30 June 2001. The introduction of the Debt Management Services Stream allowed the CSA to moderately improve debt collection since the previous ANAO audit for difficult debt cases. The CSA enhanced debt recovery tools available to staff, for example, through clearer debt collection documentation, improved default assessment processes, streamlined processes to action new debt and better identification of debtors suitable for litigation. However, the audit identified scope to improve debt collection performance, especially by reviewing procedures for employer withholding and employer withholding of arrears, revising performance measures of debt and collection, refining case selection criteria for individual case management and improving cross stream referral rules.

The ANAO made four recommendations directed towards: improving performance reporting by the CSA; improving the consistency of decision making for changes to assessments for child support; and ensuring more equitable and effective use of employer withholdings of arrears and employer withholdings. The CSA agreed with all four recommendations.

Audit Report No.8 2002–03

Business Support Process audit

The Senate Order for Department and Agency Contracts (September 2002)

Cross Agency

The Senate Order for Department and Agency Contracts requires agencies that operate under the *Financial Management and Accountability Act 1997* (FMA) to place on the Internet, lists of contracts of \$100 000 or more by the tenth day of the Spring and Autumn sittings of Parliament. Among other things, the lists are to indicate whether the contracts contain any confidentiality provisions. The Order provides for a new contracting accountability framework, and is based on the general principle, sometimes called the reverse onus principle, that information in contracts should not be made confidential unless there is good reason to do so.

The Auditor-General agreed to the request in the Senate Order to undertake twice-yearly examinations of agency contracts required to be listed on the Internet and report whether there has been any inappropriate use of confidentiality provisions. This summary relates to the second report under the Senate Order, namely, the audit of the contract information to be listed on the Internet by the tenth day of the Autumn 2002 sitting.¹⁶ The audit involved a desktop review of all FMA Act agencies' Internet listings, and a detailed review of the processes for making the Internet listings and the policies and practices for determining confidentiality provisions in contracts at six selected agencies.

The ANAO concluded that most agencies had reported their contracts of \$100 000 or more on the Internet and complied with most of the requirements of the Order. Furthermore, the Internet listings of the selected agencies were generally complete and accurate.

Most of the six agencies were in the process of updating their policies and procedures to reflect the requirements of the new accountability framework. However, the ANAO considered that only nine of 56 contracts reviewed were appropriately classified as confidential. The high proportion of contracts classified inappropriately was not unexpected, given that the majority of contracts were entered into before the agencies had implemented the new accountability framework and without guidance to determine if information in a contract should be protected as confidential.

¹⁶ The first audit report, in relation to the Spring 2001 Internet listing, *Senate Order of 20 June 2001 (February 2002)*, Audit Report No. 33, 2001–02, was tabled on 25 February 2002.

The audit made two recommendations—one aimed at improving the processes for compiling the Internet listings, and the other aimed at the implementation of the new accountability framework. The selected agencies agreed, or agreed in principle, with the recommendations.

Audit Report No.9 2002–03

Performance audit

Balanced Scorecard

Centrelink

The objective of the audit was to assess whether Centrelink's Balanced Scorecard (BSC) was based on key elements of better practice principles and its use assisted Centrelink to understand and communicate its performance against its strategic goals. The audit examined: the use of the BSC in setting Centrelink's vision and goals; the role of the BSC in planning; alignment of the BSC from the top down through the organisation; the interdependencies of scorecards used by various support units; the definition and use of measures, including target setting and links to goals within the BSC framework; and its use in monitoring, reporting and feedback.

The ANAO concluded that the Centrelink BSC was focussed on operational effectiveness and particularly on achieving client departments' key performance indicators (KPIs). Achieving these KPIs represented Centrelink's 'bottom line'.

The BSC demonstrated many elements of better practice in that it was:

- part of a robust planning framework which contained all the expected elements;
- based on Centrelink's six strategic goals;
- used for monitoring and reporting purposes including for the Annual Report. At Area Support Office and Customer Service Centre (CSC) level, it was being used for frequent monitoring to identify the causes of both good and poor performance as a basis for making improvements;
- available on-line throughout Centrelink so that all business units can prepare their own detailed reports on particular aspects of performance and undertake comparisons to other groups with similar characteristics as a basis for improvement; and
- reviewed regularly to ensure continued relevance.

The ANAO concluded that there were opportunities for Centrelink to improve its BSC by:

- refining the various statements of intent (purpose, vision, mission, goals, objectives) to provide a clearer focus on what was to be achieved by staff at all levels of administration;

- appropriately linking Centrelink's six strategic goals (contained in Strategic Directions 2001–06) and eight business objectives (contained in the Business Plan 2001–04 and Business Improvement Plans) so that the links between them were clear to all staff across Centrelink. This would also assist Centrelink to more clearly specify the contribution made by each level of administration, particularly National Support Office, to the achievement of its goals; and
- revising performance information, as necessary, so that performance can be assessed quantitatively and/or qualitatively, and ensuring the appropriate balance between lead and lag indicators.

At the time of the audit fieldwork, Centrelink was conducting a BSC review in conjunction with a major review of its Strategic Directions and business planning. If undertaken and implemented appropriately, these reviews should address the issues raised in this audit report.

Because there is no one right way to develop and use a BSC, the ANAO did not make any recommendations.

Audit Report No.10 2002–03

Performance audit

Management of International Financial Commitments

Department of the Treasury

The audit objectives were to:

- identify and quantify, on a consistent basis, the current value of commitments to international financial institutions and bilateral support packages administered by Treasury;
- assess Treasury's management of these financial commitments and related exposures; and
- identify opportunities to improve existing administrative practices, including any possible financial savings that may accrue to the Commonwealth from improved procedures and risk management practices.

Generally, Treasury's management of the relationship with international financial institutions was effective. Nevertheless, the governance framework and financial management practices for administering Australia's obligations could be improved by:

- comprehensively documenting administrative procedures to mitigate risks associated with staff turnover and the irregular nature of transactions;
- enhancing performance measurement and reporting to encourage a management focus on administering international financial commitments at the lowest possible long-term cost, consistent with an acceptable degree of risk exposure; and
- explicitly identifying and quantifying financial risks in relation to proposed expenditure commitments, consistent with the emphasis on agency risk management outlined in the revised framework for Commonwealth foreign exchange risk management that was introduced with effect from July 2002.

Two recommendations were made to address the first two improvement opportunities identified by the audit. Treasury agreed with both the recommendations. In relation to financial risk management, no recommendation was made as the Department of Finance and Administration announced in June 2002 that it will be developing, and releasing to agencies, principles-based guidance on foreign exchange risk management practices.

Audit Report No.11 2002–03

Performance audit

Medicare Customer Service Delivery

Health Insurance Commission (HIC)

The audit reviewed the effectiveness of HIC's approach to customer service delivery to the Australian public as customers of Medicare. The audit focused on the areas of customer service performance management, people management, customer research, and the provision of information to customers.

The audit found that HIC is a customer-focused organisation that is generally delivering services to the Australian public effectively under the Medicare program. HIC met its 2001–02 performance targets for most of its Key Performance Indicators (KPIs) relevant to customer service. There is scope, however, to enhance the agency's measurement of customer service.

HIC systematically monitored and evaluated its customer service delivery performance. HIC's KPIs that related to Medicare customer service delivery did not measure all important dimensions of key interactions between HIC and its customers and this limited the effectiveness of those that measure progress towards the goal of better meeting customers' needs and expectations.

The data collection methodologies for the majority of the KPIs were sound and established a basis for the production of accurate performance information. However, weaknesses in data collection approaches meant that HIC could not be assured of the accuracy of the performance information relevant to the accuracy of processing and Medicare office counter response time.

In general, HIC's people management function effectively supported customer service delivery. Customer service staff had the skills, knowledge and resources to perform effectively in their jobs and were committed to HIC's customer service objectives. Areas requiring attention were being addressed.

HIC conducted effective customer research that provided it with information on customers' needs, expectations and perceptions of HIC's service delivery. HIC provided information on the Medicare program to the Australian public through a range of mechanisms, including its client service charter. The Charter was an example of better practice, however, HIC did not have an ongoing communication strategy in relation to the Charter and customer awareness of the Charter was low. HIC had identified that there were a number of gaps in the public's understanding of Medicare and was seeking to raise awareness through its external communications strategy.

The ANAO made three recommendations related to the further development of KPIs to measure HIC/customer interactions, accuracy of HIC's processing Quality Control System, and the Charter of Care communications strategy. HIC agreed with each of the recommendations.

Audit Report No.12 2002–03

Performance audit

Management of the Innovation Investment Fund Program

Department of the Industry, Tourism and Resources—Industry Research and Development Board

The Innovation Investment Fund (IIF) program was introduced to redress the low level of high risk venture capital available in Australia to enable small new technology-based companies to commercialise and develop research. The objective of the audit was to determine if the IIF program was effectively managed by the Industry Research and Development (IR&D) Board and the Department of Industry, Tourism and Resources. The audit focused on corporate governance arrangements for program administration, the selection process to award licences, safeguards to protect the Commonwealth's financial interests, the management of licence agreements and program performance management. The audit also examined program performance to date.

The implementation of the IIF program required the agency to address issues that do not commonly arise within the public sector, for example, investment by the Commonwealth in the early venture capital market. The ANAO concluded that, consistent with the program's objectives, there has been considerable development in the early stage venture capital market since the initiation of the IIF program. Overall, the management of the program was effective, although there were areas that warrant improvement.

Risk management is important given that program administration needed to address a number of unique and high-risk issues. A range of risk treatments has been put in place. However, risk assessments and treatments were not supported by a systematic approach to risk management and monitoring. The ANAO considers that, as the Board has limited assurance of the accuracy of fund managers' reporting, an area that would benefit from a systematic approach to risk management was compliance by fund managers with their licence agreements.

The governance framework for the program could be strengthened by the development of a program plan that outlined the strategies to achieve the program objectives and performance measures. Performance monitoring and reporting arrangements were inadequate. For example, fund managers' performance against some program objectives was not reported, some of the outcome indicators were not measured, and there were few benchmarks or targets for the outcome and output measures.

The ANAO made two recommendations aimed at strengthening risk management and assurance of program delivery against objectives. The Department and the Board agreed with both of the recommendations.

Audit Report No.13 2002–03

Benchmarking study

Benchmarking the Internal Audit Function Follow-on Report

Cross agency

This study is one of a series of benchmarking studies of common business processes being undertaken by the ANAO. This report follows up to Audit Report No. 14, 2000–01 *Benchmarking the Internal Audit Function*. The objective of the study was to obtain and report qualitative and quantitative data on aspects of the internal audit function and compare the public sector internal audit results with international data to identify better practices and highlight areas for improvement.

The study indicated that the Commonwealth Group of 14 participants had made satisfactory progress on a number of aspects of internal audit operations including:

- internal audit staff membership of relevant professional bodies;
- average years of experience of internal auditors;
- time taken from fieldwork to the issue of the final report;
- use of formal client surveys;
- average cost per internal audit report; and
- proportion of internal audit recommendations accepted.

The study also found that, in the participating Commonwealth Group organisations, the internal audit function had the potential for further improvement in some areas, particularly, in regard to audit planning.

The results for the Commonwealth Group show that the internal audits generally focused on assurance. Given the recent problems that have emerged at the national and international level in relation to business management, this was appropriate.

The participating organisations' results are limited in scope in that they rely only on data provided by the organisations involved and, except for a quality assurance process, have not been audited. However, they do provide a basis for comparison across groups and should help organisations develop their own useful internal audit benchmark metrics for continuous improvement programs, business re-engineering or market testing.

Because of the nature of this benchmarking study, the report did not include detailed recommendations.

Audit Report No.14 2002–03

Performance audit

Health Group IT Outsourcing Tender Process

Department of Finance and Administration

On 21 June 2001, the Senate Committee Chair wrote to the Auditor-General requesting that he conduct an audit of the circumstances surrounding the unauthorised disclosure of tender information during the Health Group IT outsourcing process. The Chair advised the Auditor-General that the Senate Committee's request arose from its concerns about the processes that followed the disclosure, including the acceptance of a late tender offer. On 28 June 2001, the Auditor-General wrote to the Chair advising that, in light of the Senate Committee's request, he had decided to undertake a performance audit of aspects of the Health Group IT outsourcing process as a public interest issue.

On the basis of the evidence available, ANAO was not able to provide an assurance that no tenderer unfairly gained a competitive advantage in the Health Group tender process. Limitations in the documentation available, the apparent misunderstanding by some relevant parties of the extent to which they could rely on assurances provided by external advisers in finalising the tender, and the elapsed time since the tender activity, which had contributed to the inherent limitations in the available evidence, prevented ANAO from reaching a firm conclusion on the question.

There was a lack of transparency of the manner in which probity issues were considered by the then Office of Assets Sales and IT Outsourcing (OASITO), particularly in respect to the potential for a broader cumulative effect on the probity of the process to arise given the sequence of significant events that occurred. That is, the disclosure event of 28 July 1999 when sensitive price information from the other tenderers was inadvertently passed to IBM Global Services Australia (GSA) by OASITO, the subsequent late lodgement by IBM GSA of its revised pricing offer on 2 August 1999, and the substantial price reductions made in the 2 August re-pricing round by two of the three tenderers. Deficiencies in the contemporaneous documentation regarding the actions and deliberations undertaken on significant issues affecting the tender process, together with inconsistencies in individuals' recollections of events that occurred in mid-1999, did not allow ANAO to conclude that probity issues that arose during the course of the tender process were appropriately and effectively managed.

In light of the significant changes made to the administrative and policy arrangements for the implementation of IT outsourcing by Commonwealth

agencies since the conduct of the Health Group tender, ANAO did not make specific recommendations in this report. However, the report does highlight areas in which lessons can be learned from that tender to assist agencies in effectively managing the probity aspects of future competitive tendering processes.

Audit Report No.15 2002–03

Performance audit

The Aboriginal and Torres Strait Islander Health Program—Follow-up Performance Audit

Department of Health and Ageing

The objective of the follow-up audit was to:

- assess the extent to which the Department of Health and Ageing (Health) had implemented the recommendations of Audit Report No. 13, 1998–99 *Aboriginal and Torres Strait Islander Health Program*, taking account of any changed circumstances or new administrative issues identified as impacting the implementation of these recommendations; and
- offer continued assurance to Parliament on the management of the Aboriginal and Torres Strait Islander Health Program (the Program) and to identify areas for better practice in the delivery of the Program.

The ANAO found that Health had made progress against the 12 recommendations of Audit Report No. 13, 1998–99 with eight recommendations implemented, one partially implemented and three not implemented but in the process of implementation.

The ANAO made no further recommendations.

Audit Report No.16 2002–03

Business Support Process audit

The Administration of Grants (Post-Approval) in Small to Medium Organisations

Cross Agency

The administration of grants is a significant feature of public sector administration. Grants require a sound risk management approach as grant money is commonly provided to individuals and community organisations not directly accountable to the Government. In small to medium organisations, grants can represent a significant proportion of their total expenditure.

For the purposes of the audit, a grant was defined as a payment of money on conditions specified by the funding organisation and included arrangements whereby funds are provided as a means to support particular activities such as research and development, art and sport.

The objective of the audit was to assess whether agencies had implemented appropriate risk management strategies for grant programs; evaluate whether grants had been administered in accordance with the appropriate legislation, Commonwealth guidance, and other accepted internal controls; and to recommend improvements in the controls and practices relating to grants administration.

The audit focused on the administration of grants from the time that the grant is approved. The selection process for awarding grants was not included within the audit scope.

The ANAO concluded that the six organisations audited had implemented appropriate risk management strategies for grant programs. However, it also concluded that some audited organisations had not conducted an assessment of the risks associated with the day-to-day administration of individual grants.

Organisations were generally administering grants in accordance with applicable legislation, government policy and internal controls. Nevertheless, there were opportunities for these organisations to enhance their performance in this significant area of operations by adopting sound and better practices highlighted in the report.

The audit made seven recommendations relating to the internal control framework of the administration of grants. The selected organisations agreed, or agreed in principle, with all of the recommendations.

Audit Report No.17 2002–03

Performance audit

Age Pension Entitlements

Centrelink

Department of Family and Community Services

The objective of the audit was to assess whether the controls employed by the Department of Family and Community Services (FaCS) and Centrelink to ensure the correctness of payments made under the Age Pension program were effective and efficient.

The ANAO focused on:

- business arrangements between FaCS and Centrelink and the Business Assurance Framework;
- whether the source of error was correctly attributed in customer records assessed by FaCS and Centrelink as containing an error in the 2000–01 Age Pension Random Sample Survey;
- the correctness of Centrelink’s processing of reassessments, including Pensioner Entitlement Reviews, customer initiated reassessments and automated reassessments; and
- progress in implementing the recommendations of previous ANAO audits concerning the preventive quality controls that underpin correct payments.

Centrelink is required to provide assurance to FaCS that payments, and therefore program outlays, have been made in accordance with the Social Security Law. During 2001–02, Centrelink and FaCS worked together to develop a new Business Assurance Framework (BAF) to improve the mechanisms used to provide that assurance. The ANAO concluded that FaCS and Centrelink had made significant progress in developing the foundations for the BAF by agreeing on definitions of correctness and accuracy, and by improving their measurement tools.

Under the BAF, the program of Random Sample Surveys (RSS) is the source of performance information reported by Centrelink to FaCS concerning the integrity of outlays. The RSS is an improvement on earlier measurement tools because it separates assessment of the integrity of outlays from the operation of specific controls. Coupled with improved confidence in the integrity of the data provided by this tool, the new performance information should allow FaCS to focus on its role as a purchaser of Centrelink’s services with greater confidence in the quality of the performance information being provided.

Centrelink conducts reviews of customers' circumstances to ensure that the information it holds is correct. The ANAO concluded that the proportion of errors in age pensioner customer records varied significantly depending on whether the customer's record had been subject to a customer-initiated reassessment (CIR), a Pensioner Entitlement Review (PER) or an automated reassessment. The effectiveness and efficiency of the controls employed by Centrelink to ensure the correctness of Age Pension reassessments also varied depending on whether processing by Customer Service Officers involved simple or complex assessments.

Where processing tasks were relatively simple, or Centrelink had been able to automate them or bring other decision support tools to bear, the proportion of errors attributable to Centrelink was low. The ANAO estimated that 1 per cent of CIRs, which are often simple or use decision support tools, contained a payment error attributable to Centrelink.

Where processing tasks required a more complete reassessment of a complex range of customers' circumstances, such as PERs, the error rate was higher. The ANAO estimated that 14 per cent of PERs contained an immediate payment error attributable to Centrelink, and another 14 per cent contained an error with a potential impact on payment. However, where errors were found, most constituted only a small proportion of the customer's payment and, as a result, the dollar value of incorrect payments represented less than 2 per cent of fortnightly program outlays for customers subject to PERs.

In order to improve the correctness of payments and to ensure that procedures are followed, FaCS and Centrelink have been progressing changes to their preventive controls for Age Pension processing, such as training, quality control and guidance. Many of these actions respond to the recommendations of recent ANAO reports. Progress has been satisfactory, though some initiatives have fallen behind schedule, and some issues remain.

The ANAO made three recommendations concerning improvements to the quality assurance of RSSs and to the processing of PER. FaCS and Centrelink agreed with all three recommendations.

Audit Report No.18 2002–03

Business Support Process audit

Management of Trust Monies

Cross Agency

The audit was conducted in five Commonwealth organisations. The objective of this compliance audit was to assess the management of trust monies against the requirements of trust deeds, trust law, legislation and other Commonwealth requirements/guidelines.

The audit had a number of key findings including that organisations have generally failed to appropriately identify money as trusts. This has involved both monies being treated as trusts when they were not subject to legally binding trusts, and monies being treated as departmental or administered when in fact they were trusts. The audit found that many organisations were not aware that trust monies are a sub-class of special public money, and that there are special public monies that are not trust monies. The effect of organisations treating monies as trust monies incorrectly was, in some cases, that the Commonwealth lost potential interest earnings as a result of not having at its disposal all funds available for investment. On the other hand, where the organisations failed to identify monies as being trust monies, the Commonwealth was exposed to a number of risks, including not acting in accordance with the terms of a legally binding trust agreement.

The audit also found that, generally, organisations were not managing and recording Comcare receipts according to the Finance Minister's Orders (FMOs). FMOs require that Comcare receipts are to be initially treated as held in trust for incapacitated employees. However, organisations have adopted a process for administering these monies that is not in accordance with the FMOs or the *Safety, Rehabilitation and Compensation Act 1988*.

In addition, the audit assessed the management of trust monies against the elements of the internal control structure. Overall, the audit found that organisations were exposed to a number of risks, including not fully complying with the duties of trustees which are requirements of trust law.

Due to the nature of the audit findings, a number of agencies (Finance, Australian Office of Financial Management, and Comcare Australia), not initially included in the audit, became involved.

The ANAO made four recommendations based on the findings made in the organisations reviewed, which were either agreed, or agreed in principle, by the audited agencies.

Audit Report No.19 2002–03

Performance audit

The Australian Taxation Office's Management of its Relationship with its Tax Practitioners.

Tax practitioners have become an integral part of the tax system as intermediaries assisting taxpayers to deal with their taxation responsibilities. The audit examined the ATO's management of its relationship with tax practitioners (tax agents and the wider group of professionals such as bookkeepers lodging business activity statements, lawyers and accountants working on taxation matters for clients). The audit's main focus was the ATO's management of its relationship with tax agents because they are the core element of the tax practitioner grouping and their role is fundamental to the effective operation of the tax system. Illustrative of their significant role, tax agents lodged 76 per cent of the 10.1 million individual returns, 94 per cent of the 0.6 million company returns and 51 per cent of the 1.8 million quarterly business activity statements in 2001–02. Furthermore, the use by taxpayers of registered tax agents has grown over time (approximately 20 percent of individual tax payers used a tax agent in 1980, by 2001 this was 76 per cent).

The objective of the audit was to assess how well the ATO manages its relationship with tax practitioners, focusing on selected ATO relationships, in particular its regulatory relationship with tax agents, its service support relationship with tax agents and its relationship with tax agents and members of the wider tax practitioner group in the professional bodies as key stakeholders in tax administration.

Managing the relationship well is an ongoing and challenging task for the ATO. The audit found that aspects of the relationship have not been well managed in the past and that the current relationship could be generally described as strained and tense. Parties to the relationship consider that the present situation has arisen largely because of pressures placed on tax agents and other tax practitioners, and on the ATO's operational systems, by tax reform.

The ATO has recognised that improvements are required in its relationship with tax practitioners, and particularly with tax agents. It has been trying on many fronts, over the last two years, to better manage and enhance the relationship (e.g. with operational improvements to enhance services or remedy problems, including dedicated phone services and special complaint resolution services; more extensive consultation processes with tax agents, and members of tax and accounting professional bodies; and the reactivation of consideration of reform

in the regulation of tax agents). It now has in place some useful mechanisms to support positive tax agent relationship management, and a renewed commitment from senior ATO staff. Although these measures are helpful, the ultimate test is in the results.

The report's 10 recommendations focused on matters of strategy, planning, implementation and review in the ATO's management of its relationship with tax practitioners. The ATO accepted all the recommendations, and noted that since the ANAO completed the fieldwork for the audit, the ATO had made major new approaches and breakthroughs to improve its relationship with tax agents.

Audit Report No.20 2002–03

Performance audit

Employee Entitlements Support Schemes

Department of Employment and Workplace Relations

The original Employee Entitlements Support Scheme (EESS) was established to provide a safety net for employees who lost their jobs on or after 1 January 2000 as a result of their employer's insolvency or bankruptcy, and were left without some or all of their employee entitlements. EESS, which provides part-payment of certain unpaid entitlements, is a government-funded safety net for affected employees upon business insolvency, administered by the Department of Employment and Workplace Relations (DEWR). It is the first ever publicly funded scheme in Australia. In September 2001 the Government replaced EESS with a new scheme, the General Employee Entitlements and Redundancy Scheme (GEERS). GEERS provides a higher proportion of the unpaid entitlements than EESS.

The objective of the audit was to determine whether DEWR is efficiently and effectively managing the provision of funds to eligible employees under EESS and GEERS. This includes consideration of whether: the eligibility and entitlements of claimants were accurately and cost-effectively assessed; performance information was timely and relevant; there was a strategy to provide correct, clear and timely information to those involved in the scheme; and DEWR recovered the amounts due from insolvent employers on behalf of the Commonwealth.

The ANAO identified a range of opportunities for improvement in the administration of the schemes. The main area in which DEWR's performance has not been meeting expectations is the timeliness of making payments under these schemes. Better management information systems would help DEWR to manage the processing and improve the promptness of payment. In addition, DEWR could improve the management and operation of the schemes by:

- better management of the administrative framework under which the schemes operate including the business rules and procedures;
- the introduction of a quality assurance mechanism and improvements to the supporting IT system;
- enhancing the range of performance indicators and means of measuring performance to improve both transparency and accountability;
- developing its capacity to track and control the processing of cases and claims as they flow through the system; and
- taking a more active role in pursuing recovery of funds from the assets of the insolvent businesses.

DEWR was responsive to the issues the ANAO raised during the course of the audit, and sought to make numerous changes to its administration. The report makes nine recommendations, relating to the opportunities set out above, to enhance the management of the schemes. DEWR accepted all nine recommendations.

Audit Report No.21 2002–03

Performance audit

Performance Information in the Australian Health Care Agreements

Department of Health and Ageing

The objective of the audit was to form an opinion on whether the Department of Health and Ageing (Health) has the performance information necessary to administer the Australian Health Care Agreements (AHCAs).

A strong focus of the audit was accountability for performance, including financial accountability. Health requires robust performance indicators to inform its management decisions and policy advice to Government. This is critical given the very significant Commonwealth outlays involved, and is against the background of the ANAO's findings in its audit on *The Management of Performance Information for Specific Purpose Payments—The State of Play* (Audit Report No. 31, 1998–99) that identified the need for Health to make substantial improvements in order to bring its management of Specific Purpose Payments (SPPs) up to an adequate standard of accountability.

Health has some, but not all, of the performance information it needs to adequately administer the \$31.7 billion in Commonwealth funding expected to be provided through AHCAs up to 2002–03. It has the financial information required to ensure the accuracy of total payments made to the States and Territories in accordance with those approved by the Minister for Health and Ageing. There is, however, only limited information on the performance of the States and Territories in meeting the conditions of federal funding on free and equitable access to public hospital services. Further, Health has only partial performance information on the effectiveness and efficiency of the AHCAs.

The AHCAs commit the States and Territories to improve performance against a set of national performance indicators, which were to be developed under the Agreements. Health has worked with the States and Territories to develop these indicators. The choice of indicators was influenced by the availability of data, and by the constraints of reaching agreement in a national forum. The States and Territories also have a responsibility to provide data according to the provisions of the Agreements, in an agreed format and timeframe. Health is monitoring State and Territory performance against these indicators, although the late receipt of data from some States and Territories is an issue for the department to manage.

The AHCAs also identify the need for continued development of performance indicators on efficiency, quality, appropriateness, accessibility and equity of health services. The ANAO found no evidence of a long-term plan to address the development of these indicators. This affects Health's capacity to monitor whether the States and Territories are meeting the objectives and conditions of federal funding, as well as outcomes and outputs under the Agreements. Health has an opportunity in the renegotiation of the Agreements in 2003 to seek agreement from the States and Territories to enhance performance information for its administration of the AHCAs.

The ANAO found that Health has effective financial controls to ensure that the States and Territories receive accurate and timely payments pursuant to the Agreements. During the audit, there were deficiencies in Health's record keeping associated with estimates of payments under the Agreements. Subsequently, Health advised that it has addressed these problems.

The ANAO made three recommendations. Two of these were aimed at improving the performance information framework for the administration of the AHCAs. Health agreed with one of these recommendations, but expressed its view that the second recommendation covered matters of policy not administration. The ANAO disagreed with this view, as the AHCAs provide for the development and review of performance indicators. The third recommendation was aimed at improving Health's record-keeping practices associated with calculating the estimate of total planned expenditure under the Agreements. Health agreed with the recommendation.

Audit Report No.22 2002–03

Business Support Process audit

Payments of Accounts and Goods and Services Tax Administration by Small Commonwealth Organisations

Cross-Agency

Payments for goods and services by Commonwealth organisations operating in the General Government Sector amounted to approximately \$20 billion during 2001–02.¹⁷ In this context, the payment of accounts for goods and services is a significant business support process that required effective management and a sound control framework to achieve the best outcomes.

Goods and Services Tax (GST) administration impacts on systems, processes, people, supplier and customer management and cash flow in all in all Commonwealth organisations. For many of the Commonwealth organisations, the GST represented the first occasion they had to manage significant indirect tax obligations as part of their normal reporting, revenue and expenditure cycles.

In view of this, the audit objectives attempted to determine whether:

- organisations had implemented appropriate risk management strategies and made effective use of technology in the payment of accounts process;
- payments had been properly authorized, made only for goods and services appropriately received, and were timely in accordance with agreed terms and conditions;
- determine whether organisations had implemented adequate control frameworks and processes to mitigate the risks associated with GST obligations and transactions; and
- gather additional information from a wider range of organisations than covered in the previous audit so that a Better Practice Guide on GST administration could be developed.

The audit concluded that, although none of the organisations included in this audit had formally considered the risks associated with the payment of accounts, the majority of risks were satisfactorily mitigated in most organisations by actions taken.

Six organisations had satisfactory payment of accounts processes, which ensured that payments were accurately authorised and made on a timely basis. While

¹⁷ Commonwealth of Australia Consolidated Financial Statements for the Year ending 30 June 2002.

the other two organisations needed to actively address weaknesses in their existing processes, several agencies covered could improve their processes by examining the better use of their financial management information systems; ensuring payments are made on time; and ensuring adequate management review of transactions and sub-processes.

These findings were similar to those of the previous audit on *Payment of Accounts* (Audit Report No. 52, 2000–01) in that the majority of organisations had satisfactory payment of accounts processes, as well as opportunities for improvements, which for all organisations, included the greater use of information technology to improve the processes involved.

In relation to GST Administration, two organisations had established effective control frameworks and processes for the administration of GST. One organisation needed to make immediate improvements to GST administration, while the remaining five organisations needed to make less urgent improvements. All organisations should take action to understand better their GST environment and related risks so that cost-effective controls can be implemented.

In general, the organisations covered by this audit were found to have more successfully implemented control frameworks than those included in the previous audit. In particular, ownership and responsibility for GST administration were usually clearly assigned, approved policies and procedures were in place, and active GST related cash management was being undertaken. In these smaller organisations, managers seem to have allocated a higher priority to administering GST than those in larger organisations. The lower level of errors identified in this audit, compared with those found in the previous one, may also have been because GST had been in place longer and organisations had had more time to adjust their processes to ensure that the GST was being administered efficiently.

However, in common with the previous audit, most organisations would benefit from: using risk management as a technique to understand better their GST environment and the design of controls; formalising the BAS preparation procedures; and increasing their testing and review of transactions as a means to improve GST administration.

The audit made seven recommendations, covering issues such as: the conduct of formal process level GST risk assessments; maximising the use of electronic system-based controls; ensuring managerial controls are performed; strengthening of controls surrounding BAS preparation and reporting; obtaining appropriate and complete technical GST advice; and implementation of monitoring and review procedures.

Audit Report No.23 2002–03

Protective Security audit

Physical Security Arrangements in Commonwealth Agencies

Cross-Agency

The ANAO concluded that all agencies in the audit had made reasonable progress towards meeting their physical security responsibilities as outlined in the Commonwealth's Protective Security Manual. This typically resulted in the establishment of a physical security control framework capable of limiting their exposure to, and the consequences of, their identified physical security risks.

Most agencies had: assigned and documented security responsibilities; obtained current National Security Threat Assessments; provided staff with baseline security documentation to support them in the application of security controls and procedures; and established arrangements to provide for a physically secure and safe work environment for their staff, contractors and clients.

However, the ANAO also noted a number of deficiencies across the agencies reviewed including, to varying degrees, that agencies were not:

- undertaking periodic comprehensive protective security risk assessments;
- formally considering the physical safety of staff as part of the risk assessment process;
- establishing a clear link between the risk assessment process, control selection and procedure development;
- maintaining adequate and current documentation to support the security risk, cost-benefit analysis and decision-making processes;
- applying internal controls and procedures consistently or appropriately, thereby undermining their effectiveness;
- educating their staff, contractors, and clients of agency security standards; and
- monitoring the effectiveness and cost-efficiency of the security environment and acting on identified deficiencies in a timely and well-considered manner.

This report also highlighted that it was important for agencies to understand that deficiencies in the physical security segment of the protective security control framework need to be considered in conjunction with the performance of

agencies in other aspects of protective security (for example, information security), as an exposure in one part of the framework may result in increased exposure on an agency-wide level.

In addition, Commonwealth agencies must acknowledge that threats and risks once thought unlikely to affect them must now be considered as possibilities. Rather than reacting to certain events, agencies should be informed as to their specific exposures, and take a strategic and thorough approach to addressing their identified risks, including relevant national security risks.

These views are supported by statements issued by the Attorney-General's Department, as a result of work undertaken by the Protective Security Co-ordination Centre (PSCC). The PSCC concluded, as at June 2001, that a number of Commonwealth agencies had a weak and reactive approach to maintaining their protective security responsibilities and environments. This was typically evidenced through agencies having outdated risk assessments, inconsistent and dated security documentation, and poor quality and incomplete incident reporting.

The ANAO considers that there are a number of opportunities for agencies to improve their practices when establishing, managing and reviewing their physical security environments and made six recommendations, which were all agreed to by the agencies.

Audit Report No.24 2002–03

Performance audit

Energy Efficiency in Commonwealth Operations— Follow up Audit

Cross-Agency

The ANAO assessed agencies' progress in implementing the seven recommendations of Audit Report No. 47, 1998–99—*Energy Efficiency in Commonwealth Operations*. The earlier audit examined agency compliance with the Commonwealth Energy Policy. Among other things, the Commonwealth Energy Policy sets energy targets which must be met by all Commonwealth agencies by 2002–03.

The objectives of the follow-up audit were to (i) assess the extent to which selected Commonwealth agencies have implemented the recommendations of Audit Report No. 47, 1998–1999 taking account of any changed circumstances or new administrative issues identified as impacting upon implementation of these recommendations; and (ii) offer continued assurance to the Parliament on the management of Commonwealth agencies' compliance with the Commonwealth energy efficiency requirements, and to identify areas for better practice in energy management by those agencies.

In general, the ANAO found that most agencies investigated in this follow-up audit had implemented two (Recommendations 1 and 2) of the three relevant recommendations and had not fully implemented the third (Recommendation 3).

Latest data collected by the Department of Industry, Tourism and Resources (ITR) indicate the Government's energy intensity targets set under the Energy Policy are likely to be met before 2002–03 in the OFFICE—TENANT LIGHT AND POWER and OFFICE—CENTRAL SERVICES categories.

Seven of the agencies in this audit were, in 2001–02, performing under the 10 000 mega joules per person per annum target to be achieved by 2002–03 set for OFFICE—TENANT LIGHT AND POWER category.

The ANAO made one recommendation relating to agency reporting under the Energy Policy. The recommendation reinforces Recommendation No. 3 of the earlier audit and is aimed at improving agency accountability for compliance with all aspects of the Energy Policy. All ten agencies agreed to the recommendation.

Audit Report No.25 2002–03

Financial Statement audit

Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002

Cross Agency

This report is the second report for the financial year ended 30 June 2002. It summarises the final results of the audits of the financial statements of Commonwealth entities. The report also complements Audit Report No. 67, 2001–02 *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2002*.

The report has the following five parts:

- Part One—The Commonwealth Reporting Framework—provides ongoing commentary on the structure of and issues in relation to the Commonwealth’s financial framework. Comment is also made on the quality and timeliness of the preparation of entities’ annual financial statements.
- Part Two—Results of the Audit of the Commonwealth Government of Australia Consolidated Financial Statements—provides details of the audit of the Commonwealth’s Consolidated Financial Statements for 2001–02.
- Part Three—Summary Results of the Audits of Financial Statements—discusses, in summary, the final results of audits of the financial statements, providing details regarding qualifications and any matters emphasised in audit reports.
- Part Four—Results of Final Audit Testing—provides an overview of the results of our year-end substantiation of financial balances. It also provides a summary of continuing significant accounting issues.
- Part Five—Results of the Audits of Financial Statements by Portfolio—provides the detailed results of the individual financial statement audits and any additional significant control matters identified since Audit Report No. 67, 2001–02. It is structured in accordance with the Portfolio arrangements established in the Administrative Arrangements Order of 26 November 2001. For reporting purposes, this reflects the portfolio arrangements which existed at 30 June 2002.

Under the *Financial Management and Accountability Act 1997*, and the *Commonwealth Authorities and Companies Act 1997* for agencies and other bodies

respectively, the Auditor-General is required, annually, to report to the relevant Minister on whether the entity's financial statements have been prepared in accordance with the Finance Minister's Orders and whether they give a true and fair view of the matters required by those orders.

Since the mid-year Controls Report was issued in June 2002, the ANAO has updated its understanding of the business and corporate governance arrangements; confirmed audit risk; completed audit testing; and largely completed its program of final audits. All ANAO findings have been reported to entities' management and reported, in summary, to the responsible Minister(s).

The ANAO was responsible for the audit of the financial statements of 257 Commonwealth entities in 2001–02 compared with 272 in the previous year.

The reduction in number of Commonwealth reporting entities in the current financial year is largely due to the corporatisation of a small number of Research and Development Corporations, a reduction in the number of business operations identified as reporting entities, and the sale or windup of a number of companies/corporations.

The material portion of the Commonwealth's revenues, expenses, assets and liabilities in the 2001–02 financial year are accounted for by a relatively small number of Commonwealth entities. Notably, among the latter are the Departments of Defence, Family and Community Services, Health and Ageing, as well as the Australian Taxation Office. The focus of the report is on the final results of the financial statement audits for the 2001–02 financial year. Financial management issues (where relevant) arising out of the audits and their relationship to internal control structures are also been included in the report.

Appendix 2

Better practice guides completed in the period 1 July to 31 December 2002

The ANAO did not produce any Better Practice Guides (BPGs) for this period. See Appendix 3 for BPGs currently being prepared.

Appendix 3

Performance audit and other audit services in progress as at 1 January 2003

Ministerial Portfolio	Audit Title
Agriculture, Fisheries and Forestry—Australia	<ul style="list-style-type: none"> • Management of Pest & Disease Emergencies Follow-up • R&D Tax Concession Arrangements • Agriculture Advancing Australia
Attorney-General	<ul style="list-style-type: none"> • Fraud Control Arrangements in the Australian Customs Service
Communications and Information Technology	<ul style="list-style-type: none"> • The Administration of Telecommunications Grants • Monitoring of IT Industry Development Commitments
Defence	<ul style="list-style-type: none"> • Defence Explosive Ordnance—Safety and Suitability • Retention of Military Personnel—Follow-up Audit • Navy Operational Readiness • Defence and Industry Involvement • Defence Housing and Relocation Service Contract • IT Skills in Defence
Education, Science and Training	<ul style="list-style-type: none"> • Management of E-Business
Employment and Workplace Relations	<ul style="list-style-type: none"> • Special Ansett Employee Entitlement Scheme
Environment and Heritage	<ul style="list-style-type: none"> • <i>Environment Protection and Biodiversity Conservation Act 1999</i> Assessment Process
Family and Community Services	<ul style="list-style-type: none"> • Delivery of Parenting Payment • Business Continuity Management
Finance and Administration	<ul style="list-style-type: none"> • Administration of the Entitlements of Staff Engaged under the <i>Members of Parliament (Staff) Act</i> • Sale of Sydney (Kingsford Smith) Airport
Foreign Affairs and Trade	<ul style="list-style-type: none"> • Passport Services • Audit to East Timor (AusAID)

Ministerial Portfolio	Audit Title
Health and Ageing	<ul style="list-style-type: none"> • Plasma Fractionation Agreement Extension Review • Aged Care Standards and Accreditation Agency • HIC Financial Management
Immigration and Multicultural and Indigenous Affairs	<ul style="list-style-type: none"> • Migration Program in DIMIA • Detection and Prevention of Unlawful Non-Citizens in DIMIA • Northern Territory Land Councils
Industry, Tourism and Resources	<ul style="list-style-type: none"> • Automotive Competitiveness Investment Scheme
Prime Minister and Cabinet	
Reconciliation and Aboriginal and Torres Strait Islander Affairs	<ul style="list-style-type: none"> • Employment Strategies for Indigenous Australians • Indigenous Land Corporation Follow-up • Legal and Preventative Services Program in ATSIC
Transport and Regional Services	<ul style="list-style-type: none"> • Aviation Security • The Administration of Telecommunications Grants
Treasury	<ul style="list-style-type: none"> • ATO Management of Non-Residents Withholding Tax • ATO Management of ABN Registrations • GST Fraud Prevention and Control • Prudential Regulation of Superannuation
Veterans' Affairs	<ul style="list-style-type: none"> • Disability Compensation Appeals—Follow-up
General performance audits: cross-agency	<ul style="list-style-type: none"> • Management of Commonwealth Guarantees, Warranties, Indemnities and Letters of Comfort • Absence Management in the APS • Annual Reporting requirements under the Environment Protection Act • Survey of Fraud Control Arrangement in the APS—Follow-up • Rating of Annual Performance Reports

Ministerial Portfolio	Audit Title
Performance audit and other audit services: <ul style="list-style-type: none"> • benchmarking studies • better practice guides 	Benchmarking study Better Practice Guides <ul style="list-style-type: none"> • Project Management of Research Development and Innovation Projects • Managing Parliamentary Workflow • Internal Budgeting • Public Sector Governance • Annual Performance Reports • GST Processing
Assurance audit services: <ul style="list-style-type: none"> • financial statement audits • business support process audits • protective security audits 	<ul style="list-style-type: none"> • 3rd Progress Audit—Senate Order Confidential Provisions • Software Capitalisation • Recordkeeping Phase 2 • Business Continuity Management Better Practices (Follow-up) • Close the Books • Use and Effectiveness of HRIS in Commonwealth Agencies • Property Management

Appendix 4

Presentations and papers given by the Auditor-General and ANAO staff during the period July to December 2002

Mr Richard Rundle

Contractual Risk Management

Comcover Conference

Canberra, 17 July 2002

Ms Ann Thurley

Performance Auditing of Outsourced Government Services

Public Sector Auditing Conference

Singapore, 29 July 2002

Ms Ann Thurley

Fraud Prevention and Control

Public Sector Auditing Conference

Singapore, 30 July 2002

Mr Richard Rundle

Corporate Governance

Conference for CEOs of cultural organisations

Sydney, 15 August 2002

Mr Pat Barrett AM

Public Sector Auditing: ANAO Approaches and Practices

Macquarie University

Sydney, 23 August 2002

Mr Pat Barrett AM

The Australian National Audit Office's Program of National Audits

Forum of Commonwealth Agencies Seminar

Sydney, 23 August 2002

Mr Richard Rundle

Financial Management in the New Public Sector

International Quality and Productivity Centre

Singapore, 28 August 2002

Mr Pat Barrett AM

Some Perspectives on the Audit Relationship with Parliament

House of Representatives Occasional Seminar Series

Canberra, 17 September 2002

Ms Ann Thurley

Performance Information: A Strait Jacket, The Emperor's New Clothes or Joseph's Coat of Many Colours

Canberra Evaluation Forum

Canberra, 19 September 2002

Mr Pat Barrett AM

Expectation and Perception of Better Practice Corporate Governance in the Public Sector from an Audit Perspective

CPA Australia's Government Business Symposium

Melbourne, 20 September 2002

Mr Richard Rundle

Contract Management Performance

Department of Immigration and Indigenous Affairs Contract Managers Conference

Canberra, 26 September 2002

Mr Pat Barrett AM

Privatisation of State Activities—Role of SAIs

18th Commonwealth Auditor-General's Conference

Malaysia, 7–9 October 2002

Mr Pat Barrett AM

Role of SAIs in Transition from Cash to Accrual-based Reporting

18th Commonwealth Auditor-General's Conference

Malaysia, 7–9 October 2002

Mr Pat Barrett AM

SAIs' Involvement in System Development: Opportunities and Risks

18th Commonwealth Auditor-General's Conference

Malaysia, 7–9 October 2002

Mr Ian McPhee

Risk Management and Governance

National Institute for Governance

Canberra, 16 October 2002

Ms Maureen Allan

Turning Numbers into Strategy

International Quality and Productivity Centre Human Resources

Sydney, 23 October 2002

Ms Ann Thurley

Whole of Government Outcomes

Managing for Whole of Government Outcomes

Canberra, 30–31 October 2002

Mr Ian McPhee
Risk Management and Governance
SES Business Innovation Group: How well is the APS managing risk?
Canberra, 30 October 2002

Mr Alan Greenslade
Audit of Administration of Programs and Regulatory Procedures
Customs Brokers and Forwarders Council of Australia, Government Affairs
Conference
Canberra, 2 November 2002

Mr Ian McPhee
Role and Responsibilities of the Auditor-General
ADC Canberra Connection
Canberra, 14 November 2002

Mr Richard Rundle
Protective Security Auditing
Defence Security Authority
Canberra, 20 November 2002

Mr Pat Barrett AM
Accountability and Governance in a Changing APS
Department of Finance and Administration's Learning Centre Lecture Series
Canberra, 3 December 2002

Mr Richard Rundle
Contractual Risk Management
Comcover
Canberra, 3 December 2002

Series Titles

Audit Report No.1 Performance Audit
Information Technology at the Department of Health and Ageing
Department of Health and Ageing

Audit Report No.2 Performance Audit
Grants Management
Aboriginal and Torres Strait Islander Commission

Audit Report No.3 Performance Audit
Facilities Management at HMAS Cerberus
Department of Defence

Audit Report No.4 Audit Activity Report
Audit Activity Report: January to June 2002
Summary of Outcomes

Audit Report No.5 Performance Audit
The Strategic Partnership Agreement between the Department of Health and Ageing and the Health Insurance Commission
Department of Health and Ageing and the Health Insurance Commission

Audit Report No.6 Performance Audit
Fraud Control Arrangements in the Department of Veterans' Affairs

Audit Report No.7 Performance Audit
Client Service in the Child Support Agency Follow-up Audit
Department of Family and Community Services

Audit Report No.8 Business Support Process Audit
The Senate Order for Department and Agency Contracts (September 2002)

Audit Report No.9 Performance Audit
Centrelink's Balanced Scorecard

Audit Report No.10 Performance Audit
Management of International Financial Commitments
Department of the Treasury

Audit Report No.11 Performance Audit
Medicare Customer Service Delivery
Health Insurance Commission

Audit Report No.12 Performance Audit
Management of the Innovation Investment Fund Program
Department of Industry, Tourism and Resources
Industry Research and Development Board

Audit Report No.13 Information Support Services
Benchmarking the Internal Audit Function Follow-on Report

Audit Report No.14 Performance Audit
Health Group IT Outsourcing Tender Process
Department of Finance and Administration

Audit Report No.15 Performance Audit
The Aboriginal and Torres Strait Islander Health Program Follow-up Audit
Department of Health and Ageing

Audit Report No.16 Business Support Process Audit
The Administration of Grants (Post-Approval) in Small to Medium Organisations

Audit Report No.17 Performance Audit
Age Pension Entitlements
Department of Family and Community Services
Centrelink

Audit Report No.18 Business Support Process Audit
Management of Trust Monies

Audit Report No.19 Performance Audit
The Australian Taxation Office's Management of its Relationship with Tax Practitioners
Australian Taxation Office

Audit Report No.20 Performance Audit
Employee Entitlements Support Schemes
Department of Employment and Workplace Relations

Audit Report No.21 Performance Audit
Performance Information in the Australian Health Care Agreements
Department of Health and Ageing

Audit Report No.22 Business Support Process Audit
*Payment of Accounts and Goods and Services Tax Administration
in Small Commonwealth Agencies*

Audit Report No.23 Protective Security Audit
Physical Security Arrangements in Commonwealth Agencies

Audit Report No.24 Performance Audit
Energy Efficiency in Commonwealth Operations—Follow-up Audit

Audit Report No.25 Financial Statement Audit
*Audits of the Financial Statements of Commonwealth Entities
for the Period Ended 30 June 2002*
Summary of Results

Audit Report No.26 Performance Audit
Aviation Security in Australia
Department of Transport and Regional Services

Audit Report No.27 Performance Audit
Management of Commonwealth Guarantees, Warranties, Indemnities and Letters of Comfort

Audit Report No.28 Performance Audit
Northern Territory Land Councils and the Aboriginals Benefit Account

Better Practice Guides

Administration of Grants	May 2002
Performance Information in Portfolio Budget Statements	May 2002
AMODEL Illustrative Financial Statements 2002	May 2002
Life-Cycle Costing	Dec 2001
Some Better Practice Principles for Developing Policy Advice	Nov 2001
Rehabilitation: Managing Return to Work	Jun 2001
Internet Delivery Decisions	Apr 2001
Planning for the Workforce of the Future	Mar 2001
Contract Management	Feb 2001
Business Continuity Management	Jan 2000
Building a Better Financial Management Framework	Nov 1999
Building Better Financial Management Support	Nov 1999
Managing APS Staff Reductions (in Audit Report No.49 1998–99)	Jun 1999
Commonwealth Agency Energy Management	Jun 1999
Corporate Governance in Commonwealth Authorities and Companies—Principles and Better Practices	Jun 1999
Managing Parliamentary Workflow	Jun 1999
Cash Management	Mar 1999
Management of Occupational Stress in Commonwealth Agencies	Dec 1998
Security and Control for SAP R/3	Oct 1998
Selecting Suppliers: Managing the Risk	Oct 1998
New Directions in Internal Audit	Jul 1998
Controlling Performance and Outcomes	Dec 1997
Management of Accounts Receivable	Dec 1997
Protective Security Principles (in Audit Report No.21 1997–98)	Dec 1997
Public Sector Travel	Dec 1997

Audit Committees	Jul 1997
Core Public Sector Corporate Governance (includes Applying Principles and Practice of Corporate Governance in Budget Funded Agencies)	Jun 1997
Management of Corporate Sponsorship	Apr 1997
Telephone Call Centres	Dec 1996
Telephone Call Centres Handbook	Dec 1996
Paying Accounts	Nov 1996
Asset Management	Jun 1996
Asset Management Handbook	Jun 1996
Managing APS Staff Reductions	Jun 1996